ND STATE INVESTMENT BOARD MEETING

Friday, April 27, 2018, 8:30 a.m.
State Capitol, Peace Garden Room
600 E Blvd, Bismarck, ND

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

II. ACCEPTANCE OF MINUTES (March 23, 2018)

III. GOVERNANCE

A. Annual Board Planning Cycle – Mr. Hunter (30 minutes) **Board Action**
B. Board Self-Assessment Summary – Mr. Hunter (15 minutes) **Board Action**
C. Legacy Fund Update – Mr. Hunter, Mr. Schulz (15 minutes) *Informational*
D. Securities Litigation Update - Mr. Hunter and Ms. Flanagan (15 minutes) **Board Action**

========================= Break from 9:45 to 10:00 a.m. =============================

IV. INVESTMENTS *(Informational)*

A. BlackRock Risk Review - Mr. Hunter and Ms. Gabriella Barschdorff (45 minutes)
B. Infrastructure Update - Mr. Schulz (10 minutes)
C. Secondary Offers - Mr. Hunter (5 minutes)

V. ADMINISTRATION *(Informational)*

A. Executive Review Committee Update - Ms. Yvonne Smith (10 minutes)
B. RIO Budget Planning Update for 2019-21 – Mr. Hunter (10 minutes)

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

A. Budget and Financial Condition - Ms. Flanagan
B. Executive Limitations / Staff Relations - Mr. Hunter
C. Investment Program - Mr. Schulz
D. Retirement Program - Ms. Kopp
E. Watch List Update - None

VII. OTHER

Next Meetings: SIB Securities Litigation Committee - May 10, 2018 - RIO Conference Room
SIB Audit Committee - May 24, 2018, 3:00 p.m. - RIO Conference Room
SIB - May 25, 2018, 8:30 a.m. - State Capitol, Peace Garden Room

VIII. ADJOURNMENT

Any individual requiring an auxiliary aid or service, please contact the Retirement and Investment Office (701) 328-9885 at least three (3) days prior to the scheduled meeting.

NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
MARCH 23, 2018, BOARD MEETING

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

MEMBER ABSENT: Jon Godfread, Insurance Commissioner

STAFF PRESENT: Eric Chin, Senior Investment Officer
Connie Flanagan, Fiscal & Invt Ops Mgr
Bonnie Heit, Assist to the SIB
David Hunter, ED/CIO
Fay Kopp, Dep ED/CRA
Sara Sauter, Audit Svs Suprv
Cody Schmidt, Compliance Officer
Darren Schulz, Dep CIO
Susan Walcker, Invt Acct

OTHERS PRESENT: Julie Becker, Aon Hewitt
Patrick Brooke, Attorney General's Office
William Campbell, I Squared Capital
Jeanna Cullins, Aon Hewitt
Michael McGowan, Mercer Consulting (TLCF)
David Velasquez, I Squared Capital
Sadek Wahba, I Squared Capital

CALL TO ORDER:

Mr. Troy Seibel, Parliamentarian, called the State Investment Board (SIB) regular meeting to order at 8:30 a.m. on Friday, March 23, 2018, at the State Capitol, Peace Garden Room, Bismarck, ND.

AGENDA:

IT WAS MOVED BY MS. SMITH AND SECONDED BY TREASURER SCHMIDT AND CARRIED BY A VOICE VOTE TO ACCEPT THE AGENDA FOR THE MARCH 23, 2018, MEETING.

AYES: MS. TERNES, MR. OLSON, TREASURER SCHMIDT, COMMISSIONER SMITH, MR. SEIBEL, MR. LECH, MR. MILLER, MS. SMITH, MR. GESSNER, AND LT. GOVERNOR SANFORD
NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

MINUTES:

IT WAS MOVED BY COMMISSIONER SMITH AND SECONDED BY MS. SMITH AND CARRIED BY A VOICE VOTE TO ACCEPT THE MINUTES OF THE FEBRUARY 23, 2018, MEETING AS DISTRIBUTED.

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

NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

GOVERNANCE:

Board Self-Assessment – Ms. Jeanna Cullins and Ms. Julie Becker, Aon Hewitt, reviewed the results of the Board's self-assessment. Discussion took place on various issues. The report concluded with assessment highlights, greatest achievements, and issues for discussion.

There was no action taken by the Board regarding the self-assessment.

Securities Litigation Committee – Ms. Flanagan reviewed a draft of the SIB Securities Litigation Charter (second reading), Policy (first reading), and Thresholds.

The Board tabled approval of the Charter and Policy and elected to approve both the Charter and the Policy at the same.

ND Parks & Recreation Dept. – Mr. Hunter requested the Board accept the Investment Policy Statement for the approximately $700,000 Lewis and Clark Interpretive Center Endowment Fund, effectively accepting the ND Parks and Recreation Department as a new client within the Insurance Trust pool. The approval would be contingent upon the Industrial Commission's approval per NDCC 21-10-06.

IT WAS MOVED BY MS. SMITH AND SECONDED BY MR. MILLER TO ACCEPT STAFF RECOMMENDATION AND ACCEPT THE INVESTMENT POLICY STATEMENT OF THE LEWIS AND CLARK INTERPRETIVE CENTER ENDOWMENT FUND AND ACCEPT THE ND PARKS AND RECREATION DEPARTMENT AS A SIB CLIENT IN THE INSURANCE TRUST POOL.

AYES: MR. LECH, TREASURER SCHMIDT, COMMISSIONER SMITH, MR. SEIBEL, MR. MILLER, MR. GESSNER, MS. SMITH, MS. TERNES, AND LT. GOVERNOR SANFORD
NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSINER GODFREAD, MR. OLSON

INVESTMENTS:

Investment Policy Statements – Mr. Hunter requested approval for the following SIB client Investment Policy Statements which were recently reviewed and approved by the clients:

IT WAS MOVED BY MS. TERNES AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE CITY OF BISMARCK EMPLOYEE PENSION PLAN REVISED INVESTENT POLICY STATEMENT.

AYES: MS. TERNES, COMMISSIONER SMITH, MR. GESSNER, MS. SMITH, MR. SEIBEL, MR. MILLER, MR. LECH, MR. OLSON, TREASURER SCHMIDT, AND LT. GOVERNOR SANFORD
NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY COMMISSIONER SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE CITY OF BISMARCK POLICE PENSION PLAN REVISED INVESTMENT POLICY STATEMENT.

AYES: MR. GESSNER, COMMISSIONER SMITH, MS. SMITH, TREASURER SCHMIDT, MR. LECH, MR. OLSON, MR. SEIBEL, MR. MILLER, MS. TERNES, AND LT. GOVERNOR SANFORD
NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

IT WAS MOVED BY MS. SMITH AND SECONDED BY MR. LECH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE GRAND FORKS EMPLOYEE PENSION PLAN REVISED INVESTMENT POLICY STATEMENT.

AYES: MR. OLSON, MR. GESSNER, MR. MILLER, MS. SMITH, MR. SEIBEL, MS. TERNES, COMMISSIONER SMITH, MR. LECH, TREASURER SCHMIDT, LT. GOVERNOR SANFORD
NAYS: NONE

MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY COMMISSIONER SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE ND ASSOCIATION OF COUNTIES REVISED INVESTMENT POLICY STATEMENT.

AYES: COMMISSIONER SMITH, TREASURER SCHMIDT, MR. MILLER, MR. OLSON, MS. TERNES, MR. GESSNER, MR. SEIBEL, MR. LECH, MS. SMITH, AND LT. GOVERNOR SANFORD
NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

IT WAS MOVED BY COMMISSIONER SMITH AND SECONDED BY TREASURER SCHMIDT AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE PERS RETIREE HEALTH INSURANCE CREDIT FUND REVISED INVESTMENT POLICY STATEMENT.

AYES: MR. GESSNER, COMMISSIONER SMITH, MS. SMITH, MS. TERNES, TREASURER SCHMIDT, MR. LECH, MR. OLSON, MR. SEIBEL, MR. MILLER, AND LT. GOVERNOR SANFORD
NAYS: NONE
MOTION CARRIED
ABSENT: COMMISSIONER GODFREAD

The Board recessed at 10:30 am and reconvened at 10:43 am

Infrastructure – Mr. Schulz provided an update on the infrastructure search which has been ongoing since the summer of 2017 and the due diligence process completed by the investment team of RIO and Mercer Consulting.

I Squared representatives, Mr. Wahba, Mr. Campbell, and Mr. Velasquez presented an organization overview of the firm and the investment opportunity in the Global Infrastructure Fund II.

Mr. Hunter and Mr. McGowan, Mercer Consulting, reviewed Mercer’s due diligence work, the structure of the Fund, and the fee structure.

After discussion,

Staff recommended contracting with I Squared Capital allocating up to $140 million in the firm's Global Infrastructure Fund II. The assets would come from the Pension Trust, approximately $50-$65 million, and the Legacy Fund, approximately $55-$75 million. The exposure in JP Morgan's Infrastructure Investment's Fund in the Pension Trust, Insurance Trust, and Legacy Fund would be reduced as liquidity permits. Staff feels an investment in I Squared's Global Infrastructure Investment's Fund would offer diversification and enhance the returns of the Pension Trust and Legacy Fund's existing infrastructure portfolios by adding value-added strategies to the existing infrastructure exposures.

IT WAS MOVED BY MS. SMITH AND SECONDED BY MR. OLSON TO ACCEPT STAFF RECOMMENDATION TO INVEST UP TO $140 MILLION WITH I-SQUARED CAPITAL'S GLOBAL INFRASTRUCTURE FUND II.

AYES: MR. OLSON, MR. SEIBEL, MR. GESSNER, MS. SMITH, MR. MILLER
NAYS: TREASURER SCHMIDT, MS. TERNES, MR. LECH, LT. GOVERNOR SANFORD
ABSENT: COMMISSIONER GODFREAD, COMMISSIONER SMITH

ADMINISTRATION:

Executive Review Committee – Ms. Smith, Chair of the SIB Executive Review Committee, updated the Board on the Committee's actions since their last meeting on March 15, 2018. The SIB Executive Director's survey will be sent out April 2, 2018, by Ms. Sauter, with a due date of April 13, 2018. The survey was revised to allow the SIB to comment on each category rather than each question. The survey will include a reference to Governance Policies/Executive Limitations A1-A11 along with supporting documentation as well as a RIO Employee Survey which was completed in March 2018.

GFOA AWARD:

Mr. Hunter informed the Board RIO has received the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association. Receipt of this award marks the 20th consecutive year that RIO has been awarded the honor. Mr. Hunter acknowledged the entire RIO organization particularly Ms. Flanagan, Ms. Walcker and Mr. Schmidt.

MANAGER MEETINGS:

Mr. Hunter reviewed SIB investment manager meetings that have taken place in 2017 and those that have been scheduled and will be scheduled in 2018. All meetings are "noticed" to the SIB and posted to the Secretary of State's Office Public Meeting Notices website.

OTHER:

Private Equity – Mr. Hunter informed the Board RIO investment personnel have received a reverse inquiry on one of their private equity investments. Mr. Hunter requested the Board accept the offer to sell the investment at a price which closely approximates par based on current estimated market conditions.

The Board tabled the matter for further discussion and consideration.

The next meeting of the SIB is scheduled for April 27, 2018, at 8:30 a.m. at the State Capitol, Peace Garden Room.

The next meeting of the Securities Litigation Committee meeting is scheduled for May 10, 2018, at 3:00 p.m. at the Retirement and Investment Office.

The next meeting of the SIB Audit Committee is scheduled for May 24, 2018, at 3:00 p.m. at the Retirement and Investment Office.

ADJOURNMENT:

With no further business to come before the SIB, Mr. Seibel adjourned the meeting at 11:55 a.m.

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Mr. Seibel, Parliamentarian
State Investment Board

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Bonnie Heit
Assistant to the Board

AGENDA ITEM III. A.

Board Acceptance Requested

Annual Board Planning Cycle
Biennial Agenda and Strategic Investment Plan

April 27, 2018

Dave Hunter, Executive Director / CIO
ND Retirement & Investment Office (RIO)
State Investment Board (SIB)

Overview

Each April, the SIB reviews our Biennial Agenda for the upcoming year to ensure it is aligned with our Mission Statement and Strategic Investment Plan. Ends policies are also reviewed to confirm the SIB and RIO are meeting, if not exceeding, client expectations while adhering to approved budget guidelines. **In general, RIO believes we are meeting client expectations based on our stated Ends and noting favorable SIB & TFFR client satisfaction scores, above benchmark returns, favorable peer performance rankings (28th percentile the last 5-years) and a keen awareness to the importance of strong board governance principles and practices.**

Given a desire to further enhance our overall performance, the SIB also conducted a self-evaluation process in early-2018. Based on RIO's belief that the SIB intends to engage in a board self-assessment next year, RIO incorporated this process into the proposed Biennial Agenda for 2019 (noting the following four themes as stated in a subsequent memo).

1) **Committees -** The SIB will remain mindful of its ability to create committees (when needed), ensuring that each permanent committee has its own charter which outlines its scope of authority and responsibilities in reporting to the full Board.
2) **Education -** Maintain a steadfast commitment to continuing board education including new board member orientation/mentoring, fiduciary responsibility and the benchmark selection process. The ED/CIO may provide a recommended list of educational conferences for member consideration.
3) **Staff -** The ED/CIO evaluation process has been thoroughly reviewed and materially enhanced in recent years. The SIB can discuss if any further revisions should be considered at this time.
4) **Attendance -** RIO is able to prepare annual reports for SIB member attendance, professional education, and/or new board member orientation, upon request.

Annual Board Planning Cycle – Biennial Agenda

RIO Recommendation (Board Acceptance Requested)

Call to Action: If the SIB concurs, a motion should be made to accept the Biennial Agenda below including the revisions highlighted in blue relating to the Board Self Assessment.

Fiscal 2017-18	July 2017	August	September	October	November	December	January 2018	February	March	April	May
	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	**ED/CIO Report on Investment Work Plan** **Board Education Investments**	No Meeting Scheduled	**Board Education Governance** **Commence Board Self-Assessment**	**ED/CIO Report on Investment Work Plan** - Executive Limitations Review	**Conduct Board Self-Assessment**	**Review Biennial Agenda, Ends and Strategic Plan** **Accept Board Self-Assessment**	**ED/CIO Report on Investment Work Plan Review ED/CIO** **Review Budget Guidelines**

Fiscal 2018-19	July 2018	August	September	October	November	December	January 2019	February	March	April	May
	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	**ED/CIO 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** **Commence Board Self-Assessment** - Legislative Update	**ED/CIO Report on Investment Work Plan** - Executive Limitations Review - Legislative Update	**Confirm Budget Guidelines** **Accept Board Self-Assessment** - Legislative Update	**Review Biennial Agenda, End Policies, Strategic Investment Plan and Budget Guidelines**	**ED/CIO Report on Investment Work Plan Review ED/CIO** Review Investment Guidelines

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 & submit a biennial budget pursuant to OMB guidelines as established by the Governor that 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 20, 2018

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) The vast majority of SIB clients generated positive excess returns for the 5-years ended 12/31/2017 while adhering to approved investment guidelines for risk and reducing investment management fees (as a % of assets under management) from 0.65% to 0.46% over the last four fiscal years.
2) RIO implemented a transparency enhancement initiative which has 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, 2017 Performance

	1 Yr Ended 12/31/2017	3 Yrs Ended 12/31/2017	5 Yrs Ended 12/31/2017	Risk 5 Yrs Ended 12/31/2017	Risk Adj Excess Return 5 Yrs Ended 12/31/2017
PERS (Main Plan)					
Total Fund Return - Net	17.20%	8.07%	9.29%	4.9%	0.51%
Policy Benchmark Return	14.21%	7.00%	8.24%	4.6%	
Excess Return	3.00%	1.08%	1.06%	106%	
TFFR					
Total Fund Return - Net	16.98%	8.00%	9.29%	4.8%	0.52%
Policy Benchmark Return	14.24%	6.96%	8.24%	4.6%	
Excess Return	2.74%	1.04%	1.04%	106%	
BISMARCK EMPLOYEES					
Total Fund Return - Net	14.76%	7.29%	8.33%	4.2%	0.50%
Policy Benchmark Return	12.17%	6.32%	7.29%	3.9%	
Excess Return	2.60%	0.98%	1.04%	107%	
CITY OF BISMARCK POLICE PENSION					
Total Fund Return - Net	15.47%	7.50%	8.63%	4.5%	0.47%
Policy Benchmark Return	13.02%	6.60%	7.64%	4.2%	
Excess Return	2.45%	0.90%	0.99%	107%	
JOB SERVICE PENSION PLAN					
Total Fund Return - Net	7.70%	5.47%	7.07%	3.7%	0.42%
Policy Benchmark Return	8.29%	4.95%	6.16%	3.4%	
Excess Return	-0.59%	0.52%	0.91%	108%	
CITY OF GRAND FORKS PENSION PLAN					
Total Fund Return - Net	16.51%	7.73%	9.28%	4.9%	0.43%
Policy Benchmark Return	14.41%	7.03%	8.51%	4.8%	
Excess Return	2.11%	0.70%	0.77%	104%	
GRAND FORKS PARK DISTRICT PENSION PLAN					
Total Fund Return - Net	16.87%	7.84%	9.66%	4.9%	0.62%
Policy Benchmark Return	14.63%	6.92%	8.77%	4.8%	
Excess Return	2.25%	0.91%	0.89%	103%	

1) **Every Pension client generated positive "Excess Return" for the 3- and 5-years ended 12/31/17.**

2) **"Excess Return"** is defined as actual investment return (after deducting fees) over the expected return of the underlying investment policy or benchmark (i.e. a passive index).

3) **SIB's use of active management generated over $300 million of net incremental income** (after fees) **in the last 5-years for our SIB clients.** This is based on $10 billion of managed assets and **Excess Return of over 0.60%** ($10 billion x 0.60% = $60 million per year x 5 years = $300 million).

4) **Strong returns have been achieved while adhering to approved risk levels, as measured by standard deviation and risk adjusted excess return over the last 5-years.**

Data as of 12/31/2017 is unaudited and subject to change, but deemed to be materially accurate.

Non-Pension Clients – December 31, 2017 Performance

	1 Yr Ended 12/31/2017	3 Yrs Ended 12/31/2017	5 Yrs Ended 12/31/2017	Risk 5 Yrs Ended 12/31/2017	Risk Adj Excess Return 5 Yrs Ended 12/31/2017
WSI					
Total Fund Return - Net	10.91%	6.24%	6.68%	3.2%	1.31%
Policy Benchmark Return	8.28%	4.65%	4.93%	2.9%	
Excess Return	2.63%	1.59%	1.76%	OK	
LEGACY FUND					
Total Fund Return - Net	14.61%	7.74%	5.99%	4.1%	0.49%
Policy Benchmark Return	12.81%	6.42%	4.94%	3.7%	
Excess Return	1.80%	1.32%	1.05%	OK	

Non-Pension Clients:

- **Every Non-Pension Client generated positive "Excess Return" for the 5-years ended December 31, 2017, with two exceptions for PERS Retiree Health Insurance Credit Fund (-0.10%) and Group Insurance (-0.05%).**
- Returns were achieved in a risk controlled framework as nearly 99% of SIB clients (based on average assets under management) generated positive "**Risk Adjusted Excess Return**" for the 5-years ended 12/31/2017.

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.

Data as of 12/31/2017 is unaudited and subject to change, but deemed to be materially accurate.

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 **0.42% in fiscal 2016 before increasing to approximately 0.46% in fiscal 2017.**

All State Investment Board Clients	Investment Fees and Expenses	Average "Assets Under Management"	% of AUM
	a	b	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%**
Fiscal Year Ended June 30, 2017	**$54.5 million**	**$11.8 billion**	**0.46%**

Key Point: Based on over $10 billion of AUM, this 19 bps decline between fiscal 2013 and 2017 translates into over $19 million of annual savings.

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

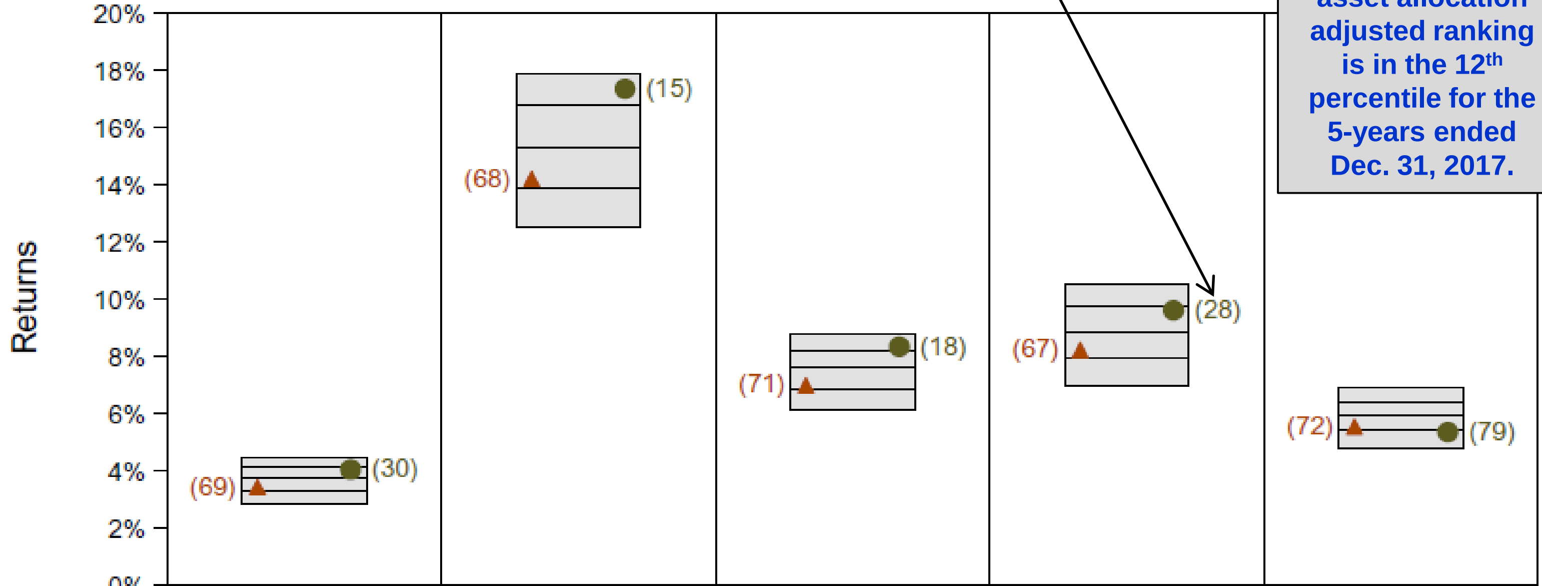
A basis point (or “bp”) is equal to one one-hundredth of one percent (or 0.01%) such that 100 basis points (“bps”) is equivalent to 1%.

Note: All amounts are deemed to be materially accurate, but are unaudited and subject to change.

Pension Trust “gross” returns were ranked in the 28th percentile for the 5-years ended December 31, 2017, based on Callan’s “Public Fund Sponsor Database”.

Callan Public Fund Sponsor Database

The Pension Trust asset allocation adjusted ranking is in the 12th percentile for the 5-years ended Dec. 31, 2017.



	Last Quarter	Last Year	Last 3 Years	Last 5 Years	Last 10 Years
10th Percentile	4.41	17.88	8.75	10.50	6.89
25th Percentile	4.12	16.75	8.17	9.72	6.36
Median	3.71	15.28	7.59	8.85	5.91
75th Percentile	3.28	13.83	6.85	7.93	5.42
90th Percentile	2.83	12.54	6.10	6.93	4.73
Total Fund ●	4.02	17.34	8.32	9.59	5.33
Policy Target ▲	3.41	14.19	6.97	8.21	5.52

* Current Quarter Target = 16.1% Russell 1000 Index, 16.0% MSCI World, 13.2% Blmbg Aggregate, 11.2% MSCI World ex US, 10.5% NCREIF Total Index, 6.5% NDSIB PEN - Private Equity, 5.6% CPI-W, 5.4% Blmbg Glob Agg ex USD, 4.9% Russell 2000 Index, 4.6% Blmbg HY 2% Iss Cap, 3.1% MSCI EM, 2.5% NCREIF Timberland Index and 0.4% 3-month Treasury Bill.

SIB Client Satisfaction Scores Remain Strong in 2017

TO: State Investment Board

FROM: Dave Hunter, Executive Director/CIO

DATE: October 23, 2017

SUBJECT: SIB Client Satisfaction Survey – Cover Memo

The Audit Services team conducted the 2017 Customer Satisfaction Survey over the past few months.

SIB clients assigned a 3.6 overall rating in 2017 which is the comparable to prior years. 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.

SIB Client Boards:

1. PERS Pension
2. TFFR Pension
3. Bismarck Employee Pension
4. Bismarck Police Pension
5. Grand Forks Employee Pension
6. Grand Forks Park District Pension
7. Workforce Safety & Insurance
8. Insurance Commissioner
9. State Risk Management
10. ND Association of Counties
11. Council on the Arts
12. Board of Medical Examiners
13. City of Fargo (Fargo Dome)
14. Legacy & BSF Advisory Board
15. Office of Management & Budget
16. Parks & Rec (Lewis & Clark)

Parks & Rec. added in Q1 of 2018

RIO attends 40 client board meetings per year (e.g. SIB 10, TFFR/PERS 12, Audit 4, Legacy 2, WSI 2, Other Client Boards 10).

RIO 2017-19 Strategic Investment Plan

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. All investment decisions are driven by our desire to maximize risk adjusted returns based on our clients stated risk appetite and liquidity profile. SIB clients generated over **$300 million** of incremental income via the prudent use of active management the last 5 years including over **$120 million** of incremental income in **2017**.

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.**

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 $300 million of incremental income via the prudent use of active investment management since 2013.**

  - **SIB clients generated over $120 million of excess return via the prudent use of active investment management in 2017.**

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 opportunity was realized in 2017 noting that our new office space offers improved client access, a better physical working environment and enhanced employee and customer safety while remaining within RIO's approved budget.**

Enhance Existing Risk Management Framework

- **Enhance RIO's internal control environment by improving use of proven risk management solutions relating to investment risk, fraud risk awareness 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 continues to broaden stakeholder awareness of the challenges faced in estimating Legacy Fund earnings for any given period.**

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:

	Base Level	Adjustments or Enhancements	Appropriation
Salaries and wages	$4,340,551	$85,019	$4,425,570
Operating expenses	990,874	(128,390)	862,484
Contingencies	82,000	(30,000)	52,000
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.

State Investment Board – Client Assets Under Management

As of 12/31/17, 6/30/17 and 12/31/16

Fund Name	Market Values as of 12/31/17 [(1)]	Market Values as of 6/30/17 [(2)]	Market Values as of 12/31/16 [(1)]
Pension Trust Fund			
Public Employees Retirement System (PERS)	2,994,979,615	2,781,347,059	2,563,018,948
Teachers' Fund for Retirement (TFFR)	2,473,097,233	2,318,214,336	2,147,574,445
City of Bismarck Employees Pension	98,190,912	91,954,163	85,523,410
City of Grand Forks Employees Pension	65,631,836	63,392,385	58,008,561
City of Bismarck Police Pension	39,669,311	38,136,784	35,374,745
Grand Forks Park District	6,632,313	6,160,568	5,871,117
Subtotal Pension Trust Fund	**5,678,201,220**	**5,299,205,294**	**4,895,371,226**
Insurance Trust Fund			
Workforce Safety & Insurance (WSI)	1,941,922,235	1,894,614,793	1,825,110,509
City of Fargo FargoDome Permanent Fund	44,602,637	41,634,919	33,312,203
Budget Stabilization Fund	38,399,123	6,127,845	103,537,937
PERS Group Insurance Account	35,284,686	37,500,315	36,834,347
State Fire and Tornado Fund	23,591,124	22,008,326	22,545,969
Petroleum Tank Release Compensation Fund	6,493,334	6,396,410	6,842,054
State Risk Management Fund	5,298,651	5,781,004	6,246,768
State Risk Management Workers Comp Fund	5,335,413	5,534,627	5,748,688
ND Association of Counties (NDACo) Fund	5,937,947	4,383,922	4,164,771
State Bonding Fund	3,428,672	3,374,398	3,292,172
ND Board of Medicine	2,242,647	2,179,911	2,258,841
Insurance Regulatory Trust Fund	1,254,637	5,289,165	1,477,615
Bismarck Deferred Sick Leave Account	733,682	698,132	661,093
Cultural Endowment Fund	459,249	431,471	406,389
Subtotal Insurance Trust Fund	**2,114,984,037**	**2,035,955,239**	**2,052,439,356**
Legacy Trust Fund			
Legacy Fund	5,252,300,943	4,687,963,730	4,189,334,992
PERS Retiree Insurance Credit Fund	125,251,245	116,150,947	106,879,605
Job Service of North Dakota Pension	98,324,290	97,332,819	95,685,427
ND Tobacco Prevention and Control Trust Fund	58,139,612	57,462,736	50,509,542
Total Assets Under SIB Management	**13,327,201,347**	**12,294,070,765**	**11,390,220,148**

[(1)] *Market values are unaudited and subject to change.*

[(2)] *6/30/17 market values as stated in the Comprehensive Annual Financial Report.*

- **SIB client assets grew by 17% or $1.9 billion in 2017 largely due to $1.7 billion of net investment income including $635 million for Legacy, $440 million for PERS, $360 million for TFFR and $195 million for WSI.**
- **The Pension Trust posted a net return of 17.1% in the last year.** During the last 5-years, the Pension Trust generated a net annualized return of 9.3%, exceeding the performance benchmark of 8.2%.
- **The Insurance Trust generated a net return of 10.5% in the last year.** During the last 5-years, the Insurance Trust posted a net annualized return of 5.5%, exceeding the performance benchmark of 4.1%.
- **Legacy Fund generated a net return of 14.6% last year, exceeding its policy benchmark.** During the last 5-years, Legacy Fund earned a net annualized return of 6.0%, exceeding the performance benchmark of 5.0%.
- **SIB client assets totaled approximately $13.3 billion as of December 31, 2017, based on unaudited valuations.**

Fundamental Investment Beliefs of the NDSIB

Asset allocation is the # 1 driver of investment returns, but the prudent use of active management can improve performance and contribute towards our clients attaining their stated investment objectives. (See example below.)

a) **SIB clients earned approximately $1.7 billion of net investment income (after all fees and expenses) for the 1-year ended December 31, 2017.**

b) **RIO estimates that active management enhanced net investment returns by at least 1% or $120 million during the last year** noting total Assets Under Management (AUM) exceeded $12 billion, while net investment returns exceeded their benchmarks by 1% last year (e.g. $12 billion x 1% = $120 million).

c) **Based on the above estimates, "asset allocation" was responsible for $1.58 billion (or 93%) of the net investment income, while "active management" was responsible for $120 million (or 7%) of net investment income in 2017.**

d) **SIB governance policies reinforce our fundamental investment beliefs by monitoring actual versus target asset allocation levels every quarter and comparing actual net investment returns versus approved benchmarks.**

e) **Based on AUM, nearly 98% of our clients benefitted from the use of active management for the 1-, 3- and 5-years ended Dec. 31, 2017. This translates into over $300 million of incremental investment income the last 5-years.**

The above amounts are preliminary estimates and subject to change.

AGENDA ITEM III.B.

Board Acceptance Requested

TO:	State Investment Board
FROM:	Dave Hunter (on behalf of the SIB Chairman and Vice-Chairman)
DATE:	April 20, 2018
SUBJECT:	**Board Self-Assessment Summary**

The SIB engaged Aon Hewitt to conduct a Board Self-Assessment Survey during the first quarter of 2018. The results of this survey were reviewed by the SIB on March 23, 2018. After board member discussion at our last meeting, Aon Hewitt prepared the following Board Self-Assessment for further review and acceptance by the SIB.

If the Board desires, the SIB may make a motion to accept the attached summary and/or direct the ED/CIO to take further action based on this board self-assessment process.

Confidential Memo

To:	**North Dakota State Investment Board Members**
From:	Jeanne Cullins, Partner, Fiduciary Services Practice Leader, Aon Julie Becker, Associate Partner, Fiduciary Services, Aon
Date:	April 9, 2018
Re:	Summary of the 2017 Board Self-Assessment Discussion

At its March 23, 2018 regular meeting, the Board discussed the results of its Self-Assessment and performance during calendar year 2017. The purpose of this memo is to summarize the topics and next steps articulated during the Board's discussion.

Background

This is the first year the Board engaged in conducting a board self-evaluation assessment, which is a recognized best practice in governance. We at Aon administered a two-part survey in advance of the meeting. The first part asks Board members to reflect on the quality of their individual service to the Board. Topics include meeting attendance, knowledge of key subjects, exhibiting ethical conduct, and interpersonal communications, among others. The second part polls satisfaction levels with various aspects of the Board's operations as a collective. Here, themes for reflection include meeting protocols and materials, the Board and Executive Director relationship, and Board responsibilities and practices, and among others.

In response to the survey, we received completed submissions from 10 of the Board Members. Responses were tabulated and summarized in a brief report that was provided to the Board for its review and discussion during the meeting.

Overall the results were very favorable. Using a five-point scale where 5 means "strongly agree" and 1 means "strongly disagree", the average overall Board evaluation ratings ranged from 3.88 to 5.00.   The median score was 4.50.

The Board indicated that it found the Self-Assessment to be a useful tool. We commend the Board for engaging in this process and for the robust comments during the discussion. We recommend that the Board adopt the Self- Assessment as an annual process, enabling the Board to benchmark against the prior year's performance, evaluating progress and adopting any identified additional enhancements to continually improve Board governance.

High Level Topics Discussed and Associated Next Steps Articulated

The Board focused on 4 overarching themes which stemmed from the Board member's responses to the Self-Assessment questionnaire. The Board focused on the following for overarching themes:

1. **Board committees-** the Board questioned whether it needed to create additional committees to handle detailed work. Some members stated that the Board has created ad hoc committees when needed, such as the securities litigation committee. However, the use of standing committees has not been a historical practice. It was noted as the duty of prudence evolves over time, the Board should as well. The question was raised how to keep the full Board engaged if there is a committee handling the detailed work. Discussion topics included the importance of each committee having regular reporting responsibilities to the full Board, acting only in an advisory capacity, and that all Board members, including those not on the committee, are welcome to attend the committee meetings. The consensus was that committees make the full Board more efficient, as some Board members have experienced with participation on other boards. The Board needs to decide what it wants to do as a whole.

Associated next steps- The Board will be mindful of the ability to create committees if the need arises, ensuring that each committee has its own charter which outlines its scope of authority and responsibilities in reporting to the full Board.

2. **New Board member orientation and Board member continuing education-**

The Board considered adoption of a Board Education Policy addressing new Board member orientation, requiring a certain number of hours of continuing education, and listing approved outside conferences.

The advantages of adopting such a policy were discussed including to address the disparate levels of experience on the board, and to establish the philosophy of the Board to encourage the importance of education to the member's ability to fulfill their fiduciary duty

Relative to new Board member orientation, the consensus was that the Board Chair can assist in pairing more seasoned mentors with newer members, taking traits into consideration. Suggested topics should also be jointly developed with input from the Board and staff. The Executive Director will also check-in with new Board members after they have served their first 6 months.

The Board may adopt a required minimum hours of continuing education, as well as relevant topics. This would be a prudent documentation to also have in light of Board travel. Board travel should be pre-approved by the Board and such travel should specify whether it is for education or due diligence.

There should be an associated tracking system for each Board Member's completion of orientation and continuing education.

The Education Policy may also have a list of approved external conferences, such as Callan, NASRA, NCPERS, IFEBP, etc. The external conferences usually have tiers depending upon the tenure of the attendees. The list could be organized accordingly. The members shared that Callan conferences were very helpful, particularly after a new member has served 9-12 months on the Board.

Internal educational presentations at Board or Committee meetings that satisfy the continuing education topics should be noted on the Board agenda and tracked accordingly.

Associated next steps- The Board will:
A. Decide on the process for new board member training and mentorship
B. Decide if it will require a minimum number of hours of annual continuing education, and if so, how many hours and in what areas
C. Request that the Executive Director present a draft of pre-approved external conferences for the Board's review and ultimate adoption
D. Request all of the above be documented in a draft Board Member Education Policy for the Board's review and ultimate adoption
E. The Board will pre-approve external travel and notate if for continuing education
F. Have assistant to the Board track each member's completion of educational sessions and notate educational presentations on Board meeting agendas.
G. Revisit the Board Education Policy biannually

3. **Staff related-** Comments from the Self-Assessment suggest a need for a revised and enhanced process to evaluate the Executive Director's performance. Members of the Board shared that the form itself may be too lengthy and potentially take 2 hours of each member's time to complete. The form has been revised a couple times in the past few years and currently a board subcommittee is working on the process already.

The Board acknowledged that performing the Executive Director evaluation is it's responsibility. There was a discussion about the importance of providing measurable and attainable pre-determined goals. The importance was expressed of giving the Executive Director thorough, honest, constructive and growth oriented feedback to assist him meet these goals.

Associated next steps-The Board should have further discussion on this topic, particularly whether the full Board or just the evaluation subcommittee should complete the Executive Director's performance review, and give guidance to the subcommittee whether the process should be changed and/or shortened.

4 **Attendance and engagement of leadership** was expressed as a critical issue, as these are fundamental to good governance. Since members can call into meetings, it was noted that attendance should not be an issue, however all members are encouraged to attend in person if possible. It was mentioned that there are other pension funds who consider a member to have resigned if they have 3 or more unexcused absences. Some pension fund elected or appointed state officials are also able to send designees if they are unable to attend a meeting. Another potential idea mentioned was to create annual attendance reports which raise awareness. The Governance Manual can also be revised to include the expectation of attendance and engagement of all members.

Future topics requested for board education include fiduciary responsibilities, the benchmark selection process and the potential impact of the millennial generation employment practices on the stability of pension plans.

We believe we have captured the discussion that occurred during the Board discussion accurately, however, if we have inadvertently missed a topic or misstated something, please let us know and we will address it.

If you would like to discuss anything in this memo in more detail, we are happy to discuss with you at your convenience.

Agenda Item III.C.

Informational

TO: **State Investment Board**

FROM: **RIO Investment Staff**

DATE: **April 20, 2018**

SUBJECT: **Legacy Fund – Asset Allocation & Investment Policy Statement Review**

Background:

In accordance with North Dakota Century Code 21-10-11, "The staff and consultants of the state retirement and investment office shall advise the board in developing asset allocation and investment policies." Furthermore, "The legacy and budget stabilization fund advisory board is created to develop recommendations for the investment of funds in the legacy and budget stabilization funds to present to the state investment board." **Given the above, the SIB approved RIO's recommendation to engage Callan to review the current Legacy Fund asset allocation policy last year.**

In anticipation of Callan presenting the results of their analysis at our next SIB meeting on May 25, 2018, RIO deemed it worthwhile to review Legacy's current asset allocation and investment policy statement. RIO notes that Callan is scheduled to present their findings to the Legacy Fund Advisory Board on (Thursday) May 24, 2018 (with a suggested time of 1:00 to 3:00 pm CT).

Overview of Asset Allocation Policy Targets:

Legacy's current asset allocation policy was recommended by RV Kuhns on April 2, 2013, as follows:

U.S. Equity	*30%*		
International Equity	*20%*	**Equity**	**50%**
Fixed Income	35%	**Fixed Income**	**35%**
Diversified Real Assets	*10%*		
Real Estate	*5%*	**Real Assets**	**15%**

For simplicity, RIO has combined *U.S. and International Equity* as "**Equity**" and *Diversified Real Assets and Real Estate* as "**Real Assets**". "Real Assets" include infrastructure and inflation linked debt securities (such as U.S. Treasury Inflation Protected Securities or "TIPS") and real estate.

RIO reviewed Legacy's current asset allocation and investment policy statement with the Legacy Fund Advisory Board on November 28, 2017. The Advisory Board affirmed our prior recommendation to engage Callan to conduct an asset allocation policy review in 2018. **Legacy Fund's current investment policy statement is presented on the following pages including excerpts from the prior presentation to the Advisory Board.**

Legacy Fund Asset Allocation Policy

April 20, 2018

Note: RIO intends to review Legacy Funds' current investment policy statement as detailed on the following pages with a focus on the terms highlighted in **green text**. RIO also intends to provide a preliminary investment update for the Legacy Fund and offer to discuss recent legislative proposals to use a portion of the Legacy Fund for statewide infrastructure projects.

Dave Hunter, Executive Director/CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

NORTH DAKOTA LEGACY FUND INVESTMENT POLICY STATEMENT

The Legacy Fund investment policy statement should be reviewed annually for accuracy and completeness.

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 Advisory 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 and BND CD	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 17, 2017, the Advisory Board acknowledged the transfer of the Bank of North Dakota Match Loan Certificates of Deposit Program ("BND CD") to the Legacy Fund in early-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 are rated AA by S&P.

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:

1. The cost does not exceed the fair market value at the time of investment.
2. 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.
3. Sufficient liquidity is maintained in the legacy 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 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	STATE INVESTMENT BOARD
______________________________	______________________________
Representative Keith Kempenich Chairman	David Hunter Executive Director / CIO
Date: __________________________	Date: __________________________

Approved by the NDSIB: 7/28/2017
Approved by the LBSFAB: 6/17/2017

Summary: The Advisory Board approved our recommendation to engage Callan Associates to conduct an asset allocation and spending study for the Legacy Fund in 2018. The last review was completed in 2013 noting that many experts consider it a "best practice" to conduct asset allocation reviews every (four to) five years or whenever there is significant change in underlying assumptions. Although RIO does not expect any material changes in the overall asset allocation policy, **RIO requested Callan to consider an increase to infrastructure (within Diversified Real Assets, while decreasing global index linked securities) along with a review of the existing BND Match Loan Certificates of Deposit (CD) Program.** The BND CD Program size is currently limited to the **lesser** of $200 million or 5% of the Legacy Fund (and represents a sector allocation within Fixed Income). **RIO requested Callan to consider a 5% target allocation to the BND CD Program** (e.g. $5.3 billion x 5% = $250 million). The BND exposure (with a 5% target allocation) may be allocated between the existing CD Program (with a minimum 1.75% return) and a new "Infrastructure CD Program" with higher market based return expectations to compensate for escalating interest rate risk. **RIO's final recommendation will be based on maximizing risk adjusted returns given the clients stated risk appetite and liquidity profile (which is materially consistent with the investment principles of all SIB client investment policy statements).**

RIO is available to assist the Advisory Board establish separate formal governance policies, if so directed.

Legacy Fund – Actual Performance vs Policy Benchmark

Net Returns Exceed Policy Benchmark – Periods Ended 12/31/17

The Legacy Fund earned $640 million of net investment income in 2017. Since inception, the Legacy Fund has earned over $1 billion of net investment income as of February 28, 2018.

	Current FYTD 12/31/2017	1 Yr Ended 12/31/2017	3 Yrs Ended 12/31/2017	5 Yrs Ended 12/31/2017
Total Fund Return - Net	7.2%	14.6%	7.7%	6.0%
Policy Benchmark Return	6.2%	12.8%	6.4%	4.9%
Excess Return	1.0%	1.8%	1.3%	1.0%

1. **For the 1-Year Ended 12/31/17**, the Legacy Fund earned a **Net Return of 14.6%** exceeding the Policy Benchmark (of 12.8%) and creating **Excess Return of 1.8%.** Actual net returns exceed the Policy Benchmark by **$72 million** **for the 1-year ended 12/31/17** (e.g. $4 billion x 1.8% = $72 million).

2. **For the 5-Years Ended 12/31/17,** the Fund earned a **Net Return of 6.0%** exceeding the Policy Benchmark (of 4.9%) and creating **Excess Return of over 1.0%.** Actual returns exceed Policy by **$100 million** **for the 5 years ended 12/31/17** (e.g. $2 billion x 1.0% = $20 million x 5 years = $100 million).

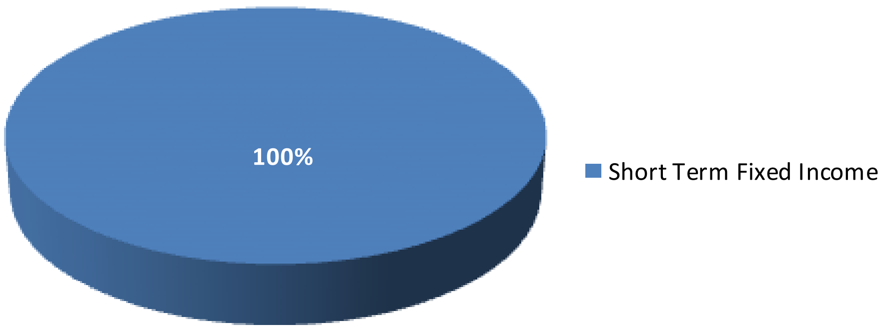
3. **The above benchmark returns were achieved while adhering to approved risk levels.**

Note: Current Fiscal Year To Date and all returns as of 12/31/2017 and 2/28/2018, are unaudited and subject to change.

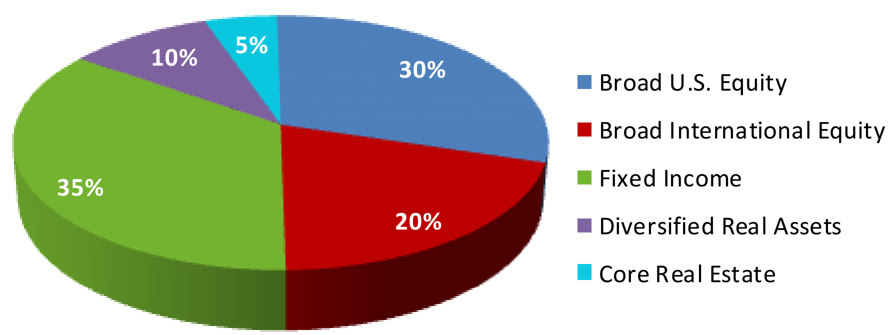
The Policy Benchmark is 50% Equity, 35% Bonds and 15% Real Assets (including Real Estate, Infrastructure and TIPS).

Legacy Fund Strategic Asset Allocation

Actual Allocation
8/1/2013



Policy Allocation
January 31, 2015 to Current



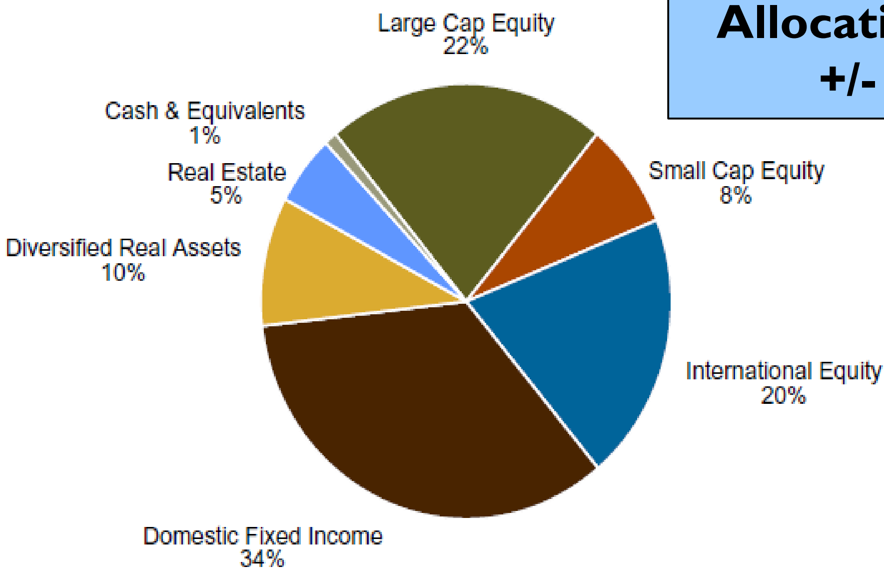
Note: Amounts are preliminary, unaudited and subject to change.

NOTE: All data included in this "Preview of Investment Returns" as of Sep. 30, 2017, is unaudited and subject to change.

Legacy Fund - Asset Allocation

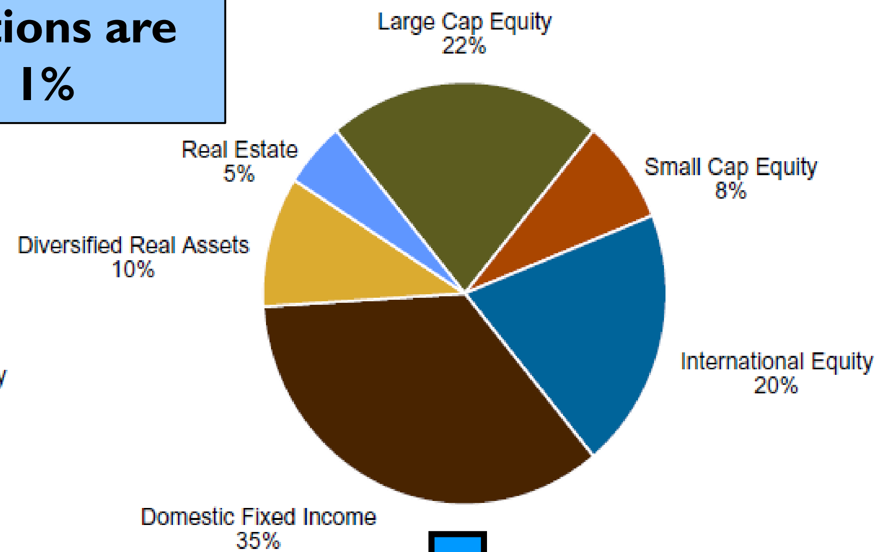
Market Valuations as of December 31, 2017

Actual Asset Allocation



Actual and Target Allocations are +/- 1%

Target Asset Allocation



Asset Class	$000s Actual	Weight Actual	Target	Percent Difference	$000s Difference
Large Cap Equity	1,153,566	22.0%	22.0%	(0.0%)	(1,941)
Small Cap Equity	415,195	7.9%	8.0%	(0.1%)	(4,989)
International Equity	1,049,343	20.0%	20.0%	(0.0%)	(1,117)
Domestic Fixed Income	1,803,653	34.3%	35.0%	(0.7%)	(34,652)
Diversified Real Assets	506,526	9.6%	10.0%	(0.4%)	(18,705)
Real Estate	271,421	5.2%	5.0%	0.2%	8,806
Cash & Equivalents	52,598	1.0%	0.0%	1.0%	52,598
Total	5,252,301	100.0%	100.0%		

* Current Quarter Target = 35.0% Blmbg Aggregate, 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.

Legacy Fund – Dec. 31, 2017

Unaudited and Subject to Change

Legacy Fund - $5.25 billion

Global Equities - $2.6 billion

- LSV	$ 765 million
- LA Capital	572 million
- Parametric	455 million
- William Blair	426 million
- PIMCO RAE	188 million (1)
- Vanguard	107 million
- DFA	105 million

Fixed Income - $1.8 billion

- Wells	$ 508 million
- Western	500 million (2)
- State Street	255 million
- Prudential	198 million
- Declaration	129 million
- Ares/Cerberus	76 million
- PIMCO	75 million (1)
- BND CD's	63 million

Real Assets - $ 778 million

- Western	$ 355 million (2)
- JPMorgan	259 million
- Invesco	132 million
- Grosvenor	32 million

	December 31, 2017 Market Value	December 31, 2017 Weight
Domestic Equity	**$1,568,760,230**	**29.87%**
Large Cap Equity	**$1,153,565,525**	**21.96%**
L.A. Capital Enhanced	221,618,115	4.22%
L.A. Capital Large Cap Growth	350,972,609	6.68%
Parametric Clifton Large Cap	227,500,511	4.33%
LSV Large Cap Value	353,474,289	6.73%
Small Cap Equity	**$415,194,705**	**7.91%**
Parametric Clifton SmallCap	227,408,276	4.33%
PIMCO RAE	187,786,429	3.58%
International Equity	**$1,049,343,140**	**19.98%**
DFA Intl SmallCap Value	104,629,132	1.99%
LSV Intl Value	411,728,637	7.84%
Vanguard Intl Explorer Fund	106,768,499	2.03%
William Blair	426,216,872	8.11%
Domestic Fixed Income	**$1,803,652,904**	**34.34%**
Ares ND Credit Strategies Fd	32,430,767	0.62%
BND CDs	63,242,695	1.20%
Cerberus ND Private Credit Fd	43,825,710	0.83%
Declaration Total Return	129,154,494	2.46%
Prudential	197,898,883	3.77%
SSgA US Govt Credit Bd Idx	254,780,214	4.85%
Wells Capital	507,806,032	9.67%
Western Asset Management	499,802,371	9.52%
Pooled Fixed Income(1)	74,711,738	1.42%
Diversified Real Assets	**$506,525,600**	**9.64%**
Western TIPS	355,642,915	6.77%
JP Morgan Infrastructure	118,746,989	2.26%
Grosvenor Cust. Infrastructure	32,135,695	0.61%
Real Estate	**$271,421,292**	**5.17%**
Invesco Core Real Estate	131,584,803	2.51%
JP Morgan RE Inc & Growth	139,836,489	2.66%
Cash & Equivalents **Northern Trust & BND**	**$52,597,775**	**1.00%**

Legacy Fund – Investment Fees and Expenses

Fiscal 2017 vs Fiscal 2016

		FY 2017				FY 2016		
		Average Market Value	Fees in $		Fees in %	Average Market Value	Fees in $	Fees in %
Investment managers' fees:								
Domestic large cap equity managers		965,570,487	1,922,415		0.20%	778,006,246	2,095,229	0.27%
Domestic small cap equity managers		364,557,307	630,814		0.17%	279,004,042	1,204,775	0.43%
International equity managers		859,092,053	3,553,654		0.41%	686,819,896	2,752,321	0.40%
Domestic fixed income managers		1,481,415,976	4,987,591		0.34%	1,261,572,841	3,376,076	0.27%
Diversified real assets managers		406,004,165	1,368,397		0.34%	355,643,550	1,485,125	0.42%
Real estate managers		255,143,146	1,514,247		0.59%	208,482,344	1,347,554	0.65%
Short-term fixed income managers		-	-		0.00%	-	-	0.00%
Cash & equivalents managers		12,637,988	9,758		0.08%	14,048,537	20,951	0.15%
Total investment managers' fees	3	**4,344,421,122**	**13,986,877**	4	**0.32%**	6 **3,583,577,456**	**12,282,031**	**0.34%**
Custodian fees			355,376		0.01%		355,571	0.01%
Investment consultant fees			222,477		0.01%		198,884	0.01%
Total investment expenses		2	**14,564,731**		**0.34%** 1		**12,836,486**	**0.36%**
Performance Fees Paid (included in totals above)								
Total Performance Fees Paid			**2,167,158**		**0.05%**		**1,988,561**	**0.06%**
Actual Investment Performance (Net of Fees)					**12.03%**			**1.06%**
Policy Benchmark					**9.91%**			**1.01%**
			Outperformance	5	**2.12%**		**Outperformance** 5	**0.05%**

- **Investment fees and expenses decreased slightly to 0.34% in fiscal 2017 from 0.36% in fiscal 2016 despite a significant increase in manager outperformance (increasing to 2.12% in fiscal 2017 versus 0.05% in fiscal 2016).**
- **The use of active management paid significant returns for the Legacy Fund in Fiscal 2017 as we paid $14.6 million in fees to earn 12% (or $480 million) in fiscal 2017, including $80 million over our Policy Benchmark.**

3 - Average Market Value of Assets in Fiscal 2017 of $4 billion x Outperformance of 2% = $80 million.

LEGACY FUND
Statement of Net Position
As of 2/28/2018

Legacy Fund balances and returns are posted on RIO's website at each month-end.

	As of 2-28-18	As of 6-30-17
ASSETS:		
INVESTMENTS (AT FAIR VALUE)		
DOMESTIC EQUITIES	$ 1,576,658,004	$ 1,407,188,529
INTERNATIONAL EQUITIES	1,062,951,589	935,447,142
DOMESTIC FIXED INCOME	1,842,951,855	1,605,730,810
REAL ASSETS	797,161,623	712,121,488
INVESTED CASH (NOTE 1)	47,489,368	9,349,540
TOTAL INVESTMENTS	5,327,212,439	4,669,837,509
RECEIVABLES		
DIVIDEND/INTEREST RECEIVABLE	15,161,553	18,126,221
MISCELLANEOUS RECEIVABLE	17,688	10,501
TOTAL RECEIVABLES	15,179,241	18,136,722
OTHER ASSETS		
INVESTED SECURITIES LENDING COLLATERAL (NOTE 2)	25,982,646	33,301,257
OPERATING CASH	82,000	95,642
TOTAL ASSETS	5,368,456,326	4,721,371,130
DEFERRED OUTFLOWS OF RESOURCES		
DEFERRED OUTFLOWS RELATED TO PENSIONS	97,379	119,384
LIABILITIES:		
SECURITIES LENDING COLLATERAL (NOTE 2)	25,982,646	33,301,257
ACCOUNTS PAYABLE	-	99,334
ACCRUED EXPENSES	232,937	253,138
INVESTMENT EXPENSE PAYABLE	2,187,487	2,187,485
TOTAL LIABILITIES	28,403,070	35,841,214
DEFERRED INFLOWS OF RESOURCES		
DEFERRED INFLOWS RELATED TO PENSIONS	11,569	11,569
NET POSITION:		
HELD IN TRUST	5,340,139,066	4,685,637,731
TOTAL NET POSITION	$ 5,340,139,066	$ 4,685,637,731

These financial statements are preliminary, unaudited and subject to change. 4/4/2018

State Investment Board
Statement of Changes in Net Position
For the Month Ended 2/28/2018

	Month Ended 2-28-18	Year-to-Date
ADDITIONS:		
INVESTMENT INCOME		
GAIN ON SALE OF INVESTMENTS	$ 97,367,024	$ 411,957,246
LOSS ON SALE OF INVESTMENTS	95,991,529	312,312,429
NET GAINS (LOSSES) INVESTMENTS	1,375,495	99,644,817
NET APPREC (DEPREC) MARKET VALUE	(140,150,020)	178,183,175
NET CHANGE IN FAIR VALUE OF INVESTMENTS	(138,774,525)	277,827,992
INTEREST, DIVIDEND & OTHER INVESTMENT INCOME	9,400,066	67,948,890
	(129,374,459)	345,776,882
LESS INVESTMENT EXPENSES	855,080	7,563,883
NET INCOME FROM INVESTING ACTIVITIES	(130,229,539)	338,212,999
SECURITIES LENDING INCOME	50,815	504,352
SECURITIES LENDING EXPENSES	10,153	100,787
NET SECURITIES LENDING INCOME	40,662	403,565
NET INVESTMENT INCOME	(130,188,877)	338,616,564

EARNINGS AVAILABLE

Section 26 of Article X of the Constitution of North Dakota dictates that earnings of the Legacy Fund accruing after June 30, 2017, shall be transferred to the general fund at the end of each biennium. Earnings accrued prior to June 30, 2017, become part of the principal of the fund.

NDCC 21-10-02 defines "earnings" for the purposes of Section 26, Article X as "net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses."

As of the date of these financial statements, the principal balance of the Legacy Fund is $ 4,693,731,356

As of the date of these financial statements, earnings of the Legacy Fund eligible for transfer to General Fund at the end of the biennium is $ 160,051,708

These financial statements are preliminary, unaudited and subject to change.

Legacy Fund Earnings Estimate
April 11, 2018

Background

RIO was requested to provide a revised Legacy Fund earnings estimate for the remaining 2017-19 and upcoming 2019-21 biennia. RIO relied on oil and gas tax estimates provided by OMB and expected investment earnings over the next three-plus years. Estimates are based on the anticipated average balance of the Legacy Fund during the forecast period acknowledging that commodity prices are volatile in addition to the impact of this price volatility on oil and gas production and related tax collections.

The Legacy Fund is currently undergoing an asset liability study which may impact the current target asset allocation of 50% equity, 35% fixed income and 15% diversified real assets. Given that our current asset allocation includes a 50% allocation to the public equity markets which are inherently subject to significant return volatility including the potential for negative investment returns over any defined time period, RIO notes it is reasonable to expect to the Legacy Fund to lose money during certain periods when the equity markets are experiencing losses, credit markets are experiencing elevated defaults and/or when liquidity in the private markets is challenged. Despite these investment concerns (which are present in most any return seeking portfolio), RIO is confident that the Legacy Fund will meet or exceed its targeted investment return of 6% over the long term. In order to be prudent and diligent and in light of our significant fiduciary responsibility, the SIB and RIO work with expert consultants (including R.V. Kuhn and Callan Associates) and professional investment management firms to confirm the reasonableness of our future capital market assumptions which serve as the foundation for overall long-term return estimates.

RIO notes the prior earnings estimate of $200 million for the 2017-19 biennium was based on a 2% average "earnings" rate and anticipated Legacy Fund average balance of approximately $5 billion ($5 billion x 2% = $100 million per year or $200 million per biennium). The **2%** average "earnings" rate was based on the midpoint of the RV Kuhn consultant forecast including a 6% Base Case and -2% Worst Case, noting the Worst Case was raised by 1% (from -3%) based on the expected strength of the capital markets during the prescribed time period. **RIO notes that NDCC 21-10-02 defines "earnings" as "net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses." This definition**

of “earnings” is materially different than net investment return including realized gains and losses. For comparison, the Legacy Fund generated over $1 billion of net investment earnings since inception (as of February 28, 2018) whereas “earnings” as defined in accordance with NDCC 21-10-02 was less than $600 million during this same time period.

Legacy Fund “Earnings” Estimate

Based on the expected strength of the capital markets over the next three years, RIO continues to recommend a 2% average “earnings” rate for the upcoming 2019-21 biennium. Based on this 2% “earnings” rate assumption and incorporating actual “earnings” of the Legacy Fund through February 28, 2018 in addition to OMB’s expected oil and gas tax estimates through June 30, 2021, RIO estimates Legacy Fund “earnings” will approximate $300 million in 2017-19 and $280 million in 2019-21. RIO acknowledges the $300 million estimate for 2017-19 is $100 million higher than our prior forecast due to incredibly strong global equity markets in late-2017 and escalating oil and gas tax revenues in recent months. The $280 million “earnings” estimate for the 2019-21 biennia is largely driven by forecasted growth in oil and gas tax revenues causing average Legacy Fund investments to approximate $7 billion next biennium (e.g. $7 billion x 2% “earnings” rate = $140 million x 2 years = $280 million).

Legacy Fund Earnings

		"Earnings" under current definition
FY2012		
Net Investment Income w/out Gains/Losses	2,350,618	
Net Realized Gains (Losses)	220,857	2,571,475
Net Unrealized Gains (Losses)	(271,250)	
Net Increase (Decrease) per financials	2,300,225	
FY2013		
Net Investment Income w/out Gains/Losses	16,547,631	
Net Realized Gains (Losses)	(598,542)	15,949,089
Net Unrealized Gains (Losses)	(11,733,063)	
Net Increase (Decrease) per financials	4,216,026	
FY2014		
Net Investment Income w/out Gains/Losses	39,126,389	
Net Realized Gains (Losses)	10,907,266	50,033,655
Net Unrealized Gains (Losses)	63,120,007	
Net Increase (Decrease) per financials	113,153,662	
FY2015		
Net Investment Income w/out Gains/Losses	54,076,842	includes PPA
Net Realized Gains (Losses)	41,067,063	95,143,905
Net Unrealized Gains (Losses)	4,751,745	
Net Increase (Decrease) per financials	99,895,650	
FY2016		
Net Investment Income w/out Gains/Losses	77,306,531	
Net Realized Gains (Losses)	(11,979,858)	65,326,673
Net Unrealized Gains (Losses)	(19,474,993)	
Net Increase (Decrease) per financials	45,851,680	
FY2017		
Net Investment Income w/out Gains/Losses	89,624,346	
Net Realized Gains (Losses)	118,190,529	207,814,875
Net Unrealized Gains (Losses)	271,780,381	
Net Increase (Decrease) per financials	479,595,256	
Net earnings (per NDCC) since inception (left in principal)		436,839,672
FY2018	February 2018	
Net Investment Income w/out Gains/Losses	60,406,891	
Net Realized Gains (Losses)	99,644,817	160,051,708
Net Unrealized Gains (Losses)	178,183,175	
Net Increase (Decrease) per financials	338,234,883	
Net earnings (per NDCC) since 7/1/2017		160,051,708
Net earnings (per NDCC) from inception to 2/28/2018		596,891,380

Per NDCC 21-10-12: For the purposes of section 26 of article X of the Constitution of North Dakota, the term "earnings" means net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses.

Total Net Investment Earnings	1,083,247,382

Agenda Item III.D. – Part 1

Board Action Requested

Securities Litigation Policy Overview

April 24, 2018

Note: Recommended revisions to the Securities Litigation Policy primarily relate to Non-U.S. cases in which the "expected loss" threshold is less than $5 million.

Dave Hunter, Executive Director/CIO

Connie Flanagan, Fiscal and Investment Operations Manager

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

SIB Securities Litigation Policy Hand-Out

Securities Litigation Committee (SLC)

U.S. and Canada (Active Participation = Opt-Out):

Key Points:
- i) Most securities litigation recoveries result from U.S. class action claims filing.
- ii) This is not "active" participation because you have to "opt out" to be excluded.
- iii) SIB policy is to "opt out" only if the expected loss > $5 million (or 0.1% of assets).
- iv) If SLC "opts out" due to the expected loss > $5 million, the SIB will be informed at the next SIB meeting. These should be infrequent occurrences.

Non-U.S. and Non-Canada (Active Participation = Opt-In):

Key Points:
- a) Parties must "opt in" to obtain securities litigation recoveries outside U.S./Canada.
- b) This is considered "active" participation because the impacted party must "opt in".
- c) Recommended SIB policy is to "opt in" if the expected loss > $5 million (like the U.S.), but with two exceptions for "Very Low Risk" and "Low Risk" jurisdictions (see below).

Exeption 1) "Very Low Risk" if expected loss > $20,000 (e.g. Australia, Israel, Netherlands)
Exeption 2) "Low Risk" if expected loss > $1 million (e.g. Japan)

NOTE: The above securities litigation policy does not impact our policy when the SIB is a named defendant in a lawsuit. The above policy only impacts our policy when the SIB is seeking to recover losses in securities litigation cases in which we have already suffered losses.

Preliminary summary subject to further review and confirmation.

Securities Litigation Charter, Policy and Thresholds

Based on discussion with the SIB and expert legal counsel (e.g. FRT, BLBG, G&E & RGRD), RIO proposed new **"Thresholds"** to govern our policy to engage in "active" securities litigation.

- RIO's recommended policy thresholds are summarized below:
  - **U.S. and Canada**: **The SIB acknowledges the Securities Litigation Committee (SLC) may commence active securities litigation** (in the U.S. and Canada) **if the "expected loss threshold" exceeds $5 million, subject to the Board affirming the SLC action at the next SIB meeting.** (RIO's policy review noted that dollar thresholds generally ranged from $1 million to $10 million for most other U.S. public pension plans.)
  - **Non-U.S. and Non-Canadian**: **The SIB will allow the SLC and RIO to enter into "Opt In" securities litigation actions** (outside the U.S. and Canada) **based on the following guidelines, subject to the SIB affirming the SLC decisions for "moderate and high risk" jurisdictions at the next Board meeting. The SLC and RIO will report on "Opt In" securities litigation actions in "low or very low risk" jurisdictions on a periodic basis.**
    - **$20,000 for passive or very low risk jurisdictions** characterized by simple claim filing or registration demands, strong anonymity and very low costs (e.g. Australia, Israel, Netherlands)
    - **$1 million for low risk jurisdictions** with no discovery demands and low costs (e.g. Japan)
    - **$5 million for moderate risk jurisdictions** with some restricted discovery requirements, limited anonymity, the ability to fund/insure upfront fees and moderate overall costs (e.g. Germany, Austria, Belgium, Switzerland, Denmark, Spain, Finland, France, Hong Kong, Indonesia, Ireland, Italy, Korea, Luxembourg, Malaysia, Norway, New Zealand, Portugal, Sweden and Thailand)
    - **$10 million for high risk jurisdictions** which may require in-person discovery, no anonymity and uncapped fees (e.g. Taiwan, United Kingdom, Singapore and Brazil)

FRT = Financial Recovery Technologies **BLBG = Bernstein, Litowitz, Berger & Grossman LLP**
G&E = Grant & Eisenhofer **RGRD = Robbins Geller Rudman & Dowd**

Securities Litigation Charter, Policy and Thresholds

Next Steps:

1. Review recommended changes to our existing Securities Litigation Policy including new dollar based thresholds for Non-U.S. / Non-Canadian securities litigation actions by governing legal jurisdiction;
2. Review our new Securities Litigation Committee (SLC) Charter which incorporates board member input shared at recent SIB meetings;
3. If the SIB so desires, **make a motion to accept the recommended changes to our Securities Litigation Policy** (including $ thresholds for actively engaging in further litigation related actions);
4. If the SIB so desires, **make a motion to accept the new SLC Charter incorporating all revisions shared by the SIB in recent meetings**; or
5. Request RIO and SLC to incorporate additional revisions to either the Securities Litigation Policy or Charter for further consideration by SIB.

Securities Litigation Charter, Policy and Thresholds

SUMMARY

- **Goal is to create policy that allows process to be as automatic as possible.**
- **FRT will provide coverage for Non-U.S. and Antitrust cases that previously were not covered under custodian agreement. There is no significant change in the U.S./Canadian class action process.**
- **This process does not apply to cases where SIB is a named defendant (e.g. Tribune and GM cases).**
- **Committee's role will be to provide more flexibility in being able to meet on shorter notice or in the interim for cases that have shorter deadlines for making decisions on opting in to Non-US cases.**
- **All Committee decisions will be reported to the full SIB.**
- **Committee will also receive periodic reporting on all cases filed.**
- **Based on the parameters set in the policy, it is not anticipated that there will be many cases that require specific Committee or Board approval.**

Securities Litigation Process

Appendix A

US and Canadian Actions (Opting Out)

1. Litigation is initiated in courts which results in a settlement
2. A class of litigants is established
3. FRT receives notice of class action settlement
4. FRT reviews SIB portfolios for affected securities/transactions
5. FRT calculates recognized loss

- If below proposed policy limit of $5 million, FRT will automatically file the necessary documentation to become part of class action (noting that this is our current class action claims filing process).
  - Recovery will be based on SIB's pro rata share of final settlement amount.

- If above proposed policy limit, FRT will assist Staff/Committee in analyzing considerations for **Opting Out** of the class action and pursuing direct action (we expect this course of action to be infrequent).
  - Considerations for opting out of US/Canadian class actions
    - How SIB losses compare to overall class
    - Merits of the matter
    - Identity and capability of outside counsel, including cost structure (will require special appointment)
    - Potential sources of additional recovery outside the class
    - Internal and external resources needed
    - Whether direct action will have stronger impact on future corp. behavior
    - Whether SIB involvement may increase likelihood of recovery (both to class or in separate action)
    - Impact of publicity
    - Likely burden to staff time, money and/or cost in relation to outcome.

Securities Litigation Process

Appendix B

Non-US/Non-Canadian Actions (Opting In)

1. Litigation is initiated in courts
2. FRT monitors and identifies potential **Opt-in** actions
3. FRT reviews SIB portfolios for affected securities/transactions
4. FRT identifies jurisdiction and calculates estimated loss
   - If below proposed policy limit, FRT will not automatically file documentation
   - If above proposed policy limit, FRT will advise Staff/Committee of potential factors/options for opting in to the group action
     - Provide transaction history to litigator for anonymous loss calculation
     - Provide risk analysis based on jurisdiction which may include:
       - Cost/Benefit
       - Participation requirements
       - Anonymity
       - Identity and capability of outside counsel, including review of retainer agreements and cost structure (will require special appointment)
       - Likely burden to staff time (discovery)
     - For cases involving little to no additional cost or time (relatively simple opt-in cases), staff will direct FRT to move forward without additional Committee approval (likely in "Very Low Risk" or "Low Risk" jurisdictions)

Agenda Item III D – Part 2

Board Action Requested

TO: State Investment Board

FROM: Dave Hunter and Connie Flanagan

DATE: March 14, 2018

SUBJECT: **Review of Current Securities Litigation Policy**

Based on SIB guidance shared at recent Board meetings, RIO requests the SIB make a motion to accept the proposed revisions to our current Securities Monitoring and Litigation policy including any requested changes.

POLICY TITLE: *SECURITIES MONITORING AND LITIGATION*

General Purpose

1. The North Dakota State Investment Board (“SIB”) is a fiduciary for assets held in trust for the benefit of SIB clients~~’~~, including their beneficiaries~~ and to defray expenses of administration of their respective investment funds~~.

2. In order to carry out its fiduciary duty to prudently invest and diversify the assets of the various investment funds, the SIB invests considerable assets in global public securities markets.

3. The efficient and effective deployment of plan assets requires that in seeking returns market risks must be prudently assumed and managed. Investing in publicly-traded securities in regulated markets under accounting, disclosure and business practice laws and regulations provides general, but not perfect assurance that the information forming the basis for investments is accurate, conforms with accepted accounting practices, and is not distorted due to misfeasance, malfeasance or nonfeasance, or the timing of information disclosures by persons or entities with the ability to affect market prices of the investment securities.

4. Legal action is sometimes necessary to attempt to recover all or part of losses the funds may incur due to alleged improper action or inaction that results in the impairment of the value of the fund~~’~~s’ security holdings.

5. Most such actions will be prosecuted ~~by the~~through class action ~~bar~~litigation whether or not the SIB takes an active role as a plaintiff or a passive role as a member of a certified class of plaintiffs. Any ultimate award or settlement from a class action ~~filing~~ will be ratably allocated among legitimate claimants.

6. The SIB will generally only consider pursuing active participation in securities actions when such a role is expected to add value by enhancing the prospect for recovery, increasing the amount of recovery, assuring more efficient and effective prosecution of the case, or identifying and addressing corporate governance issues through litigation.

For purposes of this Policy, "active participation" means seeking status as lead plaintiff, co-lead plaintiff, or filing separate legal action.

Non-Active Recovery and Filing

1. SIB will require as part of its agreement with its custodial bank or other designated agent, that adequate securities class action monitoring is maintained on an ongoing basis, sufficient to assure that most of the actual awards and settlements for such cases are tracked and identified and that proof of claim forms, including supporting documentation, will be properly and timely filed.

2. ~~To augment and enhance coverage, identification and tracking of class-action cases (potential or actual)~~ SIB may engage one or more legal firms that specialize in ~~monitoring and~~ prosecuting security class-action cases; any such engagement is subject to the special appointment requirements of N.D.C.C. § 54-12-08. For these purposes only, such firm(s) may be granted ongoing access to security holdings information through the custodian bank or other designated agent.

3. An ~~monitoring~~ agreement with any law firm for ~~monitoring~~ non-litigation services ~~access and reporting~~ will not commit SIB to employing said firm in the event that it seeks to represent SIB as an active participant in any securities related litigation. Such representation must be effected by a separate retainer agreement between the SIB and said firm, or another, depending on such factors as the potential monetary scope, the nature of the case and industry specialty that may be required, the allocation of current or past cases among candidate firms, the likely duration and cost of prosecuting such a case, retainer fees or contingency splits, the venue in which the case is to be filed, and other considerations.

4. The custodial bank or other designated agent will be required to provide the Retirement and Investment Office ("RIO") with periodic reports that detail class action cases monitored, claims filed, and award or settlement distributions received. RIO will maintain these records and provide an update to the SIB or Securities Litigation Committee (Committee) with regards to accounting information on distributions received on claims filed by the custodian bank or other designated agent on our behalf.

Active Participation in Cases

1. The Executive Director will initiate active participation in securities cases only upon prior review and approval of the SIB or Committee. Before bringing any recommendations to the ~~Board~~SIB or Committee, the Executive Director, with significant assistance ~~by~~ from legal counsel from the Office of the Attorney General, will assess the merits and prospects for active participation by reference to the criteria and factors outlined in this section.

2. Decision Criteria and Factors:

   a. The decision to participate in an active capacity in security litigation should be based on the totality of the circumstances. Dollar loss amounts are important, but not the sole or overriding factor to consider in making such recommendations by the Executive Director, or determinations by the SIB or Committee.

   b. Potential losses to SIB clients must be significant in order to warrant participation as a lead plaintiff, co-lead plaintiff, or separate ~~"opt-out"~~ litigant in U.S. or Canadian cases. Generally, in cases where the potential loss does not exceed the ~~greater of 0.1% of trust assets or~~ $5 million, the SIB will avoid active participation.

   c. The *prima facia* merits of the claim for loss, and the factual basis for the action, recognizing that the full discovery process will not commence until the class has been certified by the court in which such case is to be filed.

   d. The availability of witnesses, and possible support that may be obtained from investment managers, consultants, and the custodial bank through discovery.

   e. The potential that any defendants or insurers will be able to pay an adequate recovery to the class, without impairing the value of any current security holdings SIB may yet hold in the issuer in the portfolio.

   f. The ability of the law firm recommending action on the part of SIB to prosecute the case effectively, in the venue where such case is likely to be filed, and the experience of the firm in managing such cases individually or in partnership with other firms.

   g. Potential long-term benefits from corporate governance changes from pursuing litigation.

   h. The ability of SIB to serve as a fiduciary on behalf of all class members in the case, especially in relative terms to other institutional investors that may be considering the same case.

   i. Potential costs that may be incurred. Special consideration must be given to any case that must be filed in a non-U.S. venue under the "Morrison" criteria established by the U. S. Supreme Court in a 2010 decision, since costs of litigation and potential liabilities of unsuccessful claims may be significant.

   j. Current workload and staffing resources required for the fulfillment of SIB's primary member service functions, and whether participation might displace time and staff resources needed for core business functions.

3. Decision Criteria and Factors for cases filed in a non-U.S. venue: In addition to the Criteria and Factors set forth in Subsection 2, the SIB or Committee may consider the following:

a. The proposed funding arrangements for the action.

b. Evaluate the merits and risks of the case in light of the law of the jurisdiction in which the action would be brought. Generally, in cases where the potential loss does not exceed the Jurisdictional Thresholds referenced in Exhibit A, the SIB will avoid opt-in or group litigation participation.

~~c. The role or level of participation in the case by the SIB.~~

Roles in Managing and Monitoring Litigation

1. The SIB or Committee will make the final determination of whether it is in the SIB's best interest to pursue active participation in any case and whether to engage any law firm and the terms of such engagement.

2. Decisions regarding the conduct and implementation of the ~~Board's~~ SIB's or Committee's decision to participate will be the responsibility of the Executive Director, or an approved member of the management staff if he so delegates. When feasible and advisable, the Executive Director shall seek advice and direction from the ~~Board~~ SIB or Committee on strategic and legal issues that may arise in prosecuting the action on behalf of the SIB and its clients. The Executive Director shall timely report to the ~~Board~~SIB or Committee on the progress of the litigation.

3. The Executive Director shall be responsible for management of the relationship with any portfolio monitoring law firm or organization for such purpose. Based on the need for additional coverage, the Executive Director and Committee will determine whether one or several firms are needed to fulfill the goals of this Policy and may terminate such monitoring agreements as judgment advises.

4. Any agreement for portfolio monitoring services that includes a fee or subscription cost must first be approved by the SIB or Committee before execution by the Executive Director.

Policy Review

1. The Committee and ~~Board~~SIB shall review this policy at least every three years to ensure that it remains relevant and appropriate.

Exhibit A

Non-US Opt-In and Group Litigation Jurisdictional Thresholds

Jurisdictional Description	Threshold
Passive/very low risk jurisdictions, simple registration or claim filing (no participation in litigation required, strong anonymity, very low costs) including, but potentially not limited to: Australia, Israel, Netherlands (including Dutch Foundations), regulatory funds (e.g. Compensation Schemes in UK)	$20,000
Low risk jurisdictions (no discovery, low cost) including, but potentially not limited to: Japan	$1 million
Moderate risk jurisdictions (moderate cost, funded/insured to protect from cost shifting, some restricted discovery, not fully public) including but potentially not limited to: Germany, Austria, Belgium, Switzerland, Denmark, Spain, Finland, France, Hong Kong, Indonesia, Ireland, Italy, Korea, Luxembourg, Malaysia, Norway, New Zealand, Portugal, Sweden, and Thailand	$5 million
High risk jurisdictions (potential in-person discovery, no anonymity, uncapped fees) including, but potentially not limited to: Taiwan, United Kingdom, Singapore, Brazil	$10 million

Jurisdictional Thresholds are developed in consultation with legal counsel including other designated agents which are experts in global securities litigation matters.

Policy Implemented: November 20, 2015
Policy Revised: April 27, 2018

Board Action Requested

TO: SIB

FROM: Dave Hunter and Connie Flanagan

DATE: April 24, 2018

SUBJECT: **Proposed Charter for Securities Litigation Committee**

RIO's Fiscal & Investment Operations Manager Connie Flanagan drafted the proposed Charter for the Securities Litigation Committee based on the *SIB Audit Committee Charter*. The proposed Charter was reviewed and discussed with the Committee at our last Committee meeting on February 16, 2018. **After further review and discussion with the SIB on March 25, 2018, RIO recommends the Board approve the revised Securities Litigation Committee Charter, which incorporates comments provided by the Board, and/or offer alternative language for further consideration.**

CHARTER OF THE
SECURITIES LITIGATION COMMITTEE OF THE
NORTH DAKOTA STATE INVESTMENT BOARD

PURPOSE

The Securities Litigation Committee (the Committee) is a standing committee of the North Dakota State Investment Board (SIB) created to assist in fulfilling its fiduciary oversight responsibilities of monitoring the investment of assets entrusted to it by the various statutory and contracted funds, and to serve as a communications link for the SIB, RIO's management and staff, third party securities litigation firms, and others.

The Committee will determine when an active role should be pursued in regards to securities litigation affecting securities within the SIB's portfolios.

AUTHORITY

The Committee is authorized to:

- ~~create SIB~~ **draft** policy **(to be formally approved by SIB)** regarding dollar and/or risk thresholds for determining when to opt-out of class actions and/or seek direct litigation or lead plaintiff status;
- **based on SIB approved policy,** make decisions on the level of participation the SIB will take in direct litigation, opt-in or group litigation, anti-trust and other class actions; and

- approve the selection of special assistant attorneys in cases of direct litigation.

COMPOSITION

The Committee will consist of the Executive Director of RIO, one member of RIO fiscal or investment staff, **RIO general counsel**, and two members of the SIB appointed by the Chair.

Membership on the Committee will be for one year or termination of term on the SIB. Vacancies will be filled by the SIB Chair at the first scheduled meeting following the vacancy. There will be no limit to the number of terms served on the Committee.

The Committee will elect a Chair and a Vice Chair. The Chair will preside at all meetings of the Committee and serve as the liaison to the SIB. In the absence of the Chair, the Vice Chair will perform the duties of the Chair. The liaison will report at least four times a year to the SIB on the activities of the Committee and other pertinent information.

The Committee may form, and delegate authority to, subcommittees when it deems appropriate.

MEETINGS

The Committee will meet generally four times a year, with authority to convene additional meetings, as circumstances require or to adequately fulfill all the obligations and duties as outlined in this charter.

Meeting agendas will be prepared by the Executive Director and approved by the Committee Chair, unless otherwise directed by the Committee and will be provided to the Committee members along with briefing materials before the scheduled committee meeting.

Committee members are expected to attend each meeting, in person or via tele- or video-conference. RIO's executive management and others necessary to provide information and to conduct business will attend meetings. The Committee may invite staff of RIO or others to attend meetings, as necessary. The Committee may hold executive sessions as allowed under state law.

The Committee will act only on the affirmative vote of three of the committee members at a meeting. To conduct business, a quorum will be three members of the Committee. Should a quorum not be present before a scheduled meeting or during a meeting, the Chair will announce the absence of a quorum and the members will disburse. Meetings unable to transact business for lack of a quorum are not considered meetings. Meeting minutes will be prepared by RIO, or as otherwise directed by the Committee. Approved meeting minutes of the Committee will be submitted to the SIB.

RESPONSIBILITIES

RIO's management is responsible for ongoing monitoring of securities litigation and claims filing. **Based on SIB approved policy guidelines,** the Committee has the responsibility to provide oversight in the areas of:

- policy development
- determination on direct litigation and/or lead plaintiff status
- approval of special assistant attorneys (outside counsel)

To this end, the Committee will:

- Develop initial policy and periodically review policy to determine if changes are needed.
- Review reports from RIO staff and third parties in order to maintain awareness of potential and actual securities litigation affecting the SIB portfolios.
- Make decisions on whether to pursue direct litigation and/or lead plaintiff status on cases exceeding policy thresholds for passive participation.
- Select third party litigation firms when deemed appropriate.
- Perform other activities related to this charter as requested by the SIB.
- Review and assess the adequacy of the Committee charter annually, requesting the SIB approval for proposed changes.
- Confirm annually the review of all responsibilities outlined in this charter.

Reporting Responsibilities

- Report to the SIB about the Committee's activities, issues, and related recommendations.
- Provide a written report annually to the SIB, describing the Committee's composition, responsibilities and how they were discharged, and any other information required.

DATE OF CREATION OF COMMITTEE AMENDMENTS: ~~**March**~~ **April 27**, 2018
DATE SECURITIES LITIGATION COMMITTEE CHARTER ADOPTED AND APPROVED: ~~**March**~~ **April 27**, 2018

POLICY TYPE: GOVERNANCE PROCESS

POLICY TITLE: *STANDING COMMITTEES*

The board's standing committee is that which is set forth in this policy as follows:

1. Audit Committee
2. Securities Litigation Committee

   A. The audit committee and securities litigation committee shall operate under the terms of a charter approved by the board.

INTRODUCTION – Audit Committee

An Audit Committee has been established as a standing committee of the State Investment Board (SIB). The Audit Committee will assist the SIB in carrying out its oversight responsibilities as they relate to the Retirement and Investment Office (RIO) internal and external audit programs, including financial and other reporting practices, internal controls, and compliance with laws, regulations, and ethics.

The primary objective of the internal audit function is to assist the SIB and management in the effective discharge of their responsibilities. To this end, internal auditing will furnish them with analyses, appraisals, recommendations, and pertinent information concerning the activities reviewed.

Functions and units within RIO will be reviewed at appropriate intervals to determine whether they are effectively carrying out their responsibilities of planning, organizing, directing, and controlling in accordance with SIB and management instructions, applicable laws, policies, and procedures, and in a manner consistent with both the RIO objectives and high standards of administrative practice.

POLICY OF THE STATE INVESTMENT BOARD – Audit Committee

The audit staff shall have full, free, and unrestricted access to all RIO activities, records, property, and personnel relative to the subject under review. The audit function will be conducted in a manner consistent with acceptable professional standards and coordinated with others to best achieve the audit objectives and the RIO objectives.

The Internal Audit Services Unit is responsible for developing and directing a broad, comprehensive program of internal auditing within RIO. The Internal Audit Services Unit will report administratively to management and functionally to the Audit Committee of the SIB.

The RIO unit supervisors are responsible for seeing that corrective action on reported weaknesses is either planned or taken within 30 days from the receipt of a report disclosing those weaknesses if known or applicable. The unit supervisors are also responsible for seeing that a written report of action planned or completed is sent to the executive director. If a plan for action is reported, a second report shall be made promptly upon completion of the plan.

INTRODUCTION – Securities Litigation Committee

A Securities Litigation Committee (SLC) has been established as a standing committee of the State Investment Board (SIB). The SLC will assist the SIB in fulfilling its fiduciary oversight responsibilities of monitoring the investment assets entrusted to it by the various statutory and contracted funds, and to serve as a communications link for the SIB, RIO's management and staff, third party securities litigation firms, and others.

The SLC will determine when an active role should be pursued in regards to securities litigation affecting investments within the SIB's portfolios based on the SIB approved Securities Litigation Policy and approved SIB Securities Litigation Committee Charter.

POLICY OF THE STATE INVESTMENT BOARD – Securities Litigation Committee

The SLC is authorized to:

- ~~create~~ draft policy (to be formally approved by SIB) regarding dollar and/or risk thresholds for determining when to opt-out of class actions and/or seek direct litigation or lead plaintiff status;
- based on SIB approved policy make decisions on the level of participation the SIB will take in direct litigation, opt-in or group litigation, anti-trust and other class actions; and
- approve the selection of special assistant attorneys (in conjunction with the approval of the Office of the Attorney General) in cases of direct litigation.

RIO's management is responsible for ongoing monitoring of securities litigation and claims filing. RIO management and staff will enable the SLC to provide a periodic update to the SIB on the SLC's activities and related recommendations.

The SLC has the responsibility to provide oversight in the areas of:

- policy development;
- determination on direct litigation and/or lead plaintiff status; and
- approval of special assistant attorneys (outside counsel) with concurrence of the Attorney General.

Board Approval Requested on Governance Manual Policy Changes on Standing Committees:

RIO requests the Board to provide input on the proposed governance policy language relating to the newly established Securities Litigation Committee. This language would be inserted into Section B – 6 (on Standing Committees) in the SIB Governance Manual if formally approved by the SIB on April 27, 2018. Given that this is a "Second Reading" of previously revised governance section, RIO is requesting the SIB to formally accept the revised changes at this time.

Policy Implemented: June 23, 1995.
Policy Amended: April 27, 2018.

Agenda Item IV.A.

Informational

TO: State Investment Board

FROM: RIO Investment Staff

DATE: April 20, 2018

SUBJECT: BlackRock Portfolio Risk Review – Cover Memo

Background:

RIO's 2017-19 Strategic Investment Plan contains six pillars including # 5 – "Enhancing our internal control environment by improving the use of proven risk management solutions" noting that "a robust risk management framework serves as the foundation to support a sound internal control environment and lessen downside risk".

During the past year, RIO and BlackRock worked together to build out our Aladdin risk management system which offers a comprehensive investment risk management tool. RIO believes this enhanced risk management framework will enhance our ability to analyze various risk factors inherent within our client portfolios and aid our ability to perform various stress testing scenarios to improve our expected ability to withstand unfavorable market events in the future.

The following presentation to be made by Ms. Gabriella Barschdorff, CFA and Managing Director for BlackRock Client Portfolio Solutions, should offer a high level overview of the following four key points:

1) Identify alternative ways of defining investment risk;
2) Review and quantify the most basic drivers of risk;
3) Compare and review SIB client portfolios using this risk factor framework; and
4) Define stress testing and the use of stress testing to manage downside investment risk.

Next Steps:

RIO intends to develop a Risk Dashboard using this enhanced risk management system to improve downside risk awareness and performance within our SIB client portfolios while expanding our investment risk management reporting metrics in the upcoming year.

North Dakota State Investment Board

Portfolio Risk Review

April 27, 2018

Data as of December 29, 2017

Quantitative Ways of Defining risk

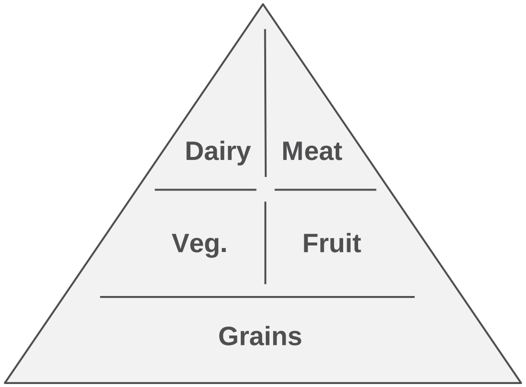
There are several metrics for describing the risk of an investment and of an entire portfolio in aggregate. Today's discussion focuses on risk factor analysis across a portfolio in aggregate.

Commonly Used Metrics	
Standard Deviation/ Volatility	• Volatility of the portfolio around its expected return • Over a period, returns are generally within +/- 1 standard deviation 2/3rds of the time
Beta	• Sensitivity to overall market movement ("rising tide lifts all boats")
Active Risk / Tracking Error	• Standard deviation of active returns around a particular benchmark
Risk Attribution	
Risk Factors	• Common exposures across various asset classes • Influence investment return and risk characteristics of any given asset class or security • Help investors understand the true drivers of risk/return of each asset class as well as at the total portfolio level
Tail Events Risk Metrics	
Scenario / Stress Testing	• Supplements traditional volatility-based risk to provide event-based risk analysis to estimate portfolio performance in different market regimes. • Two types of stress tests: historical and hypothetical • The historical scenarios attempt to model how the current portfolio would perform should the historical scenario occur today (assumes instantaneous shocks). The hypothetical scenarios are driven by an extreme move in a single asset class, with the rest of the shocks implied by a covariance matrix.
Conditional VaR (CVaR)	• Quantifies the average loss in a tail event beyond the VaR limit in a portfolio distribution ○ "In an extreme tail risk scenario (occurring only 1% of the time), the portfolio would expect to lose xx%"
VaR	• Value at Risk: the severity of a downside scenario with a given confidence interval over a stated time horizon ○ "99% of the time, the portfolio can expect to lose no more than xx% of its portfolio in a given year"
Expected Shortfall	• The average of the risk in the "tail"; more technically, the mean of the parametric returns that exceed the 5% Historical VaR value. Also called CVaR, this statistic serves as a complement to Historical VaR as historical VaR only looks at the risk at a single percentile
Time Horizon	
Short-Term	• Metrics use the Weekly Long-Term Half-Life (WKL) scheme with a 26 week half-life and 104 weeks of observations; corresponds to 2 years of historical data
Medium-Term	• Metrics use the Monthly Constant-Weighted (MTC) scheme and 60 months of observations; corresponds to 5 years of historical data
Long-Term	• Metrics use the Monthly Constant-Weighted (MTC) scheme and 180 months of observations; corresponds to 15 years of historical data

What are risk factors?

BlackRock's risk models seek to identify – and quantify – the most basic drivers of risk

Broad Universe	Traditional Categories	Most Basic Elements



Domestic Equity
Real Estate
Diversified Credit
Large Cap
Commodities
Farmland
Small Cap
REITs
Direct Lending
Event Driven
Risk Parity
Timber
Synthetic Overlay
TIPS
Smart Beta
Private Equity
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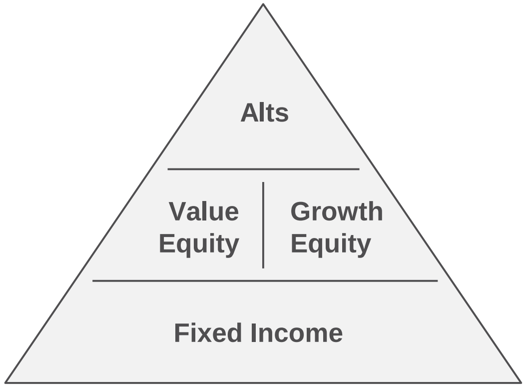
Leveraged Loans
Core Fixed Income
Energy
Hedge Funds



Risk Factors

Interest Rates	120 bps
Credit Spreads	75 bps
Inflation	53 bps
Equity	620 bps
Currency / FX	12 bps

These are the fundamental building blocks of risk

For illustrative purposes only.

Why Use Risk Factors?

Factor analysis can help asset allocation decisions in the following ways:

Enables consistent evaluation of new asset classes

Provides a **common language** across asset classes

Provides **greater freedom** in asset allocation and manager selection

Example: In traditional asset allocation, public and private equities are treated as two separate asset classes. Factor awareness recognizes that equity risk is an important driver of both. Mapping Equity to both of these asset classes allows investors to allocate to both of them consistently

Why Factors?

Highlights underlying exposures to risk factors across asset classes, bringing awareness to any concentrations that are not expressed by just looking at the asset class level breakdown

Provides information on the **key drivers of risk and returns**

Helps **differentiate** between **portfolios** along the “fuzzy frontier”

Though similar in risk and return, two portfolios may have different drawdown experiences due to different factor exposure profiles

Why Use a Risk Factor Framework?

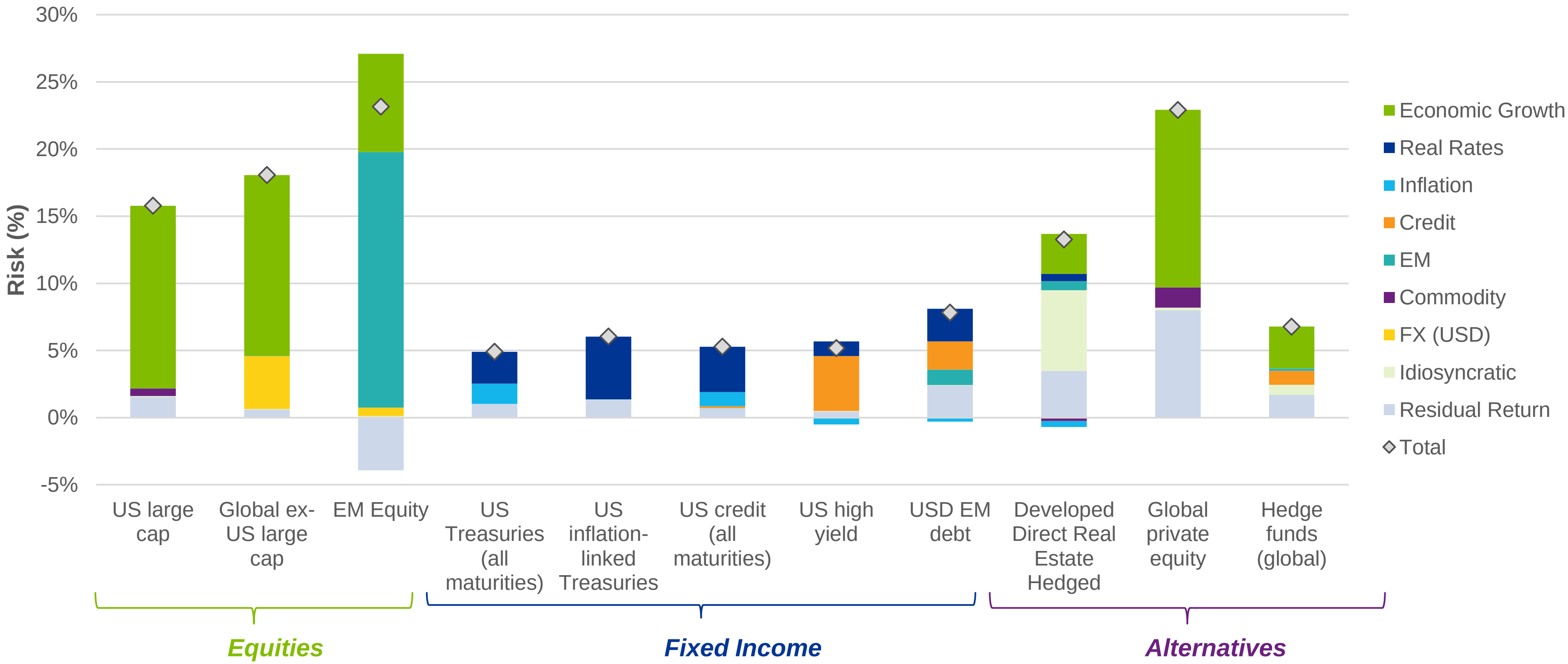
Universal risk language across asset classes

Risk factors can be understood as common exposures across various asset classes

- Influence investment risk and return characteristics of any given asset class or security

Risk factors can enable direct comparison across public and private asset classes

- Understand the true drivers of risk/return of each asset class as well as at the total portfolio level



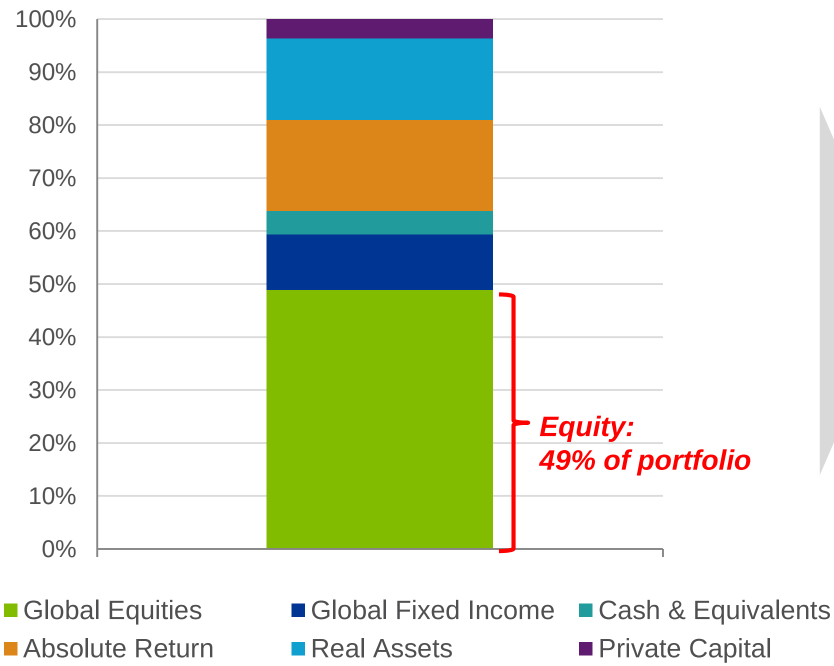
For illustrative purposes only. Source: BlackRock

Why Use a Risk Factor Framework?
A more thorough picture

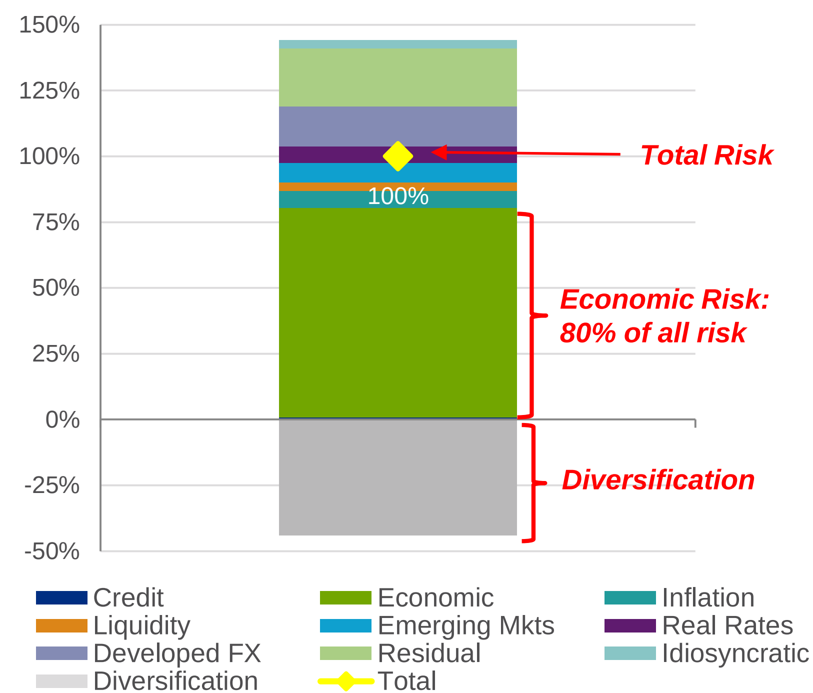
Allocation of portfolio risk can be incomplete when viewed in an asset-class framework

- In the below example, the portfolio appears diversified from an asset allocation perspective (~50% to global equities)
- However, when viewed across the portfolio on a risk factor basis, it becomes clear that economic risk is driving the majority of the portfolio risk, contributing 80%

Illustrative Sample Portfolio Asset Allocation



Risk Factor Allocation



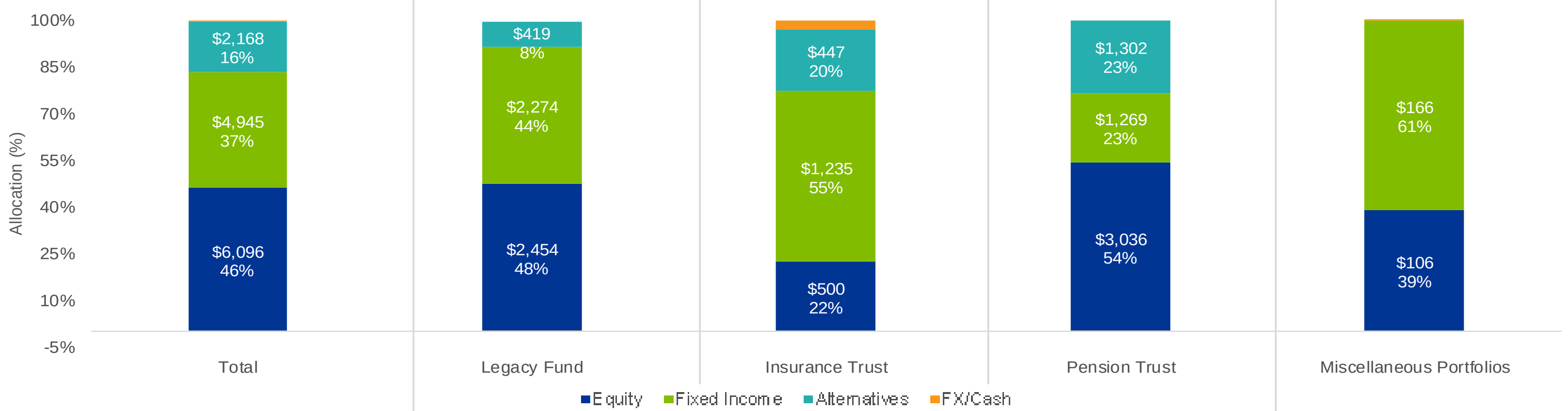
For illustrative purposes only. Calculations performed on a sample portfolio using the BlackRock Solutions risk model and exposures; Monthly Constant Weighted (MTC model) with 102 monthly observations; Macro Factor scheme.

Portfolio Overview

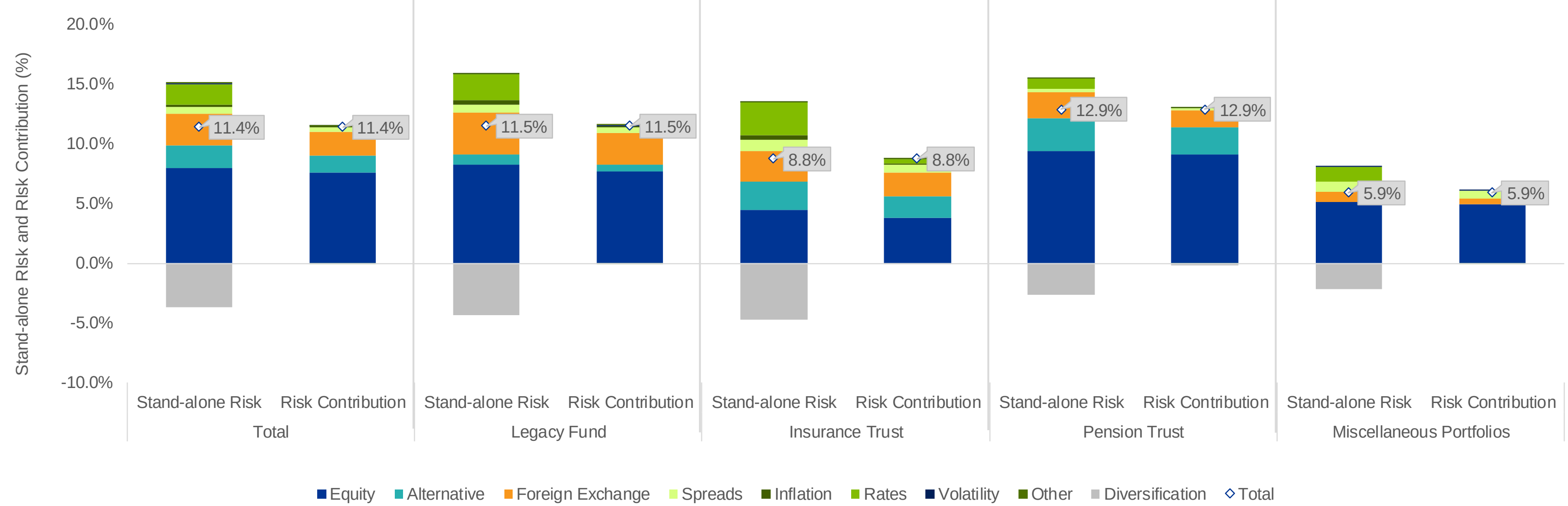
Asset Allocation and Risk Decomposition

NAV	NDRIO Total Plan	Legacy Fund	Insurance Trust	Pension Trust	Misc. Portfolios
	$13,255MM	$5,132MM	$2,249MM	$5,601MM	$273MM

Portfolio Allocation by Asset Class



Long-Term (15 Yr) Stand-alone Risk and Risk Contribution By Factor (%)



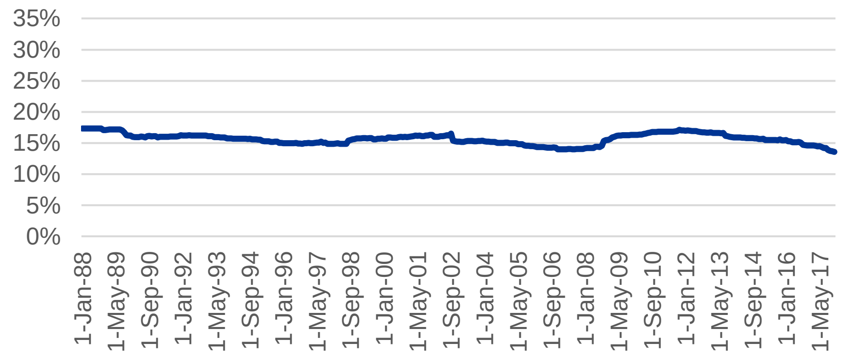
Source: BlackRock, data as of 12/29/2017. Private Credit and Infrastructure related assets were moved from Fixed Income to Alternatives as a part of port group changes made in 1Q18. Calculated using BlackRock Solutions Aladdin Risk Model with an exposure date as of 12/29/2017 and 180 months of constantly weighted observations.

Total risk numbers are calculated using historical correlation data

Considering risk calculations using long term and short term periods can be helpful

- At right we show the total risk of the S&P 500 Index over rolling 15-year and 2-year look-back periods
- The total risk number of the 2-year look-back period changes based on the market environment during that 2-year period

S&P 500 Index Risk using Rolling 15-year Look-back Period (%)



S&P 500 Index Risk using Rolling 2-year Look-back Period (%)

Source: BlackRock, data as of 12/29/2017. “Risk” is defined as value at risk (“VaR”).

What is stress testing?

Stress testing quantifies anticipated portfolio losses under various calamitous market events

BRS leverages our global multi-asset risk models by identifying portfolio level exposures to risk factors and then subjecting them to adverse economic conditions

There are two types of stress tests:

Type of Test	Description	Pros	Cons
Historical	Stress tests are created by identifying meaningful historical market events. The move in each underlying risk factor during the period of market stress is quantified and applied to the risk factor exposure of the current portfolio Examples: 2008 Market Crash, 2013 Fed Tapering Scare	▸ Events occurred; no doubt to plausibility of the scenario ▸ Size of shocks reflect historical market moves ▸ Covariance matrices and shocks are compatible	▸ History is unlikely to repeat itself in the exact same way ▸ Limited to scenarios that have occurred in the past
Hypothetical	Scenarios are designed to reflect *potentially* calamitous market events. The market conditions are simulated to reflect how various risk factors would perform under the scenario Calibration of the shocks involves both qualitative and quantitative assessment Examples: equity market down	▸ More flexibility in choosing a stress scenario ▸ Ability to target specific risk factors of concern ▸ Flexibility in designing a scenario to reflect any combination, direction and magnitude of risk factor shocks	▸ Design can be disputed: arguments can be made that a hypothetical scenario is unlikely to occur ▸ Choosing the appropriate number of risk factors and properly sizing shocks can be challenging

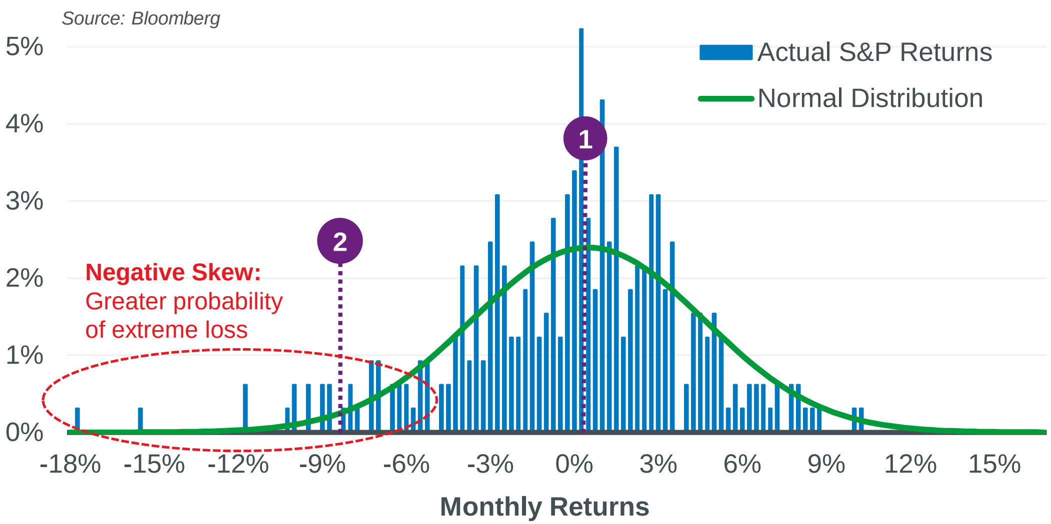
Why perform stress tests?

When returns are normally distributed, the volatility can be used to estimate portfolio loss; however, not all distributions are normal

- The below graph illustrates two distributions with the same mean and volatility
  - The green curve reflects a normal distribution with a mean of 0.7% and a standard deviation of 4.2%
  - The distribution shown in blue plots the frequency of the monthly returns of the S&P 500 since 1988
- Non-normal distributions can mean a higher probability of larger losses
  - In a normal distribution, the chance of a two standard deviation decline is approximately 2.3%
  - In a non-normal distribution, the chance of a move of the same magnitude can be significantly higher

S&P 500 Monthly Returns		
Mean Return	1	0.7%
One Standard Deviation		4.2%
Two Standard Deviations	2	8.4%
Expected frequency of drawdowns larger than -8.4%		2.3%
Actual occurrence of monthly drawdowns larger than -8.4%		4.0%

US Large Cap Equity Monthly Returns (1988 – 2015)

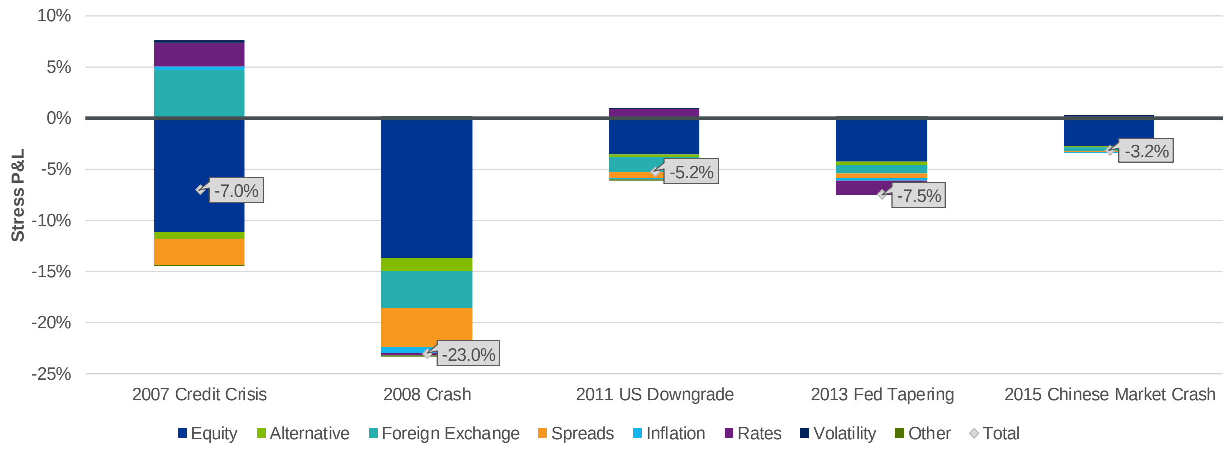


Evaluating portfolios under "extreme" scenarios is beneficial as the frequency of "rare" moves can be higher than expected

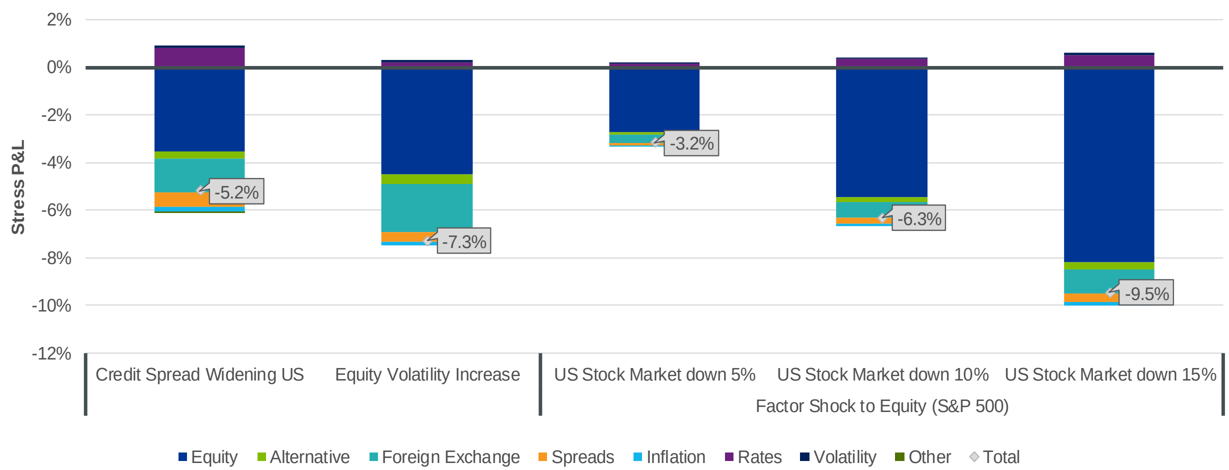
Stress Testing Analysis

Legacy Fund

Stress Testing – *Historical* Scenarios



Stress Testing – *Hypothetical* Scenarios

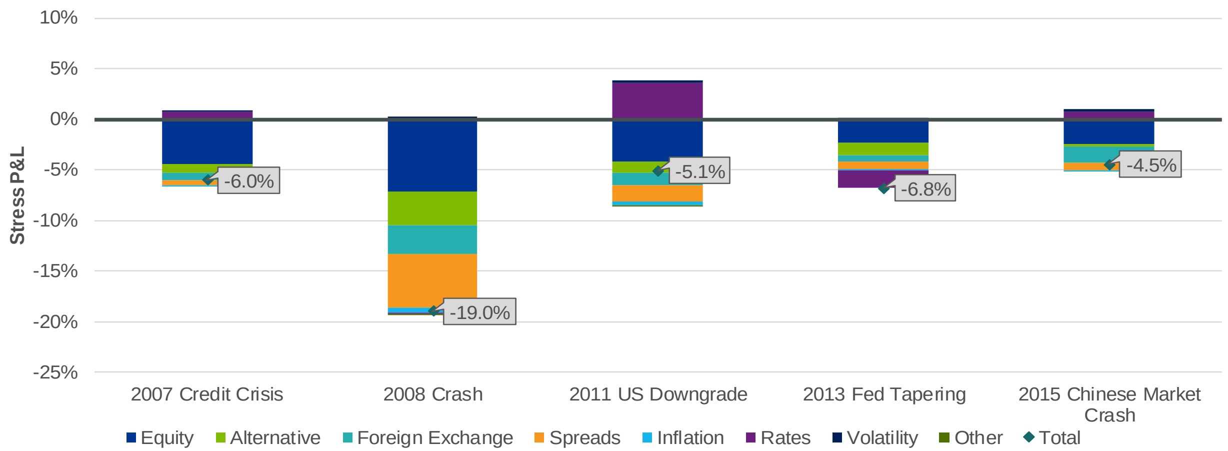


Source: BlackRock. Stress scenario analysis is performed using BlackRock Solutions Aladdin Risk model with 180 months of constant-weighted observations as of 12/29/2017. Scenario definitions can be found in the appendix.

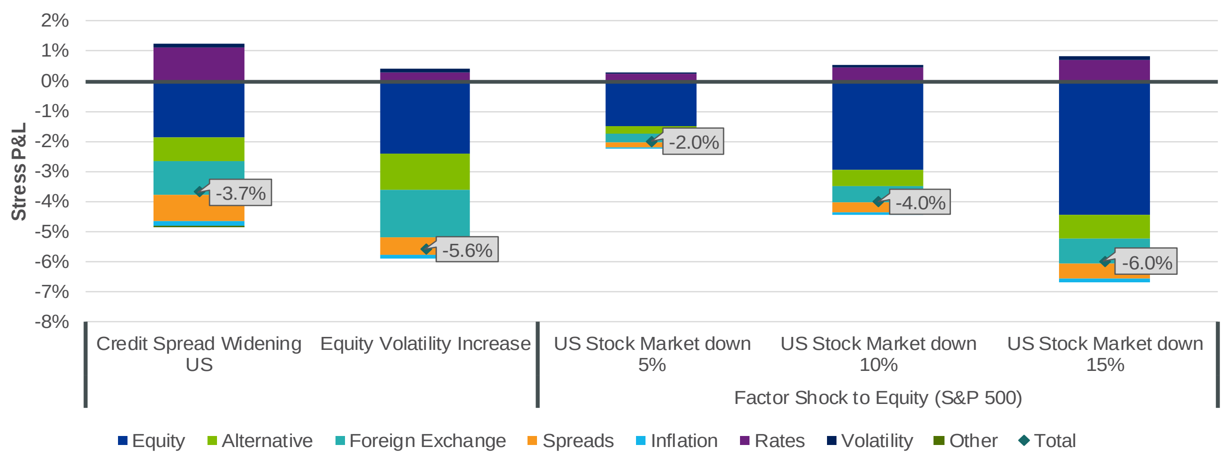
Stress Testing Analysis

Insurance Trust

Stress Testing – *Historical* Scenarios



Stress Testing – *Hypothetical* Scenarios

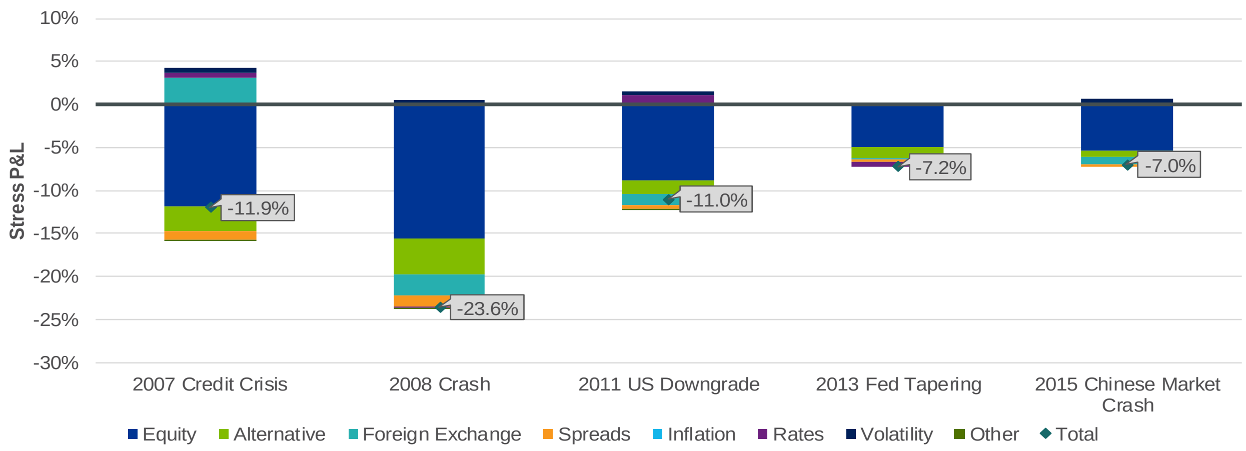


Source: BlackRock. Stress scenario analysis is performed using BlackRock Solutions Aladdin Risk model with 180 months of constant-weighted observations as of 12/29/2017. Scenario definitions can be found in the appendix.

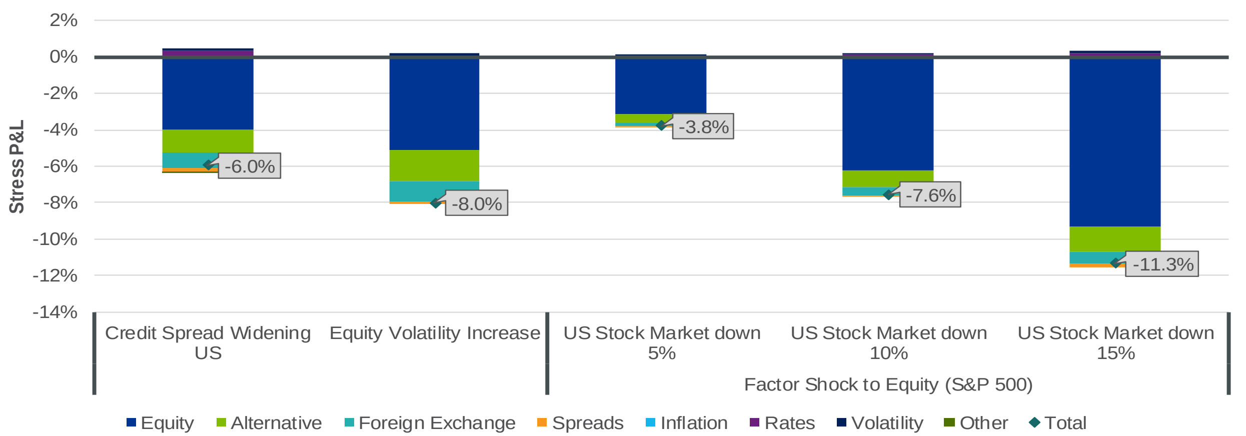
Stress Testing Analysis

Pension Trust

Stress Testing – *Historical* Scenarios



Stress Testing – *Hypothetical* Scenarios



Source: BlackRock. Stress scenario analysis is performed using BlackRock Solutions Aladdin Risk model with 180 months of constant-weighted observations as of 12/29/2017. Scenario definitions can be found in the appendix.

Stress Test Scenario Definitions

Historical Scenarios

1. **2007 Credit Crisis**
   July 2007 - July 2008
   Credit & liquidity crisis stemming from a severe slowdown in the housing market causing significant widening of credit spreads and increased implied volatility. Shocks for DxS Factors are spreads.

2. **2008 Crash**
   September - November 2008
   Credit & liquidity crisis and equity market crash set off by Lehman Brothers bankruptcy. Significant credit spreads widening caused by massive deleveraging. Shocks for DxS Factors are spreads.

3. **2011 US Downgrade**
   July - September 2011
   The period starts with 50% chance US downgrade indication from S&P Standards and ends with Operational Twist announcement by Fed. Stock market incurred losses while bonds markets saw gains due to flight to safety. Shocks for DxS Factors are spreads.

4. **2013 Fed Tapering Scare**
   May - June 2013
   Tapering Talks stirred the market since Congress Testimony by Bernanke with both equity and bond markets sold off. Emerging Market suffered badly due to hot money flight back to US. Shocks for DxS Factors are spreads.

5. **Chinese Market Crash '15**
   June-August 2015
   Chinese stock market crash beginning with the popping of the stock market bubble on 12 June 2015

Hypothetical Scenarios

1. **Credit Spread Widening US**
   US Credit Spread widen by 29.96%, calibrated to a 1% likelihood event for a 21-day movement using 7 years of rolling data as of 09/30/2014 with DLY as the weighting scheme (252 days and 8 weeks half-life).

2. **Equity Volatility Increase**
   US S&P VIX increases by 17.20%, calibrated to a 1% likelihood event for a 21-day movement using 7 years of rolling data as of 09/30/2014 with DLY as the weighting scheme (252 days and 8 weeks half-life).

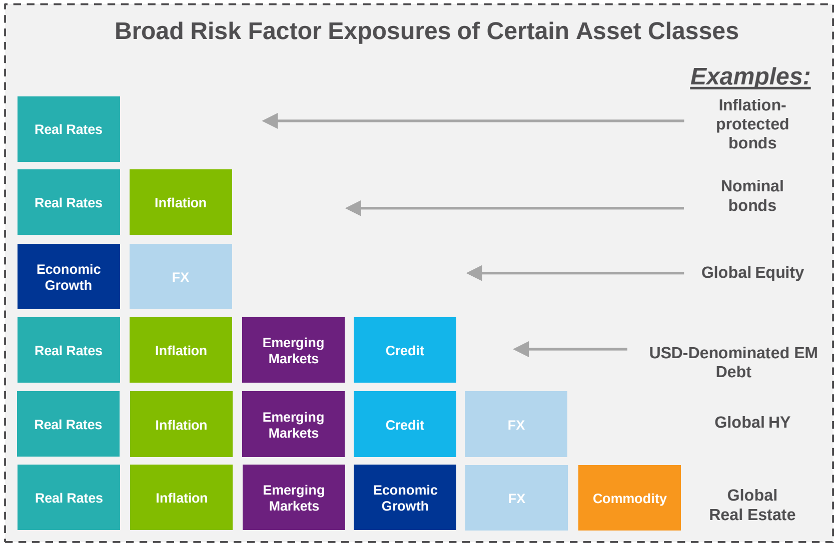
3. **US Stock Market Down 5%/10%/15%**
   Risk factor shocks specified for S&P 500, with S&P 500 declining by 5%, 10% and 15%

Defining risk factors

Macro risk factors and additional descriptive factors explained

These common economic factors are intuitive, applicable across all asset classes, and explain the majority of asset class risk

Economic Growth	Risk associated with global equity markets *Broad-market equity index returns*
Inflation	Risk of bearing exposure to changes in nominal prices *Return of long nominal bonds, short inflation-linked bonds portfolio*
Real Rates	Risk of bearing exposure to real interest rate changes *Inflation-linked bond returns*
Commodity	Risk associated with commodity markets *Weighted GSCI Commodity index returns*
Credit	Risk of default or spread widening *Return of long corporate bonds, short nominal bonds portfolio*
Emerging Markets	Risk that emerging sovereign governments will change capital market rules *Equally weighted basket of EM assets*
FX	Risk associated with developed foreign currency exposure *USD-denominated basket of EUR, JPY, GBP, CAD and AUD*



Though the macro factors explain the majority of asset class returns, there are three additional components which supplement the risk factors in explaining total risk/return

Diversification*	The risk composition illustrated throughout the presentation depicts the standalone risk contribution of each of the factors. As the factors are not perfectly correlated with one another, exposure to multiple factors produces some diversification benefit
Idiosyncratic*	The risk unexplained by the 2,200+ risk factors in the BRS risk model
Residual	The sum of the macro factors and idiosyncratic contribution should match the total risk/return as modeled by the complete set of underlying risk factors (2,200+); the difference is identified as the residual factor

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Agenda Item IV.B.

Informational

TO: State Investment Board
FROM: RIO Investment Staff
DATE: April 20, 2018
SUBJECT: Infrastructure Update

Background:

On October 27, 2017, the SIB approved RIO's recommendation to conduct an infrastructure consultant search to assist staff in identifying at least one new manager to complement existing infrastructure mandates with JPMorgan and Grosvenor. RIO noted the proposed timing of this search was favorable given the upcoming Legacy Fund asset allocation policy review.

On November 17, 2017, the SIB approved RIO's recommendation to engage Mercer to assist staff in conducting a search to identify one or two infrastructure managers which would provide complementary exposures to our existing global real asset investment portfolios.

On March 23, 2017, the SIB approved the recommendation of RIO and Mercer to invest up to $140 million with I-Squared Capital's Global Infrastructure Fund II (including up to $65 million for the Pension Trust and up to $75 million for the Legacy Fund).

Implementation Update:

RIO intends to complete legal documentation for ISQ Global Infrastructure Fund II on or before May 1, 2018. RIO notes that Mr. Scott Cheskiewicz of Jackson Walker was appointed Special Assistant Attorney General by the Office of the Attorney General effective as of March 26, 2018, (as previously approved by the SIB on November 17, 2017) to provide expert legal assistance in negotiating this transaction in addition to the outstanding legal guidance already provided by Assistant Attorney General Patrick Brooke.

Infrastructure Benchmark Review:

Based on recent infrastructure investment due diligence, RIO requested Callan Associates to review our current benchmark and consider recommending a new benchmark which would better evaluate the contribution of the infrastructure investment within those SIB funds that utilize this asset class. RIO notes that we have historically utilized CPI-W to benchmark our infrastructure investments (including JPMorgan and Grosvenor).

Next Steps:

RIO will request Callan to present their infrastructure recommendation to the SIB at our next board meeting on May 25, 2018, in connection with Callan's quarterly investment performance review and in conjunction with Callan presenting the results of their asset allocation policy reviews of WSI and the Legacy Fund. Please see the attached Infrastructure Benchmark Analysis presentation offered by Callan Associates for further background. RIO notes a custom built index is necessary because there is not a passive investible index and there is no robust private peer index available.

April 11, 2018

North Dakota
State Investment Board

Infrastructure Benchmark Analysis

Paul Erlendson
Senior Vice President

Alex Browning
Senior Vice President

Adam Lozinski, CFA
Assistant Vice President

Introduction

Objective:

- Select a benchmark (a representative performance proxy) to evaluate the investment contribution of the infrastructure asset class within those NDSIB Funds that utilize the asset class.

- A custom built index is necessary because there is not a passive investible index and there is not a robust private peer index available.

Analysis Inputs:

- To model the NDSIB Infrastructure Composite, Callan equal-weighted the four current managers: Grosvenor Custom Infra, Grosvenor Custom Infra II, JP Morgan Infra, and JP Morgan Asian Infra.
  - The data goes back to July 2007. However not all managers have data histories extending back to 7/2007.
  - As a consequence of the non-contemporaneous benchmark histories, our analysis equal weighted those managers with available data in each sub-period across the entire timeframe of the analysis.

- Alternative benchmarks and corresponding economic rationale:
  - **NCREIF ODCE**: Should exhibit income and equity replacement values similar to infrastructure
  - **NCREIF Total**: Should exhibit income and equity replacement values similar to infrastructure
  - **FTSE Global 50/50**: Public equity infrastructure benchmark should have similar assets
  - **CPI-U**: Inflation adjustments are frequently part of the long-term lease contracting
  - **Bloomberg Long Credit**: Long duration of infrastructure cash-flows should exhibit interest rate sensitivity
  - **Bloomberg Long Gov/Credit**: Long duration of infrastructure cash-flows should exhibit interest rate sensitivity

- Additionally, multiple time lags were applied to each benchmark to test various measures of fit.

Approaches

Returns, Risk, and Statistics:

- The NDSIB Infrastructure Composite proxy was compared to the various index returns using the following measures:
  - Returns and Standard Deviation
  - Correlation of quarterly returns, rolling 3-year returns, and incorporated time lags
  - Return/Risk ratios
- In pursuit of the best fit custom benchmark we used various techniques including:
  - Correlation analysis
  - Regression
  - Returns-based style analysis
  - Optimization
- Given the risk of over-engineering a model to fit historical data, these analyses were used as a guide, not as a definitive answer.
- Looking at the potential custom benchmarks through various analytical lenses we were able to identify the indices that were routinely "chosen" by the models.
- It is important to note that return-based analyses do not directly replicate the unique factors influencing infrastructure asset class returns or specific manager strategies.

Conclusion

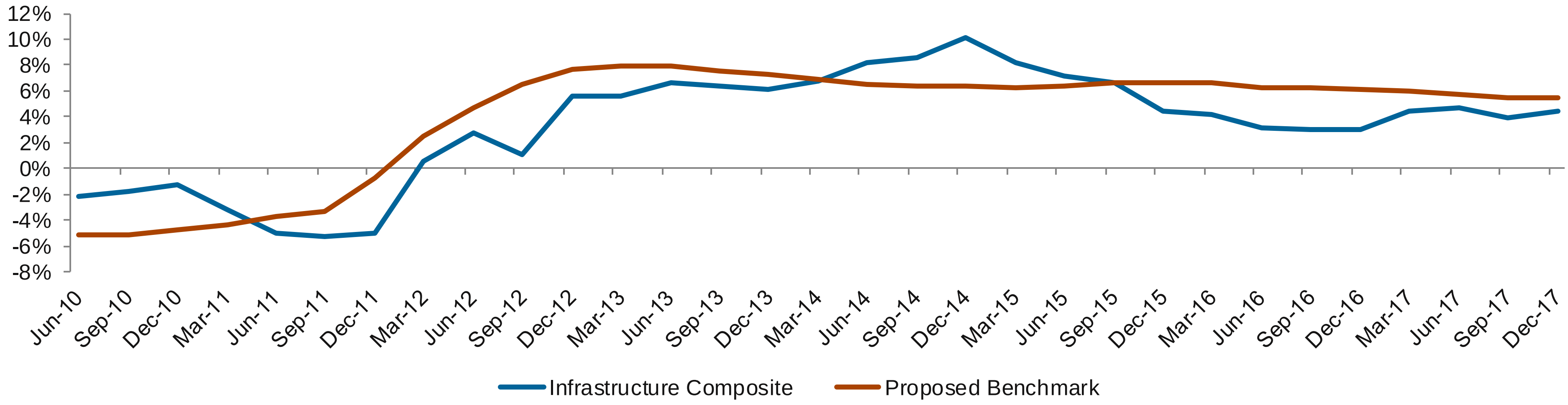
- Given the results of our analysis, we recommend considering the following custom benchmark:

<u>50% NCREIF ODCE and 50% CPI-U Lagged 1 Quarter</u>.

- The NCREIF ODCE represents a proxy for private income-oriented real assets; the lagged CPI-U accounts for the repricing of infrastructure leases and contracts based on observed inflation.

Portfolio Statistics for Periods 7/2007 to 12/2017	Annualized Returns (%)	Standard Deviation (%)	Return/Risk Ratio	Correlation of Quarterly Returns	Correlation of Rolling 3-Year Returns
Infrastructure Composite	3.51	7.42	0.47	0.52	0.86
Proposed Benchmark	3.12	4.64	0.67		

Rolling 3-Year Returns



AGENDA ITEM V.A.

INFORMATIONAL

TO: State Investment Board

FROM: Dave Hunter (on behalf of SIB Executive Review Committee)

DATE: April 20, 2018

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, Jodi Smith and Rob Lech. Ms. Yvonne 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 25-question survey completed by participating SIB members.

The Executive Review Committee intends to provide the SIB with an update of the annual review process at our April 27th board meeting. The annual evaluation of the Executive Director will be completed in May and finalized at our next SIB meeting on May 27, 2018.

Note: The SIB Executive Review Committee may elect to distribute the meeting materials from their Committee meeting on April 25th after review and discussion with the Executive Director/CIO.

BUDGETING / FINANCIAL CONDITION

AS OF MARCH 31, 2018

			EXPENDITURES			
	2017-2019 BUDGET	ADJUSTED APPROPRIATION	BIENNIUM TO DATE ACTUAL	BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	$ 4,425,570.00	$ 4,425,570.00	$ 1,603,023.32	$ 2,822,546.68	63.78%	62.50%
OPERATING EXPENDITURES	862,484.00	862,484.00	220,484.60	641,999.40	74.44%	62.50%
CONTINGENCY	52,000.00	52,000.00	0.00	52,000.00	100.00%	62.50%
TOTAL	$ 5,340,054.00	$ 5,340,054.00	$ 1,823,507.92	3,516,546.08	65.85%	62.50%

EXPENDITURE REPORT

QUARTER ENDED MARCH 31, 2018

	INVESTMENT	RETIREMENT	QUARTERLY TOTALS	FISCAL YEAR TO - DATE	BIENNIUM TO - DATE
CONTINUING APPROPRIATIONS					
INVESTMENT EXPENDITURES (SEE ATTACHED DETAIL)	$ 7,395,146.69	$ 0.00	$ 7,395,146.69	$ 21,520,507.45	$ 21,520,507.45
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0.00	50,272,219.91	50,272,219.91	151,222,971.65	151,222,971.65
2. REFUND PAYMENTS	0.00	1,160,831.78	1,160,831.78	4,948,362.12	4,948,362.12
TOTAL MEMBER CLAIMS	0.00	51,433,051.69	51,433,051.69	156,171,333.77	156,171,333.77
OTHER CONTINUING APPROPRIATIONS	170,862.83	93,245.57	264,108.40	598,374.85	598,374.85
TOTAL CONTINUING APPROPRIATIONS	7,566,009.52	51,526,297.26	59,092,306.78	178,290,216.07	178,290,216.07
BUDGETED EXPENDITURES					
1. SALARIES & BENEFITS					
SALARIES	200,521.45	204,048.64	404,570.09	1,182,015.39	1,182,015.39
OVERTIME/TEMPORARY	0.00	0.00	0.00	0.00	0.00
TERMINATION SALARY & BENEFITS	0.00	0.00	0.00	0.00	0.00
FRINGE BENEFITS	64,917.51	79,895.63	144,813.14	421,007.93	421,007.93
TOTAL SALARY & BENEFITS	265,438.96	283,944.27	549,383.23	1,603,023.32	1,603,023.32
2. OPERATING EXPENDITURES					
DATA PROCESSING	3,449.37	14,840.28	18,289.65	53,951.30	53,951.30
TELECOMMUNICATIONS - ISD	824.46	1,483.56	2,308.02	6,093.74	6,093.74
TRAVEL	7,876.28	707.01	8,583.29	19,133.65	19,133.65
IT - SOFTWARE/SUPPLIES	0.00	12.00	12.00	246.98	246.98
POSTAGE SERVICES	444.69	11,459.04	11,903.73	30,484.16	30,484.16
IT - CONTRACTUAL SERVICES	59.12	163.78	222.90	2,425.19	2,425.19
BUILDING/LAND RENT & LEASES	8,028.81	13,513.98	21,542.79	65,998.37	65,998.37
DUES & PROF. DEVELOPMENT	75.00	3,595.00	3,670.00	7,480.00	7,480.00
OPERATING FEES & SERVICES	695.16	721.46	1,416.62	6,462.48	6,462.48
REPAIR SERVICE	0.00	0.00	0.00	229.39	229.39
PROFESSIONAL SERVICES	726.74	1,915.26	2,642.00	9,832.00	9,832.00
INSURANCE	0.00	0.00	0.00	609.80	609.80
OFFICE SUPPLIES	70.73	388.91	459.64	977.64	977.64
PRINTING	281.40	4,632.95	4,914.35	11,834.09	11,834.09
PROFESSIONAL SUPPLIES & MATERIALS	0.00	100.63	100.63	851.37	851.37
MISCELLANEOUS SUPPLIES	57.51	141.83	199.34	378.09	378.09
IT EQUIPMENT UNDER $5000	0.00	81.00	81.00	81.00	81.00
OTHER EQUIP. UNDER $5000	0.00	0.00	0.00	2,321.80	2,321.80
OFFICE EQUIP. & FURNITURE UNDER $5000	73.20	695.62	768.82	1,093.55	1,093.55
TOTAL OPERATING EXPENDITURES	22,662.47	54,452.31	77,114.78	220,484.60	220,484.60
3. CONTINGENCY	0.00	0.00	0.00	0.00	0.00
TOTAL BUDGETED EXPENDITURES	288,101.43	338,396.58	626,498.01	1,823,507.92	1,823,507.92
TOTAL EXPENDITURES	$ 7,683,248.12	$ 51,771,448.27	$ 59,718,804.79	$ 180,113,723.99	$ 180,113,723.99

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED MARCH 31, 2018

FOR QUARTER ENDED 9/30/17		
CUSTODIAN		
Northern Trust		261,702.68
TOTAL FOR QUARTER ENDED 9/30/17		**261,702.68**
FOR QUARTER ENDED 12/31/17		
PENSION DEVELOPED INTERNATIONAL EQUITY POOL		
Northern Trust	26,358.41	
Wellington	207,641.64	
William Blair	148,123.31	
TOTAL PENSION INTERNATIONAL EQUITY		382,123.36
PENSION GLOBAL EQUITY POOL		
Epoch	683,632.38	
LSV	138,066.00	
TOTAL PENSION GLOBAL EQUITY		821,698.38
PENSION BELOW INVESTMENT GRADE FIXED		
Loomis Sayles		211,784.85
PENSION INVESTMENT GRADE FIXED INCOME POOL		
PIMCO	29,148.20	
State Street	7,417.26	
TOTAL PENSION INVESTMENT GRADE FIXED INCOME		36,565.46
PENSION INFRASTRUCTURE POOL		
JP Morgan		381,262.13
PENSION LARGE CAP EQUITY POOL		
LA Capital		253,097.07
PENSION SMALL CAP EQUITY POOL		
Atlanta Capital		249,837.00
PENSION REAL ESTATE		
Invesco		212,770.92
PENSION INTERNATIONAL FIXED INCOME		
Brandywine	149,598.67	
UBS	77,960.82	
TOTAL PENSION INTERNATIONAL FIXED INCOME		227,559.49
INSURANCE FIXED INCOME POOL		
Prudential	76,003.04	
State Street	6,526.16	
Wells	123,287.12	
Western Asset	100,689.57	
TOTAL INSURANCE FIXED INCOME		306,505.89

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED MARCH 31, 2018

INSURANCE LARGE CAP EQUITY POOL		
LA Capital	56,190.76	
LSV	58,970.00	
TOTAL INSURANCE LARGE CAP		115,160.76
INSURANCE SMALL CAP EQUITY POOL		
PIMCO RAE		27,239.23
INSURANCE INT'L EQUITY		
LSV	74,823.00	
William Blair	72,513.13	
TOTAL INSURANCE INT'L EQUITY		147,336.13
INSURANCE DIVERSIFIED REAL ASSETS		
JP Morgan	181,689.52	
Western Asset	37,929.20	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS		219,618.72
INSURANCE REAL ESTATE		
Invesco	54,102.98	
JP Morgan	162,099.29	
TOTAL INSURANCE REAL ESTATE		216,202.27
LEGACY FIXED INCOME		
Prudential	127,110.93	
State Street	13,828.84	
Wells	194,241.74	
Western Asset	157,885.94	
TOTAL INSURANCE FIXED INCOME		493,067.45
LEGACY LARGE CAP EQUITY		
LA Capital	252,223.60	
LSV	258,390.00	
TOTAL INSURANCE LARGE CAP		510,613.60
LEGACY SMALL CAP EQUITY		
PIMCO RAE		115,693.83
LEGACY INT'L EQUITY		
LSV	403,951.00	
William Blair	402,499.14	
TOTAL INSURANCE INT'L EQUITY		806,450.14
LEGACY DIVERSIFIED REAL ASSETS		
JP Morgan	241,056.40	
Western Asset	109,880.68	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS		350,937.08
LEGACY REAL ESTATE		
Invesco	106,498.56	
JP Morgan	312,214.04	
TOTAL INSURANCE REAL ESTATE		418,712.60

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED MARCH 31, 2018

PERS RETIREE HEALTH INSURANCE CREDIT FUND		
SEI		88,476.43
JOB SERVICE FUND		
SEI		69,823.37
TOBACCO PREVENTION & CONTROL TRUST FUND		
STATE STREET		2,711.24
CUSTODIAN		
Northern Trust		284,823.80
CONSULTANT		
Adams Street	15,040.00	
Callan	103,702.91	
Novarca	45,821.14	
TOTAL CONSULTANT		164,564.05
TOTAL FOR QUARTER ENDED 12/31/17		**7,114,635.25**
FOR QUARTER ENDED 3/31/18		
PENSION CASH		
Northern Trust		18,808.76
TOTAL FOR QUARTER ENDED 3/31/18		**18,808.76**
TOTAL FEES PAID DURING QUARTER ENDED 3/31/2018		**7,395,146.69**

NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE

QUARTERLY MONITORING REPORT

Quarter Ended March 31, 2018

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 Director/CIO held three full office meetings and three manager meetings during the first calendar quarter of 2019 in order to promote an open and collaborative work environment while enhancing team member communication, awareness and engagement.

RIO notes that our three newest team members including Denise Weeks - Retirement Benefits Specialist, Missy Kopp - Administrative Assistant, and Sara Sauter - Supervisor of Audit Services, are performing well during their first three months of employment (since January 1, 2018).

In order to enhance employee engagement, RIO announced the re-instatement of "Flex Hours" on a trial basis from May 1, 2018 to October 31, 2018. In the past, "Flex Hours" were generally only offered during the summer months. Based on recent employee feedback, there was a growing desire to expand "Flex Hours" year-round. RIO notes that our "Office Dress Code" policy was also revised in 2017 in response to increased employee feedback and constructive input from all RIO team members.

RIO is fully staffed as of March 31, 2018.

Quarterly Report on Ends
Q3:FY18

Investment Program

Ongoing due diligence conducted on the following organizations:

Ares (direct lending)
Axiom (emerging market equity)
Declaration (fixed income)
PIMCO (domestic fixed income)
Wellington (non-US small cap equity)
Wells Capital (fixed income)
Western (domestic fixed income)

Preliminary due diligence conducted on the following organizations:

Barings (real assets)
Basalt (infrastructure)
Brookfield (infrastructure)
Carlyle (infrastructure)
First State (infrastructure)
GIP (infrastructure)
IFM (infrastructure)
I-Squared (infrastructure)
JP Morgan (derivatives)
KKR (infrastructure)
Macquarie (infrastructure)
Westbrook (real estate)

At the January SIB meeting, Aon Hewitt presented Board education relating to fiduciary trends in public pension plan governance.

During the first quarter, Staff continued to work with Mercer to identify suitable private infrastructure manager candidates to complement existing infrastructure platform investments. Staff conducted on-site due diligence meetings during the quarter with a number of private infrastructure managers.

Also at the March meeting, the Board approved the selection of I-Squared Capital to manage up to $140 million in commitments on behalf of the pension trust and Legacy Fund in total. Legal contract review is pending.

During the quarter, as part of the pension trust fixed income restructuring, global/non-US fixed income pension mandates with Brandywine and UBS in addition to a dedicated MBS mandate with JP Morgan were transitioned to a core fixed income mandate with Prudential (PGIM).

As part of the restructuring of the pension trust fixed income manager structure, Staff is conducting a search for opportunistic credit managers within the non-investment grade fixed income space.

Staff is continuing the live phase of the implementation of the BlackRock Solutions Aladdin system and is currently developing reporting packages.

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

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.

AGENDA ITEM VI.D.

Quarterly Monitoring Report on TFFR Ends
Quarter Ended March 31, 2018

Retirement Program

This report highlights exceptions to normal operating conditions.

- TFFR Member Online was moved to the production environment on February 1, 2018. Member Online allows members to view account information in a secure internet environment. To date, over 500 active and retired members have logged into the site. Staff continues to notify membership the site is available through email blasts, correspondence, publications, outreach programs, and during personal and phone interactions.

- Due to delays in the release of the 2018 IRS federal tax withholding tables and the ND State tax withholding tables, TFFR staff implemented the new federal withholding tables for February 1, 2018 retiree payroll and ND state withholding tables for the April 1, 2018 payroll. Tax information notices were sent to retirees regarding the changes in withholding. Staff received calls from retirees regarding the delay and impact on their monthly payment, but overall the implementation went very smoothly.

- TFFR's 2017 IRS favorable determination letter was contingent on approval of certain amendments to state law in the 2019 legislative session. Based on this, one TFFR legislative proposal was submitted to the Legislative Employee Benefits Programs Committee for interim study by the April 1, 2018 deadline. The bill contains technical corrections to clarify and add detail on direct rollover provisions.

- TFFR continues to identify and implement cost saving initiatives in the member and employer outreach program areas by utilizing more electronic education materials instead of printed versions.

BOARD LEADERSHIP
INNOVATIVE APPROACHES TO GOVERNANCE
NUMBER 155, JAN.–FEB. 2018
www.boardleadershipnewsletter.com

Being Real About Governance

by Caroline Oliver

This article by Caroline Oliver, editor of Board Leadership, *originally appeared in our January/February 2016 issue. She suggests that better governance would be served if we were more willing to face the limitations of our current understanding and practice, and we think this article conveys how passionately she felt about teaching and understanding the principles of governance. Here, she started the process of challenging herself on these limitations, and asks you to do the same.*

As someone who has taken a very close interest in governance for over twenty years, it seems to me worth asking the question that every child asks from the back seat of their parents' car on a long and winding road: "Are we there yet?" Like a child, I often ask the question in a rather imperious and despairing voice ("For heaven's sake, can't you lot in the front seat get us there any faster than this?"). And, like a child, maybe I don't understand, or take any responsibility for, the realities of what it is going to take to get us from A to B.

In this article, I try to start putting that right for myself and hope that you may come some or all of the way with me. Please note that, throughout this article, I am using the word *governance* to denote the work of the board.

ALSO IN THIS ISSUE

Noble Aims

The first question to ask, of course, is where are we trying to get to? I suspect that the answer for all of us is something along the lines of "governance that enables organizations to succeed." A noble aim indeed, but clearly one that begs at least two further questions:

1. How should success for any given organization be defined?
2. How can governance impact success or failure?

How We Fall Short

Asking these two seemingly simple questions reveals the fundamental reality that we must face if we are to be real about governance. For all the increased research and focus on governance since the very first report on corporate governance,[1] we still have no agreement on the answers to the most basic of questions.

On the question of how success should be defined for any given organization, the legal framework in many jurisdictions would say we must look to "the best interests of the corporation." As Tuvia Borok points out in

(continued on page 2)

In Memoriam

It is with a heavy heart that we announce that Caroline Oliver, *Board Leadership*'s longtime editor, passed away in January 2018.

Caroline had been involved with *Board Leadership* since 2000—first as a frequent contributor, then as managing editor, and then as editor.

Her contributions to the field of board governance as a whole are significant and far-reaching. In addition to her work on *Board Leadership*, she ran the international consulting firm Good to Govern, served as CEO of the International Policy Governance Association and chair of the UK Policy Governance Association, and was a member of the international Xylem Group partnership developing new approaches to organizational accountability.

Her published works and editorials, her leadership in the development of the British Governance Standard, and her work with the International Organization for Standardization will continue to have a lasting impact on the world of board governance for years to come.

The International Policy Governance Association has established The Caroline Oliver Fund for a New Vision, the proceeds of which the IPGA Board board will strategically designate toward the organization's research, learning, and advocacy agenda, sustaining Caroline's dream and affirming her life's life's work.

If you would like to make a donation to the fund, please visit policygovernanceassociation.org/caroline-oliver-fund. ❑

Being Real

(continued from front page)

the context of the Canadian Business Corporations Act (CBCA)[2]: "A consideration of any corporate law issue ... ultimately leads to a deliberation of how to define what the best interests of a corporation are."

The CBCA demands that "every director and officer of a corporation, in exercising their powers and discharging their duties shall act honestly and in good faith, with a view to the best interests of the corporation."2 Yet courts and academics disagree as to the appropriate definition of "acting in the best interests of the corporation."[3]

In the absence of this definition, many claims arise. Perhaps "the best interests of the corporation" can be equated with the best interests of shareholders, or employees, or stakeholders, or the local community, or the people represented by the incorporating body? Or maybe all of them? And it doesn't help our search for clarity to know that each of these terms is open to a large number of different interpretations.

In the United Kingdom, the Companies Act 2006 requires that directors consider the impact of their actions on a wide range of stakeholders. The Act requires a director to "promote the success of the company for the benefit of its members as a whole," but sets out the following six factors a director must consider in fulfilling the duty to promote success:[4]

1. The likely consequences of any decision in the long term.
2. The interests of the company's employees.
3. The need to foster the company's business relationships with suppliers, customers, and others.
4. The impact of the company's operations on the community and the environment.
5. The desirability of the company maintaining a reputation for high standards of business conduct.
6. The need to act fairly as between members of a company.

To put the position briefly, board members can be forgiven for being confused about whose interests should come first when it comes to defining success.

On the second basic question of "How can governance impact success or failure?" we are also falling short of our noble aim of "governance that enables organizations to succeed" as those associated with FIFA, Volkswagen, and charities such as Kids Wish Network, among many others, can attest.[5] Writing about Volkswagen in the October 2015 issue of Boardroom Insider, Ralph Ward says:

> *Not only are the supervisory board chair and CEO positions separate, the chief executive ... cannot even sit on the supervisory board. When it comes to governance, Germany sits near the top in global rankings on the rule of law in business, solid regulatory structures, low corruption, and audit integrity. ... All good—and yet none of this created internal controls that could stop or detect a massive, international emissions tampering scandal. Volkswagen's supervisory board has launched an investigation to learn what happened and who is responsible—not only didn't their internal controls spot the mischief, they still can't determine how extensive the tampering is, who was involved, and in what countries.*

He concludes: "... Volkswagen is a company in a governance zone that should have seen everything done right. If their controls failed them so disastrously, what could your company's internal controls be missing right now?"[6]

When things go wrong—as we have seen time after time from Enron onwards—given that no one can be expected to know everything about everything, we still don't know what boards should and should not know about what, nor what CEOs should and should not know about what. We still don't know whose head or heads should roll.

Is Perfect Governance Even Possible?

T. S. Eliot's suggestion that ultimately we are all trying to escape the darkness within and without by "dreaming of systems so perfect that no one will need to be good"[7] has much merit. The very best of boards using the very best of governance systems and the very best of CEOs using the very best of management systems have to give others some freedom to get the job done. This inevitably involves some element of trust and, equally inevitably, sometimes there will

> For all the increased research and focus on governance since the very first report on corporate governance, we still have no agreement on the answers to the most basic of questions.

FOOD FOR THOUGHT

You gain strength, courage, and confidence by every experience in which you really stop to look fear in the face. You must do the thing you think you cannot do.

Eleanor Roosevelt
First Lady of the United States
(1933–1945)

be failures. As our world gets more and more complex, more and more employees know more about many things than their employers can ever hope to know. Some things will always be beyond the capacity of the average board member or CEO to understand. Even third parties that boards and CEOs hope they can rely on to assure the veracity of the data they are receiving will fail. In many scandals we find ourselves asking not only "Where were the directors?" but also "Where were the auditors, the regulators, and the testing agencies?"

As Baroness Onora O'Neill points out:[8]

> *Trusting intelligently gets harder when tasks are more complex. Most of us cannot judge the products marketed by the financial services industry, or by insurers. Most of us cannot assess scientific claims or new technologies. In these complex cases we can place and refuse trust intelligently only by finding proxy evidence of trustworthiness, since the complete evidence is too complicated for the less expert. We can all think of examples of useful proxy evidence provided by experts. In the best cases, auditors, examiners, regulators, evaluators, peer reviewers and experts of other sorts can judge trustworthiness, and then offer an intelligible summary that serves as proxy evidence for the less expert. Most of us can unfortunately also think of cases in which the proxy evidence provided by experts was too complex, irrelevant or unusable, so could not support the intelligent placing and refusal of trust.*

What Will It Take to Close the Gap?

So is it hopeless? Should we just accept that the answer to the question "Are we there yet?" is "No, and we never will be"?

Clearly, we do have to accept that we are never going to be able to 100 percent guarantee that we have "governance that enables organizations to succeed" permanently in place in every organization across the globe. However, I do believe that getting closer to where we want to get to is only impossible if we give up the quest. I also believe that we have a moral obligation to try. Organizations are human creations, and therefore we are responsible for bringing them into being and ensuring, as far as we possibly can, that they do indeed fulfill the purposes for which we created them.

Indeed, it seems to me that the first thing we can do to close the gap between where we are and our ultimate goal revolves around the issue of organizational purpose. Defining success is fundamentally about defining purpose. There are undoubtedly lots of people that boards should listen to and take account of in considering purpose, but we have to be clearer than we are today about who the ultimate arbiters of purpose are. Not all stakeholders are created equal, and I want to suggest that there is a significant difference between those whose interests a wise board would consider and those to whom the board is ultimately accountable. I further want to suggest that it is only the interests of the latter group that should be considered the ultimate legitimators of purpose.

My fear is that much of the discussion today is serving to muddy the waters and therefore to obscure rather than illuminate accountability. I therefore believe that one major thing we could do to help close the gap between where we are today and "governance that enables organizations to succeed" is to establish legal and practice frameworks that clarify to whom boards are ultimately accountable for the definition of organizational purpose as distinct from their other accountabilities to other persons.

Turning to the question of "How can governance impact success or failure?" I think we can do a whole lot better at fleshing out the board's crucial role as the highest authority within

(continued on page 8)

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:** Principles, theories, ideas, methodologies and practices.
- **Board governance:** The job of governing whole organizations. ❑

NEWS

U.K. Corporate Governance Proposed Overhaul

More than 250 entities have responded to the proposed revamp of the United Kingdom's best practice rules for London Stock Exchange companies, according to the Financial Times (March 6, 2018).

The proposal, which would be the first major overhaul of the 25-year-old corporate governance code since 2014, would take effect during the summer of 2018 and would instill several major changes:

1. **Board independence:** The proposal would introduce a nine-year tenure limit for independent chairs and directors.
2. **Executive pay:** Shares received as part of an executive bonus should be held for at least five years.
3. **Financial reporting:** Corporations would need to disclose how they arrived at conclusions in their statements.
4. **Diversity:** Companies will be asked to disclose what action they have taken to increase ethnic and social diversity in their "executive pipeline".
5. **Contribution to society:** Companies should for the first time disclose how they "contribute to wider society.

Nonprofit and Philanthropic Leaders Call on Congress to Preserve Johnson Amendment

Nonprofit and philanthropic leaders are calling on Congress to preserve the Johnson Amendment, the long-standing legislation that prohibits 501(c)(3) nonprofit organizations from endorsing or opposing political candidates.

On February 7, 2018, nearly 150 national organizations sent a letter to House and Senate appropriators expressing their opposition to the inclusion of anti–Johnson Amendment language in spending bills that Congress will soon be considering.

Leaders from across the charitable, religious and philanthropic communities shared why they think this legislation must remain in place:

Anne Wallestad, president and CEO of BoardSource: "At BoardSource, we believe in the importance of nonprofit engagement in discussions about public policies that impact our missions and the people and communities we serve. But we also understand that electioneering is a completely different matter, and that allowing nonprofits to endorse and support specific candidates is a dangerous and slippery slope. That is why we strongly oppose any effort to weaken or repeal the Johnson Amendment."

Vikki Spruill, president and CEO of the Council on Foundations: "Charitable foundations serve to channel the generosity of private citizens towards the causes and issues that resonate with their passions and experiences. For them to continue to fulfill this purpose, it is crucial that the public trust they have earned over the years is not diminished by partisan labels or influence."

Tim Delaney, president and CEO of the National Council of Nonprofits: "The nonprofit community cannot afford the division and lack of trust that plague the partisan political process. Leaving partisan labels at the door allows nonprofit employees, board members and volunteers to come together in service of that nonprofit's mission—something that wouldn't be possible if the long-standing Johnson Amendment is weakened in any way."

Lee Sherman, president and CEO of the National Human Services Assembly: "The Johnson Amendment allows nonprofits to cultivate public trust in the sector's public services, facilitate cross-sector collaboration and offer bipartisan solutions that are core to our missions and the development of well-being in our communities. Weakening the Johnson Amendment will create pressure on nonprofits to divert resources to political campaigns, identify with a political party and accept funding that is conditioned on supporting or opposing specific candidates. It is, therefore, important that the protections against participation in political campaign activities remain intact, leaving organizations free to focus on their missions."

Jatrice Martel Gaiter, executive vice president of external affairs for Volunteers of America: "Nonprofit human service providers are bracing for large cuts to programs that help the sick, the disabled, the undereducated and veterans, among many others. Our sector remains one of the last bastions free from politics and partisanship. When it comes to our staff, board members, and volunteers, we have but one mission … to support our clients. Partisan differences are set aside to focus on the uniting power of our shared goals. Any tinkering with the Johnson Amendment would dissolve the line of demarcation from political fundraising and endorsements that has existed in the nonprofit sector since 1954. Please preserve the Johnson Amendment and maintain the nonpartisan environment that allows nonprofits to continue helping people in need rebuild their lives and reach their full potential."

Informed Board, Active Risk Management Keys to Keeping Fraud in Check

Keeping your board of directors and key personnel informed of policies relating to conflicts of interest and having robust risk management programs in place are key to curtailing fraud in your nonprofit, according to experts at global accounting firm BDO.

According to the company's Nonprofit Standards benchmarking survey, some 88 percent of nonprofits give a copy of the organization's conflict-of-interest policy to the governing board, 69 percent give one to management and 35 percent give a statement to all employees. The latter should be considered a baseline, according to Laurie De Armond, national co-leader of BDO's Nonprofit & Education Practice.

"At a minimum, the policy should be included in the employee handbook and read by all employees," De Armond said.

Better still would be for all compensated management to be required to read and sign it, she added.

According to BDO, limiting conflicts of interest is key to effective nonprofit governance, and ensuring everyone understands how and where potential issues may arise is crucial. Just as important is having the proper protocols in place for determining if specific circumstances constitute a conflict, and what should be done to address it. BDO's research shows that over half of nonprofits let the governing board be the final arbiter for handling conflicts of interest, while 14 percent leave that in the hands of the president/executive director and 10 percent delegate it to a special audit committee. But the ideal setup would be for attorneys to make that determination, De Armond said.

"The best practice would be to have their internal counsel handle it," she said. "If they don't have internal or external counsel, the board or executive director should be next in line."

Aside from conflicts of interest, outright fraud and theft can be kept in check by good governance practices too. On this front, most nonprofits surveyed by BDO are already following best practices by having formal hotlines in place that allow board members, staff and volunteers to report, anonymously, if they've seen something questionable. About two-thirds of nonprofits have a whistleblower hotline in place, the survey showed, and about the same amount use annual risk assessments to ferret out fraud as well.

About half of surveyed groups have an internal audit function, while about 10 percent have a special fraud committee or have an external audit, corporate training and/or compliance officers to minimize fraud.

By far the most effective is the tried-and-true whistleblower hotline.

"Studies show most often, it's by hotline," De Armond said. "Nonprofits should make sure that their employees and volunteers are all aware of the hotline number" and when they should call it, she said.

Nonprofits shouldn't rely too heavily on external auditors to root out fraud, she said.

"Very few instances of fraud are detected by external audits, but it's better than nothing. Internal audits are a bit better. However, if the nonprofit doesn't have the resources to hire an in-house auditor, they should outsource the task to an external firm," she said.

And, just to make sure that your auditing firm isn't ripping you off as well, it's a good idea to competitively bid out the job every few years to make sure you are getting your auditing services for a good price.

"Nonprofits should bid it out every five years or so," De Armond said. "They don't necessarily need to change firms that often, but they should at least put it out to bid to check that the pricing is still competitive."

—Nicholas King

Keep Board Members Engaged

Kelly Rosenleaf, a board executive director in Missoula, Montana, said it can be a "huge challenge" to keep board members enthused and engaged.

She considers herself "intermittently successful" in this aspect of her relationship with the board. When it is going well, these ideas help:

1. **Model passion and energy for the board.** "This part is easy for me—I am committed to our mission, our programs, our role in the community, and our staff and the board's vital contribution," said Rosenleaf.

   But this can change. "In honesty, several years ago I went through a difficult period—a slump, burnout," said Rosenleaf.

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Thinking of publishing in* Board Leadership*? Contact Samara Kuehne for criteria at skuehne@wiley.com

CALENDAR OF EVENTS

May 16–18, 2018

The Private Company Governance Summit 2018

—Westin City Center, 1400 M St. NW, Washington, DC 20005 USA

This conference will focus on how private and family businesses build an engaged and effective board of directors to copilot through today's turbulence, including blockchain, sexual harassment, cybersecurity, the Amazon effect and more. Learn from directors, business owners, investors and experts who have been there and can guide you on the governance path to success.

For more information, visit privatecompanydirector.com.

June 15, 2018
9:30 a.m.–3:00 p.m.

ICSA Charity Governance Conference

—ICSA, Saffron House, 6-10 Kirby St., London, England EC1N 8TS, London, UK

This full-day conference will focus on themes relevant to charities and not-for-profit organizations. It will provide attendees with an insight into the latest thinking and offer a unique opportunity to share ideas and gain valuable knowledge on some of the challenges faced by governance professionals in the sector.

For more information, visit icsa.org.uk.

June 20–22, 2018

Certificate of Nonprofit Board Consulting

—Hyatt House Denver/Lakewood at Belmar, 7310 W. Alaska Dr., Lakewood, Colorado 80226 USA

To better meet the ongoing need for governance training among nonprofit organizations throughout the country, BoardSource has created the Certificate of Nonprofit Board Consulting. This three-day course is designed to heighten the skills and abilities of those who currently, or would like to, consult and train nonprofit boards of directors on governance issues.

For more information, visit boardsource.org.

June 20–23, 2018

Society for Corporate Governance National Conference

—Renaissance Downtown, 999 9th Street NW, Washington, DC 20001, USA

The Society for Corporate Governance is dedicated to shaping corporate governance through education, collaboration and advocacy. This year's theme is "Building Our Governance Capital."

For more information, visit societycorpgov.org

June 21–23, 2018

2018 International Policy Governance Association Annual Conference

—Hilton Savannah DeSoto Hotel, 15 East Liberty St., Savannah, Georgia 31401 USA

This is the annual conference for boards, CEOs and administrators using the Policy Governance® system, and young governance professionals and others exploring good governance. This year's event focuses on exploring governance excellence.

For more information, visit policygovernanceassociation.org.

June 25–28, 2018

International Corporate Governance Network Annual Conference

—Unicredit, Head Office, Piazza, Gae Aulenti 3, 20154, Milan Italy

For more information, visit icgn.org.

July 9–10, 2018

International Conference on Corporate Governance

—Hotel Ambassador - Zlatá Husa, Václavské nám. 5 - 7111 24 Prague, Czech Republic

This event aims to bring together leading academic scientists, researchers and research scholars to exchange and share their experiences and research results on all aspects of corporate governance. It also provides a

WRITING FOR BOARD LEADERSHIP

Board Leadership **is looking for articles from governance practitioners, researchers and consultants on topics related to the discovery, explanation and discussion of innovative approaches to board governance. If you have something new to say or want to provide a new perspective on something already said, please get in touch to discuss your idea further and to get a copy of our publishing criteria. Email: skuehne@wiley.com** ❑

premier interdisciplinary platform for researchers, practitioners and educators to present and discuss the most recent innovations, trends and concerns, as well as practical challenges encountered and solutions adopted in the fields of corporate governance.

July 10–11, 2018

ICSA Annual Conference: The New Agenda for Governance

—ExCeL, Royal Victoria Dock, 1 Western Gateway, London, England E16 1XL

This year's program will explore the implications of the revised UK Corporate Governance Code and what it will mean for boards. It will also examine how businesses can prepare for Brexit, alongside a wealth of quality opportunities for professional and personal development.

For more information, visit icsa.org.uk.

October 14–16, 2018

Executive Retreat 2018: Coming Together to Discover, Collaborate, and Learn

—Loews Coronado Bay, 4000 Coronado Bay Rd., Coronado, California, 92118 USA

During this collaborative three-day program, you will have the opportunity to meet and connect with other nonprofit executives from throughout the United States and the sector who understand exactly what you're experiencing as your organization's chief staff leader. Together with a nationally respected faculty, you'll discuss what it takes to strengthen the leadership partnership between you and your board, as well as have the opportunity to have open and honest conversations with your peers about the unique challenges of your role. The course will encourage self-reflection and provide a "safe" place for sharing and learning.

For more information, visit boardsource.org. ❑

News

(continued from page 5)

"And board energy and commitment floundered."

Rosenleaf soldiered through it, but said she should have taken three months off instead. "The staff and board would have done better without me during a leave, and the slump lasted about six months," she said.

Board members will not be engaged and energetic if the CEO is not. "This seems obvious; however, I know some burned-out, low-energy nonprofit leaders, and the whole organization is just going through the motions," Rosenleaf said.

2. **Know why board members serve.** "It's helpful to know the motivation for board service of individual members," Rosenleaf said. "Some are initially moved by the mission, but not all. Some seek professional networking, some seek greater community connection, some work someplace where board service is expected and some seek to share a skill set."

   There are lots of ways a board member might contribute—and if there are particular opportunities that match a board member's motivation, they are more likely to eagerly engage, Rosenleaf said.

   "This involves individual meetings, preferably annually with each member—this I confess I don't always do," she said. "I prioritize meeting with new members."

3. **Engage board members early on in their service.** "When board members get hooked in early, when we have a task that is well-suited to their skills or passion early in their service, they develop a commitment to the organization," Rosenleaf said.

   It's best if that activity involves at least one other board member too, to help develop board relationships, she said. If a board member is not engaged early, it's more likely they will not engage at all, Rosenleaf said.

4. **Tell stories.** These should be stories of success, Rosenleaf said, but also of strong efforts that fell short due to limitations.

   "Those who succeed also have spectacular failures as they push toward the goal," Rosenleaf said. "There are tons of barriers we encounter—ways we work around them, or bust through them, our customers succeed in spite of everything with our support."

   Whatever the mission is, the organization needs to be striving at all levels to reach it and the board needs to hear about successes and failures in real terms—whatever the purpose of the organization, Rosenleaf said.

5. **Acknowledge and openly appreciate all board efforts.** "People are able to contribute in different ways, and have varying time available," Rosenleaf said. "I'm grateful for all board member efforts. Encouragement is a more successful motivator than guilt. Appreciation makes for happy meetings, and nobody likes crabby meetings."

—Jeff Stratton

Being Real

(continued from page 3)

an organization—a role that encompasses leadership as well as stewardship on behalf of those to whom the board is ultimately accountable. We need to be clear what it is reasonable to hold boards accountable for doing and knowing, and that means we need clear job design, not merely the bolting together of bits and pieces that seem to make sense individually. And boards need to be clear about what they are delegating to whom with what authorities and accountabilities—which again calls for clear job design.

In other words, I believe that getting real about governance means facing the fact that it is not something that can be left to each board to invent for itself based on the opinions of the board members of the day. Closing the gap between where we are today and "governance that enables organizations to succeed" requires all those involved in governance in every sphere to work together to clarify principles and practices that can be systematically applied to the job, no matter who is carrying it out at any given time.

Yes, there will always be failures, but can we not build systems that ensure that we can clearly see what has gone wrong at what level and all learn from every failure? Can we not find ways of clearly stating our expectations of each other? Can we not aim to get to a place where we can hold all involved at every level accountable for providing intelligible evidence of their fulfillment of those expectations and the integrity of that evidence?

I believe that the Policy Governance system[9] provides a great starting point for getting real about governance, which is why I have been involved in teaching it and promoting it throughout my career. However, we need many more people to know about it and to engage in understanding and challenging it, as well as seeking to enhance it and develop better alternatives to it, if we are truly going to get to "governance that enables organizations to succeed." ❑

Notes

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9. See www.carvergovernance.com and www.policygovernanceassociation.org for more on the Policy Governance system.

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BOARD LEADERSHIP

INNOVATIVE APPROACHES TO GOVERNANCE

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BOARD LEADERSHIP
INNOVATIVE APPROACHES TO GOVERNANCE

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The Special Challenges of Association Governance

by Bill Charney

The US Internal Revenue Service (IRS) recognized 92,331 trade and professional associations in 2010, a 3.4 percent increase since 2001.[1] Here, experienced consultant Bill Charney, who has helped a wide variety of associations implement governance improvements—often using the Policy Governance® system—highlights some of the particular challenges they face.

Kenneth Dayton, a preeminent philanthropist and former chairman and CEO of Dayton Hudson Corporation (now Target Corporation), gave his now-famous "Governance Is Governance" speech to the 1986 *Independent Sector* leadership forum (published in 1987).[2] Dayton's message to nonprofit leaders confounded the notions, common then and now, that we still refer to as "traditional" board practices.

Conveying his "deeply held conviction" that governance is not management, Dayton stated that chair and CEO roles must be separated, that an all-powerful chair or a weak CEO is a threat to organizational success, and that the governance job is identical in both the nonprofit and for-profit sectors. The only distinction, he noted, is that nonprofit "trustees" also should volunteer in service to, not exercising authority over, the CEO.

ALSO IN THIS ISSUE

These notions added great credence to John Carver's Policy Governance® model. For critics grumbling that a singular model cannot attend to an organization's uniqueness, Dayton articulated brilliantly how failing to recognize that "governance is governance" is itself detrimental to success and sustainability.

Is Association Governance Different?

Associations are formed when people join together to advance common interests, be they business or social. This article focuses particularly on trade and business associations, in which members may be individuals, organizations, or both. Many of the dynamics addressed are also common in other membership organizations (e.g., clubs, guilds, fraternities/sororities, homeowner associations).

The job of an association board is no different than that of a charity or an equity corporation: to define and ensure the achievement of Ends reflecting owners' needs/interests, and to ensure that the organization conducts itself appropriately in producing these outputs.

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Wiley is looking for a dynamic, experienced editor to lead *Board Leadership*. The ideal candidate will be knowledgeable about corporate governance and policy and be truly excited by the field. This is a freelance, contract position and includes writing and editing responsibilities.

For more information and details on how to apply, please contact Samara Kuehne at skuehne@wiley.com. ❑

The Caroline Oliver Fund

In honor of *Board Leadership* editor Caroline Oliver, who passed away earlier this year, the International Policy Governance Association has established The Caroline Oliver Fund for a New Vision. The IPGA Board board will strategically designate the proceeds of this fund toward the organization's research, learning, and advocacy agenda, sustaining Caroline's dream and affirming her life's life's work.

If you would like to make a donation to the fund, please visit policygovernanceassociation.org/caroline-oliver-fund. ❑

Associations

(continued from front page)

Different industry sectors often exhibit common patterns or nuances that may foster or impede successful governance. Challenges pronounced in association boardrooms are not exclusive to the sector but occur with sufficient frequency to merit exploration as to cause and effect. These include:

1. The "We are an association, not a business" conundrum.
2. Owner representation and board size.
3. Volunteer engagement on committees.
4. Board chairs/presidents empowered as pseudo-CEOs.
5. Officer candidates "running for election."
6. Tradition valued more than progress.

Challenge 1: The "We Are an Association, Not a Business!" Conundrum

In associations that resist adaptation of management and governance best practices, this refrain is often cited as a reason "not to change." Yet as associations are entities in which people invest certain resources and expect return on that investment, associations *are* businesses.

Resistance to "acting like a business" is primarily typical to long-standing volunteer-driven associations, in which paid employees historically worked in administrative roles at the behest of volunteer leaders with little or no relevant business experience.

Though board members today have a better general understanding of their fiduciary duties, the sentiment behind the refrain remains surprisingly prevalent in associations, with sound business practices often overshadowed by organizational tradition.

Challenge 2: Owner Representation and Board Size

While identification, understanding and linking with the "ownership" is challenging in many nonprofit sectors, it is less so for most associations. Typically elected by the membership, association boards recognize, at least conceptually, the membership as the primary "ownership" on whose behalf they serve.

Unfortunately, however, board structures and size often obscure this otherwise simple matter. Among nonprofits, the larger the board, the more likely it belongs to an association! *Board Leadership* and other publications have featured numerous articles about board size (most recommending between seven and 12 as the "sweet spot"). In associations, board sizes expand with good intentions that range from securing "representation" for affiliate, chapter and special interest groups to offering more leadership opportunities without "pushing out" colleagues via term limits, or even "to ensure we have enough board members to staff committees."

> Typically elected by the membership, association boards recognize the membership as the primary "ownership" on whose behalf they serve.

That board members appointed or elected to represent specific membership segments perceive their role as advocating and voting for that segment is understandable, it contradicts and blurs their fiduciary duty of loyalty to the interests of all members. Instead of the owner-representative hat ("What will best serve our collective, long-term needs?"), constituency-based board members tend to wear that of customers ("What do I, or those just like me, want?").

In *Race for Relevance,*[3] Coerver and Byers compellingly suggest how a five-member governing board can serve an association membership far better than the larger, more cumbersome structures that are prevalent. Their rationale is substantive, ranging from the basic ("Large boards are cumbersome … slow …") to the consequential ("The larger a board gets, the less engaged the individual director tends to be"). They note that as boards get large (the teens and beyond), true governing authority typically becomes vested in a group of approximately five people: the executive committee. Thus, they propose the efficiency and authenticity (no charades) of a five-member board.

The "linkage" component of the board's job is to take into account the needs and interests of the ownership. Smaller boards can do so quite effectively, as representation is characterized by the diversity of interests genuinely sought and considered by a board, not how many board members are voting.

Challenge 3: Volunteer Engagement on Committees

Volunteer engagement is vital to vibrant associations, which are venues for members to learn from and support the growth and success of peers. In many instances, boards appropriately expect their association executives to actively engage and recognize member voluntarism.

CEOs with authority over volunteer committees don't find this a problem, but the "governance creep" challenge arises when boards make staff support of committee activities a higher priority than efficiently serving the membership as a whole. Another problem is that association boards often "impose" committee structures mirroring management positions, with oversight/approval authority over key staff functions (e.g., membership, education, human resources/personnel, finance, facilities, government affairs).

When management must take direction and/or seek approvals from subsets of the board, one-voice leadership and accountability for performance are nullified, taking a back seat to "ensuring that x, y and z were part of the decision."

Education committees are a prime example. As conferences/education are vital programs for most associations, a time-honored tradition for many is to assign members to a committee that will design the program and pick speakers. If the president or board appoints the group, and the educational programs are hugely successful, all is well.

If, however, there are conflicts in planning, or disappointments in outcomes, authority gets muddied. "Group-think" often emerges, and rather than criteria-based decisions (e.g., past speaker ratings, new programming needs), they become based on "who knows whom?" While accountability for performance evaporates, blame does not! Even when a board explicitly delegates authority over the education program to a committee rather than to the CEO, a weak program bodes poorly for the CEO and his/her job security.

Kenneth Dayton wondered, in *Governance Is Governance*: "Why is it that so many corporate directors grow horns when they become trustees?" doing things "they would never think of doing as [corporate] directors, interfering with management's role and making decisions or requests that no corporate director would think of making?"

The solution, as Policy Governance® boards identify, is simpler governance structures, replacing most "standing committees" with more ad-hoc, short-term efforts convened to do governance rather than management tasks.

To the extent collegiality and networking are held out as reasons for large boards and committee structures (whether board- or CEO-led), these should be seen as a by-product of, not a higher priority than, optimizing organizational performance.

Challenge 4: Board Chairs/ Presidents Empowered as Pseudo-CEOs

For many decades, association presidents were those who, after ascending through a hierarchy of offices, substantially put their own businesses/ careers aside for a year, and served as volunteer CEOs. Bylaws often delegated "executive authority" to this position. The top-ranking executive employee reported to the president, and the "executive vice president" (EVP) title became common, more so in associations than any other sector.

Recognizing that a "president" typically "runs the company," shifting the top volunteer title from "president" to "board chair" (or chief governance officer) has been a trend in the past 10 to 15 years, particularly for larger associations, with "EVP" increasingly transitioning to "CEO" or "president/ CEO."

> The biggest challenges for many associations are not external, but lie within the structures that are hurdles to their own competitiveness.

A title should reflect the role and authority of its holder. Dayton's message nearly 30 years ago still resonates: "... the (full-time professional staff) executive is the CEO of the institution. It matters not what the actual title is ... these professionals are the CEOs and they should consider themselves that, and should be so viewed by the entire board. A position description should clearly state that fact—and everyone on the board should accept that fact, particularly the chair."

Anytime a board president or chair is empowered to treat the executive as his/her subordinate, the organization is at risk of becoming the fiefdom of one person with inadequate checks and balances.

Challenge 5: Officer Candidates "Running for Election"

When a membership elects both board members *and* candidates "running for office," new challenges arise. Significant disruption can occur when an elected officer arrives with his or her "agenda." In associations, deference to these prerogatives is too often the norm, regardless of whether they reflect current association needs or contradict previously agreed-upon board initiatives.

Many associations have annual "installation" events, at which the new president gets sworn in. It is common for the incoming president to be given the authority to determine the "theme" of that year's (often expensive) installation party. The personal preferences can be extreme, such as one Realtor® association at which the incoming president literally directed the EVP to procure "a tiara and scepter" for her to wear and hold at her installation. Sadly, it was no joke!

The ceremonial value of these traditions can be very engaging and beneficial. Boards might consider, however, if celebrating the profession's achievements and contributions to society would produce greater membership engagement and benefit.

Challenge 6: Tradition Valued More Than Progress

Boards should honor their organization's heritage, while facing the challenge that yesterday's solutions may not meet tomorrow's needs. Governance is the act of steering an organization to a desired future. While a rearview mirror is integral to safe driving, it is for good reason that the windshield is much larger!

Just as John Carver's *Boards That Make a Difference*[4] was groundbreaking for governance, Coerver and Byers's books *Road to Relevance*[5] and *Race for Relevance* provide similar wake-up calls and proposed solutions for associations. In the latter, they note six "marketplace realities" that have irrevocably altered the landscape and threatened the relevance of associations:

1. *Time.* Today's leaders struggle with work-life balance and want their volunteer time used more scrupulously. "Old model"

(continued on page 8)

Design the Perfect 'Career Ladder' to Develop an Outstanding Board Chair

By Jeff Stratton

Preparations for developing a board's top leader need to begin at the board recruitment stage. Here is one way to go about building a career ladder to develop competent leadership in the chair position.

Board chairs are sometimes unprepared for the job. That was a key finding of "Voices of Board Chairs, A National Study on the Perspectives of Board Chairs: How They Prepare for and Perceive Their Role in Relation to the Board," from the Alliance for Nonprofit Management's Governance Affinity Group.

Here is one important finding: 55% of chairs have fewer than three years on the board, with 16% having served less than one year.

Terrie Temkin, CoreStrategies for Nonprofits Inc., said preparations for developing the board's top leader need to begin at the board recruitment stage.

Does this happen at your organization? When a board member is "promoted" to chair without a proper onboarding and education process, the organization often finds itself six months later with a chair who can't do the job, Temkin said. Here's how to go about building a career ladder to develop competent leadership in the chair position:

1. **Start work on chair development early.** Chair prep begins at onboarding. When the board recruits new members, it needs to view every person it recruits as having the potential to become a board chairperson. "That's very important," Temkin said.

   To develop these types of high-quality individuals into board leaders, the board needs strategic programs for board orientation and ongoing board education. "Those are the programs that provide the background about the organization, the knowledge of the mission, the understanding of the community and the organization's impact to board members," Temkin said.

   The orientation should also introduce board members to the governance function, the board's job, and how to do it well, she said.

   "When the ongoing education provided covers these skills or dimensions of board service, people are far more knowledgeable and can use that knowledge in a way that strengthens them when they are in positions of leadership," Temkin said.

   After the onboarding occurs and with a strong education component in place, the organization then should identify early on the board members it wants to groom for board leadership positions.
2. **Provide those identified with opportunities to develop.** Once the organization has selected an individual to groom for leadership positions on the board, he or she needs plenty of chances to grow and develop. This can occur through the opportunity to attend conferences, or through classes at a local community college or a United Way, for example, Temkin said.

   "It would be great if this could be accomplished at the organization's expense, because that would allow all potential leaders to have the experience regardless of their financial situation," she said.

   Realistically, some organizations are opposed to spending on board development philosophically and others won't have the budget, "but it sends a very important message that preparation and education are essential to you as a leader and to the future of the organization," Temkin said.

   For organizations with limited funds for board education, getting creative provides opportunities for board member development. "This can occur at each meeting, in the form of a quick quiz on a topic that gives people a chance to test themselves on what they know," Temkin said. Other ideas:

   - Program tours.
   - Visits to state legislators to work on advocacy.
   - Creating a board education calendar.
   - Bringing in outside expertise.
   - Opportunities for networking.

"These types of opportunities are motivational and help an individual understand the issues at hand while getting excited about a leadership role," she said.

3. **Build a board leader "career ladder."** Building a career ladder for a talented board member requires the organization to provide the necessary opportunities for this individual to take on other leadership positions. This might be chairing a bylaws or planning committee, Temkin said.

   "Those are two committees that would provide incredible background for a potential leader," Temkin said.

   Another option for career ladder building is to ensure those leaders being groomed have a chance to serve on all committees. "You want them to understand inside and out what it takes to run the organization and all of the issues involved," Temkin said.

   More options for building a career ladder for a board chair are in the making:

   - Have the individual take on key roles when the board is reorganizing or the organization is merging with another.
   - Prepare a list of top educational resources for an incoming chair for the individual to review.

   If during the course of career ladder building you sense a lack of enthusiasm or realize you have made the wrong choice, "stop feeding that horse and move onto someone else," Temkin said. "You want someone who is excited about these opportunities. Those are your best leaders."

   Also, you may want to invest in coaching for your top leadership prospects, Temkin said, someone who has experience working with chairs, or a public speaking or meetings expert, if those topics present challenges to these individuals. This "coach" might be a past chair from your or another local organization, Temkin said.

> When the board recruits new members, it needs to view every person it recruits as having the potential to become a board chairperson.

4. **Spend more time with your future leaders as CEO.** The organization should offer opportunities for lunch or breakfast with the CEO to those board members it is grooming for board leadership, Temkin said.

"The past board chair or current chair can be involved here too," Temkin said. "It's an opportunity for everyone to discuss the wide range of topics affecting the organization."

It's also a great opportunity for a potential chair to ask questions of current leaders such as what they wish they had known before taking the position or which skills they wish had been developed more fully before taking on the job, Temkin said. ❑

WRITING FOR *BOARD LEADERSHIP*

***Board Leadership* is looking for articles from governance practitioners, researchers and consultants on topics related to the discovery, explanation and discussion of innovative approaches to board governance. For more information email: skuehne@wiley.com** ❑

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:** Principles, theories, ideas, methodologies and practices.
- **Board governance:** The job of governing whole organizations. ❑

Do No Harm: The Board Member, Personal Expression and Social Media

By Jeff Stratton

In this piece, we cover how to manage board members' political views and other personal expression with their duty to their organizations.

If a board member combines her political views with her service to the organization on Facebook, Twitter or any number of online media, your organization can suffer.

How the board addresses this issue can be tricky, because although a board member has every right to her personal views, if your organization becomes linked to them it can create a negative impression.

The board's leadership should create awareness among board members that there can be unintended consequences to the nonprofit if the board member is airing strong views online. The chair can lead in this area, using the following ideas:

1. **Board members who are active online should make clear with their posts that their views don't represent the organization's.** Nonprofit consultant Carol Weisman (www.boardbuilders.com) believes board members who post controversially on social media can be a problem if they post when they are representing the nonprofit organization. In such instances, they should be asked to take offending posts down, Weisman said.

   This is the type of issue where the board chair should speak directly to the board member who is creating a problem for the organization with controversial views.

   Years back, Weisman worked with an organization whose cause was pediatric cancer. One of the women who served on the board of the organization started a very popular blog with helpful tips for parents of children who had been stricken with pediatric cancer. "It was information such as 'If they tell you to show up at 7:30 a.m., don't come until 8:15 a.m. They aren't ready for you until then' and 'Judy is the best infusion nurse, the worst is....'"

   Parents loved this information, Weisman said, but the hospital hated it being made public.

   But the hospital was a donor to the organization and a partner with it, so the blogger had to shut down the blog. "She could do the blog, but not as a board member, and not while mentioning her organization," Weisman said.

2. **Be careful about trying to limit board members' personal social media.** In these fraught and tense times, people are expressing strong political views, but also expressing themselves personally. This includes board members.

   Christina Green, writing on *frankjkenny.com* in "Should Board Members and Staff Have Personal Lives on Social Media?" says it gets tricky trying to enforce what board members post on social media.

   Green suggests thinking seriously about how much you want to control a board member's personal life. Instead of prohibiting behavior, "use helpful language like: 'Be a connector for the community, not a detractor.' [and] 'Raise yourself and others up in all social media interactions.'"

   For more information, go to frankjkenny.com/should-board-members-have-personal-lives-on-social-media/.

3. **Keep the topic of social media in front of the board with training.** As part of your organization's ongoing board training and education program, suggest the board chair lead the board through a reminder of thoughtful posting on personal social media if representing the organization.

   This activity should be coupled with negative examples from other organizations where board members have led the organization into hot water with their controversial posts.

   "Social Networking and Board Service

   Here are some practical social media posting guidelines for board members:

- Set up two accounts for each medium, one for use as a board member and one for personal postings.
- Avoid social media arguments.
- Alert the CEO and board chair if the trustee notices misrepresentations about the nonprofit on social media.
- Make it clear that the views you express as a board member are yours alone and are not representative of what the nonprofit or board thinks or believes.
- Change settings from "public" to "friends."
- Avoid all direct or indirect political campaign intervention (such as supporting or opposing candidates for public office) in the name of nonprofit XYZ and when using XYZ media.
- Discuss and set expectations as a board.

CALENDAR OF EVENTS

May 16–18, 2018

The Private Company Governance Summit 2018

—Westin City Center, 1400 M St. NW, Washington, DC 20005 USA

This conference will focus on how private and family businesses build an engaged and effective board of directors to copilot through today's turbulence, including blockchain, sexual harassment, cybersecurity, the Amazon effect and more. Learn from directors, business owners, investors and experts who have been there and can guide you on the governance path to success.

For more information, visit privatecompanydirector.com.

June 7–8, 2018

Annual Leadership Development Conference

—Hyatt Regency San Francisco, 5 Embarcadero Center, San Francisco, CA 94111 USA

Learn how practitioners take steps to address critical leadership challenges at all levels of their enterprises. Having direct access to speakers and panelists enables attendees to customize their experience at the conference to solve problems, brainstorm ideas and strengthen their leadership pipelines and the performance of their leaders at all levels of the organization.

For more information, visit conference-board.org.

June 15, 2018 9:30 a.m.–3:00 p.m.

ICSA Charity Governance Conference

—ICSA, Saffron House, 6-10 Kirby St., London, England EC1N 8TS UK

This full-day conference will focus on themes relevant to charities and not-for-profit organizations. It will provide attendees with an insight into the latest thinking and offer a unique opportunity to share ideas and gain valuable knowledge on some of the challenges faced by governance professionals in the sector.

For more information, visit icsa.org.uk.

June 20–22, 2018

Certificate of Nonprofit Board Consulting

—Hyatt House Denver/Lakewood at Belmar, 7310 W. Alaska Dr., Lakewood, CO 80226 USA

To better meet the ongoing need for governance training among nonprofit organizations throughout the country, BoardSource has created the Certificate of Nonprofit Board Consulting. This three-day course is designed to heighten the skills and abilities of those who currently, or would like to, consult and train nonprofit boards of directors on governance issues.

For more information, visit boardsource.org.

June 20–23, 2018

Society for Corporate Governance National Conference

—Renaissance Downtown, 999 9th Street NW, Washington, DC 20001 USA

The Society for Corporate Governance is dedicated to shaping corporate governance through education, collaboration and advocacy. This year's theme is "Building Our Governance Capital."

For more information, visit societycorpgov.org.

June 21–23, 2018

2018 International Policy Governance Association Annual Conference

—Hilton Savannah DeSoto Hotel, 15 East Liberty St., Savannah, GA 31401 USA

This is the annual conference for boards, CEOs and administrators using the Policy Governance® system, and young governance professionals and others exploring good governance. This year's event focuses on exploring governance excellence.

For more information, visit policygovernanceassociation.org.

June 25–28, 2018

International Corporate Governance Network Annual Conference

—Unicredit, Head Office, Piazza, Gae Aulenti 3, 20154 Milan, Italy

For more information, visit icgn.org.

July 10–11, 2018

ICSA Annual Conference: The New Agenda for Governance

—ExCeL, Royal Victoria Dock, 1 Western Gateway, London, England E16 1XL UK

This year's program will explore the implications of the revised U.K. Corporate Governance Code and what it will mean for boards. It will also examine how businesses can prepare for Brexit, alongside a wealth of quality opportunities for professional and personal development.

For more information, visit icsa.org.uk.

Associations

(continued from page 3)

associations are time-intensive (board and committee meetings, advocacy work, attending conferences, etc.).

2. *Value expectations.* In many professions, joining an association was "the right thing to do." And not joining was a social faux pas. Today, return on investment is expected.
3. *Consolidation.* Many industries are emerging with fewer, larger players, which often have the resources to effectively produce their own training programs, research, advocacy efforts and so on.
4. *Generational differences.* Today's young professionals don't value "membership" as did previous generations. They aspire for professional knowledge and success, but they "connect differently."
5. *Competition.* The emergence of smaller specialty associations, in-house programming by consolidated corporations, and online resources all compete for attention, attendance, volunteer time and dues.
6. *Technology.* Coerver and Byers assert that associations have been painfully slow to embrace technology. Such risk aversion inadvertently disenfranchises those more progressively adapting.

Conclusion

"Five radical changes" are proposed in *Race for Relevance* to meet these challenges. The latter four are:

2. Empower the CEO and enhance staff.
3. Rationalize the member market.
4. Rationalize programs, services and activities.
5. Bridge the technology gap and build a framework for the future.

From the lens of most sectors, these are sensible business strategies, but why are they "radical"?

The answer lies in context. The biggest challenges for many associations are not external, but lie within the structures that are hurdles to their own competitiveness. Cognizant that sound governance creates an environment in which management can excel, Coerver and Byers emphatically convey that the first step in the sequence of change must be radical change #1: "Overhaul the Governance Model." ❑

Notes

1. http://www.asaecenter.org/files/FileDownloads/PublicPolicy/Associations-Matter-FINAL.pdf
2. http://www.independentsector.org/uploads/Accountability_Documents/governance_is_governance.pdf
3. Coerver, H., and M. Byers. *Race for Relevance: 5 Radical Changes for Associations* (Washington, DC: ASAE, 2011).
4. Carver, J. *Boards That Make a Difference: A New Design for Leadership in Nonprofit and Public Organizations, 3rd ed.* (San Francisco, CA: Jossey-Bass, 2006).
5. See note 3.

Bill Charney can be contacted at bill@bcharney.com.

FOOD FOR THOUGHT

Teamwork is the ability to work together toward a common vision. The ability to direct individual accomplishments toward organizational objectives. It is the fuel that allows common people to attain uncommon results.

Andrew Carnegie
Business leader and philanthropist
(1835–1919)

BOARD LEADERSHIP
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