

## Executive Summary - Informational

**TO:** State Investment Board  
**FROM:** Dave Hunter  
**DATE:** April 20, 2020  
**SUBJECT:** SIB Meeting Materials – April 24, 2020

The SIB meeting on Friday, April 24<sup>th</sup>, will be held in a virtual manner using video and teleconferencing technology in light of ongoing public health concerns related to the COVID-19 outbreak and cover the following topics:

- Interim Investment Update** – Estimated client returns are generally consistent with their underlying asset allocation with TFFR, PERS and Legacy down approximately 3%, WSI up approximately 3% and Budget Stabilization Fund down approximately 1% for the Fiscal Year To Date (FYTD) July 1, 2019 to April 17, 2020, as summarized below:

Estimated YTD Through 4/17/2020  
 (Actual returns are net of fees; estimates are gross indices)

		TFFR	PERS	Legacy	WSI	Budget Stabilization
Market Value	29-Feb	2,566,905,667	3,170,230,556	6,731,941,268	2,116,255,006	712,481,242
Total Fund Actual through	29-Feb	1.56%	1.56%	2.46%	4.66%	2.67%
Total Fund Policy through	29-Feb	1.10%	1.12%	2.08%	4.25%	2.66%
Est. MTD through	3/31/2020	-8%	-8%	-9%	-4%	-4%
Est. MTD through	4/17/2020	4%	4%	4%	2%	0%
Estimated FYTD Return	4/17/2020	-3%	-3%	-3%	3%	-1%

Although FYTD returns are disappointing, indicative estimates have generally improved in the past month when comparing 4/17 estimates (above) to our prior 3/19 estimates (below).

Estimated YTD Through 3/19/2020  
 (Actual returns are net of fees; estimates are gross indices)

		TFFR	PERS	Legacy	WSI	Budget Stabilization
Market Value	31-Jan	2,680,818,159	3,308,729,753	6,915,413,432	2,135,747,745	678,180,739
Total Fund Actual through	31-Jan	5.85%	5.87%	6.17%	5.62%	2.30%
Total Fund Policy through	31-Jan	5.40%	5.31%	5.78%	4.93%	1.83%
Est. MTD through	2/29/2020	-4%	-4%	-4%	-1%	1%
Est. MTD through	3/19/2020	-14%	-14%	-14%	-8%	1%
Estimated FYTD Return	3/19/2020	-12%	-12%	-12%	-4%	4%

March & April returns are rough indicative estimates based on underlying benchmark data, not actual results. All estimates are preliminary, unaudited and subject to material change.

2. **Portfolio Rebalancing Update** – On March 27<sup>th</sup>, the SIB approved a recommendation to engage Parametric to assist us in synthetically rebalancing fund exposures in an efficient and cost effective manner. The SIB previously engaged Parametric to synthetically rebalance client portfolios in 2008 in order to maintain target asset class exposures during a period of extreme market volatility. Overlay programs effectively rebalance investments towards long term strategic asset allocation targets via the use of equity and fixed income futures contracts. Exchange traded futures are widely used by institutional investors to prevent a disadvantaged sale of physical securities during a period of distressed pricing, poor liquidity and/or wide bid-ask spreads. **RIO will provide a status update of rebalancing actions noting the Pension Pool, Insurance Pool and Legacy Fund have been rebalanced to within 1% to 3% of SIB client board approved targets.**
3. **SIB Client Updates** – RIO will provide an update of recent discussions with our SIB clients including those relating to reductions in future investment return assumptions and/or significant available liquidity in the Legacy and Budget Stabilization Funds.
4. **Executive Review Committee Update** – **The Executive Review Committee will request the SIB to review and approve the ED/CIO performance evaluation results for the past year.** The Committee will also review and discuss ED/CIO compensation levels versus other U.S. public pension plan peers while specifically excluding any market compensation data from the private sector.
5. **RIO Agency Update** – RIO will provide a succession planning update for RIO's Deputy Executive Director and highlight recent efforts to hire a new Retirement Benefits Counselor (noting the later vacancy was created when Denise Weeks was promoted to Retirement Program Manager on March 1). RIO will also discuss recent actions taken by the agency to address ongoing public health concerns of the COVID-19 outbreak and its impact on agency operations while remaining fully functional. RIO will express their sincere gratitude to Fay Kopp, who will retire as RIO's Deputy Executive Director and Chief Retirement Officer after over 32 years of exceptional and dedicated public service on April 30.



## ND STATE INVESTMENT BOARD MEETING

Friday, April 24, 2020, 9:00 a.m.

RIO Conference Room (**Virtual Meeting Host**)

**Teleconferencing - 701.328.7950 Participant Code – 696855#**

**3442 East Century Avenue, Bismarck, ND**

### **REVISED AGENDA**

**I. CALL TO ORDER AND ACCEPTANCE OF AGENDA**

**II. ACCEPTANCE OF MINUTES (March 27, 2020)**

**III. INVESTMENTS**

- A. Interim Investment Update – Mr. Hunter (15 minutes) *Informational*
- B. Portfolio Rebalancing Update – Mr. Schulz (10 minutes) *Informational*
- C. SIB Client Updates (Pension Clients & Legacy Fund) - Mr. Hunter (10 minutes) *Informational*  
(verbal)

**IV. GOVERNANCE / EDUCATION**

- A. Executive Review Committee Update - Ms. Yvonne Smith (20 minutes) *Informational*
  - 1. ED/CIO Performance Evaluation **Board Action Requested**
  - 2. ED/CIO Compensation Review & Discussion *Informational*
  - 3. ED/CIO Compensation Recommendation **Board Action Requested**
- B. RIO Agency Update – Mr. Hunter (10 minutes) *Informational* (verbal)

**V. OTHER**

SIB Securities Litigation Committee - May 19, 2020, 1:00 p.m. - RIO Conference Room  
SIB Audit Committee - May 21, 2020, 3:00 p.m. - RIO Conference Room  
SIB - May 22, 2020, 8:30 a.m. – RIO Conference Room

**VI. ADJOURNMENT**

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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 27, 2020, BOARD MEETING**

**MEMBERS PRESENT:** Brent Sanford, Lt. Governor, Chair  
Rob Lech, TFFR Board, Vice Chair  
Bryan Klipfel, Director of WSI  
Troy Seibel, PERS Board, Parliamentarian  
Toni Gumeringer, TFFR Board  
Keith Kempenich, Legacy/Budget Stab. Adv. Board  
Adam Miller, PERS Board  
Mel Olson, TFFR Board  
Kelly Schmidt, State Treasurer  
Jodi Smith, Commissioner of Trust Lands  
Yvonne Smith, PERS Board

**MEMBERS ABSENT:** Jon Godfread, Insurance Commissioner

**STAFF PRESENT:** Eric Chin, Chief Risk Officer/Senior CIO  
Connie Flanagan, Chief Financial Officer  
Ann Griffin, Investment Accountant  
Bonnie Heit, Admin Svs Suprv  
David Hunter, Exec Dir/CIO  
Fay Kopp, Dep Exec Dir/CRO  
Matt Posch, Investment/Compliance Officer  
Sara Sauter, Suprv of Internal Audit  
Darren Schulz, Dep CIO  
Susan Walcker, Senior Financial Accountant

**GUESTS:** Alex Browning, Callan LLC  
Paul Erlendson, Callan LLC  
Ben Lazarus, Parametric  
Thomas Lee, Parametric  
Bob McConnell, City of Bismarck

**CALL TO ORDER:**

Lt. Governor Sanford, Chair, called the State Investment Board (SIB) regular meeting to order at 9:00 a.m. on Friday, March 27, 2020. The virtual meeting was held at the Retirement and Investment Office, 3442 East Century Avenue, Bismarck, ND with the majority of the participants attending remotely.

**AGENDA:**

The Board considered the agenda for the March 27, 2020, meeting,

**IT WAS MOVED BY DR. LECH AND SECONDED BY MR. OLSON AND CARRIED BY A VOICE VOTE TO ACCEPT THE AGENDA FOR THE MARCH 27, 2020, MEETING.**

**AYES: COMMISSIONER SMITH, TREASURER SCHMIDT, MR. MILLER, MR. OLSON, MR. KLIPFEL, MS. GUMERINGER, MR. SEIBEL, DR. LECH, MS. SMITH, AND LT. GOVERNOR SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: COMMISSIONER GODFREAD**

**MINUTES:**

**IT WAS MOVED BY MS. SMITH AND SECONDED BY DR. LECH AND CARRIED BY A VOICE VOTE TO APPROVE THE FEBRUARY 28, 2020, MINUTES AS DISTRIBUTED.**

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

#### INVESTMENTS:

Mr. Hunter highlighted returns for the five largest SIB clients for the period ending March 25, 2020. Estimated client returns are consistent with their underlying asset allocation with Teachers' Fund for Retirement (TFFR), Public Employees Retirement System (PERS) down approximately 9 percent, Legacy Fund down approximately 8 percent, Workforce Safety & Insurance down about 1 percent, and the Budget Stabilization Fund up approximately 4 percent from July 1, 2019 - March 25, 2020. Funds with higher equity allocations are more adversely impacted by the recent severe equity market decline. TFFR, PERS, and Legacy Fund have target allocations to public equities of 52 percent, 51 percent, and 50 percent, respectively, while TFFR and PERS have target private equity allocations of 6 percent and 7 percent, respectively.

Callan LLC representatives also provided a general market analysis.

Mr. Hunter also reviewed recent asset class returns and the speed and severity of the current market decline in comparison to prior market corrections. He reviewed S&P 500 returns in the 12 months following the last seven major downturns, dating back to Black Monday in 1987, and highlighted the historical benefits of staying invested for the last 20 years which included the March 2000 Tech Bubble, 2007 Financial Crisis, 2011 U.S. Credit Downgrade, and 4<sup>th</sup> quarter 2018 Trade War. Mr. Hunter reminded the board that the goal is to remain invested and remain focused on the long term asset allocation policies.

Mr. Hunter updated the Board on proxy voting negotiations with Broadridge Financial Solutions and the SIB's custodian - The Northern Trust (TNT). Investment personnel continue to work with both entities to develop a practical and cost efficient process to enhance staff's ability to efficiently monitor the proxy voting policies, practices and actions of the SIB's equity managers in order to gain assurance that the managers are materially aligned with the investment beliefs of the SIB and the best interests of the SIB's stakeholders and constituents. Mr. Hunter hopes to finalize the process between the two entities soon and will provide a future update.

Parametric - Mr. Hunter updated the board on the Parametric overlay program. Due to a sharp selloff in global equities in recent weeks amid the novel coronavirus pandemic, the three primary SIB investment pools have experienced variances from equity target allocations that are approaching policy lower bounds. Given liquidity challenges in bond markets globally, the cost to transact in physical bonds is prohibitively expensive, which restricts institutions from using bonds as a source of funds to rebalance into public equities. Futures contracts remain a liquid and relatively inexpensive way to access public market exposure synthetically. The overlay program is similar to Board action undertaken during the depths of the Global Financial Crisis in 2008 and generated \$100 million of net investment gains for the SIB's clients when used to synthetically rebalance exposures.

Parametric representatives reviewed the firm's overlay services and the benefits of using an equity and fixed income overlay program to synthetically rebalance fund exposures in an efficient and cost effective manner.

After the review, staff recommended the following:

The SIB engage Parametric to establish a synthetic rebalancing overlay program that could be activated should market conditions persist. The goal is to have a timely, efficient and inexpensive rebalancing solution to supplement trading in physical markets, which in the case of fixed income has seen a deterioration of liquidity, challenging price discovery, wide bid-ask spreads, and dramatically higher transaction costs.

**IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION TO RETAIN PARAMETRIC TO ESTABLISH A CONTINGENT FUTURES OVERLAY PROGRAM.**

**AYES: TREASURER SCHMIDT, MS. GUMERINGER, MR. KLIPFEL, COMMISSIONER SMITH, MS. SMITH, DR. LECH, MR. MILLER, MR. SEIBEL, MR. OLSON, AND LT. GOVERNOR SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: COMMISSIONER GODFREAD**

SIB Client (New) - At the January 24, 2020, meeting, the SIB authorized staff to work towards accepting the Office of the State Treasurer as an investment client in relation to the ND Veterans' Cemetery Trust Fund. The Industrial Commission, at their March 9, 2020, meeting, approved the relationship per NDCC 21-10-06.

Staff recommended the SIB formally accept the Office of the State Treasurer as a contractual investment client for the Veterans' Cemetery Trust Fund along with their Investment Policy Statement.

**IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY DR. LECH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION.**

**AYES: MS. SMITH, MR. MILLER, MR. OLSON, MS. GUMERINGER, DR. LECH, MR. SEIBEL, MR. KLIPFEL, COMMISSIONER SMITH, TREASURER SCHMIDT, AND LT. GOVERNOR SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: COMMISSIONER GODFREAD**

#### **GOVERNANCE:**

Executive Review Committee (ERC) - The board-assessment and trustee-assessment results were presented by Ms. Sauter. There was 100 percent participation. On a 4.0 scale there were no ratings below 3.0. Generally, overall comments were positive for both portions.

Discussion followed on the results and areas that need improvement.

**IT WAS MOVED BY MS. GUMERINGER AND SECONDED BY MR. OLSON AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE BOARD-ASSESSMENT AND TRUSTEE-ASSESSMENTS.**

**AYES: TREASURER SCHMIDT, MR. SEIBEL, MR. OLSON, COMMISSIONER SMITH, DR. LECH, MR. MILLER, MS. GUMERINGER, MS. SMITH, MR. KLIPFEL, AND LT. GOVERNOR SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: COMMISSIONER GODFREAD**

The ERC requested Ms. Sauter to send out the Executive Director/CIO survey on March 19, 2020, with a due date of April 2, 2020.

The ERC will present a summary of the Executive Director/CIO survey, RIO employee survey, and Executive Limitations along with a compensation recommendation at the April 24, 2020, meeting.

Agency Update - Mr. Hunter informed the board the office is fully functional. The office is closed to the public and most non-managerial positions are working remotely.

The Deputy Executive Director/Chief Retirement Officer position was reposted on March 9, 2020, with a closing date of April 9, 2020.

The Retirement Program Manager position was accepted by Ms. Denise Weeks, effective March 1, 2020. RIO will be posting a Retirement Programs Specialist vacancy in the near future.

The Investment Accountant position has been filled by Ms. Ann Griffin, effective March 2, 2020.

The office website is still moving forward with processes being automated.

The Pension Administration System has not had as much time devoted to it but staff hopes to get back on schedule once the critical issues are addressed.

Mr. Hunter stated he is pleased on how the office is running considering the challenging times RIO and everyone else is working through.

**OTHER:**

The next meeting of the SIB Executive Review Committee has been scheduled for April 13, 2020, at 8:30 a.m. at the Retirement and Investment Office.

The next meeting of the SIB for regular business has been scheduled for April 24, 2020, at 8:30 a.m., at the State Capitol, Ft. Union Room.

The next meeting of the SIB Securities Litigation Committee is scheduled for May 19, 2020, at 1:00 p.m. at the Retirement and Investment Office.

The next meeting of the SIB Audit Committee is scheduled for May 21, 2020, at 3:00 p.m. at the Retirement and Investment Office.

**ADJOURNMENT:**

With no further business to come before the SIB, Lt. Governor Sanford adjourned the meeting at 10:35 a.m.

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Lt. Governor Brent Sanford, Chair  
State Investment Board

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Bonnie Heit  
Recorder

# SIB Interim Investment Report

For the Periods Ended December 31, 2019 and February 29, 2020  
**Preliminary Indicative Return Estimates as of April 17, 2020**

April 20, 2020

Note: This document contains unaudited data which is deemed to be materially accurate, but is unaudited and subject to change.

Dave Hunter, Executive Director/CIO

Fay Kopp, Deputy Executive Director / Chief Retirement Officer

Darren Schulz, Deputy Chief Investment Officer

Connie Flanagan, Chief Financial Officer

Eric Chin, Chief Risk Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)



# State Investment Board – Five Largest Clients

## Interim FYTD Estimated Returns – April 17, 2020

Interim estimated FYTD investment returns for the SIB's five largest clients are deemed to be largely consistent with underlying asset allocations and summarized below on a fiscal year to date basis through April 17, 2020:

Estimated YTD Through 4/17/2020

(Actual returns are net of fees; estimates are gross indices)

		TFFR	PERS	Legacy	WSI	Budget Stabilization
Market Value	29-Feb	2,566,905,667	3,170,230,556	6,731,941,268	2,116,255,006	712,481,242
Total Fund Actual through	29-Feb	1.56%	1.56%	2.46%	4.66%	2.67%
Total Fund Policy through	29-Feb	1.10%	1.12%	2.08%	4.25%	2.66%
Est. MTD through	3/31/2020	-8%	-8%	-9%	-4%	-4%
Est. MTD through	4/17/2020	4%	4%	4%	2%	0%
Estimated FYTD Return	4/17/2020	-3%	-3%	-3%	3%	-1%

March and April returns are rough indicative estimates based on underlying benchmark data (not actual results) and all amounts are preliminary, unaudited and subject to change.

### Interim Investment Overview for the Fiscal Year To Date as of April 17, 2020

1. SIB client investments peaked in mid-February of 2020 given strong capital market and economic conditions which generated \$2.3 billion of net investment income in 2019 including an 18% investment return for TFFR, PERS & Legacy.
2. Based on preliminary market data which is unaudited and subject to material change, TFFR, PERS and Legacy Fund returns are roughly estimated to approximate -3% on a fiscal year to date basis as of April 17, 2020. SIB client returns are assumed to be largely consistent with their underlying asset allocation benchmarks in March and April.
3. SIB clients are long-term investors who understand asset allocation is the #1 driver of returns and diversifying investments in fixed income and real assets serve to moderate return volatility inherent in the equity markets.

# State Investment Board – Pension Clients

## Interim Fiscal Year to Date Estimated Returns – April 17, 2020

Interim estimated investment returns for the SIB's seven Pension clients are deemed to be largely consistent with underlying asset allocations and summarized below on a fiscal year to date basis through April 17, 2020:

Estimated YTD Through 4/17/2020

(Actual returns are net of fees; estimates are gross indices)

		TFRR	PERS	Job Service	Bismarck Employees	Bismarck Police	Grand Forks	Grand Forks Parks
Market Value	29-Feb	2,566,905,667	3,170,230,556	96,519,452	105,607,817	41,969,957	65,014,117	7,285,152
Total Fund Actual through	29-Feb	1.56%	1.56%	2.46%	2.47%	2.02%	1.69%	2.09%
Total Fund Policy through	29-Feb	1.10%	1.12%	2.87%	1.91%	1.49%	1.24%	1.47%
Est. MTD through	3/31/2020	-8%	-8%	-3%	-7%	-8%	-9%	-8%
Est. MTD through	4/17/2020	4%	4%	3%	3%	4%	5%	4%
Estimated FYTD Return	4/17/2020	-3%	-3%	2%	-2%	-3%	-3%	-2%

March and April returns are rough indicative estimates based on underlying benchmark data (not actual results) and all amounts are preliminary, unaudited and subject to change.

**Pension Funds:** Interim estimated fiscal year to date returns as of April 17, 2020, are down at least 2% to 3% for most SIB Pension clients with a target asset allocation to equities ranging from 50% to 60%. Job Service with an asset allocation of 20% equity and 80% fixed income is estimated to be up roughly 2% due to this plan being de-risked in recent years (with a funded ratio over 140% using a 4.5% return assumption).

# State Investment Board – Non-Pension Clients

## Interim Estimated Returns – April 17, 2020

Interim estimated returns for Non-Pension clients are deemed to be largely consistent with their underlying asset allocation and summarized below on fiscal year to date basis from July 1, 2019 through April 17, 2020, although short term fixed income returns will trail benchmarks in March due to corporate credit exposure.

Estimated YTD Through 4/17/2020

(Actual returns are net of fees; estimates are gross indices)

		PERS Retiree Health (SEI)	Fire & Tornado	Bonding	Insurance Reg	Petroleum Tank	Risk Mgmt Risk Mgmt	Risk Mgmt WC	NDACo
Market Value	29-Feb	138,350,062	23,368,334	3,763,046	1,085,848	6,230,950	4,491,573	5,025,740	6,585,540
Total Fund Actual thru	29-Feb	1.75%	3.47%	4.25%	3.00%	3.95%	4.24%	3.84%	3.99%
Total Fund Policy through	29-Feb	1.75%	3.28%	4.04%	2.33%	3.79%	4.31%	3.99%	3.72%

Est. MTD through	3/31/2020	▼ -10%	▼ -6%	▼ 0%	▼ -5%	▼ 0%	▼ -5%	▼ -6%	▼ -5%
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Est. MTD through	4/17/2020	▼ 6%	▼ 4%	▼ 1%	▼ 3%	▼ 1%	▼ 4%	▼ 5%	▼ 4%
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Est. FYTD Return	4/17/2020	-3%	1%	5%	1%	5%	3%	2%	2%
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		Bismarck Def.Sick	Board of Medicine	Cultural Endowment	FargoDome	Tobacco	Parks & Rec.	PERS Group Ins	AG Settlement
Market Value	29-Feb	761,706	2,440,719	485,318	43,982,070	7,490,321	781,839	31,785,382	1,150,155
Total Fund Actual thru	29-Feb	4.14%	3.64%	2.14%	2.42%	2.27%	4.07%	1.82%	1.74%
Total Fund Policy through	29-Feb	3.84%	3.24%	2.28%	2.17%	2.08%	3.63%	1.82%	1.96%

Est. MTD through	3/31/2020	▼ -5%	▼ -4%	▼ -9%	▼ -9%	▼ 1%	▼ -6%	▼ -4%	▼ -4%
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Est. MTD through	4/17/2020	▼ 3%	▼ 3%	▼ 6%	▼ 5%	▼ 0%	▼ 4%	▼ 0%	▼ 0%
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Est. FYTD Return	4/17/2020	3%	2%	-2%	-2%	3%	2%	-2%	-2%
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**BlackRock®**

# North Dakota Retirement and Investment Office

*Recent Market Volatility & Scenario Analysis*

# Overview & Methodology

*We analyzed ~70 US Public Pensions asset exposures to estimate the impact of recent market volatility on asset portfolios and funded status. We further assessed the stressed asset allocations using potential future market scenarios to help determine the effects of rebalancing to original weights versus letting portfolios drift with markets.*

*The analysis leverages the Aladdin® risk model to estimate the portfolio's ex - ante risk factor decomposition and estimated PnL in stress scenarios.*



## **Model Public Pension Allocations on the Aladdin® platform**

Partner with Pensions & Investments (P&I) to aggregate investment data of 69 US Public Pensions; map fund exposures to public index and private market proxies

## **Analyze Asset Class and Portfolio Risk and Stress**

Measure impact on current portfolio exposure

## **Estimate impact on funded status**

Imply actuarial asset changes from portfolio asset losses stress while assuming liabilities remain constant

## **Determine 'stressed' portfolio allocations**

Calculate new portfolio exposure based on asset class PnL

## **Assess implications of rebalancing vs. drifting with the market**

Evaluate impact of different shaped recoveries on investment portfolio and funded status under different rebalancing methodologies

# US Public Pension Universe

Alaska Retirement Management Board | Arkansas Public Employees Retirement System | Arkansas Teachers Retirement System | Austin City Employees' Retirement System | Boston Retirement System | California State Teachers' Retirement System | Chicago Teachers Pension Fund | City & County of San Francisco Employees' Retirement System | City of Dallas Employee Retirement Fund | City of Los Angeles Department of Fire & Police Pensions | City of Milwaukee Employees' Retirement System | City of Orlando | Commonwealth of Pennsylvania State Employees' Retirement System | Contra Costa County Employees' Retirement Association | Dallas Police & Fire Pension System | District of Columbia Retirement Board | Employees' Retirement System of Rhode Island | Employees Retirement System of Texas | Employees' Retirement System of the State of Hawaii | Fairfax County | Fort Worth City Employees' Retirement Fund | Fresno County Employees' Retirement Association | Houston Municipal Employees Pension System |

69

plans

included in our  
universe

\$2.1

trillion+

assets modeled and  
analyzed on  
Aladdin®

\$30.3

billion

average market value  
of plan assets  
*ranging from*  
*\$1.2B to \$214.9B*  
*with a median of \$15.6B*

~72

percent

average funded  
status of plans  
*ranging from*  
*33% to 108%*  
*with a median of 76%*

Houston Police Officers' Pension System | Illinois Municipal Retirement Fund | Illinois State Board of Investment | Illinois State Universities Retirement System | Indiana Public Retirement System | Iowa Public Employees' Retirement System | Kansas Public Employees Retirement System | Kentucky Retirement Systems | Los Angeles City Employees' Retirement System | Los Angeles County Employees Retirement Association | Los Angeles Water & Power Employees' Retirement Plan | MAPension Reserves IMB | Maryland State Retirement & Pension System | Minnesota State Board of Investment | Montana Board of Investments | Montgomery County Public Schools Retirement System Trust | New Hampshire Retirement System | New Mexico Educational Retirement Board | New York City Retirement System | New York State Common Retirement Fund | New York State Teachers' Retirement System | North Dakota State Investment Board | Ohio Police & Fire Pension Fund | Ohio Public Employees Retirement System | Oklahoma Public Employees Retirement System | Orange County Employees Retirement System | Philadelphia Public Employees Retirement System | Public Employees Retirement Association of New Mexico | Public Employees' Retirement System of Nevada | Public Employees' Retirement System of Mississippi | Sacramento County Employees' Retirement System | San Bernardino County Employees' Retirement Association | San Diego City Employees' Retirement System | San Diego County Employees Retirement Association | San Mateo County Employees' Retirement Association | Santa Barbara County Employees' Retirement System | School Employees Retirement System of Ohio | South Carolina Retirement System | South Dakota Investment Council | State of Michigan Retirement Systems | Teachers' Retirement System of Louisiana | Teachers' Retirement System of Oklahoma | Teachers' Retirement System of the State of Illinois | Texas County & District Retirement System | Texas Municipal Retirement System | Ventura County Employees' Retirement Association

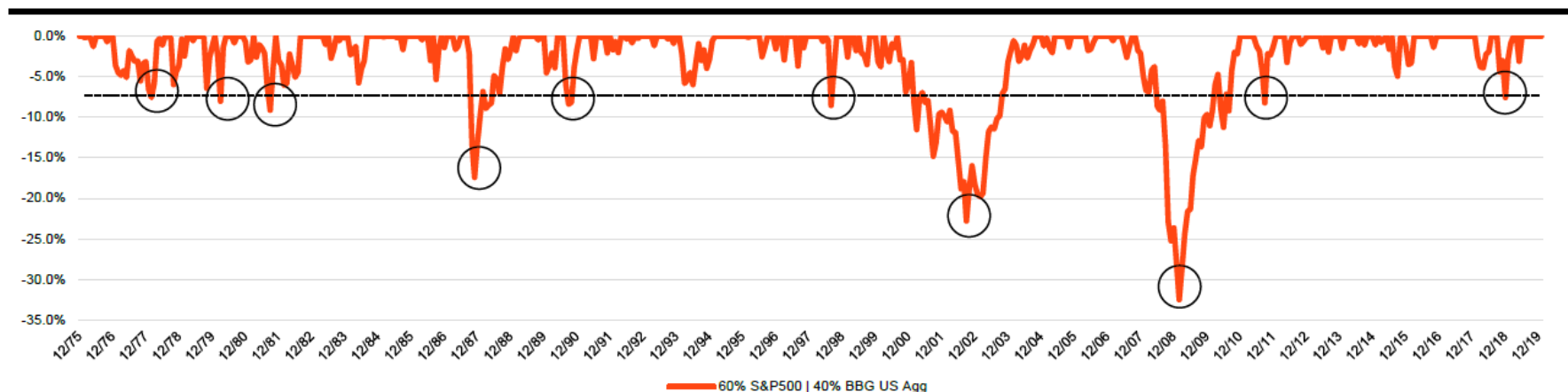
**A 100% Recovery will occur, the question is not “if”, but “when”.**

## Historical Drawdowns & Recoveries

*Over the last 40+ years, the average drawdown of a hypothetical 60%/40% portfolio occurred over a period of ~8 months and recovered over the following ~8 months*

Client  
Insight  
Unit

### Historical Drawdowns (%)



### Drawdown Information (Drawdowns greater than 7.5%)

Max Drawdown Period	Average	Jan-77 Feb-78	Feb-80 Mar-80	Apr-81 Sep-81	Sep-87 Nov-87	Aug-90 Sep-90	Jul-98 Aug-98	Sep-00 Sep-02	Nov-07 Feb-09	May-11 Sep-11	Oct-18 Dec-18
Max Drawdown Return, %	-13.02	-7.55	-8.03	-9.15	-17.42	-8.39	-8.53	-22.81	-32.53	-8.23	-7.56
Max Drawdown Duration (Month)	7.8	14	2	6	3	2	2	25	16	5	3
Recovery Period	NA	Mar-78 Jul-78	Apr-80 May-80	Oct-81 Nov-81	Dec-87 Jan-89	Oct-90 Jan-91	Sep-98 Oct-98	Oct-02 Oct-04	Mar-09 Dec-10	Oct-11 Jan-12	Jan-19 Mar-19
Recovery Percent, %	100	100	100	100	100	100	100	100	100	100	100
Recovery Duration (Month)	8.3	5	2	2	14	4	2	25	22	4	3

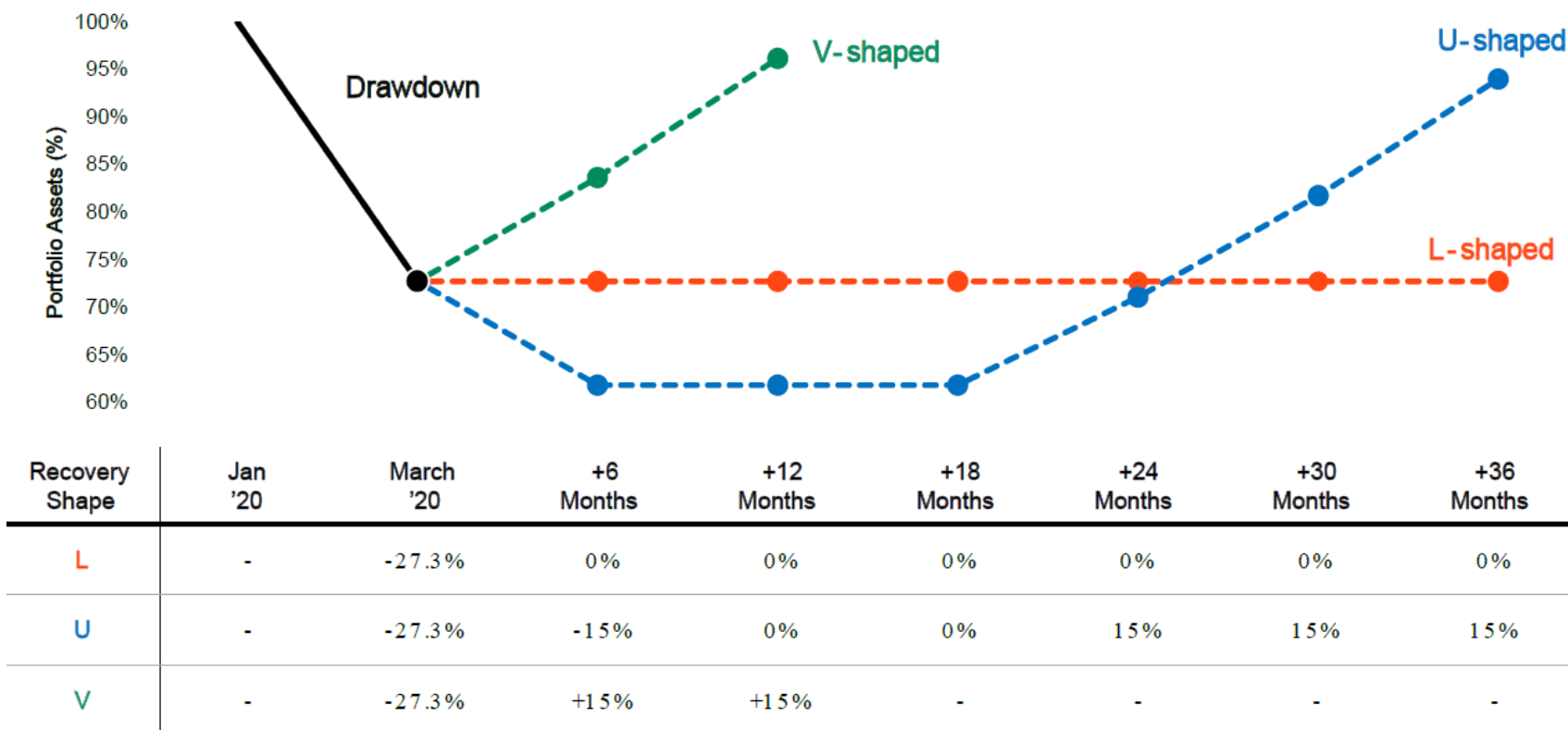


**A substantial recovery in 12 months under a V-shaped scenario and 36 months under a U-shaped recovery, but not in an L-shaped recovery.**

## Recovery Scenarios

Client  
Insight  
Unit

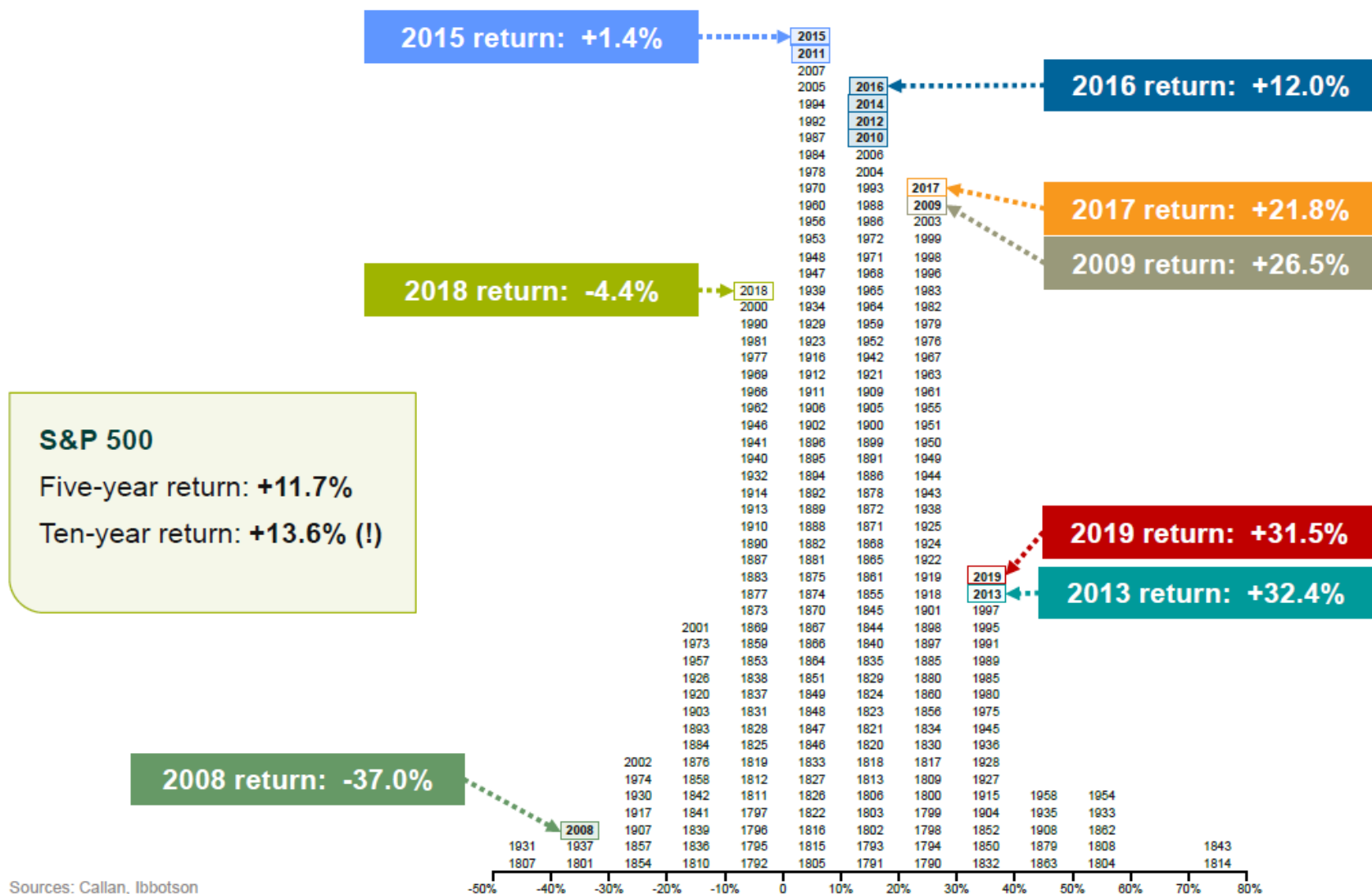
### Recovery Shapes and Sizes





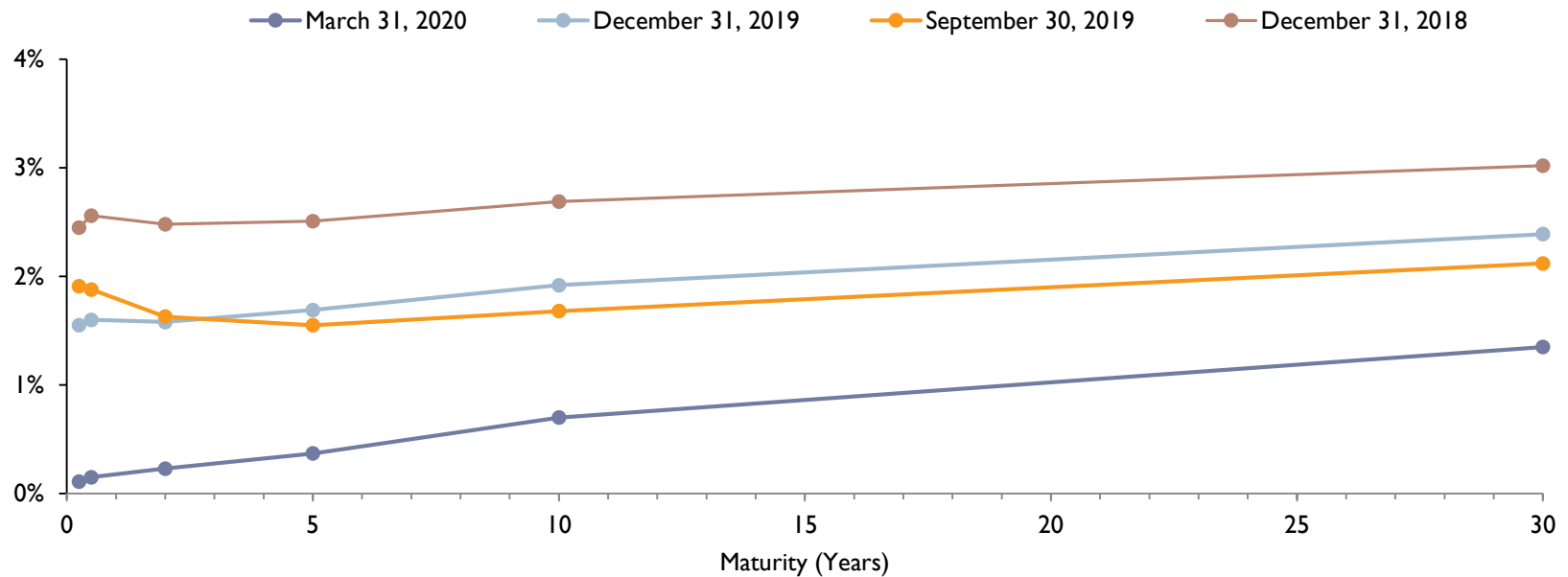
# Stock Market Returns by Calendar Year

2019 performance in perspective: History of the U.S. stock market (230 years of returns)



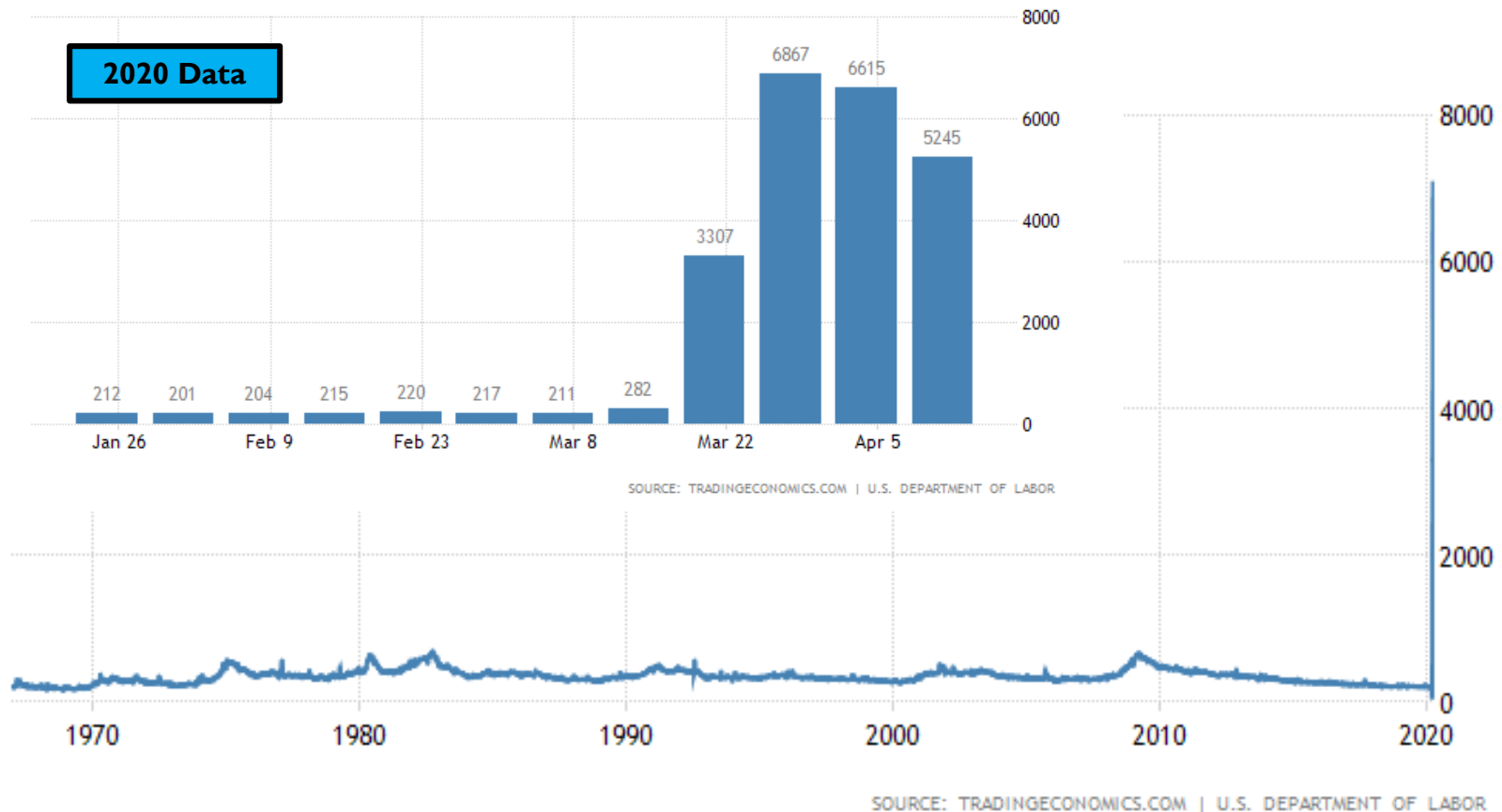
# U.S. Treasury Yield Curves

## U.S. Treasury Yield Curves



	1 Mo	2 Mo	3 Mo	6 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
12/31/2019	1.48	1.51	1.55	1.6	1.59	1.58	1.62	1.69	1.83	1.92	2.25	2.39
03/31/2020	0.05	0.12	0.11	0.15	0.17	0.23	0.29	0.37	0.55	0.70	1.15	1.35
Difference	(1.43)	(1.39)	(1.44)	(1.45)	(1.42)	(1.35)	(-1.33)	(-1.32)	(-1.28)	(-1.22)	(-1.10)	(-1.04)

# Unemployment Claims Spiked After Social Distancing Imposed



The number of Americans filling for unemployment benefits was 5.245 million in the week ended April 11, down from the previous week's 6.615 million and compared to market expectations of 5.105 million. **The latest figure brought the total reported over the past month to 22 million, as the coronavirus pandemic swept across the US. The 4-week moving average, which removes week-to-week volatility, jumped to an all-time high of 5.509 million, while continuing jobless claims hit a record 11.976 million in the week ended April 4.**

## Fiscal Policy Response – CARES Act

Signed into law on March 27, 2020

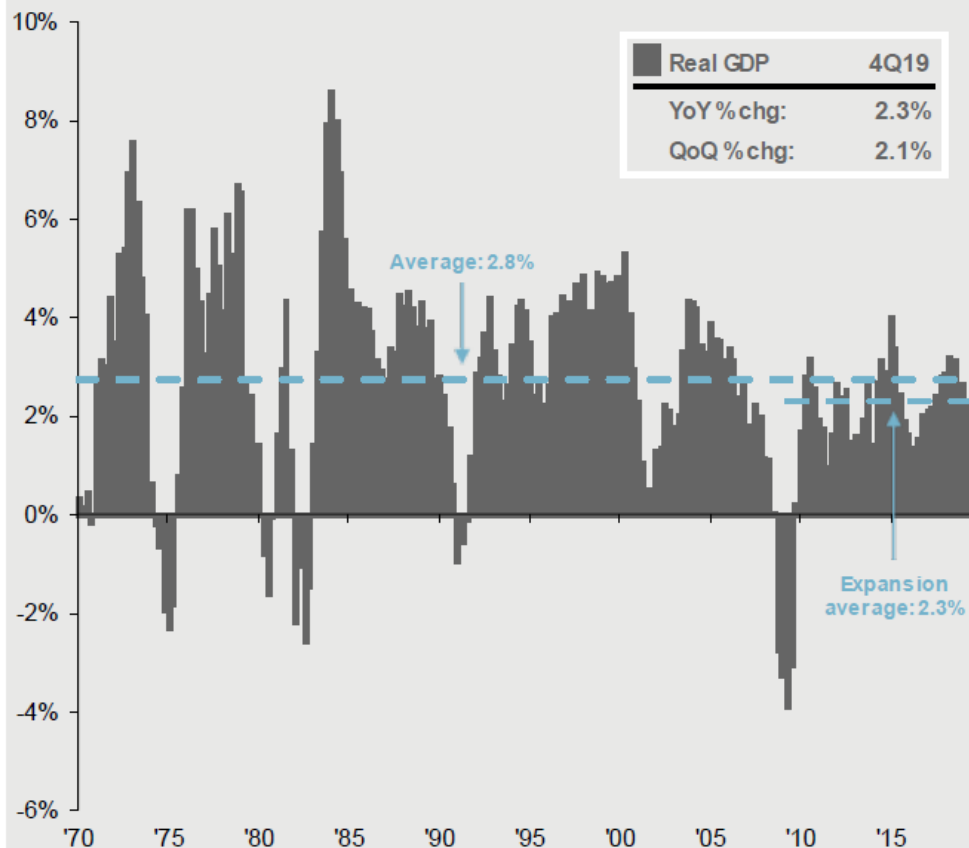
### Coronavirus Aid, Relief, and Economic Security Act

Amount (\$ bn)	Measure
\$290	One-time stimulus checks amounting to \$1,200 per adult and \$500 per child up to certain income limits
\$260	Enhanced, expanded and extended unemployment benefits, adding \$600 per week to every unemployment check for 4 months, expanding program to cover contractors and self-employed and extending program to 39 weeks from 26 weeks
\$510	Loans to distressed businesses, cities and states. Includes \$29 billion for airlines, \$17 billion for firms deemed important for national security and \$454 billion as backstop for loans to other businesses, cities and states
\$377	Small business relief, largely in the form of "forgivable loans" for spending on payroll, rent and utilities
\$150	Direct aid to state and municipal governments
\$180	Health-related spending
\$516	Other spending and tax breaks
<b>\$2.283 trillion</b>	<b>~10.8% of GDP</b>

## GDP and the Role of the Consumer

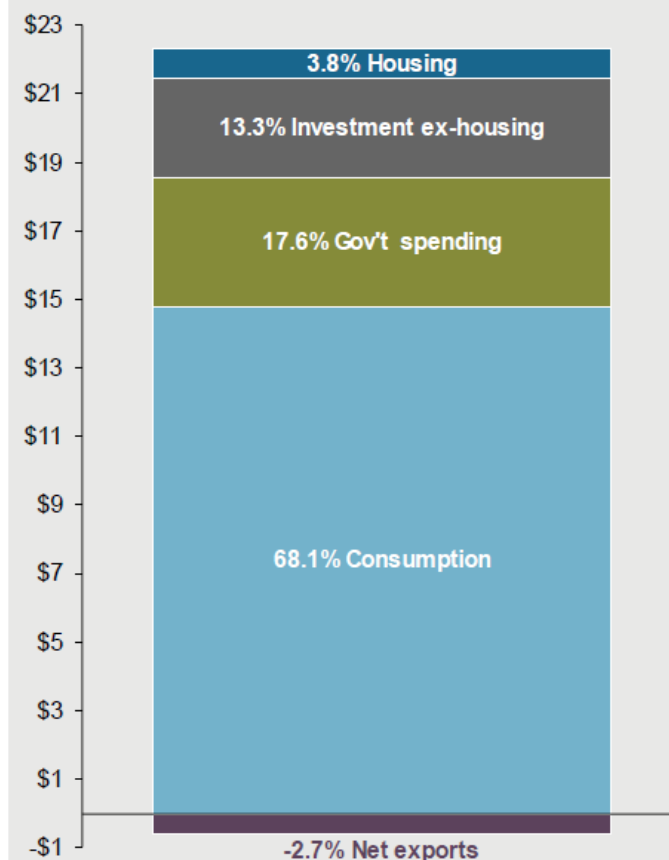
### Real GDP

Year-over-year % change



### Components of GDP

4Q19 nominal GDP, USD trillions



# The S&P 500 has experienced significant market rebounds following the last seven major market downturns since Black Monday in 1987

## Focus on the Long Term

Market rebounds can be swift and powerful

History shows that financial markets tend to go up over time. Only by staying invested can investors participate in the full breadth of the ensuing recovery.

### 12-month performance following major declines

S&P 500 biggest declines	Black Monday 8/25/87- 12/4/87	Gulf War 7/16/90- 10/11/90	Asia Crisis 7/17/98- 9/31/98	Tech Bubble 3/27/00- 10/9/02	Financial Crisis 10/9/07 -3/9/09	US Credit Downgrade 3/10/11- 10/3/11	Trade War 10/3/18- 12/24/18
% decline	-33.5%	-19.9%	-19.3%	-49.0%	-56.8%	-19.0%	-19.6%
Next 12 months	+21.4%	+29.1%	+37.9%	+33.7%	+68.6%	+32.0%	+37.1%

Source: BlackRock; March 12, 2020

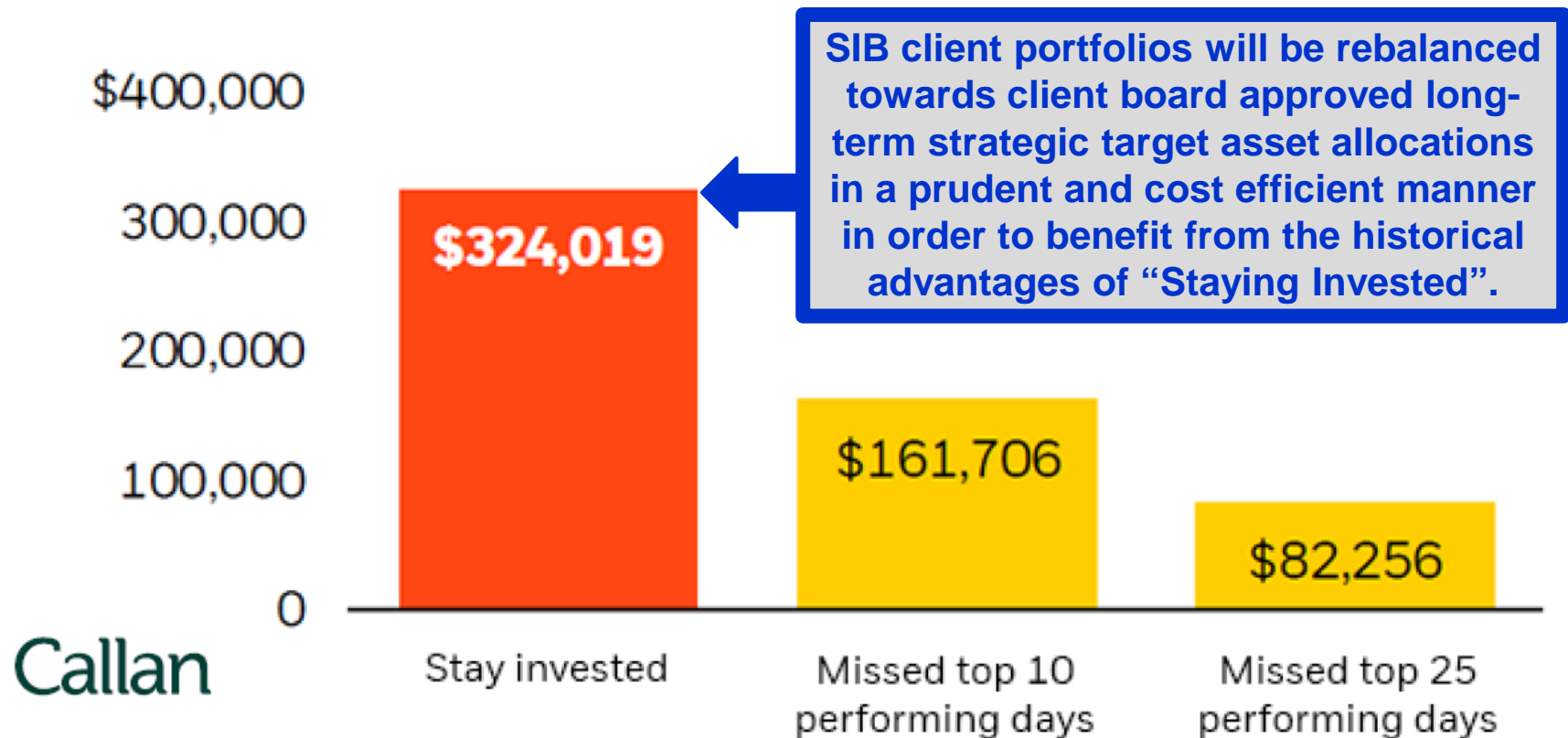
Source: Morningstar as of 2/28/20. Returns are principal only not including dividends. U.S. stocks represented by the S&P 500 Index. Past performance does not guarantee or indicate future results. Index performance is for illustrative purposes only. You can't invest directly in an index.

# The Impact of “Missing the Top Ten Days” the last 20-years is over 50% Action: RIO will rebalance our SIB client portfolios to “Stay Invested”

## Focus on the Long Term

Timing market cycles is nearly impossible to do with any consistency

Hypothetical return of \$100,000 invested in the S&P 500 Index over a 20-year period (March 2000 to March 2020), versus the return if the 10 and 25 top-performing days were missed.



Callan

## Informational

TO: State Investment Board

FROM: Dave Hunter, Darren Schulz and Eric Chin

DATE: April 20, 2020

SUBJECT: Portfolio Rebalancing Update

**Background:**

On March 27<sup>th</sup>, the SIB approved a recommendation to engage Parametric to assist us in synthetically rebalancing fund exposures in an efficient and cost effective manner. Overlay programs effectively rebalance investments towards long term strategic asset allocation targets via the use of equity and fixed income futures contracts. Exchange traded futures are commonly used by institutional investors to prevent a disadvantaged sale of physical securities during a period of distressed pricing, poor liquidity and/or wide bid-ask spreads. The SIB previously engaged Parametric to synthetically rebalance assets in 2008 in order to maintain target asset class exposures during a period of extreme market volatility. **The Pension Pool, Legacy Fund and Insurance Pool were within 1% to 3% of SIB client board approved asset allocation targets due to the above noted rebalancing actions and a significant recovery in equities in late-March and early-April.**

**Pension Pool (including TFFR and PERS):**

ND Pension Pool Asset Allocation	Min	Max	Target	Actual (as of 4/17/20)	Variance from Target
Total Domestic Equity (S&P 500)	25.2%	37.5%	31.3%	31.3%	0.0%
Total Int'l Equity (EAFE)	16.0%	23.9%	19.9%	20.0%	0.0%
Private Equity			6.5%	4.9%	1.6%
Total Fixed Income (UST-Agg)	18.5%	28.0%	23.3%	22.3%	1.0%
Real Assets			18.6%	20.0%	-1.5%
Cash			0.4%	1.5%	-1.0%
			<u>100.0%</u>	<u>100.0%</u>	

As of April 17, the Pension Pool was on target for public equity, while Fixed Income was underweight by 1% and Cash was overweight by 1%. Private Equity was also underweight by 1.6% and Real Assets were overweight by 1.5%. Synthetic rebalancing actions are not intended to address private market investments.



### Legacy Fund:

ND Legacy Fund Asset Allocation				Actual (as of 4/17/20)	Variance from Target
	Min	Max	Target		
Total Domestic Equity (S&P 500)	25.3%	34.8%	30.0%	30.5%	-0.5%
Total Int'l Equity (EAFE)	17.5%	22.5%	20.0%	19.2%	0.8%
Total Fixed Income (UST-Agg)	30.6%	39.4%	35.0%	32.0%	3.0%
Real Assets			15.0%	15.4%	-0.4%
Cash			0.0%	2.8%	-2.8%
			100%	100%	

As of April 17, the Legacy Fund was within 0.3% of target allocations to public equity with a **slight overweight to U.S. Equity of 0.5%** and slight underweight to International Equity of 0.8%. Legacy was also underweight to Fixed Income by 3%, **but overweight Cash by 2.8%**.

### Insurance Pool (including WSI):

ND Insurance Pool Asset Allocation				Actual (as of 4/17/20)	Variance from Target
	Min	Max	Target		
Total Domestic Equity (S&P 500)	8.2%	13.7%	10.9%	10.9%	0.1%
Total Int'l Equity (EAFE)	4.6%	7.6%	6.1%	5.7%	0.3%
Total Fixed Income (UST-Agg)	39.0%	50.2%	44.6%	43.9%	0.7%
Real Assets			12.3%	12.6%	-0.2%
Short Term Bonds			25.4%	25.2%	0.1%
Cash			1.0%	1.7%	-0.7%
			100%	100%	

As of April 17, the Insurance Pool was within 1% of target allocations including 0.7% underweight to Fixed Income and **0.7% overweight to Cash**.

### Summary:

SIB client portfolios were rebalanced towards client board approved long-term strategic target asset allocations in a prudent and cost efficient manner in order to benefit from the historical advantages of “Staying Invested”.

**Executive Review**  
**Mr. David Hunter, Executive Director/Chief Investment Officer**  
**April 14, 2020**

**Evaluation Process:**

In compliance with the State Investment Board (SIB) Governance Policy, the SIB conducted a formal evaluation of the Executive Director/Chief Investment Officer, based on accomplishment of *Ends* and *Compliance with Executive Limitations*. An Executive Review Subcommittee, consisting of SIB board members Mel Olson, Adam Miller and Yvonne Smith, was appointed to oversee the evaluation process. Staff assistance was provided by Sara Sauter, Supervisor of Internal Audit Services, and by Bonnie Heit, Assistant to the Board.

- The primary feedback tool for this evaluation was a survey instrument designed to evaluate compliance with the SIB Governance Ends Policy and Executive Limitations Policies.
  - The survey instrument focused on board meetings, board relations, office operations, investment programs and program operations, public/legislative relations, and professional skills and development.
  - The instrument used the following three-point scale: 1- Does Not Meet Expectations, 2-Meets Expectations, and 3 - Exceeds Expectations.
  -
- In addition to the survey, the following reports were taken into account:
  - Independent Audit Report for the period ending June 30, 2019, issued by CliftonLarsonAllen LLP.
  - RIO Financial FY Ended 6/30/2019 – November 22, 2019
  - Quarterly Monitoring Reports – February 22, 2019, May 24, 2019, September 27, 2019, and November 22, 2019
  - Executive Limitation Audit CY 2019 – February 28, 2020
  - ED/CIO Effectiveness survey
- Mr. Hunter also completed a self-assessment of his performance for consideration.

On April 13, 2020, the Executive Review Subcommittee reviewed the results and discussed areas of strength and developmental opportunities. The results and subsequent discussion form the basis for the formal evaluation. The evaluation will be presented to the SIB for final approval at the April 24, 2020, SIB Board Meeting.

## Findings and Conclusions:

All SIB board members completed the evaluation survey. The composite results were as follows:

- 100% of the responses were “Meets Expectations” or “Exceeds Expectations.” None of the board members indicated a need for improvement in any of the categories.
- The overall average rating of Mr. Hunter’s performance has improved year over year.
- Themes of the comments regarding Mr. Hunter’s skills included:
  - **Board Meetings:** Information is provided in a comprehensive, yet manageable, format. Particularly impressed with the executive summary addition to the information. A reevaluation of board education may be necessary to assist board members’ understanding of the information.
  - **Board Relations:** Anticipates problems and provides ample time for us to understand and act appropriately. Very timely and responsive to questions, and provides options to solve problems when problems arise. Timely use of outside experts to assist us with decision making.
  - **Office Operations:** Respectful organized work environment, and maintains a positive and organized work environment. Cordial relationship with staff, and gives credit for good works to the members of his staff.
  - **Investment Programs and Program Operations:** Comprehensive, consistent and efficient approach. Committed to monitoring asset allocation, risk levels, and money manager performance. High level of assurance that our investments are prudent and will yield results that are in line with or above our benchmarks.
  - **Public/Legislative Relations:** Audits have shown that Mr Hunter has excellent contact with stakeholders and government leaders. Able to bring very complex material to an easily understood level. High level of credibility with legislators. Suggest that he be more engaged in the legislative discussion..
  - **Professional Skills and Development:** Constantly looks for ways to improve the functioning of the SIB. An ardent professional of high integrity. Consistent in his philosophy and rationale for decision-making.
  - **General Comments:** Extremely satisfied; Mr Hunter is a true professional; meets all obligations; Excellent job of keeping the communication open; very accepting of critical feedback and implements strategies to address that feedback; adapts well to changing environments; could possibly institute some type of transparency/tracking of contacts with fund managers.

## **Investment Performance**

- SIB client investments exceeded \$16.3 billion as of December 31, 2019. This is a 22% rise in the past year, including \$2.3 billion of net investment income for SIB clients in 2019.
- The Pension Trust, the Insurance Trust, and the Legacy Fund all exceeded their performance benchmarks for the one year ended December 31, 2019, by 45, 85 and 65 basis points respectively, on a net of fees basis.
- The Pension Trust, the Insurance Trust, and the Legacy Fund all exceeded their performance benchmarks for the five years ended December 31, 2019, by 50, 100 and 70 basis points respectively, on a net of fees basis.

## **Executive Director/DIO Effectiveness Survey Results**

- Survey participation responses were received from ten out of eighteen employees. This is 56% participation rate. Overall survey responses continued to trend positive although some minor dissent was noted.
- There was a slight down tick in the marks with regards to the leadership of the Executive Director/CIO.
- Nine employees believe the Executive Director/CIO demonstrates integrity and sets an example for others.
- Eight out of the ten responses also agreed that the Executive Director/CIO provides a clear sense of purpose direction, roles and responsibility for staff.
- The Executive Director/CIO scores for communication improved from last year. Nine of the employees agree that the Executive Director/CIO keeps employees informed about what is occurring throughout the organization when appropriate.
- The majority of employees agreed the Executive Director/CIO takes time to understand other perspectives and is open to changing his position.
- Nine out of ten employees agree that the Executive Director/CIO keeps employees informed about what is occurring throughout the organization and seeks input from all team members.
- Consistent with prior years, the Executive Director/CIO received favorable responses in the area of valuing employees. Staff overwhelmingly agrees that the Executive Director/CIO shows genuine concern for staff and treats everyone with respect.
- The responses to the open ended question were very positive with a majority of employees indicating that they are very satisfied with the job being done by the Executive Director/CIO.

## **Executive Director Self-Evaluation**

- Mr Hunter ranked his performance as meeting expectations in all survey items, with the exception of question 9 in Category 3, RIO Office Operations in regard to a safe, fair and respectful work culture, which he rated “exceed expectations.”

## Summary

This evaluation shows that Mr. Hunter continues to provide excellent leadership as the Executive Director/Chief Investment Officer. His credibility and respect among board members, stakeholders, clients, and staff continues.

Improvements have been achieved during the year in regard to increasing transparency, improving clarity in communication in SIB meeting materials, continued efforts to reduce fees, continued efforts to provide critical education for the SIB, and increasing emphasis on investment management risk, due diligence reporting and compliance monitoring.

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Mr. David Hunter, State Investment Board ED/CIO

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Date

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Yvonne M. Smith, Executive Review Committee Chair

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Date

# MEMORANDUM

**TO:** State Investment Board

**FROM:** Executive Review Committee

**DATE:** April 24, 2020

**SUBJECT:** Executive Review Committee Recommendation

The Executive Review Committee (ERC) met on April 13, 2020 to discuss the performance of David Hunter, Executive Director/CIO. As stated in the Executive Director/Chief Investment Officer Evaluation, Mr. Hunter continues to provide excellent leadership and performs consistently at high standard. Mr. Hunter continues to improve and is receptive to feedback. Board members, stakeholders, clients, and staff respect and trust Mr. Hunter.

When Mr. Hunter joined RIO on December 2, 2013, the assets under management (AUM) was \$7.5 billion. In six years, AUM has doubled, to greater than \$15 billion. Net investment returns have been materially above median, when compared to other U.S. pension plan peers. For the five years ending 12/31/2019, ND investment returns ranked at the 28th percentile when compared to peers. During the same five years, ND generated 0.60% average excess returns, which given the average AUM of \$10 billion, results in \$300 million in incremental income.

In contrast, Mr. Hunter's compensation has increased less than 2% per year on average. In fact, in three of the six years, his base salary increased by 0%. Last year, the base salary increase was 1%. The Executive Review Committee recommended an 8.3% one-time performance bonus; however the SIB chose to provide a 5% one-time performance bonus.

Bottom line, while ND enjoys the stellar performance described above, we have been unable to recognize that performance through our level of compensation. Mr. Hunter's salary remains well below the median for executive directors/chief investment officers with similar responsibilities.

In the past year, Mr. Hunter has worked diligently with HRMS on increasing compensation for RIO staff. All current permanent (non-probationary) staff have received some level of salary increase effective April 1, 2020. The increases range from 3% to 8% with the average being approximately 6%. This will be in addition to an average 2.5% increase per Legislative approval on July 1. Also, all current probationary employees will be eligible for up to a 5% increase upon successful completion of their probation as well as the 2.5% Legislative increase, for which they are not eligible while on probation. In consideration of these salary adjustments, the Executive Review Committee confirmed with Connie Flanagan, CFO, that RIO's budget has sufficient budget authority to award the salary increase we are recommending below.

ERC makes the following recommendation:

**Mr. Hunter to receive an 8% performance increase effective as of April 1, 2020, and the 2.5% increase on July 1, 2020.**

- This increase recognizes our continued satisfaction with and appreciation for the excellent service Mr. Hunter has provided over the course of his employment.
- This increase will not move Mr. Hunter's salary up to the median of his peers, but will be a good faith effort to move in that direction.
- This increase will provide assurance to Mr. Hunter that his work is recognized and appreciated by the SIB. Hopefully, it will provide incentive to Mr. Hunter to continue his exemplary work with the SIB when inevitable opportunities for advancement are presented by other organizations.





# BOARD LEADERSHIP

## INNOVATIVE APPROACHES TO GOVERNANCE

NUMBER 168, MAR.–APR. 2020

[www.wileyonlinelibrary.com/journal/bl](http://www.wileyonlinelibrary.com/journal/bl)

## Evaluative Diversity and the Board, Part 2

By Chris Santos-Lang

Chris Santos-Lang maintains *GRINfree.com* which documents tools that social groups can use to manage their evaluative diversity, sometimes called “political diversity” or “moral disagreement.” This article updates his 2016 article in *Board Leadership* by describing three additional emerging tools for boards of directors.

In 2016, Caroline Oliver challenged me to contribute an article entitled “Evaluative Diversity and the Board” to *Board Leadership*. Evaluative diversity has also been called “moral diversity” or “political diversity,” and it refers to a kind of biological diversity that can be concealed in the sense that sexual orientation can be concealed even if biological. It has very high stakes—people of different evaluative types are predisposed to disagree on certain important issues. Not all evaluative types are equally good. Some really do reflect immaturity or illness, but no single evaluative type would generally outperform the best collaboration of diverse evaluative types. That isn’t an accident of biology; it’s true of artificial intelligence as well. Rather than make everyone else think like oneself, it is more effective to be part of something greater than oneself, and one does that by specializing. Caroline challenged me to explain the implications of these facts for boards.

The 2016 article<sup>1</sup> described the interdependence of different evaluative types—the conservator versus the innovator, the subjective empath versus the objective analyst. It highlighted recent research (e.g., in *Predisposed*,<sup>2</sup> *Teamology*,<sup>3</sup> and *The Righteous Mind*<sup>4</sup>), and drew two implications for boards:

### Best Practices

Included below are five best practices organizations can adopt to mitigate the inherent risks associated with the rising instability and uncertainty.

1. Much as monitoring pH can give ecosystem managers early warning of pending ecosystem collapse in a lake, monitoring organizational culture could give boards early warning of pending organizational collapse. Boards should watch for unexpected shifts in organizational culture as they would watch for unexpected shifts in financial ratios.
2. One strategy for protecting minorities is to select boards that mirror the diversity of the full organization, but that won’t work for all evaluative minorities, because innovators tend not to represent anyone else—not even other innovators.

(continued on page 2)

## CALENDAR OF EVENTS

APRIL 30–MAY 1

### Conference Board Leadership Development Conference

Westin New York at Times Square,  
270 West 43rd St., New York, NY  
10036, USA

According to organizers, today’s mix of economic, social, and political issues is challenging leadership like never before. Organizations are experiencing significant change and transformation, and pressures have led to an intense need for human-centered, high-impact leadership applications and methodologies. This year’s event will examine the latest best practices, strategies, and success stories for transforming the world of leadership. There will be a focus on innovative and superior practices and mindsets necessary to advance your leadership development into the future. Participants will have the opportunity to engage in a highly interactive and human-centered conference experience.

For more information, visit  
<https://bit.ly/2SO2IKv>.

JUNE 8–10

### International Corporate Governance Network Annual Conference

Fairmont Royal York, 100 Front St.  
West, Toronto, Ontario M5J 1E3,  
Canada

According to the ICGN, this year’s conference holds particular significance, as it celebrates the  
(continued on page 7)

### ALSO IN THIS ISSUE

THE BEDROCK OF BOARD EFFECTIVENESS:  
A GENERATIONAL GEARBOX . . . . . 4

FOOD FOR THOUGHT . . . . . 8



## Diversity

(continued from front page)

The second implication was less a positive suggestion than a warning not to manage evaluative diversity in the same way we manage racial diversity. Exactly how to manage evaluative diversity seems to be a new frontier. The current article follows up by offering further advancements into that frontier.

The first advancement is evidence that consciousness of different subjects takes place at different levels depending upon the subject of the consciousness.<sup>5</sup> For example, to achieve consciousness of heat may require only a fraction of a human brain—consciousness of heat could survive even if most of the brain dies—but to achieve consciousness of morality may require collaboration among many human brains. Certain subjects could be beyond the capacity of any individual brain. This raises awareness of two common assumptions we can now question: (1) that minds correspond one-to-one with brains and (2) that we must be either individual or not individual. Thus far, the evidence supports an alternative theory that each of us has individual consciousness of some subjects (perhaps even multiple consciousness of some subjects) but can be no more than a mere interdependent part of a larger consciousness when facing greater challenges.

Interdependence is not a factor in racial diversity—any race could thrive by itself—so it makes sense to speak about equity between races. If races are independent, then they can be equal or unequal. However, the interdependent parts of a body or machine have different abilities, so a body or machine cannot thrive without diverse parts. When parts cannot share in one another's labor, then comparing them is like comparing apples to oranges. It makes no sense to talk about equity between bones and skin or between the axle and the gas cap. Likewise, when facing our greatest challenges, we are interdependent, so it makes sense to suppose that we need one another, but not to suppose that we

can be equal. To seek equity would be to shrink our consciousness and to concede defeat to our greatest challenges.

A second advancement in the study of interdependence is the math. People who don't do the math cannot fully understand the stakes behind our organizational choices. Bennette Harris and I began to do the math in an open-source software project called "Varieties of Elitism."<sup>6</sup> The software models the consequences of different forms of social organization. Under the assumption that interdependence gives us the intelligence required to solve greater challenges, our math indicates that our organizations could be at least 700% smarter if we shift

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To optimize collective intelligence requires not merely that we have contrary teammates, but that we actually work with them. In other words, we must overcome temptations to disenfranchise contrary teammates or be disenfranchised ourselves.

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from self-segregation (e.g., polarization) to more disciplined forms of social organization. Much as humans dominate other species, organizations that make this shift could dominate organizations that don't, so all organizations should at least check the math.

Political polarization is when we try to disenfranchise anyone who doesn't share our own evaluative type. The phenomenon isn't limited to politics; the same discrimination happens in businesses, churches, and families,

but disagreement there is typically resolved by segregating the organization. The "Varieties of Elitism" project quantifies the potential benefit of undoing that segregation, but merely forcing diverse people back together would not be sufficient. To fully realize the potential 700% improvement, teams would need to let each person play his or her part.

When children of certain evaluative types reject the conservative church they were raised in, how can that church bring them back and allow them to play their part in that church without sacrificing conservative values? How can numbers-driven Wall Street firms embrace otherwise-driven employees without sacrificing attention to the numbers? To optimize collective intelligence requires not merely that we have contrary teammates, but that we actually work with them. In other words, we must overcome temptations to disenfranchise contrary teammates or be disenfranchised ourselves. The way to overcome temptation is through carefulness, so my own nonprofit has added the following discipline to its bylaws. I challenge you to join in this third advancement by making a similar innovation to your own bylaws:

### ARTICLE 7: Careful Decision-making

*Section 1. The Association may indemnify those who act on its behalf from liability for such action only so far as the action is authorized by a plan (e.g., a budget, schedule, map or policy) that meets the standard of approval defined by these Bylaws and only so far as the relevant part of the plan faces no unresolved challenge as defined by these Bylaws.*

*Section 2. Plans can be approved only through action by the Board of Directors.*

- *Additionally, if the plan could authorize action risking more than \$100 in potential harm, then it does not qualify as "approved" until 30 days after*



the plan and its reasoning have been openly published where it can be accessed for free on the World Wide Web and notification of the publication (with a link to it) has been communicated through the Association's communication channels. As an example, reasoning for a budget item should explain why the budgeted purchase should be made and why the budgeted price or bidding procedure is appropriate.

- Additionally, if the plan could authorize action risking more than \$50,000 in potential harm, then it does not qualify as "approved" unless the publication includes a review issued by an independent committee in good standing without conflict of interest (e.g. IRB).
- Additionally, if the plan could authorize action risking more than \$1 million in potential harm, then it does not qualify as "approved" unless the independent review includes review of a smaller-scale test and reasoning that the results of the smaller-scale test justify the larger-scale implementation.

**Section 3.** Approval never undermines the significance of ongoing discovery. Any part of any plan qualifies as "challenged" if the Board receives written communication (from anyone) citing a conflicting precedent or relevant consideration (e.g. evidence or argument) not already addressed in published reasoning for that part of the plan (i.e. in the original publication of the plan, in published resolutions to challenges, or in the published reasoning of precedents).

**Section 4.** Gaps in reasoning can be filled over time. A challenge qualifies as "resolved" 30 days after reasoning addressing that challenge is openly published by the Board (or by any independent

committee in good standing that lacks conflict of interest) where it can be accessed for free on the World Wide Web and notification of the publication (with a link to it) has been communicated through the Association's communication channels. Iterations of challenge and resolution/revision expand the set of considerations made and the body of precedent available to resolve future challenges.

**Section 5.** Whichever court settles any suit of liability for action conducted on behalf of the Association will also settle disputes over whether the liability falls to the Association or to individuals, thus resolving disputes over whether a plan qualifies as "challenged" and whether the challenge qualifies as "resolved." Lack of challenge to any supposed resolution is evidence that it fully resolved the original challenge, so the process of resolution can be an effective strategy to reduce personal liability. However, if the Board deems obstructionists to be issuing unending claims of challenge without citing unaddressed relevant consideration/precedent or to be issuing unending claims of resolution without fully addressing a challenge, it may ignore these disputes until such time as a suit of liability is filed in a court (if ever).

This text is under public domain (see <https://osf.io/9ks45/>), so feel free to use and modify it as you see fit. Instead of communicating its plans and reasoning to the entire world, your board might communicate them only to members of your organization. Instead of accepting challenges from all corners, your board might accept challenges only from members of your own organization.

The obvious objection to Article 7 is that it creates elitism. Some people are not as good as others at planning far in advance and at articulating reasoning that would stand up to challenge. We expect lawyers and engineers to be able to do this, but not everyone. The adoption of this article could force

some boards to rely on consultants to articulate plans and reasoning. The requirement that the board publish its reasoning far in advance seems to set up these analytical types as elite.

Furthermore, Article 7 gives power to critics. Challengers need not be elected or appointed—they could be very unpopular individuals—yet they could block duly elected leaders from acting simply by pointing out potential flaws in the published reasoning. Even a critic who lacks sufficient analytical skills to fix the reasoning could block action if sufficiently creative (consider the trial of Socrates). Letting critics play their part sets them up as a second elite alongside those with rare analytical ability.

Furthermore, Article 7 dismisses challenges that have already been resolved by precedent, and it names unaddressed conflict with precedent as grounds for challenge. Thus, when precedent builds up to the point of creating a field of expertise, both the critic and logician may be trumped by the expert who knows the field. Whenever the board relies on the expertise of a few members or the expertise of external consultants, those experts are held up as elite.

And yet Article 7 also reinforces a form of elitism already present in boards, the form that privileges people who are good at working with others, a skill not necessarily coincident with analytical skills, critical skills, or field mastery. Article 7 requires all actions to be authorized by the board, and permits only groups such as a board to address a challenge. People who already enjoy that elitism might not notice this aspect of Article 7, but people who prefer to make decisions individually could find it burdensome.

All in all, anyone who seeks power will find something to dislike about the discipline described in Article 7. By trying to converge toward perfectly justified decision-making, Article 7 leaves less opportunity for anyone to exercise power. So why would any organization choose to add something like Article 7 to its bylaws?

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# The Bedrock of Board Effectiveness: A Generational Gearbox

By Chuck Underwood

*Chuck Underwood trains all of business (including corporate boards), government, education, and religion in a full list of generational strategies. In this article, he explains the foundation of generational study and presents insights into the values, preferences, strengths, and weaknesses of each generation of directors.*

It is no longer optional. It's now—and forevermore—imperative. Board members must possess the Holy Grail of boardroom leadership and productivity—a generational gearbox—when dealing with the following board functions, and all other activities that involve human beings:

- ethics;
- investor activism;
- board composition;
- pay ratios;
- board culture;
- say-on-pay;
- risk;
- transparency;
- communications;
- political spending;
- boldness, vision;
- social matters;
- board harmony; and
- legislative relation.

In the past, boards were composed of members of only one or two generations: the older, more experienced, and presumably wiser business minds in their 60s and 70s. And, overwhelmingly, white and male.

Well...

Welcome to 2020. Boards are now more age-diverse, gender-diverse, and ethnically diverse. But this new complexity can be simplified: Every single board member belongs to a generation and brings powerful generational core values to his or her performance and final decision-making. And so, if boards are trained in generational diversity and strategies, they will possess the Holy Grail of human interaction: a generational gearbox, which enables them to shift gears instantly

and accurately when dealing with—and frequently attempting to persuade—human beings from one generation to the next.

"Generation" used to be such a breezy, fluffy word. Pepsi Cola used it decades ago for an advertising campaign targeting baby boomers, whom it tried to convince were "The Pepsi Generation." But then in the 1980s, all of that changed when a half-dozen of us here on Planet Earth were struck by the same lightning bolt: a moment of insight that whispered in our brains "Generation is something far more important than anyone recognizes." And so began our lonely journey of creating a field of study from nothing, conducting the formal research to prove to ourselves that our gut hunches were right, codifying the principles that would give our discipline its legitimate and unshakable foundation, and then hopping on airplanes, crisscrossing the country (and in my case, Canada and Europe), and presenting it to any audience that would listen. Generational study burst onto the scene—quite spectacularly in the decade of the 2000s.

Right at the turn of this century, after we had spent the 1980s and 1990s building our discipline (and a couple of people had tinkered with it in the '60s and '70s), major advertisers—Disney, Cadillac, Gap, and a few others—broke the long-standing tradition of creating products and ad campaigns for age brackets and, instead, did so for generations. And lo and behold, it worked!

Disney's ad campaign for its 100-year anniversary of the birth of its founder Walt Disney targeting Silent Generation grandparents and their grandkids was a success, as was a separate ad campaign just for boomers.

Staid, conservative Cadillac went radical and created a model just for one generation, the boomers: a muscle-car concept (!)—the CTS—which goes down in history, as *The Wall Street Journal* headline shouted, as "the car that saved Cadillac."

Gap boldly broke from the fashion industry's long-standing age bias that said women over age 35 were to be ignored and never used as models and instead launched a very successful multigenerational campaign that targeted both GenX and over-35 boomer women, even using print ads for its "hoodie" sweatshirt that included a full-page pose by model Lauren Hutton, who was then ... gasp ... 59 years young!

And just as these kinds of generational marketplace strategies were proving their worth in the first decade of the 2000s, America's next generation was arriving in adulthood and bewildering employers across all industry types. And to understand the millennials, human resource executives began clamoring for training in the other major pillar of our field of study, generational workforce strategies.

And so, in the past 20 years, generational study and strategies have exploded onto the scene of American business, government, education, and religion, and proved their central and permanent and bottom-line value (yes, *that* bottom line; the important one) to American business.

But for a few more years, there's an odd dilemma: Most 20-, 30-, and 40-somethings have undergone training in generational strategies, because when our field of study finally emerged, the training tended to target supervisory and line personnel; the (older) executives and board directors were busy elsewhere. And what that means today is this: the least savvy businesspeople in generational dynamics are the executives and directors who need to know it most deeply,



because generational considerations must be a part of the big decisions.

The subordinates know more about it than the ones at the top.

I introduced the National Association of Corporate Directors (NACD) to generational strategies in 2014, first at a "2020 Leadership" event for several hundred directors in Beverly Hills, and then at its national conference in Washington, D.C., to an audience of more than 1,000. I am grateful and humbled that it became the highest-evaluated speech in NACD history. And from those first two presentations, individual NACD chapters promptly asked me to bring generational strategies to their local directors: in New York, New Jersey, D.C., Atlanta, Dallas, Fort Worth, Chicago, and Southern California.

Here's why:

*Generational differences can either tie a board in knots and diminish its governance performance or deliver rich and varied insights, ideas, and effective governance solutions, because all directors bring unique generational strengths and weaknesses and powerful core values to their minute-by-minute, month-by-month decision-making.*

Here's where it begins:

The entire foundation of generational study is based upon four now heavily researched and universally accepted truths:

- **Truth #1:** Between the time we're born and the time we leave the full-time classroom and get fully into adulthood—late teens to early 20s—we form most of the core values and beliefs we'll embrace our entire lives. Yes, we'll evolve, we'll change. But those core values will remain largely intact. And they will be burned into us by the times we witness as we come of age, and by the teachings we absorb from older generations of parents, educators, religious leaders, and others. And the age group that shares the same formative years' times and teachings will by and large share the same core values. And by sharing the

same core values, we become ... a generation. And any time in American life that either the times or teachings, or both, change in a significant way and a widespread way, it means young kids coming of age during those different times and different teachings will mold different core values and become our next generation.

- **Truth #2:** And this is why generational study has become such a hot topic: Life in America, in the past century, has changed so often. And when it has changed, it seems to have changed so sharply into new directions. And we are now living nearly 30 years longer in 2020 than we did in 1920. So for the first time in U.S. history, our life

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Generational differences can either tie a board in knots and diminish its governance performance or deliver rich and varied insights, ideas, and effective governance solutions.

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expectancy has room for five living generations, and soon a sixth, each of whose formative years were very different from all other generations and each of whose core values, as a result, are also very different.

- **Truth #3:** The unique core values each generation molds during its unique formative years will now exert astonishing influence over that generation's lifelong career decisions and on-the-job performance, consumer choices, lifestyle preferences, personal relationships, and personal behavior.

- **Truth #4:** There is no such thing as a 16-year-old, 12-year-old, or 2-year-old member of a generation. We do not join a generation until we finish our classroom years, and especially our K–12 school years. Until then, we are in our *pre-generation years*, the bewildering and fast-moving formative years, when we are constantly "trying on" a blizzard of core values being handed to us by our elders and deciding which ones we'll keep and which we'll discard. This is the sorting process of youth, when we might change a core value in a nanosecond. And so generations begin at age 18, which is when each of us now possesses a set of core values we are likely to keep for life, even as we change and evolve.

So, if we understand the unique formative years that molded the unique core values that guide the unique lifelong decision-making of each generation, we can fully connect with and succeed with the members of each generation with whom we deal, day after day.

With those permanent and proven principles of generational study, here are America's five living generations, and soon a sixth:

Name	Born	Age in 2020
G. I.	1901–1926	94+
Silent	1927–1945	75 to 93
Boomer	1946–1964	56 to 74
Generation X	1965–1981	39 to 55
Millennials	1982–??	?? to 38
Generation Z	soon to arrive	

In 2020, three generations—*younger silents*, all boomers, and older Xers—dominate most boards (the tech sector probably skews younger, health care probably tilts older, etc.), and because of their unique and sometimes difficult-to-understand early-life passage and core values, millennials are entering in some industries at a much earlier age than before.

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## Gearbox

(continued from page 5)

Here are some bullet points about each generation. If you think this is actionable information and you will now know enough to execute generational board strategies, then shame on you: You're about to fall spectacularly on your face. Many have tried to take shortcuts with generational strategies and had their brainstems snapped. This stuff can turn on you if used improperly.

This is merely a broad brushstroke:

### *Silents as board directors*

- Believe in the traditional hierarchy, chain of command
- Not as combative, aggressive as boomers
- Courtesy and civility are important
- They like to solve it quietly over lunch
- Prefer in-person over phone
- Prefer phone over email
- Excellent at reading body language
- They listen before talking
- They don't talk as fast as Xers and millennials
- Don't misinterpret their silence during a meeting; they aren't missing a thing
- Rapidly catching up on tech
- Boards should accommodate possible diminished eyesight and hearing

### *Boomers as board directors*

- Believe in the best idea, not hierarchy
- Still idealistic
- Still ethical
- Most believe in transparency
- Their women and minorities are arriving in force
- Assertive, passionate

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Board Leadership?  
Contact Nicholas King for criteria  
at [nicholaskingllc@gmail.com](mailto:nicholaskingllc@gmail.com)*

- Willing to be combative
- Fight hard for their values and expect you to push back just as hard, but courtesy and civility are still important
- Love a group dynamic
- Prefer in-person over phone
- Prefer phone over email
- Excellent at reading body language

### *Xers as board directors*

- Excellent at creativity, finding solutions
- Entrepreneurial mind-set
- They'll give the world new products, services, efficiencies
- Self-reliant, independent; might not ask for help when they need it
- They're tough; survival of the fittest
- Women continue to surge
- Might prefer solitary work over groups
- Not as aggressive in groups; might need to be pulled in to discussion
- Like to research issue before discussing
- Strong self-focus; vulnerable to "me-over-we"
- Might be vulnerable to greed, corruption
- Might stress company metrics over quality and "the human touch"
- They'll benefit from Xer-specific leadership training

### *Millennials as board directors*

- Relentless job hoppers (the good: varied experiences; the bad: weak loyalty)
- Lack depth of knowledge with single company
- Excellent career "spirit"
- Eager to learn, eager to please
- Love group dynamics
- The Tech Generation, which is very good and very bad
- Delaying marriage, parenting to latest ages ever
- Idealistic, empowered, engaged
- Like boomers, "we"-oriented
- Demand good corporate

citizenship, ethics

- As a generation, sickened by executive/director/raider ruthlessness
- Many are avoiding careers with publicly held corporations
- Stress quality over metrics
- Defend workers, customers
- Will mature in careers later than prior generations

### *Millennials as board directors: Damaged by the technology revolution*

- Sense of immediacy has given them a unique impatience, restlessness
- Short attention spans
- Crave variety and change
- Knowledge is superficial; they've learned in mini-blasts
- Tech addiction
- Communication
- Punctuality
- Critical thinking
- Social savvy
- Empathy
- Creativity
- Organization
- Adaptability
- Silent fluency: the ability to read body language
- Phone skills

Don't forget: Everyone is an individual, and we should never use generational strategies to unfairly stereotype anyone. But used with proper training, and used accurately and sensitively, this knowledge will serve as a trustworthy lighthouse to guide you through your interpersonal dealings with all generations. □

*Chuck Underwood, one of the half-dozen people who codified and popularized generational study and strategies, is the host of the PBS national television series America's Generations With Chuck Underwood, author of the book America's Generations in the Workplace, Marketplace, and Living Room, and trainer and consultant in all generational strategies for more than 500 clients. For board training in generational strategies, email him at [chuck@genimperative.com](mailto:chuck@genimperative.com) or go to [www.genimperative.com](http://www.genimperative.com).*



## Calendar of Events

(continued from page 1)

organization's 25th year. Noting that the group has grown from humble beginnings of just a handful of members to where it is now, representing over 790 members in 50 countries, this conference will serve as a time of reflection as its members take stock of what they have learned and achieved over the past 25 years, but also look to the future with regard to priorities for reform. As the governance and investor stewardship landscape continues to evolve, leading expert speakers will provide attendees with key insights into best practices and highlight future priorities for companies, investors, and stakeholders.

For more information, visit <https://bit.ly/2PxXTUS>.

### JUNE 18–20

#### 2020 Govern for Impact Conference

*The Worthington Renaissance Fort Worth Hotel, 200 Main St., Fort Worth, TX 76102, USA*

The annual conference for Govern for Impact—formerly known as the International Policy Governance Association—brings together boards, CEOs, and administrators using the Policy Governance System, as well as young governance professionals and others exploring good governance.

The theme of this year's conference is "Accountability Powered by Purpose."

Sessions will be organized around three tracks: "Policy Governance Fundamentals, Practices and Principles," which will look at topics such as "Governing Risk Under Policy Governance in a High Risk World" and "Duties of Directors: Servant Leaders Meeting Legal and Fiduciary Obligations in Policy Governance"; "Innovation in Advanced Policy Governance Practices," which will include sessions such as "Focus on Purpose: Applying the Power of Ends" and "Valuing the Impact You Are Achieving: A Critical Board Job"; and "Governance

Excellence," which will explore topics such as "Applying Policy Governance in Different Settings," "Translating Lofty Ends to Real-World Impact: Effective CEO Ends Interpretation," and "The Continuous Journey Toward Board Effectiveness."

For more information, visit <https://governforimpact.org>.

### JUNE 21–23

#### 26th Annual Stanford Directors' College

*Crown Quadrangle, 559 Nathan Abbott Way, Stanford, CA 94305, USA*

The Directors' College is billed as the nation's premier executive education program for directors and senior executives of publicly traded firms. At the Directors' College, attendees will engage with leading CEOs, directors, regulators, jurists, and scholars on a rigorous and balanced examination of a broad range of issues that confront modern boards, including crisis anticipation and management, shareholder engagement, compensation strategy, board evaluation and refreshment, and emerging challenges, including artificial intelligence and the politicization of the corporation.

For more information, visit <https://stanford.io/3bGh1cq>.

### JULY 14–15

#### ICSA Annual Conference: Governance 2020

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

Governance 2020 brings together governance professionals and students from around the world. According to organizers, as we head into a new decade, a new governance landscape is emerging, one with challenges and opportunities. From emerging technologies to the challenges of environmental and social governance and the realigning of global and national interests, some very significant forces are reshaping regulatory and boardroom agendas.

For more information, visit <https://icsa.org.uk>. ■

## WHEN WE SAY...

**B**oard 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. ■



## Diversity

(continued from page 3)

The reason to add something like Article 7 to one's bylaws is to defend one's legacy against future leaders. What value is there in serving an organization that will devolve into an unintelligent polarized (or segregated) monstrosity? We are all aware of organizations that once stood as beacons of hope but now seem stuck, and it is hard to imagine that their founders and sustainers would have sacrificed so much if expecting their legacy to end that way. Yet today we know what to expect. We know that it takes discipline to avoid organizational degradation, so we are willing to endure discipline ourselves in order to force the same discipline on our successors.

Without something like Article 7, leaders will claim that their decisions are justified by whatever process selected them to be leaders. In other words, any process for selecting leaders would hand those leaders a blank check, and greater consciousness will not happen. Greater consciousness cannot happen if plans and reasons are not shared between the parts of that greater consciousness. In retrospect, Article 7 is common sense, so much so that one might be tempted to suppose its discipline is already

required of anyone who has fiduciary responsibility.

Yet some boards would not choose to amend their bylaws to add something like Article 7. Most boards would not add it until after they see other organizations succeed with such an amendment. Some boards would even hold out until most bylaws include such an article. This is reasonable. If enough small nonprofits and businesses prove the viability of such an amendment, then it can spread to larger organizations, states, and, ultimately, nations.

The reason to adopt an amendment like Article 7 is not merely to improve decision-making in one's own organization, but also to create a model that can spread to other organizations. Boards who pass such amendments—and survive—can set a new standard that may ultimately be applied globally. Every organization ultimately shares in global threats, and raising global standards by innovating better governance is something every organization can do about those threats. Imagine a world in which every government responded to every legitimate challenge by refining its reasoning. Is that not our goal? And is there really any other way to reach it? □

Chris Santos-Lang can be contacted at [chris@grinfree.com](mailto:chris@grinfree.com).

## FOOD FOR THOUGHT

"It is well to respect the leader. Learn from him. Observe him. Study him. But don't worship him. Believe you can surpass. Believe you can go beyond. Those who harbor the second-best attitude are invariably second-best doers."

David J. Schwartz

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