

**Friday, October 22, 2021, 8:30 a.m.**  
**WSI Board Room (Virtual Meeting Host)**  
**Teleconferencing – 701.328.0950    Participant Code – 444 469 170#**  
**1600 E Century Ave, Bismarck, ND**

AGENDA

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

- A. Executive Summary

**II. ACCEPTANCE OF MINUTES (September 24, 2021)**

**III. BOARD EDUCATION (30 minutes)**

- A. Board Education – SIB Investment Program Operations – Ms. Flanagan

**IV. INVESTMENTS (60 minutes)**

- A. Asset and Performance Update – Mr. Chin
- B. Legacy and Budget Stabilization Fund Advisory Board Update – Ms. Murtha
- C. Watch List – Mr. Posch

**V. GOVERNANCE (45 minutes)**

- A. Executive Search Committee Update – Dr. Lech
- B. Audit Committee Update – Dr. Lech
- C. Committee Assignments – Ms. Murtha
- D. SIB Client Satisfaction Survey – Ms. Sauter

**VI. QUARTERLY MONITORING – Board Acceptance (15 minutes)**

- A. Executive Limitations/Staff Relations – Ms. Murtha
- B. Budget/Financial Conditions - Ms. Flanagan
- C. Investment Program - Mr. Chin

**VII. OTHER (5 minutes)**

- A. Service Resolution for Commissioner Jodi Smith

**Next Meetings:**

Executive Search Committee: Friday October 22, 2021 approx 11:00 a.m.(following SIB)

Executive Review Committee: Cancelled

Securities Litigation Committee: Thursday, November 4, 2021 at 2:00 p.m.

Audit Committee: Tuesday, November 16, 2021 at 2:30 p.m.

TFFR Board: Thursday, November 18, 2021 at 1:00 p.m.

SIB: Friday, November 19, 2021 at 8:30 a.m.

**VIII. ADJOURNMENT**

**An informal reception for Ms. Smith will follow the SIB meeting.**

# **EXECUTIVE SUMMARY**

## **SIB Regular Meeting**

**October 22, 2021 – 8:30am CT**

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- I. Agenda:** The October Board Meeting will be held at the WSI Conference room to accommodate in person attendance, however, a link will also be provided so that Board members and other attendees may join via video conference. The board member video link is included in the email with the Board materials. There will be a call in number for the public.
- II. Minutes:** The September 24, 2021 Board meeting minutes are included for review and approval.
- III. A. Board Education:** Ms. Flanagan, RIO Chief Financial Officer, will provide board education on the vital role fiscal operations plays in fund allocation, monitoring, and rebalancing.
- IV. A. Asset and Performance Update:** Staff will provide an update on investment performance and projects.  
  
**B. Legacy and Budget Stabilization Fund Advisory Board Update:** Staff is presenting information related to the developing in-state investment program before the Advisory Board on Thursday October 21, 2021. The Board book will be updated with that presentation when available and staff will provide the SIB with comments and feedback from the Advisory Board at the meeting.  
  
**C. Watch List:** Staff will present information related to the Watch List: what it is, why managers get designated for the watch list, why they are removed, and the current status of the list.
- V. A. Executive Search Committee Update:** Committee Chair Dr. Lech will provide the Board with an update on the status of the CIO search efforts and committee work.  
  
**B. Audit Committee Update:** Dr. Lech will present recommendations from the Audit Committee relating to Board Governance.  
  
**C. Committee Assignments:** With the upcoming resignation of Commissioner Jodi Smith, the Chair will need to appoint replacement members to the Audit, Securities Litigation, and Executive Search committees.  
  
**D. SIB Client Satisfaction Survey:** Staff will present the results of the SIB Client Satisfaction survey.
- VI. A-C. Quarterly Monitoring:** Staff will provide quarterly monitoring reports for Executive Limitations/Staff Relations, Budget and Financial Conditions and the Investment Program.
- VII. Other:** Service Resolution for Commissioner Jodi Smith.

### **Adjournment**

**An informal Reception for Commissioner Jodi Smith will follow adjournment of the meeting.**

**NORTH DAKOTA STATE INVESTMENT BOARD  
MINUTES OF THE  
SEPTEMBER 24, 2021, BOARD MEETING**

**MEMBERS PRESENT:** Brent Sanford, Lt. Governor, Chair  
 Rob Lech, TFFR Board, Vice Chair  
 Troy Seibel, PERS Board, Parliamentarian  
 Thomas Beadle, State Treasurer  
 Jon Godfread, Insurance Commissioner  
 Keith Kempenich, Legacy/Budget Stab. Adv. Board  
 Bryan Klipfel, Director of WSI  
 Cody Mickelson, TFFR Board  
 Adam Miller, PERS Board  
 Mel Olson, TFFR Board  
 Jodi Smith, Commissioner of Univ & School Lands  
 Yvonne Smith, PERS Board

**STAFF PRESENT:** Eric Chin, Interim CIO  
 Connie Flanagan, Chief Financial Officer  
 Jayme Heck, Retirement Programs Spec  
 Missy Kopp, Executive Assistant  
 Jan Murtha, Interim Exec Dir  
 Matt Posch, Investment/Compliance Officer  
 Ann Nagel, Investment Accountant  
 Sara Sauter, Internal Audit Supvr  
 Stephanie Starr, Retirement Programs Spec  
 Dottie Thorsen, Internal Auditor  
 Tami Volkert, Employer Svs Coordinator  
 Susan Walcker, Senior Financial Accountant

**GUESTS:** Daniel Arche, L.A. Capital  
 Nick Archuleta, ND United  
 John Arnold, Insurance Dept.  
 Jace Beehler, Governor's Office  
 Alex Browning, Callan LLC  
 Jeff Diehl, Adams Street  
 Dean DePountis, Attorney General's Office  
 Paul Erlendson, Callan LLC  
 Luke Frey, Adams Street  
 Miguel Gonzalo, Adams Street  
 Kelvin Hullet, BND  
 Scott Miller, PERS  
 Chet Pollert, Legislative Assembly  
 Thomas Stevens, L.A. Capital  
 Hope Wedul, HRMS

**CALL TO ORDER:**

Lt. Governor Sanford, Chair, called the State Investment Board (SIB) regular meeting to order at 8:30 a.m. on Friday, September 24, 2021. The meeting was held at Workforce Safety and Insurance, 1600 E Century Ave., Bismarck, ND.

**The following members were present: Treasurer Beadle, Commissioner Godfread, Mr. Klipfel, Dr. Lech, Mr. Mickelson, Mr. Miller, Mr. Olson, Lt. Gov. Sanford, Mr. Seibel, Commissioner Smith, and Ms. Smith**

**ACCEPTANCE OF AGENDA:**

The Board considered the agenda for the September 24, 2021, meeting.

**IT WAS MOVED BY TREASURER BEADLE AND SECONDED BY DR. LECH AND CARRIED BY A VOICE VOTE TO APPROVE THE AGENDA AS DISTRIBUTED.**

**AYES: COMMISSIONER SMITH, TREASURER BEADLE, MR. MILLER, COMMISSIONER GODFREED, MR. OLSON, MR. KLIPFEL, MR. MICKELSON, MR. SEIBEL, DR. LECH, MS. SMITH, AND LT. GOV. SANFORD**  
**NAYS: NONE**  
**MOTION CARRIED**

**MINUTES:**

The Board considered the minutes of the August 27, 2021, SIB meeting.

**IT WAS MOVED BY DR. LECH AND SECONDED BY MS. SMITH AND CARRIED BY A VOICE VOTE TO APPROVE THE AUGUST 27, 2021, MINUTES AS DISTRIBUTED.**

**AYES: MR. MICKELSON, COMMISSIONER SMITH, MS. SMITH, MR. KLIPFEL, TREASURER BEADLE, DR. LECH, COMMISSIONER GODFREED, MR. OLSON, MR. SEIBEL, MR. MILLER, AND LT. GOV. SANFORD**  
**NAYS: NONE**  
**MOTION CARRIED**

**BOARD EDUCATION:****Equity Market Overview:**

Mr. Stevens and Mr. Arche, L.A. Capital, presented Board education on trends, insights, and current risks affecting equity markets.

**INVESTMENTS:****Performance Review:**

Mr. Erlendson and Mr. Browning, Callan LLC, reviewed the performance of the Pension Trust, Insurance Trust, and Legacy Fund as of June 30, 2021, and provided an analysis of current market conditions. Each of the trust's asset allocations was within policy ranges, and cash flows were managed to rebalance towards strategic targets as of June 30, 2021. The returns for PERS, TFFR, WSI, Budget Stabilization, and the Legacy Fund each have exceeded their respective total fund benchmarks on a net-of-fee basis for the one-year and five-year periods ended June 30, 2021. The small cap equity allocation within the Pension, Insurance, and Legacy has underperformed benchmark over most cumulative periods ended June 30, 2021. Two small cap managers were terminated due to performance concerns and were replaced by new firms within the last year. Total fund net-of-fee results exceed benchmark. As of June 20, 2021, the plans are meeting objectives. Board discussion followed.



The Board recessed at 10:30 a.m. and reconvened at 10:45 a.m.

Private Equity Overview:

Mr. Chin provided an overview of the SIB's private equity program. Private equity commitments made in 2015 and later have performed well, with both Adams Street and Blackrock significantly outperforming the public market equivalent. In addition, the decision to use diversified private equity fund of funds strategies as the core of the Pension Pool's private equity program and diversifying over vintage years has worked well.

Adams Street and Blackrock pacing models suggest that \$100-\$140 million of private equity commitments in 2021 is appropriate to achieve the Pension Pool's 8.2% private equity target. Both models incorporate the \$62.5 million that has already been committed to the Blackrock private equity program for 2021. Blackrock's private equity program is different in structure from Adams Street's. The \$250 million committed to the NDSIB Private Opportunities Fund, L.P. – 2020 Series is deployed over four years with \$62.5 million committed each year from 2021-24. Staff will recommend a commitment of up to \$60 million to Adams Street's 2021 Global Private Equity Program for a total private equity commitment of \$122.5 million in 2021.

Commitments made to Adams Street before 2015 have fared well, with the total Adams Street program generating 4.45% excess returns over the public market equivalents. However, the SIB's primary investment portfolio has underperformed due to insufficient vintage year and portfolio diversification.

Executive Session:

**IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A VOICE VOTE TO ENTER INTO EXECUTIVE SESSION TO DISCUSS CONFIDENTIAL COMMERCIAL AND FINANCIAL INFORMATION PURSUANT TO N.D.C.C. 44-04-18.4(1).**

**AYES: MR. OLSON, MR. SEIBEL, COMMISSIONER SMITH, MR. MICKELSON, COMMISSIONER GODFREAD, MS. SMITH, MR. MILLER, TREASURER BEADLE, DR. LECH, AND LT. GOV. SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: MR. KLIPFEL**

The executive session began at 10:54 a.m. and ended at 11:10 a.m. It was attended by the SIB Board, RIO staff members, and SIB legal counsel.

**IT WAS MOVED BY DR. LECH AND SECONDED BY COMMISSIONER GODFREAD TO RETAIN NORTHLAND SECURITIES FOR PRICING AGENT SERVICES.**

A conflict of interest was declared by Commissioner Smith and Treasurer Beadle.

**IT WAS MOVED BY DR. LECH AND SECONDED BY MR. MILLER AND CARRIED BY A ROLL CALL VOTE TO ALLOW COMMISSIONER SMITH AND TREASURER BEADLE TO VOTE ON THE MOTION.**

**AYES: MS. SMITH, MR. MILLER, MR. OLSON, MR. MICKELSON, DR. LECH, COMMISSIONER GODFREAD, AND LT. GOV. SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: MR. KLIPFEL, MR. SEIBEL**

**THE ORIGINAL MOTION CARRIED BY A ROLL CALL VOTE.**

**AYES: TREASURER BEADLE, MR. OLSON, COMMISSIONER SMITH, DR. LECH, MR. MILLER, MR. MICKELSON, MS. SMITH, AND LT. GOV. SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: MR. KLIPFEL, MR. SEIBEL**

Adams Street - Global Private Equity:

Mr. Gonzalo and Mr. Diehl, Adams Street, presented an overview of the 2021 Adams Street Global Private Equity Program. Adams Street is happy with performance on both an absolute and relative basis. The total portfolio since inception net Internal Rate of Return (IRR) of 12.2% is exceeding public equities by 5.0%. Since 2010, ND's commitments to the Global Fund Program have a since inception net IRR of 25.7%, outperforming public equities by 10.7% and exceeding the pooled Burgiss private equity market by 8.1%. The portfolio is well-diversified by geography, strategy, industry, and subclass to mitigate risk and is mature and generating liquidity due to consistent investment pacing.

The 2021 Adams Street Global Private Equity Program will focus on primary partnership strategies but will also have exposure to co-investment and secondary funds to capitalize on market inefficiencies and mitigate the j-curve.

Staff Recommendation:

Mr. Chin shared the RIO staff recommendation that the SIB approve a commitment of up to \$60 million to Adams Street Partners 2021 Global Fund for the Pension Pool. This commitment will keep the long-term allocation goals to private equity on track to reach the 8.2% policy target for the Pension Pool.

**IT WAS MOVED BY COMMISSIONER SMITH AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE STAFF RECOMMENDATION TO COMMIT UP TO \$60 MILLION TO ADAMS STREET PARTNERS 2021 GLOBAL FUND FOR THE PENSION POOL.**

**AYES: TREASURER BEADLE, MR. OLSON, COMMISSIONER SMITH, DR. LECH, MR. MILLER, MR. MICKELSON, MS. SMITH, AND LT. GOV. SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: COMMISSIONER GODFREAD, MR. KLIPFEL, AND MR. SEIBEL**

GOVERNANCE:

Executive Search Committee Update:

Dr. Lech provided an update of the activities of the Executive Search Committee. On September 22, 2021, the Committee met to review the Chief Investment Officer (CIO) specifications for publication. The specifications were approved and have been published. The Committee will discuss the CIO salary range and will bring a recommendation to the SIB.

Reports:

**IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A VOICE VOTE TO ACCEPT THE ANNUAL BUDGET AND EXPENSE REPORT, ANNUAL INTERNAL AUDIT REPORT, AND THE TFFR QUARTERLY MONITORING/PENSION ADMINISTRATION SYSTEM UPDATE REPORT AS PRESENTED.**

**AYES: MR. OLSON, TREASURER BEADLE, COMMISSIONER SMITH, DR. LECH, MR. MILLER, MS. SMITH, MR. MICKELSON, AND LT. GOV. SANFORD**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: COMMISSIONER GODFREAD, MR. KLIPFEL, AND MR. SEIBEL**

**ADJOURNMENT:**

With no further business to come before the SIB, Lt. Gov. Sanford adjourned the meeting at 11:39 a.m.

Respectfully Submitted:

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Lt. Governor Sanford, Chair  
State Investment Board

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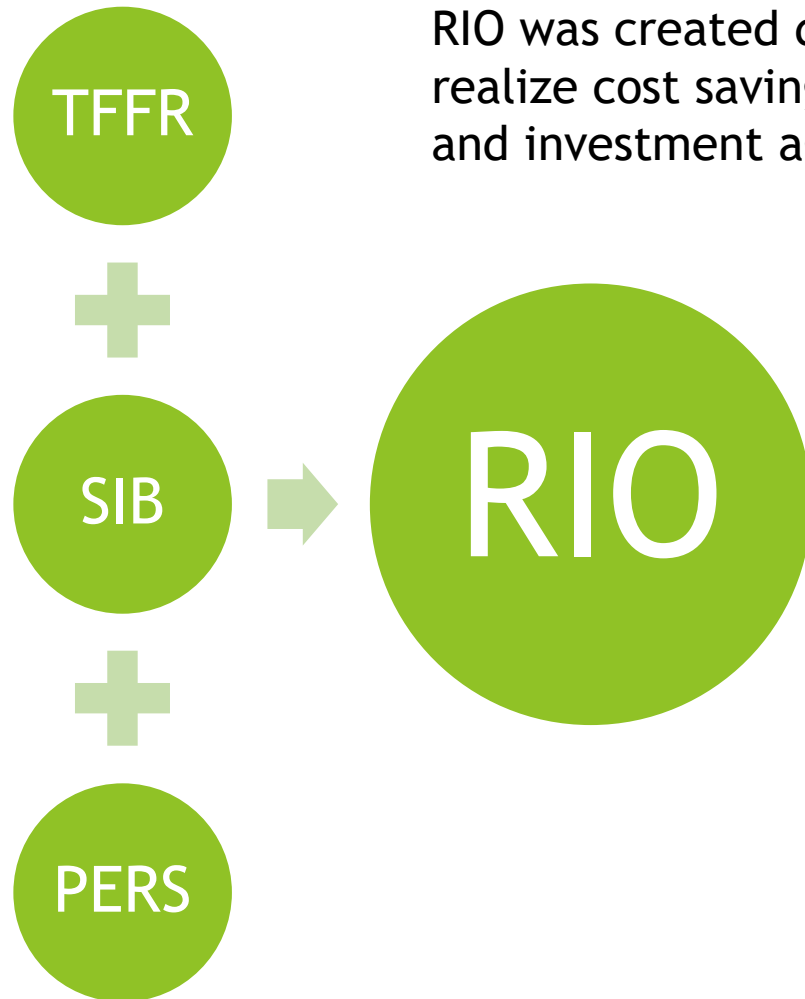
Missy Kopp  
Recorder

# SIB INVESTMENT PROGRAM OPERATIONS – AN OVERVIEW

ND Retirement and Investment Office (RIO)

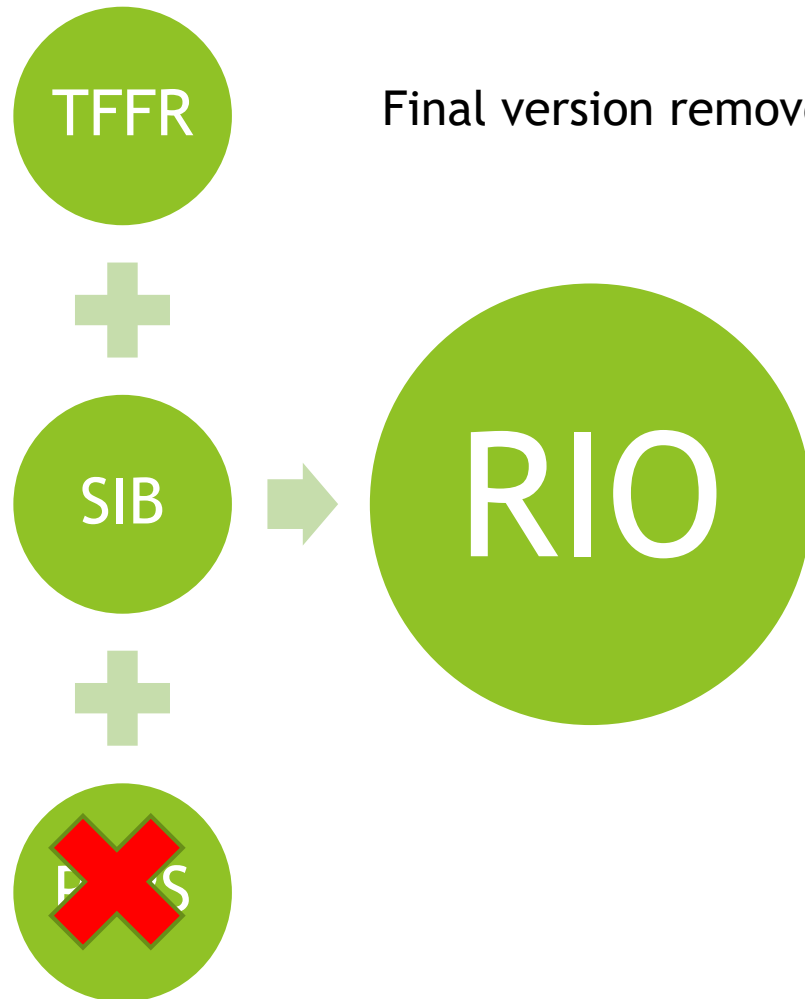
Connie Flanagan, CFO

# RIO - Who are we?



RIO was created during the 1989 Legislative session to realize cost savings between multiple state retirement and investment agencies.

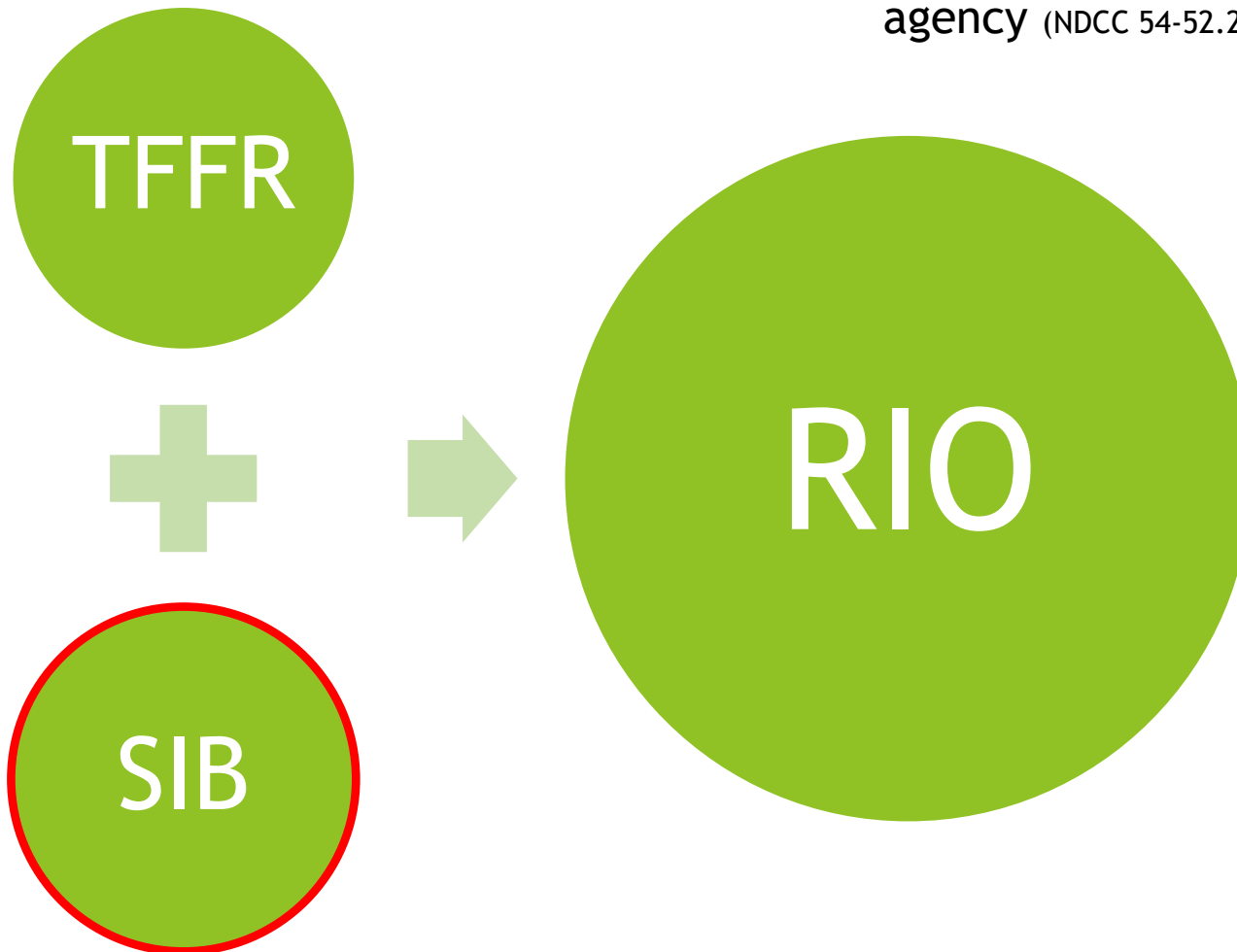
# RIO - Who are we?



Final version removed PERS from the mix.

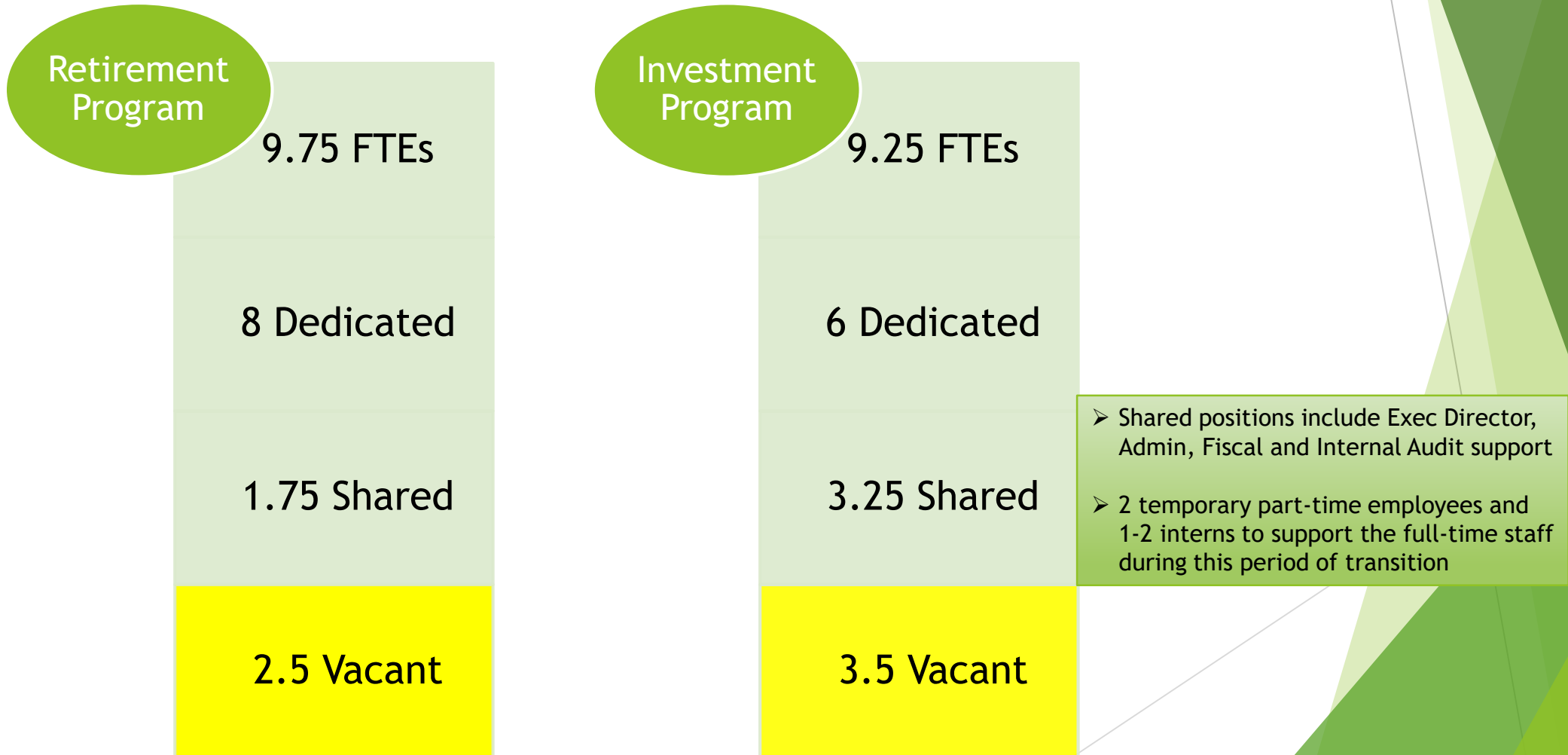
# RIO - Who are we?

The State Investment Board is  
the governing board for the  
agency (NDCC 54-52.2-02)



# RIO - Who are we?

## RIO Team - 19 FTEs





# RIO - Who are we?

## Retirement Program

Collecting contributions from participating employers (211 employers/11,000+ members)

Payment of benefits to participating members (9,000+ retirees and beneficiaries)

Providing retirement planning education and outreach to membership

Ensuring the plan is sustainable for future generations of ND teachers and administrators

Report to the TFFR Board who is ultimately responsible for plan administration

# RIO - Who are we?

## Investment Program

Manage assets of 26  
Funds (13 statutory)

Safeguard assets

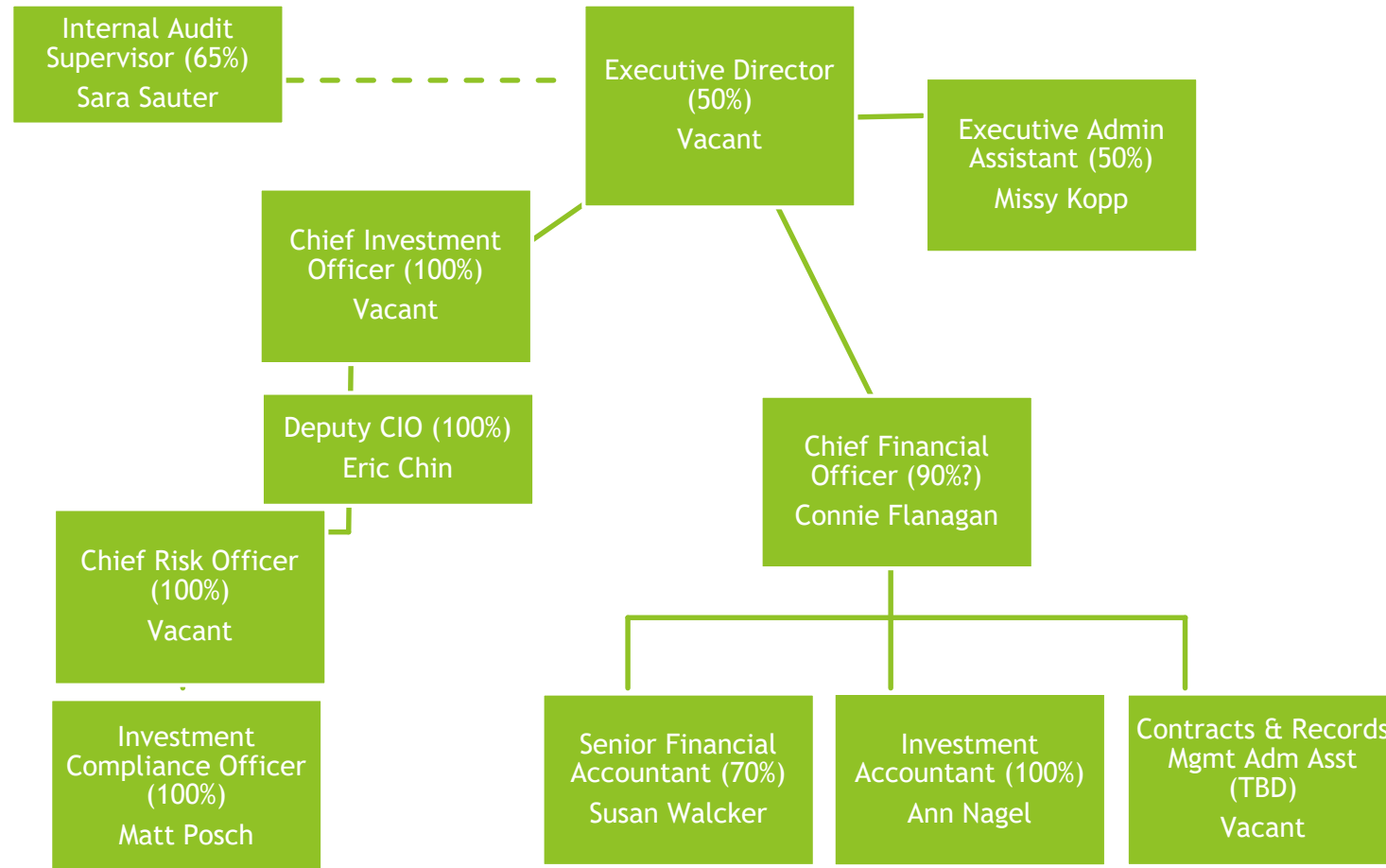
Implement/monitor  
asset allocations

Research/monitor  
investment  
managers

Evaluate/report  
results

# RIO - Who are we?

## Investment Program - Staffing (9.25 FTEs)



# Investment Program

RIO Staff and SIB are a  
“manager of managers”  
for investment program

AUM  
\$19.7 billion  
as of  
8/31/2021

10 asset classes

26 investment client funds

33 asset class pools

42 investment managers

77 investment strategies

135 custodian bank accounts

# Investment Program - External Partners - Investment Managers



# Investment Program - External Partners - Investment Managers

## Types of Portfolios

### Separately Managed Account (SMA)

- Portfolio is created just for our account(s) and holds individual stocks or bonds, depending on the mandate
- Portfolio is “custodied” at our custodian bank (trades are settled at the bank daily and current fair values are reflected in our reporting as of close of previous business day)
- Managers are responsible for reconciling with the custodian bank at month-end to ensure data is accurate
- Individual stocks/bonds show up within our custodian reporting

# Investment Program - External Partners - Investment Managers

## Types of Portfolios

### Commingled/ Mutual Funds

- SIB participates with other investors in a fund that is made up of underlying publicly traded stocks or bonds
- SIB holds units within these funds, not the actual underlying investments
- Some funds strike a daily price that the custodian bank captures, others only report at month-end
- These funds show up as a single line within our custodian reporting

# Investment Program - External Partners - Investment Managers

## Types of Portfolios

### Limited Partnerships

- Similar to Commingled or Mutual Funds, SIB participates with other investors in a fund
- Underlying investments in these funds are generally private investments rather than publicly traded
- Value is reported as Net Asset Value (NAV) rather than unitized
- These funds also show up as a single line with our custodian reporting



# Investment Program - External Partners - Custodian Bank

Master custodian is Northern Trust in Chicago - official book of record for SIB investments

## Domestic (US) Custody Services

- Safekeeping - all investments held in SIB name with the bank
- Settle trades
- Collect income - interest, dividends, corporate actions, etc.
- Provide reporting services, including assistance with accounting standards and footnote disclosures
- For funds not custodied at the bank (limited partnerships, commingled/mutual funds) they still provide reporting within their system to allow flow-through for all investments

## Global Custody Services

- Same services as domestic plus
- Global tax monitoring and filing and
- Sub-custodian services based on individual country requirements

## Securities Lending

- Short-term lending of individual securities within SIB portfolios

## Derivatives Processing (Futures, Options, Swaps)

## Foreign Currency Exchange

## Short-term Cash Management

# Investment Program - External Partners - Consultants

Role - to provide services that cannot be performed internally due to staff and/or budget limitations

Research databases - ability to collect, review and analyze large quantities of data

Focused expertise (specific to asset classes, services, etc)

Public Fund specific experience - familiar with what and how other public funds do business

# Investment Program - External Partners - Consultants

## SERVICES PROVIDED BY OUR CONSULTANT

### General Services

- Performance measurement and portfolio monitoring - Quarterly Reports
- Capital Market Research - Long-term Expected Returns
- On-going research and educational assistance
- Assistance with negotiations with managers
- Access to Specialty Consulting Staff

### Special Projects

- Asset/Liability Studies
- Investment Fee Reviews
- Asset Class Research
- Due Diligence Reviews
- Manager Search Assistance

# Investment Program - External Partners - Consultants

## PERSPECTIVES ON CONSULTING RELATIONSHIPS

Consulting relationships can be broad based or project/task based

Historically SIB has chosen to centralize consultant relationship with one main consultant but there have been instances of expanding those services with other firms based on specific circumstances

Centralizing with one firm creates efficiencies and allows staff to focus on other priorities rather than “managing” the consultant

Consultants are an additional resource to staff, not a replacement

# Investment Program - External Partners - Other

## Financial Recovery Technologies (FRT)

- Monitors and files US class actions
- Monitors global securities litigation
- Monitors and files anti-trust actions

## Adams Street

- Private equity monitoring services

## Blackrock

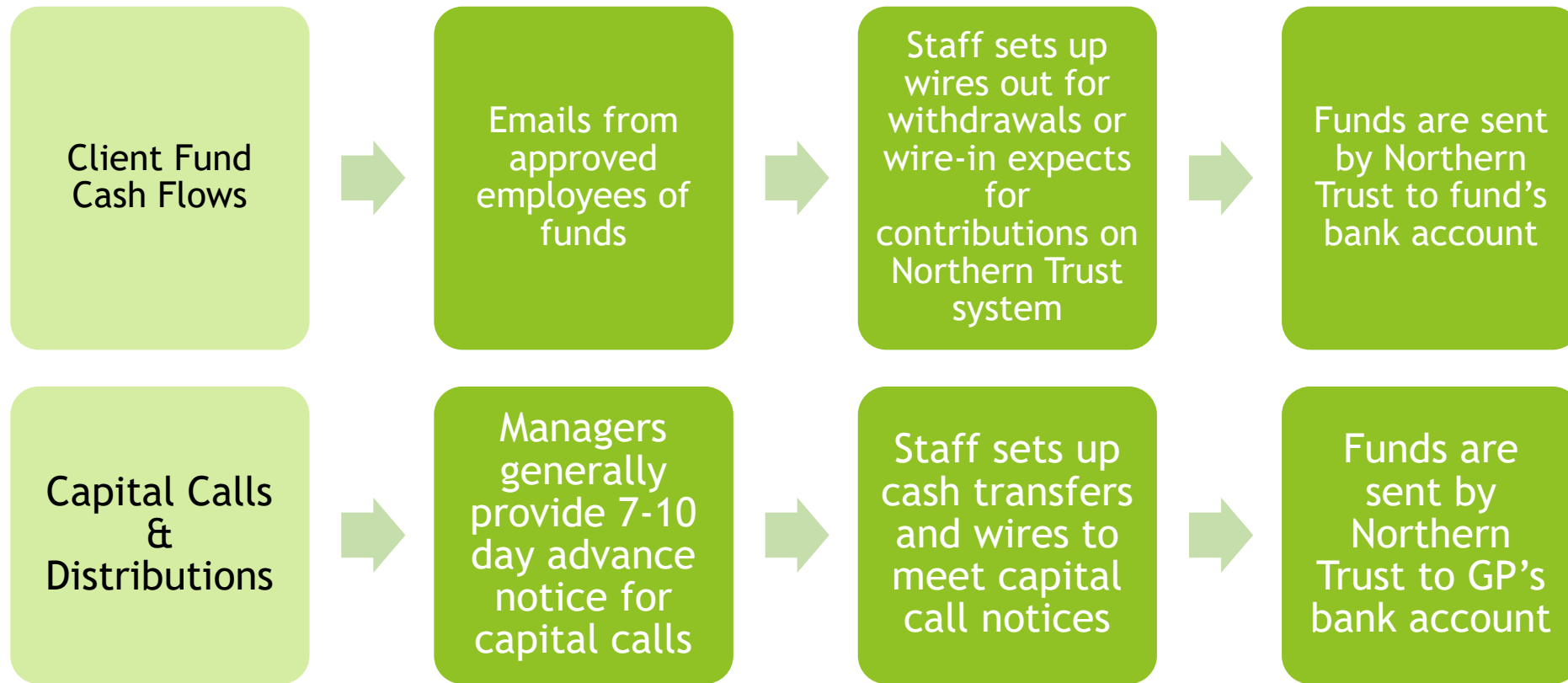
- Risk monitoring and analytics

## Novarca

(contract expired)

- Investment management fee negotiations

# Investment Program - Internal Operations - Fiscal Monthly/ On-Going Processes



Staff monitors available cash balances to ensure adequate liquidity - rebalancing done as needed (details coming up)

# Investment Program - Internal Operations - Fiscal Monthly/ On-Going Processes

## ACCOUNTING

1<sup>st</sup> of the  
month through  
approximately  
9<sup>th</sup> Business  
Day (BD)

- Investment managers report/reconcile with Northern Trust
- Northern Trust posts activities for monthly/quarterly reporters
- RIO Fiscal Staff collects and records valuation and performance information as it becomes available from the investment managers

# Investment Program - Internal Operations - Fiscal Monthly/ On-Going Processes

## ACCOUNTING

9<sup>th</sup> -  
11<sup>th</sup> BD

- RIO Fiscal Staff downloads ending values from Northern Trust system and compares with data received from investment managers.
- Differences outside of tolerance levels are investigated with Northern Trust and/or manager
- Once reconciliation process is complete, Staff authorizes Northern Trust to “close” the month for accounting purposes (target is 11<sup>th</sup> BD)



# Investment Program - Internal Operations - Fiscal Monthly/ On-Going Processes

## ACCOUNTING

### Prep of Pool Level Data for Financial Reporting

- Allocation reports for the 33 asset class pools are prepared from the Northern Trust pool level data
- Weighted beginning values (actual values adjusted for client specific cash flows) are used to allocate the activity for each pool to the participants in that pool
- Journal entries (JEs) are created in Microsoft Dynamics (accounting software)
  - Monthly SIB administrative expenses (budgeted and continuing appropriation) are allocated based on pro rata share of total AUM
  - Over 200 JEs made each month
- Month-end reconciliation process performed
- Financial statements generated for each client fund and posted to the website (goal is 30 days or less)

# Investment Program - Internal Operations - Fiscal Monthly/ On-Going Processes

## PERFORMANCE CALCULATIONS & REPORTING

### Pool Level

- Process begins on 11<sup>th</sup> BD once monthly accounting is closed at Northern Trust
- Callan receives electronic feed of our data from Northern Trust
  - Recalculates the performance for each manager portfolio using Northern Trust data
  - Reviews activity and compares with available market data to ensure reasonableness
  - Helps ensure consistency between similar funds in different pools
- Staff receives monthly portfolio level data through Callan's database software - PEP
  - Compares investment returns received from the manager with Callan's recalculated returns and investigates difference outside of tolerance levels
  - Compares ending portfolio values between Callan's system and Northern Trust to ensure consistency
  - Checks reasonableness of asset class and total fund returns

# Investment Program - Internal Operations - Fiscal Monthly/ On-Going Processes

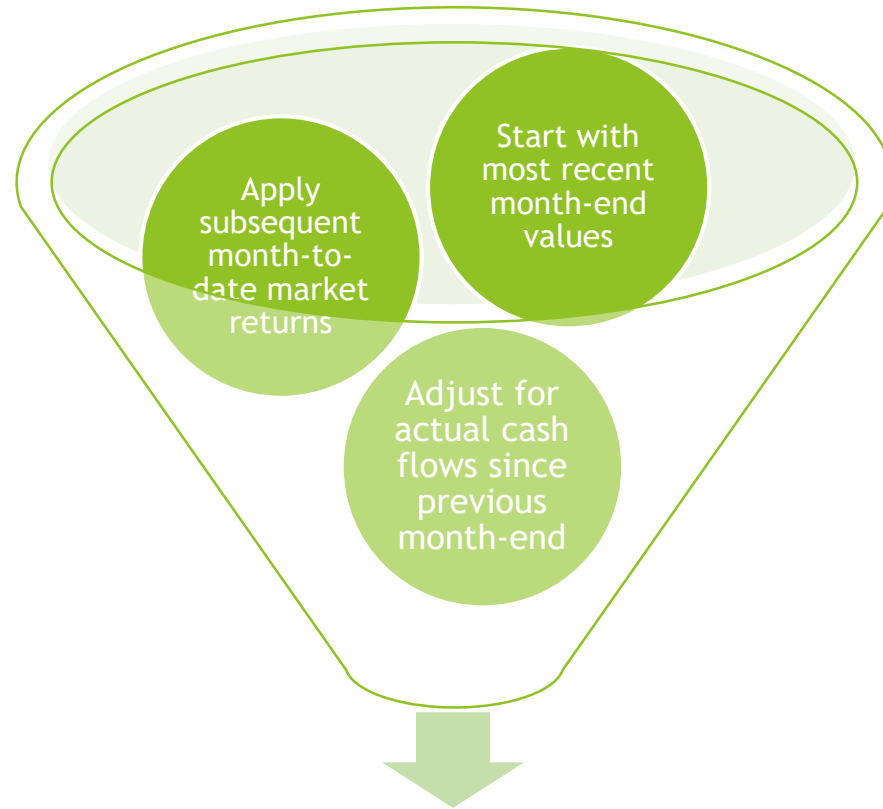
## PERFORMANCE CALCULATIONS & REPORTING

### Plan Level

- Staff provides Callan with data regarding client specific values and cash flows
  - TFFR, PERS, WSI and Budget Stabilization Fund
  - Callan calculates asset class and total fund level returns for these 4 funds
  - Staff receives data through PEP and reviews for reasonableness
- Staff completes internal performance reports
  - Callan data is pulled in for pool level reports - Pension Pool, Insurance Pool and Legacy Fund
  - Callan data is pulled in for the big 4 client level reports
  - Staff calculates asset class and total fund level returns for other 21 client funds using manager level returns calculated by Callan and actual allocations of each fund
  - Once reviewed and tied out, performance reports are posted to the website (goal is 30 days or less)

# Investment Program - Internal Operations - Fiscal

## REBALANCING



Adjusted balances are compared to target allocations and decisions are made regarding needed rebalancing

# Investment Program - Internal Operations - Fiscal

## REBALANCING

Smaller funds are rebalanced using an “internal rebalancing” technique

- No actual cash flows/trades are necessary - simply a trading of positions between clients
- Offset against the largest funds - TFFR/PERS for pension pools and WSI for insurance pools

Larger funds are rebalanced with actual trades and cash flows

- Review internal portfolio level targets against actual
- Consider watch list
- Consider known upcoming events - manager search/termination/liquidation
- Consider illiquidity constraints in certain asset classes/portfolios and adjust accordingly

# Investment Program - Internal Operations - Fiscal

## REBALANCING

### Finalize with managers and custodian bank

- Written notice to managers - date and dollar amount
- Track confirmations
- Enter transactions into Northern Trust system (transfers between accounts)

# Investment Program - Internal Operations - Fiscal

## QUARTERLY/ANNUAL PROCESSES

Quarterly Callan  
Performance  
Reports

Investment  
management  
fees

Global Tax

Annual Audit

Annual  
Comprehensive  
Financial Report

# Investment Program - Internal Operations - Investments

**SNEAK PEEK - COMING SOON!**

Asset Allocation

Portfolio Construction

Investment Due Diligence Process

Risk Analytics

Compliance

In-State Investment Process (In Development)



# Investment Program - Internal Operations - Fiscal

## SUMMARY

Fiscal Team (Connie, Susan and Ann) is a lean, mean, efficient machine

- Long-term employees have traditionally allowed us to “do more with less”
- RIO had more accounting staff in 1990’s than today
- Strong external partners have been integral in helping achieve success
- We have now reached a turning point - opportunity to reassess and make changes

Times they are a-changing

- Assets under management have more than quadrupled in just over 10 years
  - 6/30/2010 - \$4.8 billion
  - 6/30/2021 - \$20.01 billion
- Market landscape has evolved and become more complicated
- Expectations are high - transparency and education are a necessity

**Thank you!**

**RIO Staff greatly appreciates  
the support received from the  
SIB over the years**

# INTERIM FYTD PERFORMANCE

## FIVE LARGEST CLIENTS – SEPTEMBER 30, 2021

	Date	TFFR	PERS	WSI	Legacy	Budget Stabilization
Market Value	August 31	\$ 3,300,781,620	\$ 4,111,905,573	\$ 2,344,386,284	\$ 8,437,770,222	\$ 750,797,228
Net Investment Return - Actual through	August 31	2.30%	2.41%	1.79%	2.62%	0.16%
Total Fund Policy through	August 31	1.93%	2.07%	1.64%	2.12%	0.17%
Excess Return for 2 month period	August 31	0.36%	0.34%	0.14%	0.50%	-0.01%
Estimated Month-to-Date	September 30	-1.87%	-2.08%	-1.40%	-2.14%	-0.10%
Estimated 2022 FYTD Return	September 30	0.4%	0.3%	0.4%	0.4%	0.1%

*(Actual returns are net of fees; estimates are based on index returns)*

- Based on preliminary market data, which is unaudited and subject to material change, the top five NDSIB clients are estimated to end slightly positive for the first quarter of the new fiscal year.
- Broad U.S. equity benchmarks were positive from July to August and down across the board in September. September was the S&P 500's worst-performing month since the height of the pandemic in March 2020.
- NDSIB small cap equity managers had a strong quarter with outperformance estimated at over 3% relative to the Russell 2000.

Estimated Month-to-Date and Fiscal Year-to-Date Returns as of September 30, 2021, are rough indicative estimates based on underlying benchmark data (not actual results) and all amounts are preliminary, unaudited and subject to material change.

# INVESTMENT UPDATE

## **Contracts/Onboarding:**

Following recent Board approval, Staff has worked to onboard the following funds:

- Adams Street 2021 Global Fund: Contract under review
- Arrowstreet International ACWI ex-US: Contract under review

## **In-State Investments:**

Staff is finalizing the contract with Northland Securities for pricing agent services relating to the private market investment opportunity.

Staff has also conducted preliminary work on indicative pricing for the private market investment opportunity.

## **Staff Hiring:**

Interviews are currently underway for the Chief Risk Officer position. Staff is looking to schedule second round interviews shortly and hoping to fill the position by December.

## MEMORANDUM

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**TO:** SIB  
**FROM:** Jan Murtha, Interim Executive Director  
**DATE:** October 20, 2021  
**RE:** Legacy and Budget Stabilization Fund Advisory Board Update

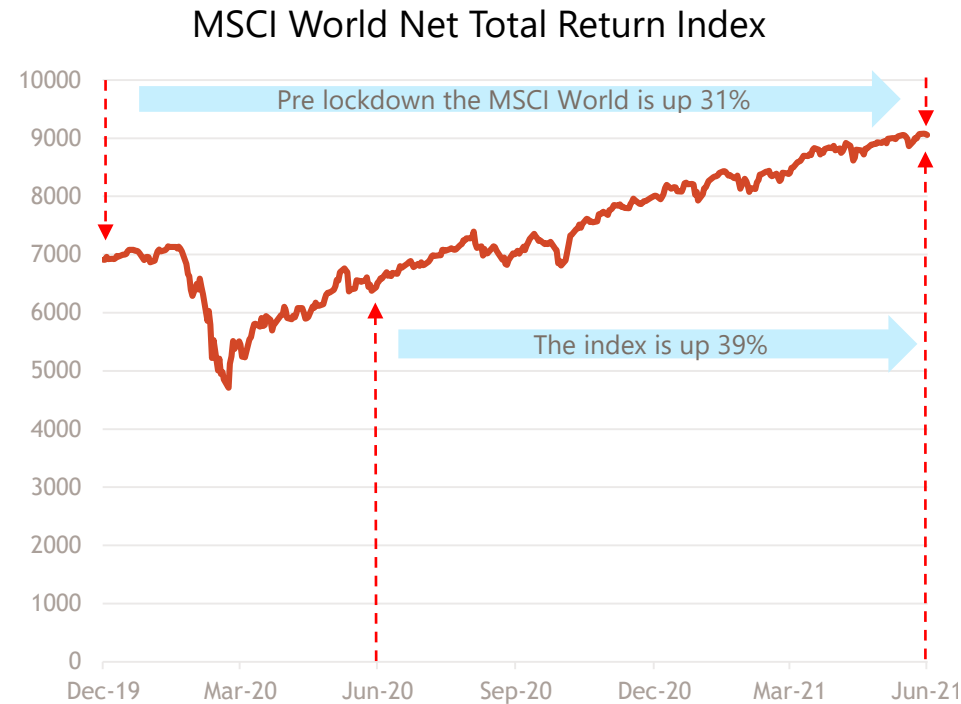
The Legacy and Budget Stabilization Fund Advisory Board is scheduled to meet Thursday, October 21, 2021. Enclosed for your reference are the materials staff provided to the advisory board. Staff will review advisory board presentation materials related to the in-state investment program at the SIB meeting and relay comments and feedback from the advisory board to the SIB.

**NO BOARD ACTION REQUESTED: Information only.**

LEGACY AND BUDGET STABILIZATION FUND  
ADVISORY BOARD  
INVESTMENT AND PERFORMANCE UPDATE  
AS OF JUNE 30, 2021

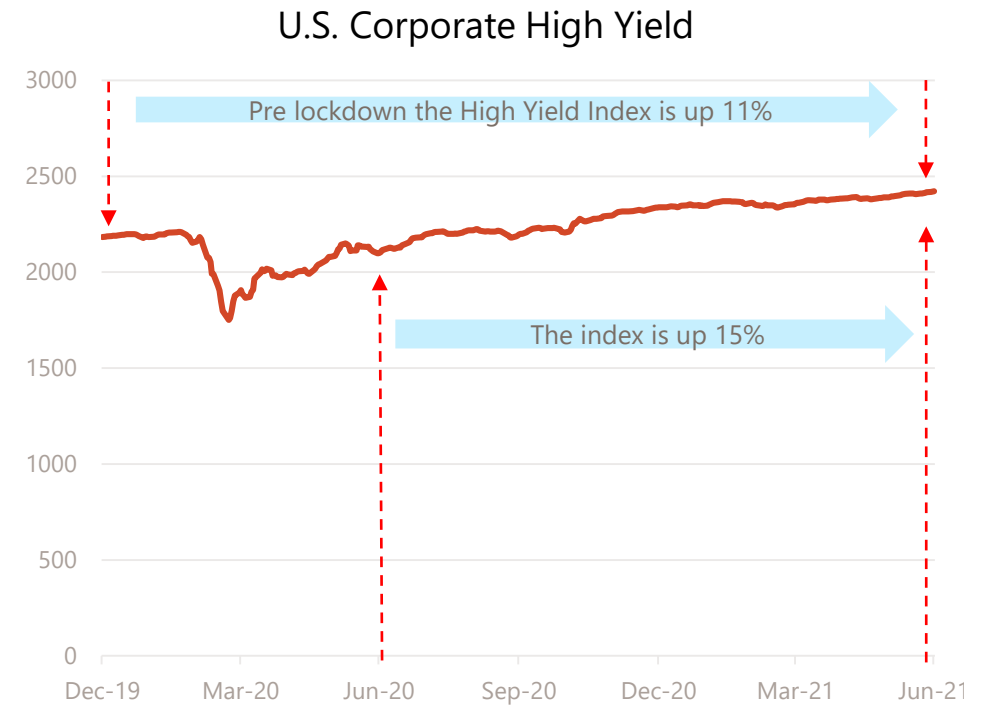
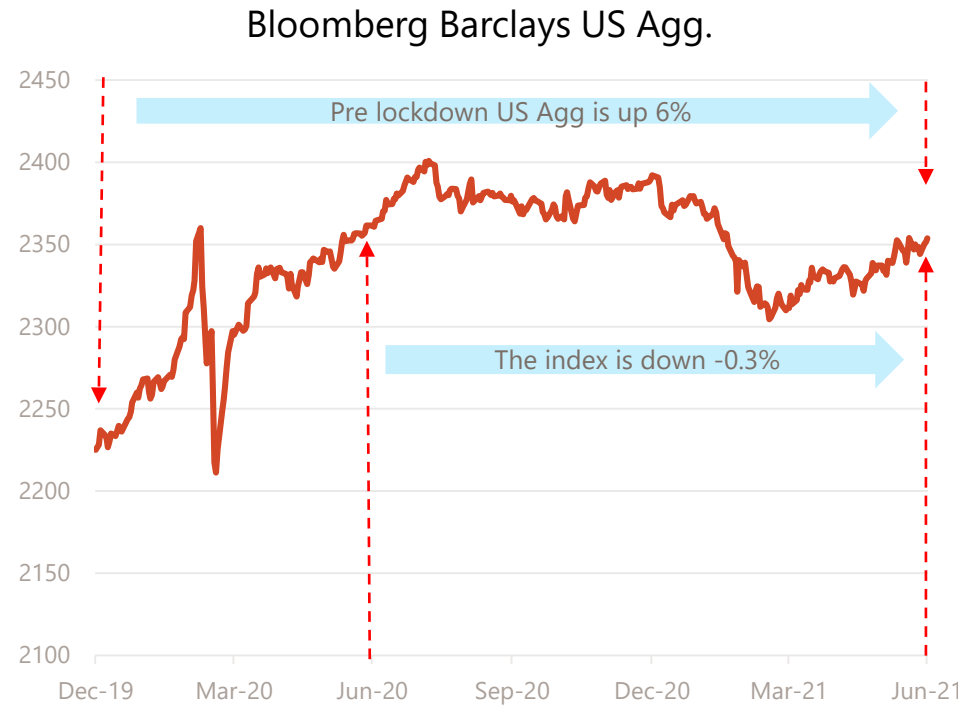


# STRONG PERFORMANCE ACROSS EQUITIES



- Pandemic drawdown for both the MSCI World Index and the S&P 500 was -34%
- Despite the correction, equities have been strong reaching new highs
- From the low point of the correction, from March 23, 2020 to June 30, 2021 the S&P 500 is up 92%

# FIXED INCOME PERFORMANCE



Surprisingly both equities and fixed income have generated positive returns despite the pandemic



# PERFORMANCE UPDATE – BUDGET STABILIZATION

AS OF JUNE 30, 2021

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

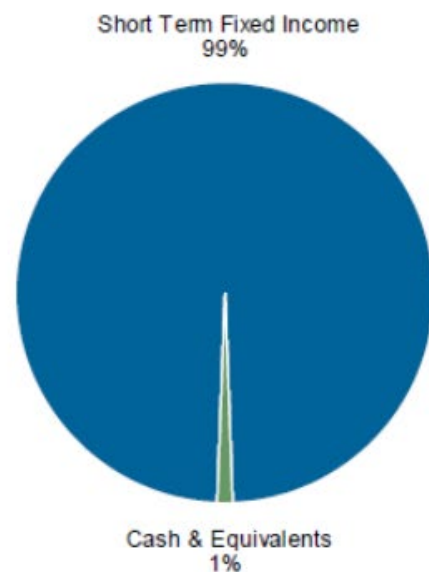
	1 Yr Ended 6/30/2021	3 Yrs Ended 6/30/2021	5 Yrs Ended 6/30/2021	Risk 5 Yrs Ended 6/30/2021
<b>Budget Stabilization \$749.6 million</b>				
<b>Total Fund Return - Net</b>	<b>3.92%</b>	<b>3.59%</b>	<b>2.37%</b>	<b>2.8%</b>
<b>Policy Benchmark Return</b>	<b>0.44%</b>	<b>2.94%</b>	<b>1.87%</b>	<b>1.1%</b>
<b>Total Relative Return</b>	<b>3.48%</b>	<b>0.65%</b>	<b>0.49%</b>	

- Budget Stabilization outperformed the policy benchmark in each of the 1, 3, and 5 year periods ended June 30, 2021
- Active management has enhanced net investment returns by roughly \$8.5 million for the 5-years ended June 30, 2021 *(Budget Stabilization investments averaged over \$350 million the last 5-years and Excess Return has averaged 0.49% per annum: \$350 million 0.49% = \$1.7 million x 5 years = \$8.5 million.)*

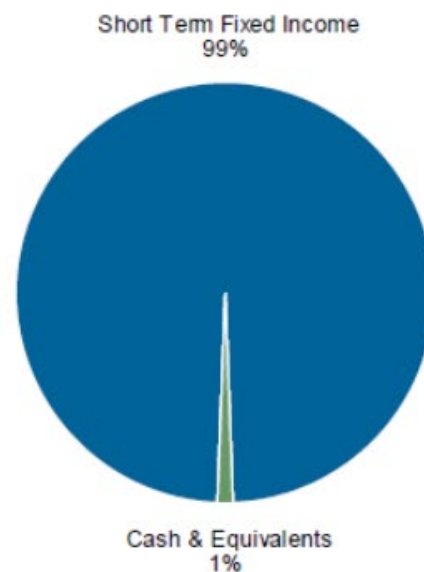
# BUDGET STABILIZATION FUND

ASSET ALLOCATION AS OF JUNE 30, 2021

Actual Asset Allocation



Target Asset Allocation



Actual asset allocations are in-line with policy targets

Asset Class	\$000s Actual	Weight Actual	Target	Percent Difference	\$000s Difference
Short Term Fixed Income	742,047	98.7%	99.2%	(0.5%)	(3,909)
Cash & Equivalents	9,849	1.3%	0.8%	0.5%	3,909
Total	751,896	100.0%	100.0%		

# BUDGET STABILIZATION FUND

ATTRIBUTION AS OF JUNE 30, 2021

## One Year Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Short Term Fixed Income	99%	99%	4.09%	0.44%	3.61%	0.00%	3.61%
Cash & Equivalents	1%	1%	0.05%	0.09%	(0.00%)	(0.00%)	(0.00%)
<b>Total</b>			<b>4.05%</b>	<b>= 0.44%</b>	<b>+ 3.61%</b>	<b>+ (0.00%)</b>	<b>3.61%</b>

Active management in short-term fixed income strategies have generated excess returns

# BUDGET STABILIZATION FUND

ATTRIBUTION AS OF JUNE 30, 2021

## Five Year Annualized Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Short Term Fixed Income	95%	95%	2.49%	1.81%	0.64%	0.00%	0.64%
BND CDs	2%	2%	-	-	0.00%	0.00%	0.00%
Cash & Equivalents	3%	3%	1.04%	1.17%	(0.00%)	0.00%	0.00%
<b>Total</b>			<b>2.52%</b>	<b>= 1.87%</b>	<b>+ 0.64%</b>	<b>+ 0.01%</b>	<b>0.65%</b>

Active management in short-term fixed income strategies have generated excess returns

## Budget Stabilization Fund Schedule of Investment Expenses

	FY 2021			FY 2020		
	Average Market Value	Fees in \$	Fees in %	Average Market Value	Fees in \$	Fees in %
Investment managers' fees:						
Short-term fixed income managers	739,251,786	840,898	0.11%	683,261,124	718,236	0.11%
Cash & equivalents managers	7,592,884	8,495	0.11%	8,585,969	8,747	0.10%
<b>Total investment managers' fees</b>	<b>746,844,669</b>	<b>849,393</b>	<b>0.11%</b>	<b>691,847,093</b>	<b>726,983</b>	<b>0.11%</b>
Custodian fees		62,363	0.01%		49,634	0.01%
Investment consultant fees		21,157	0.00%		19,757	0.00%
Administrative fees		106,354	0.01%		86,564	0.01%
<b>Total investment expenses</b>		<b>1,039,267</b>	<b>0.14%</b>		<b>882,938</b>	<b>0.13%</b>

Actual Investment Performance (Net of Fees)		3.92%	2.35%
Policy Benchmark		0.44%	4.17%
Outperformance		3.48%	-1.82%
Est. Out/(Under) Performance (\$)	\$ 25,907,512		\$ (10,963,365)

# PERFORMANCE UPDATE – LEGACY FUND

AS OF JUNE 30, 2021

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

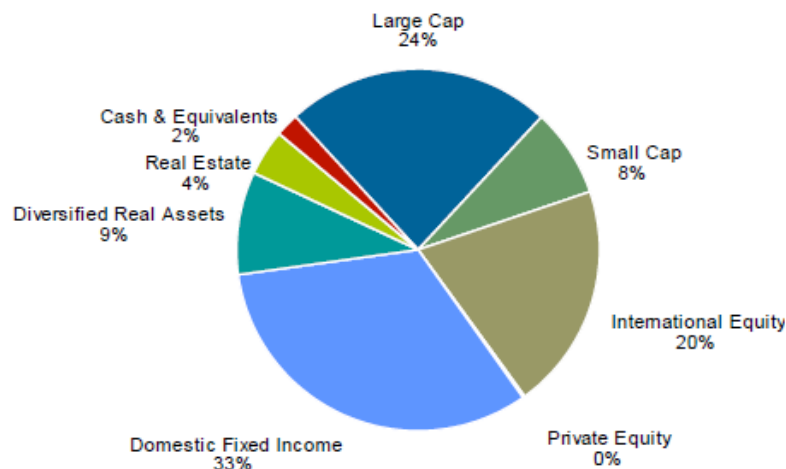
	1 Yr Ended 6/30/2021	3 Yrs Ended 6/30/2021	5 Yrs Ended 6/30/2021	Risk 5 Yrs Ended 6/30/2021
Legacy Fund \$9.0 billion				
Total Fund Return - Net	22.68%	10.31%	10.10%	10.7%
Policy Benchmark Return	20.64%	10.15%	9.36%	9.6%
Total Relative Return	2.04%	0.17%	0.74%	

- Legacy Fund outperformed the policy benchmark in each of the 1, 3, and 5 year periods ended June 30, 2021
- Active management has enhanced net investment returns by roughly \$222 million for the 5-years ended June 30, 2021 *(Legacy investments averaged over \$6 billion the last 5-years and Excess Return has averaged 0.74% per annum: \$6 billion 0.74% = \$44.4 million x 5 years = \$222 million.)*

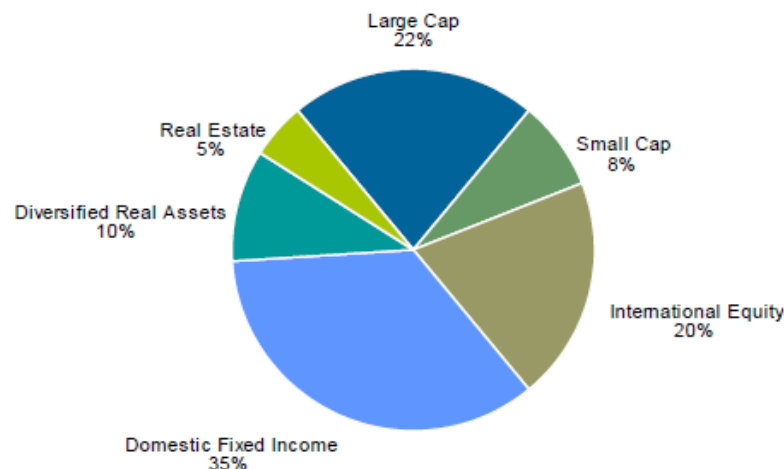
# LEGACY FUND ASSET ALLOCATION

AS OF JUNE 30, 2021

Actual Asset Allocation



Target Asset Allocation



Underweight to domestic fixed income and the higher allocation to cash was necessary to transfer earnings to the General Fund

Asset Class	\$000s Actual	Weight Actual	Target	Percent Difference	\$000s Difference
Large Cap	2,136,414	23.8%	22.0%	1.8%	157,891
Small Cap	710,115	7.9%	8.0%	(0.1%)	(9,347)
International Equity	1,814,730	20.2%	20.0%	0.2%	16,073
Private Equity	21,813	0.2%	0.0%	0.2%	21,813
Domestic Fixed Income	2,927,872	32.6%	35.0%	(2.4%)	(219,778)
Diversified Real Assets	829,376	9.2%	10.0%	(0.8%)	(69,953)
Real Estate	364,524	4.1%	5.0%	(0.9%)	(85,140)
Cash & Equivalents	188,441	2.1%	0.0%	2.1%	188,441
Total	8,993,285	100.0%	100.0%		

# LEGACY FUND ATTRIBUTION

AS OF JUNE 30, 2021

## One Year Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Large Cap	23%	22%	46.02%	43.07%	0.57%	0.07%	0.63%
Small Cap	8%	8%	42.89%	62.03%	(1.30%)	0.08%	(1.23%)
International Equity	20%	20%	38.84%	33.60%	0.93%	0.01%	0.93%
Private Equity	0%	0%	13.53%	13.53%	0.00%	0.00%	0.00%
Domestic Fixed Income	34%	35%	3.40%	(0.33%)	1.48%	0.12%	1.61%
Diversified Real Assets	10%	10%	10.81%	5.95%	0.51%	0.03%	0.55%
Real Estate	4%	5%	6.23%	7.37%	(0.06%)	0.08%	0.02%
Cash Equivalents	1%	0%	0.04%	0.04%	0.00%	(0.21%)	(0.21%)
<b>Total</b>			<b>22.95% = 20.65% + 2.12% + 0.18%</b>				<b>2.30%</b>

- Active strategies in small caps underperformed
- Relative underperformance in small caps is a result of the strength of lower quality companies highlighted by the meme stock phenomenon (GME, AMC, PLUG)



# LEGACY FUND ATTRIBUTION

AS OF JUNE 30, 2021

## Five Year Annualized Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return	
Large Cap	22%	22%	17.80%	17.99%	(0.03%)	(0.02%)	(0.05%)	
Small Cap	8%	8%	12.80%	16.47%	(0.30%)	(0.03%)	(0.32%)	
International Equity	20%	20%	12.89%	10.36%	0.51%	0.00%	0.51%	
Private Equity	0%	0%	-	-	0.00%	0.00%	0.00%	
Domestic Fixed Income	35%	35%	5.01%	3.03%	0.66%	0.02%	0.69%	
Diversified Real Assets	10%	10%	6.16%	4.08%	0.20%	0.01%	0.21%	
Real Estate	5%	5%	5.93%	6.13%	(0.01%)	(0.00%)	(0.01%)	
Cash & Equivalents	1%	0%	1.04%	1.04%	0.00%	(0.07%)	(0.07%)	
<b>Total</b>			<b>10.32%</b>	<b>= 9.36%</b>	<b>+</b>	<b>1.05%</b>	<b>+</b> (0.09%)	<b>0.96%</b>

Staff has addressed longer term underperformance of the small cap asset class with recent manager changes

## Legacy Fund

### Schedule of Investment Expenses

	FY 2021			FY 2020		
	Average Market Value	Fees in \$	Fees in %	Average Market Value	Fees in \$	Fees in %
Investment managers' fees:						
Domestic large cap equity managers	1,901,303,507	5,584,172	0.29%	1,413,507,594	2,673,660	0.19%
Domestic small cap equity managers	672,833,885	4,163,045	0.62%	499,707,561	2,064,044	0.41%
International equity managers	1,676,066,903	6,382,690	0.38%	1,277,334,864	5,160,353	0.40%
Private equity managers	10,291,186	489,404	4.76%			
Domestic fixed income managers	2,763,231,010	11,365,055	0.41%	2,357,182,137	7,071,409	0.30%
Diversified real assets managers	781,163,507	13,917,176	1.78%	684,910,595	4,408,615	0.64%
Real estate managers	344,629,956	1,515,934	0.44%	300,775,136	1,435,742	0.48%
Cash & equivalents managers	95,398,584	104,083	0.11%	62,093,357	71,072	0.11%
<b>Total investment manager expenses</b>	<b>8,244,918,538</b>	<b>43,521,559</b>	<b>0.53%</b>	<b>6,595,511,244</b>	<b>22,884,894</b>	<b>0.35%</b>
Custodian fees		758,783	0.01%		596,179	0.01%
Investment consultant fees		491,564	0.01%		246,200	0.00%
Administrative fees		1,165,358	0.01%		921,682	0.01%
<b>Total investment expenses</b>		<b>45,937,264</b>	<b>0.56%</b>		<b>24,648,955</b>	<b>0.37%</b>
<b>Total Performance Fees Paid (included in above Totals)</b>		<b>17,620,975</b>	<b>0.21%</b>		<b>3,389,150</b>	<b>0.05%</b>
<b>Actual Investment Performance (Net of Fees)</b>			<b>22.68%</b>			<b>4.23%</b>
<b>Policy Benchmark</b>			<b>20.65%</b>			<b>4.38%</b>
<b>Out/(Under) Performance (%)</b>			<b>2.03%</b>			<b>-0.15%</b>
<b>Est. Out/(Under) Performance (\$)</b>		<b>\$ 162,373,033</b>			<b>\$ (9,891,055)</b>	

# ND Legacy Fund

## Summary of Deposits, Earnings and Net Position

### As of June 30, 2021

	Deposits	Withdrawals	Total Net Earnings	Net Increase/ (Decrease)	Ending Net Position	Earnings as defined in NDCC 21-10-12
FY2012	396,585,658	-	2,300,225	398,885,883	398,885,883	2,571,475
FY2013	791,126,479	-	4,216,026	795,342,505	1,194,228,388	15,949,089
FY2014	907,214,971	-	113,153,662	1,020,368,633	2,214,597,021	50,033,655
FY2015	1,011,343,040	-	99,895,650	1,111,238,690	3,325,835,711	95,143,905
FY2016	434,853,950	-	45,851,680	480,705,630	3,806,541,341	65,326,673
FY2017	399,501,134	-	479,595,256	879,096,390	4,685,637,731	207,814,875
Totals	<u>3,940,625,232</u>	<u>-</u>	<u>745,012,499</u>	<u>4,685,637,731</u>	<u>4,685,637,731</u>	<u>436,839,672</u>

All earnings prior to 7/1/2017 became part of principal.

- Legacy Fund net investment income exceeded \$3.5 billion

FY2018	529,870,755		360,575,532	890,446,287	5,576,084,018	242,859,840
FY2019 *	628,610,681		53,186,743	681,797,424	6,257,881,442	212,403,376

<b>Earnings transferred for 2017-19 biennium</b>	<b>455,263,216</b>
--	--------------------

- Total earnings transferred to date are over \$1.3 billion

June, 2019	63,958,262	(455,263,216)	255,651,383	(135,653,571)	6,122,227,871	46,980,140
FY2020	596,589,041	-	276,492,158	873,081,199	6,995,309,070	253,723,766
FY2021	334,989,929	-	1,509,391,835	1,844,381,764	8,839,690,834	570,983,478

<b>Earnings transferred for 2019-21 biennium</b>	<b>871,687,384</b>
--	--------------------

June, 2021	45,568,041	(871,687,384)	101,630,690	(724,488,653)	8,115,202,181	<b>127,181,503</b>
FY2022	101,405,599	-	214,860,861	316,266,460	8,431,468,641	<b>156,146,990</b>

<b>Earnings to be transferred at end of 2021-23 biennium</b>	<b>283,328,493</b>
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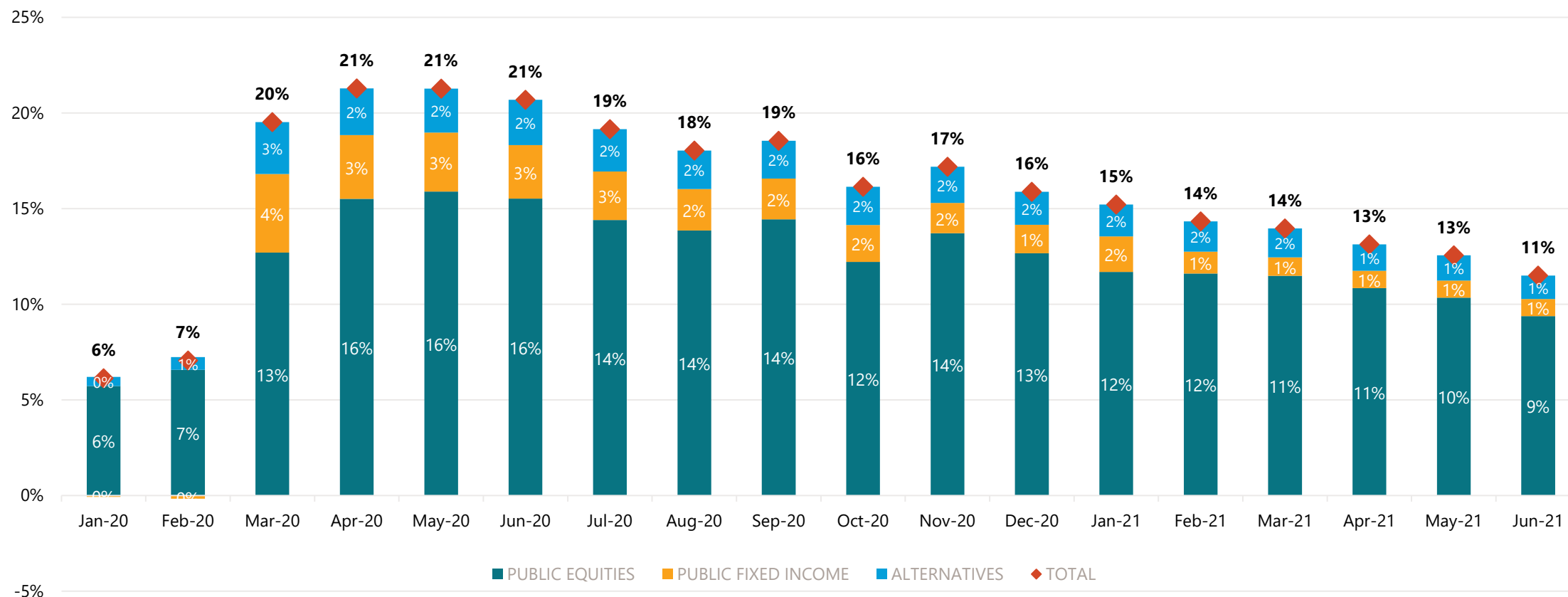
<b>Life-to-date Totals</b>	<b>6,241,617,540</b>	<b>(1,326,950,600)</b>	<b>3,516,801,701</b>	<b>8,431,468,641</b>	<b>8,431,468,641</b>	<b>2,047,118,765</b>
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\* FY2019 amounts reflect 11 months ended 5/31/19 as 2019-21 transfer was based on 23 months.

\*\* FY2022 amounts are preliminary and unaudited.

# RISK CONTRIBUTION OVER TIME

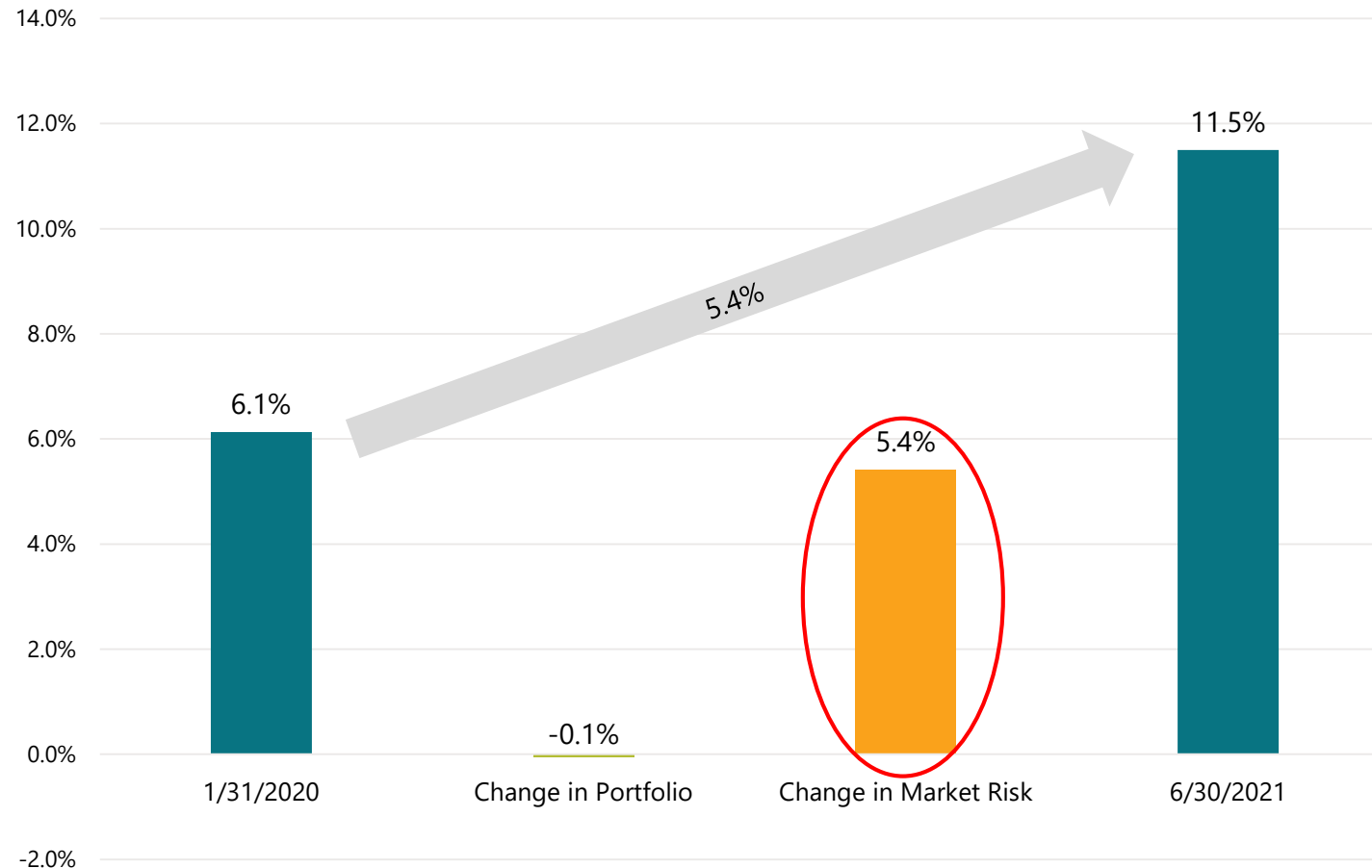
LEGACY FUND AS OF JUNE 30, 2021



- Risk has increased as a result of the global pandemic
- Risk is defined as the worst expected loss under normal market conditions (1 Year, 84% confidence)

# RISK ATTRIBUTION

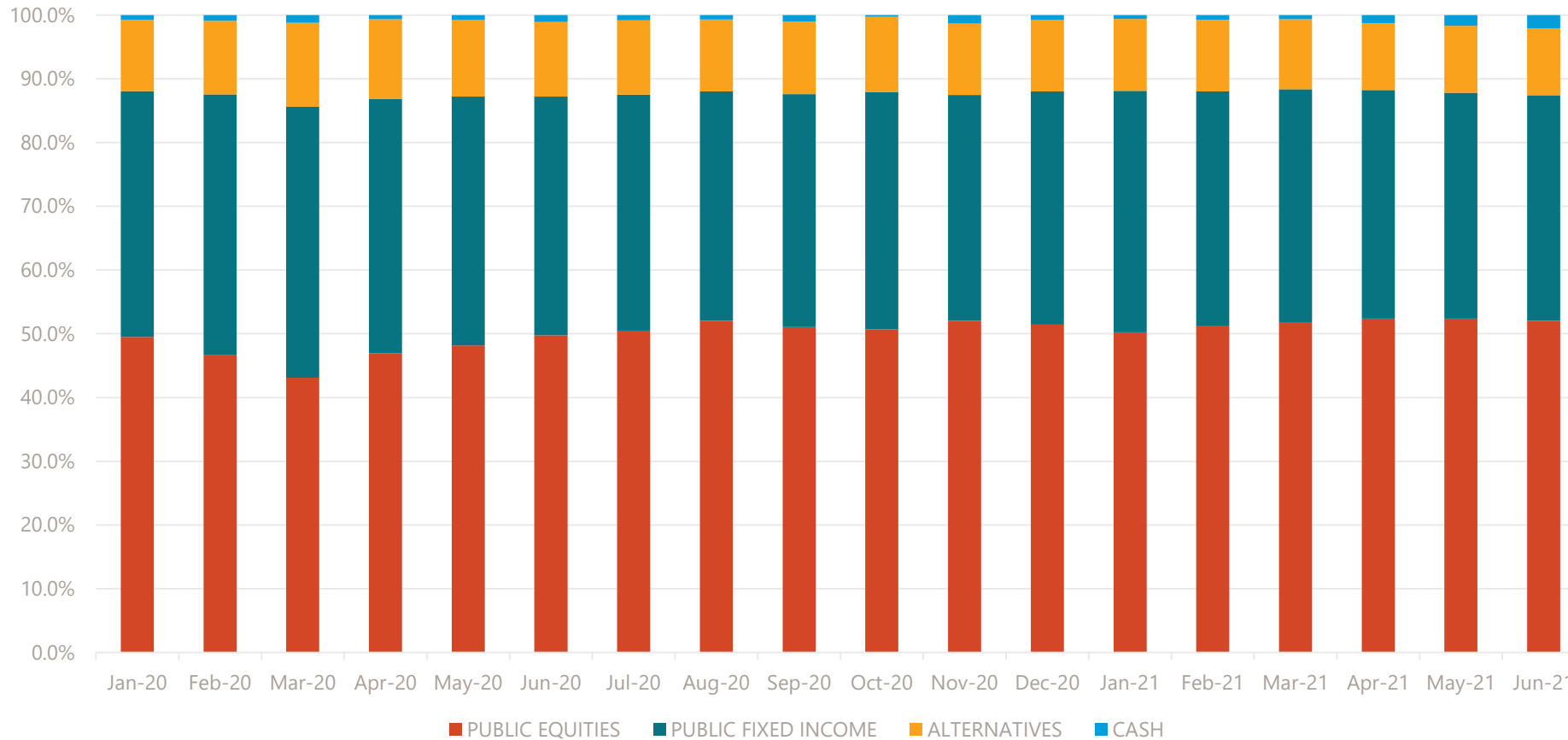
LEGACY FUND AS OF JUNE 30, 2021



- The increase in risk is driven by an increase in market risk
- Changes in the portfolio are NOT contributing to the increase in risk

# ASSET ALLOCATION OVER TIME

LEGACY FUND AS OF JUNE 30, 2021



Staff monitors portfolio allocations and rigorously rebalances to ensure exposures and allocations remain within targets

LEGACY AND BUDGET STABILIZATION FUND  
ADVISORY BOARD  
IMPACT OF THE IN-STATE INVESTMENT PROGRAM  
AS OF JUNE 30, 2021



# EXECUTIVE SUMMARY

1. Staff recommends conducting an asset allocation study to evaluate the primary and ancillary impacts of H.B. 1425
  - H.B. 1425 investments will impact the liquidity and return targets of the Legacy Fund—allocation changes to the 80% non-in-state portion of the fund may be warranted
  - An asset allocation study will be valuable for developing guidelines and a deployment schedule to judiciously invest capital for the In-State Equity Program
2. Staff has outlined a process to implement the In-State Manager Preference Program that will require two separate manager searches



# KEY COMPONENTS OF H.B. 1425

## Manager Preference

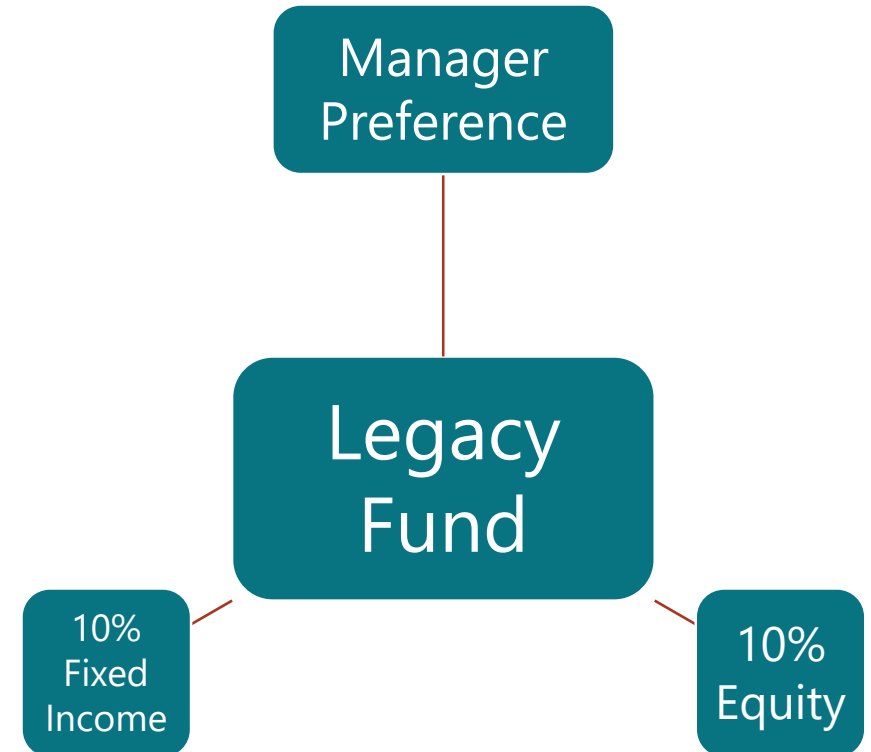
- Develop a preference program for in-state managers

## 10% Equity

- At least 3% private markets focus (50 South)
- Remainder of equity program likely invested in private markets given limited public equity opportunities

## 10% Fixed Income

- 40% infrastructure loans with 1.5% return
- 60% BND match loans with yields equivalent to comparable treasuries



# ANCILLARY IMPACT OF H.B. 1425

## Reduction of returns and earnings

- Infrastructure loan program fixed at a target rate of 1.5%
- BND Match CD program has the equivalent yield of comparable U.S. treasuries

## Increase in illiquid investments

- 10% In-State Equity allocation will likely be invested in private markets
- A portion of the 10% In-State Fixed Income Program may be illiquid

## Define process for preference program

- Process and parameters must be defined to implement the In-State Manager Preference Program

# LOWER RETURNS

## 10% In-State Fixed Income Program may reduce returns

Portfolio	Current Policy Target (%)	3 Year Ann. Perf. (Net)	5 Year Ann. Perf. (Net)
Western Asset U.S. Core Fixed Income	10.5%	6.22%	4.24%
Prudential Core Plus Fixed Income	10.5%	6.80%	4.77%
PIMCO Distressed Senior Credit Opportunities II	0.6%	5.73%	8.77%
PIMCO BRAVO II	0.1%	2.78%	4.61%
Declaration Total Return Bond Fund	2.8%	5.50%	4.96%
State Street U.S. Govt Credit Bond Index	4.9%	6.04%	3.36%
Wells Capital Medium Quality Credit	2.8%	9.80%	6.76%
Ares ND Credit Strategies	1.0%	7.65%	N/A
Cerberus ND Private Credit Fund	1.3%	9.76%	N/A
Bank of ND Match Loan CDs	0.5%	3.01%	N/A
<b>TOTAL LEGACY FUND FIXED INCOME</b>	<b>35.0%</b>	<b>6.65%</b>	<b>4.90%</b>
<b>Bloomberg Aggregate (Policy Benchmark)</b>	<b>N/A</b>	<b>5.34%</b>	<b>3.03%</b>

- BND CD program is the lowest returning fixed income strategy (With the exception of Bravo which is winding down)
- Adding infrastructure loans that yield 1.5% will likely lower long term returns

# WHY LIQUIDITY MATTERS

The Legacy Fund must maintain sufficient liquidity to meet financial obligations and to rebalance the portfolio

## 15% of Legacy Principal

- Must have enough liquid assets to raise cash if legislature votes to spend principal

## Transfer Earnings

- 2019-21 Biennium transferred \$872 million or 10% of the fund
- 2017-19 Biennium transferred \$455 million or 7 % of the fund

Limits the maximum amount of illiquid investments in the Legacy Fund

# WHY LIQUIDITY MATTERS

## Maintain liquidity for the most demanding liquidity scenarios

### Biennium 2021-2023

Liquidate total 25% of the Legacy Fund

- 15% of the principal from legislative mandate
- ~10% for earnings



### Biennium 2023-2025

Liquidate total 25% of the Legacy Fund

- 15% of the principal from legislative mandate
- ~10% for earnings



### In a 4 year time span:

A demanding liquidity scenario could require a sale of ~40-50% of liquid assets from the portfolio. Leaving a significant overweight to illiquid assets.

Insufficient liquidity can lead to significant realized losses in severe market downturns

# LEGACY FUND'S ILLIQUID STRATEGIES

Portfolio	Current Policy Target (%)	3 Year Ann. Perf. (Net)	5 Year Ann. Perf. (Net)
<b>PRIVATE EQUITY</b>			
50 South Capital 1889 Growth Fund	0.0%	N/A	N/A
Sixth Street Partners - TAO	0.2%	N/A	N/A
<b>FIXED INCOME</b>			
PIMCO Distressed Senior Credit Opportunities II	0.6%	5.73%	8.77%
PIMCO BRAVO II	0.1%	2.78%	4.61%
Ares ND Credit Strategies	1.0%	7.65%	N/A
Cerberus ND Private Credit Fund	1.3%	9.76%	N/A
<i>Bloomberg Aggregate (Benchmark)</i>		<b>5.34%</b>	<b>3.03%</b>
<b>INFRASTRUCTURE</b>			
Grosvenor Customized Infrastructure Strategies II	0.7%	15.29%	11.32%
JP Morgan Infrastructure Investments Fund	1.2%	7.21%	7.55%
ISQ Global Infrastructure Fund II	0.7%	9.58%	N/A
Macquarie Infrastructure Partners IV	0.9%	N/A	N/A
Macquarie Infrastructure Partners V	0.1%	N/A	N/A
<i>50% NCREIF ODCE/50% CPI-U (lagged one quarter)(Benchmark)</i>		<b>3.59%</b>	<b>3.07%</b>
<b>REAL ESTATE</b>			
J.P. Morgan U.S. Real Estate Income and Growth Domestic, LP	2.5%	2.79%	4.60%
Invesco Core Real Estate-USA, LP	2.5%	5.00%	6.20%
<i>NCREIF Total Index(Benchmark)</i>		<b>5.50%</b>	<b>6.13%</b>

- Illiquid strategies in the Legacy Fund diversifies the portfolio and helps generate excess returns vs the policy benchmark
- Policy target allocation to illiquid investments is currently ~12%
- In-State Equity Program likely to increase illiquid investments by at least 10%
- 10% In-State Fixed Income Program likely to increase illiquidity
- Total investments in illiquid assets could increase to 32%
- **The Legacy Fund may have capacity to increase illiquid investments—an asset allocation study will be key to determining the appropriate amount**

# 10% IN-STATE EQUITY PROGRAM

## Unresolved Questions:

- What is the appropriate pacing schedule to deploy capital?
  - Seek proper vintage year diversification
  - Ensure enough dry powder to re-up with existing programs (e.g. 50 South)
- What are the investment parameters of the program? Factors to consider include:
  - Maximum position level size
  - Sector/strategy concentration
- How to deploy additional strategies that do not compete against the existing program?

# LEGACY EARNINGS FUND

Clarification: Who is responsible for determining the asset allocation of the Legacy Earnings Fund?

1. Legacy and Budget Stabilization Fund Advisory Board
2. Legacy Fund Earnings Committee



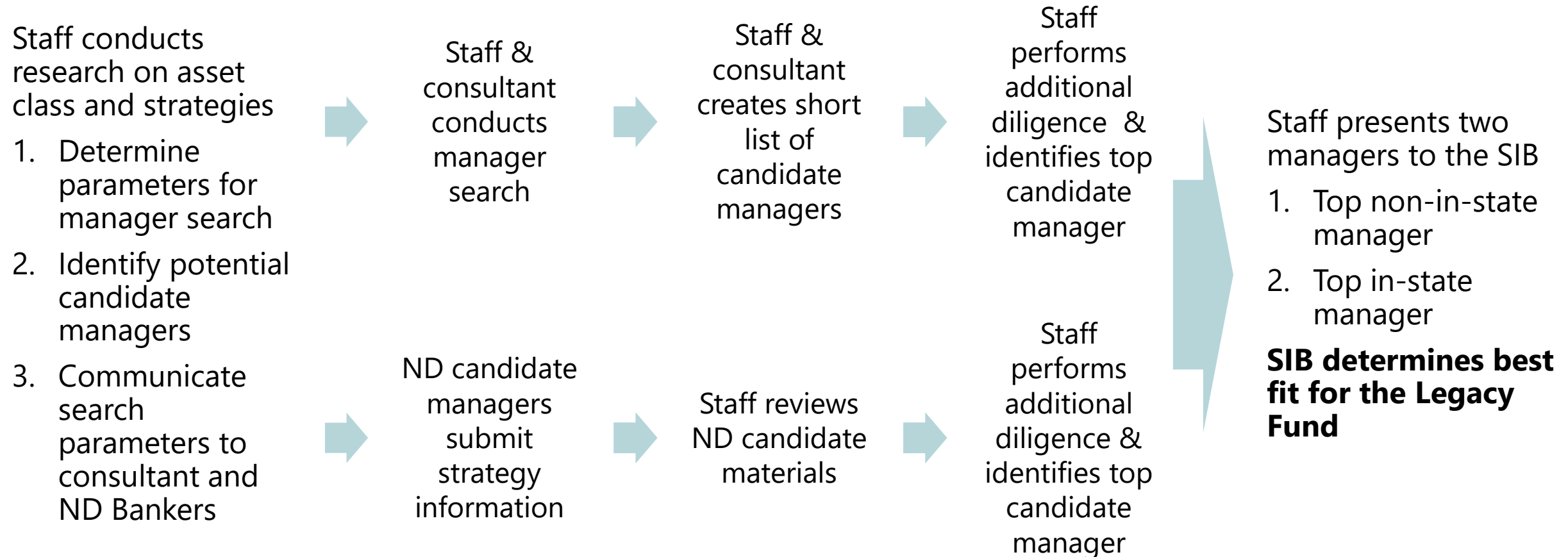
# ASSET ALLOCATION STUDY

Staff recommends conducting an asset allocation study to address key issues:

- Determine allocation targets of the 80% non-in-state portion of the Legacy Fund to account for lower returning assets in the In-State Fixed Income Program
- Ascertain maximum amount of illiquid strategies in the Legacy Fund
- Adjust allocation targets to existing illiquid strategies if necessary
- Establish a pacing schedule for the In-State Equity Program
- Determine appropriate investment guidelines for the entire In-State Equity Program
- Determine asset allocation for the Legacy Earnings Fund

# MANAGER PREFERENCE PROGRAM

Staff conducts two separate searches to implement the In-State Preference Program



**FOR INFORMATIONAL PURPOSES ONLY**

TO: State Investment Board

FROM: Investment Staff

DATE: October 22, 2021

SUBJECT: Watch List Update

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**Background:**

Staff continually performs an assessment of the current investment manager lineup through both a quantitative and qualitative lens. When a manager's performance hasn't met expectations or when a significant event at the organization occurs, a formal manager review may be warranted. Staff will bring a recommendation to place the manager on the Watchlist until the review is complete.

Factors that may trigger a manager review may include:

- Significant changes in organizational structure
- Significant changes in investment philosophy
- Significant deviation in portfolio management from stated philosophy
- Substandard investment performance
- Diminished confidence in manager

Once on the Watchlist, Staff will perform greater scrutiny of the manager's activities, circumstances, and investment results. The review may include additional calls, on-site visits, and possibly an appearance before the Board. Throughout the review process, Staff will provide updates to the Board or a recommendation for action once the review is complete.

Historically, Staff has placed managers under review for both poor performance and qualitative reasons such as key employee departures. There are currently two managers on the watch list for performance reasons, LSV Asset Management (LSV) and Epoch Investment Partners (Epoch). Staff has periodically provided updates—Staff has not recommended removing these managers from the watch list as of yet.

When evaluating manager performance, Staff assesses longer time periods. Typically, a manager's performance should be reviewed over a full market cycle which has averaged 5-7 years historically. The review focuses on their performance relative to their benchmark over the long term. Once a review is complete, Staff will bring forward a recommendation to the board for action. The current Watchlist and an overview of each manager follows.

## Current Watchlist:

### LSV:

TOTAL LSV EQUITIES	>>>>>>>	\$	1,755,560,915	1-year	3-year	5-years	10-years
LSV World Equities	Pension	\$	476,660,890	41.4%	9.9%	11.3%	-
<i>Benchmark</i>			<i>MSCI ACWI</i>	28.6%	14.3%	14.3%	-
	<i>Pension</i>		<i>Relative performance</i>	12.7%	-4.4%	-3.0%	-
LSV U.S. Large Cap Value	Insurance	\$	82,050,027	48.1%	9.8%	11.8%	13.7%
LSV U.S. Large Cap Value	Legacy	\$	535,596,298	46.7%	9.8%	12.2%	-
<i>Benchmark</i>			<i>Russell 1000 Value</i>	36.4%	11.5%	11.7%	13.0%
	<i>Insurance</i>		<i>Relative performance</i>	11.6%	-1.7%	0.2%	0.6%
	<i>Legacy</i>		<i>Relative performance</i>	10.2%	-1.6%	0.5%	-
LSV International Value	Insurance	\$	75,312,372	27.6%	4.4%	7.4%	6.6%
LSV International Value	Legacy	\$	585,941,328	27.7%	4.7%	7.5%	-
<i>Benchmark</i>			<i>MSCI EAFE</i>	26.1%	9.0%	9.7%	7.3%
	<i>Insurance</i>		<i>Relative performance</i>	1.4%	-4.6%	-2.3%	-0.7%
	<i>Legacy</i>		<i>Relative performance</i>	1.6%	-4.3%	-2.3%	-

As of August 31, 2021

LSV was placed on the Watchlist in May 2019 for performance reasons. As of August 31, 2021, LSV managed over \$1.7 billion for the SIB across global, domestic and international equity strategies. LSV is a deep value equity manager employing a proprietary, disciplined quantitative process to rank stocks and construct portfolios. Their systematic investment approach is designed with an understanding of the fundamental causes of security mispricing. Unlike other deep value managers, they do not invest in distressed companies that require major turnarounds. Rather, they look for generally healthy companies that have gone through extended periods of underperformance, but more recently exhibit positive signs of change.

At the time LSV was placed under review, performance in the short to intermediate terms was moderately below benchmarks. The primary reason was that value-oriented equities have generally underperformed since the global financial crisis. Staff has conducted onsite visits with LSV twice since the manager was placed on the Watchlist. Staff has held calls with the manager and continues to closely monitor performance. Recently, LSV's performance has rebounded and is outperforming its benchmark for the 1-year period. While recent performance has been strong, LSV is still underperforming over the intermediate timeframes. Staff is hopeful that outperformance continues, but recommends keeping LSV on watch.

## Epoch:

TOTAL EPOCH EQUITIES >>>>>>>		\$	412,602,080	1-year	3-year	5-years	Since Inception (Jan. 2012)
Epoch World Equities	Pension	\$	412,602,080	26.5%	12.2%	13.8%	11.9%
Benchmark			MSCI World	29.8%	15.0%	14.8%	12.8%
	Pension		Relative performance	-3.3%	-2.7%	-1.1%	-0.9%

As of August 31, 2021

Epoch was placed on the Watchlist in September 2020 for performance reasons. As of August 31, 2021, Epoch managed over \$400 million for the SIB in their Global Choice strategy. This strategy seeks long-term capital appreciation by investing in a concentrated portfolio of global businesses they believe have superior risk-reward profiles. Ideas are sourced across firm strategies to create a concentrated portfolio of best ideas. Companies are selected for the portfolio based on their ability to generate free cash flow rather than traditional accounting based metrics such as price-to-book and price-to-earnings. Investment analysis takes into consideration factors that can lead to growing free cash flow and management's ability to maximize return on cash flow allocation.

Epoch has underperformed its benchmark since the SIB first invested in the strategy. Compared to the Global Equity peer group in Callan and eVestment databases, Epoch falls below the median manager over long time horizons. Additionally, attribution adjusted for common equity risk factors since the inception of the mandate indicate that bottoms-up stock selection, the stated goal of the mandate, has been a detractor relative to the benchmark. Staff recommends keeping Epoch on watch and may initiate a manager search in the future.

### Conclusion:

Staff recommends maintaining both LSV and Epoch on Watch. While LSV has improved performance in the past year, Staff would like to see this improvement carry over into longer time horizons. Staff will also evaluate whether LSV's deep value factor exposure is optimal for the NDSIB portfolios. Regarding Epoch, Staff may look to initiate a new manager search after completing an evaluation on how to improve the structure of the Global Equity allocation in the Pension Pool.

## MEMORANDUM

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**TO:** SIB  
**FROM:** Jan Murtha, Interim Executive Director  
**DATE:** October 20, 2021  
**RE:** Executive Search Committee Update

Subsequent to the posting of the CIO position and specifications in September EFL began receiving applications for the position and speaking with prospective candidates.

The Executive Search Committee is scheduled to meet Friday October 22, 2021, subsequent to the conclusion of the SIB meeting. The search committee will review and discuss compensation parameters for the CIO position and discuss the current status of the search.

**NO BOARD ACTION REQUESTED: Information only.**

# Board Member Orientation and Education Program

The State Investment Board (Board) members are responsible for making policy decisions affecting all major aspects of investment program administration. Therefore, Board members will develop and maintain an appropriate level of knowledge that provides and improves core competencies necessary to govern large, complex investment funds.

## 1. Board Member Core Competencies

Board members are expected to develop and maintain their knowledge on effective Board governance. The State Investment Board will utilize a research-based framework to support the six core competencies of effective boards, which include:

- 1) **Contextual:** The Board understands and takes into account the culture, norms, and values of the organization it governs.
- 2) **Educational:** The Board takes the necessary steps to ensure that members are well informed about the organization and the professions working there, as well as the Board's own roles, responsibilities, and performance.
- 3) **Interpersonal:** The Board nurtures the development of its member as a group, attends to the Board's collective welfare, and fosters a sense of cohesiveness.
- 4) **Analytical:** The Board recognizes the complexities and subtleties in the issues it faces, and it draws on multiple perspectives to dissect complex problems and to synthesize appropriate responses.
- 5) **Political:** The Board accepts, as one of its primary responsibilities, the need to develop and maintain healthy relationships among all key constituencies.
- 6) **Strategic:** The Board envisions and shapes institutional direction and helps to ensure a strategic approach to the organization's future.

## 2. Board Member Education

The Executive Director will present an annual board education plan to align with the six core competencies. This will include a focus on critical areas necessary to effectively govern institutional investments. These board education topics will be presented, at minimum, on a 2-year rotation. These include, but are not limited to:

- a. Board governance policies
- b. Asset allocation and investment management concepts
- c. Investment terminology
- d. Prudent Investor Rule
- e. Financial reporting, controls, and audits
- f. Open meeting and open records laws
- g. Fiduciary responsibilities
- h. Ethics and conflicts of interest

Beyond regular, meeting-embedded, board education, the State Investment Board supports additional professional learning opportunities to develop core competencies, discharge their fiduciary duties, and ensure Board members have a full understanding of the issues facing the SIB. These areas include:

- a. New Board member orientation

- b. Educational conferences, workshops, and other training programs
- c. In-house education sessions
- d. Webinars, reports, and studies

The collective Board, and individual Board members, should identify areas in which they might benefit from additional education, and work with the Executive Director to find or develop educational opportunities to best address those needs.

Board members must annually report board education received each year.

### **3. New Board Member Orientation**

Each new Board member is strongly encouraged to attend a new Board member orientation session(s) as soon as possible after appointed to the Board or elected to office. The Board Chair will assign each new Board member an experienced Board mentor to assist the new member in becoming familiar with roles and responsibilities. The orientation sessions will be developed by the Executive Director, at minimum, review of the following topics and materials over the course of the Board members first year include:

- a. Introduction to RIO staff
- b. Tour of RIO office
- c. Board Governance Manual
  - a. Carver Model of Governance
  - b. Boards That Make a Difference
- d. Board duties and responsibilities
- e. History and overview of the investment program
- f. Overview of TFFR-SIB-RIO organizational structure
- g. Laws, rules, and board policies governing the investment program
- h. Fiduciary responsibilities, conflict of interests, and ethics
- i. Open meetings and open records
- j. Board meeting schedule and protocol
- k. Board meeting minutes and materials
- l. Annual financial report
- m. Investment program, investment policy statement, asset allocation, and performance
- n. RIO website – TFFR and SIB sections
- o. Legislative issues
- p. List of educational conferences and training sessions
- q. Other relevant information or materials deemed appropriate

### **4. Ongoing Board Member Education**

#### *a) Educational Conferences, Workshops, and other Training Programs*

The Executive Director will maintain a list of educational conferences, workshops, and other training programs appropriate for Board members to attend. The list will be provided at least annually to Board members. Board members may attend such conferences or others deemed to be appropriate by the Executive Director. Subject to budget availability, Board members may attend at least one out of state educational conference each year.

The Executive Director will review conference agendas and materials to ensure they are geared toward Board member education, subject to budget availability, and will approve board travel requests. Board



travel outside of the continental United States must be approved by the Board Chair and Executive Director.

The Executive Director will inform the Board of educational conferences, workshops, or other training programs attended by board members on an annual basis.

*b) In-House Education Sessions*

Based on the education needs identified by board members or staff, the Executive Director will arrange for staff or outside service providers to conduct educational sessions at regularly scheduled board meetings. Topics may include board governance, investments, asset allocations, benchmarks, and other topics determined by the Board.

*c) Webinars, Reports, and Studies*

Board members are encouraged to subscribe to mailing lists and review websites for information about public pension plan conferences, webinars, reports, and studies from pension and investment organizations.

The Executive Director will also provide links to recent published reports and studies with board meeting materials.

## **Governance & Policy Review Committee Charter**

### **PURPOSE**

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

### **KEY RESPONSIBILITIES**

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

1. Advise the SIB about operational strategies relevant to the SIB's governance manual to strengthen the SIB and empower the Board members to meet its obligations related to sound governance principles and abide by the agency's mission.
2. Advise the SIB about strategies that strive to increase the individual Board member effectiveness and their abilities to work collaboratively with their peers.
3. Review and make recommendations for policies for the governance manual that reflect best practices for overall good governance.
4. Review any complaints or allegations of any violations by a Board member occurring within their role as a Board member.
5. Lead and facilitate periodic board self-assessments to ensure superior board performance and overall trust in effectiveness.
6. Request Retirement and Investment Office staff for specific topic training and education for Board members. Make recommendations regarding an orientation process for newly appointed SIB members.

### **GOVERNANCE COMMITTEE COMPOSITION AND TERM LIMITS**

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

### **MEETINGS**

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

### **AUTHORIZATION AND LIMITATIONS OF POWER**

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

## MEMORANDUM

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**TO:** SIB  
**FROM:** Jan Murtha, Interim Executive Director  
**DATE:** October 20, 2021  
**RE:** Committee Assignments

Land Commissioner Jodi Smith currently serves on the following committees of the SIB:

- Audit Committee (Standing Committee) representing appointed and elected officials - approved by the SIB.
- Securities Litigation Committee (Standing Committee) - appointed by Chair.
- Executive Search Committee (Ad hoc Committee) – appointed by Chair.

Given Commissioner Smith's pending resignation, replacement members on these committees must be designated. Generally, replacement committee assignments occur at the first regular meeting subsequent to the vacancy, however, all three committees will meet prior to the next regularly scheduled SIB meeting in November, 2021.

**BOARD ACTION REQUESTED: Appoint/Approve new Committee Assignments.**

<b>CUSTOMER SATISFACTION SURVEY</b> <b>NORTH DAKOTA STATE INVESTMENT BOARD</b> <b>2021</b>
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Evaluation Forms Sent: 18  
 Evaluation Forms Returned: 12

**1. Availability/Responsiveness to Requests (via calls and/or emails)**

Excellent	Above Average	Average	Poor	N/A
9	2	1	0	0

**2. Clarity and Effectiveness of Communications, Reports, and Presentations**

Excellent	Above Average	Average	Poor	N/A
7	3	2	0	0

**3. Frequency of Communications/Reporting**

Excellent	Above Average	Average	Poor	N/A
8	3	1	0	0

**4. Knowledge of Investments**

Excellent	Above Average	Average	Poor	N/A
8	2	0	0	2

**5. Overall value of services provided**

Excellent	Above Average	Average	Poor	N/A
9	2	1	0	0

**2021 Summary of SIB Client Satisfaction Survey Ratings:**

	Excellent	Above Average	Average	Poor	N/A
Totals	41	12	5	0	2
Weight	4	3	2	1	0
Percent	68%	20%	8%	0%	3%
<b>Average</b>	<b>3.63</b>				

**2020 Summary of SIB Client Satisfaction Survey Ratings:**

	Excellent	Above Average	Average	Poor	N/A
Totals	40	9	15	0	1
Weight	4	3	2	1	0
Percent	62%	14%	23%	0%	1%
<b>Average</b>	<b>3.39</b>				

**2019 Summary of SIB Client Satisfaction Survey Ratings:**

	Excellent	Above Average	Average	Poor	N/A
Totals	37	15	3	0	0
Grade	4	3	2	1	0
Percent	67%	27%	5%	0%	0%
<b>Average</b>	<b>3.62</b>				

**Overall Customer Satisfaction Survey Comments and Impressions:**

- We are very pleased to have SIB working with us and helping with our pension funds. I can not think of anything that you would need to change at this time.

Following are comments made by TFFR board members through the board satisfaction review process: Thanks to the many knowledgeable staff at SIB who provide quality and friendly services. I am very satisfied with the service provided. The office is already making the shifts that I would recommend: a renewed focus on board education and more detailed information on proposals that are up for consideration. Modernizing the electronic connections between you and members will improve the immediacy and frequency in accessing information. I know it is in the works but the sooner the better. I believe it is important to continue the planning to include the TFFR board in board education on investments, such as, but not limited to, manager selections, fiduciary expectations, overall fund management, placement/removal from the watchlist, and general updates.

■ SIB is doing an excellent job - I have no suggestions for improvements.

■ I was disappointed that the SIB was absent from the initial legislative hearings last session on HB 1231. The SIB invests pension trust fund monies that under federal law must be invested in a fiduciary manner, with keen observance of the exclusive benefit rule. One interpretation of HB 1231 is that it would have required the SIB to violate that exclusive benefit rule by requiring the SIB to consider "investing moneys locally before investing moneys outside of the state." As a fiduciary body, the SIB should have been at the hearing, either requesting clarification of the proposal to ensure its compliance with the exclusive benefit rule or arguing for its demise.

■ As a SIB member, I feel the Board does an excellent job with very capable leadership of Lt Gov and members. RIO staff do an excellent job in investing the funds and working with money managers. This is demonstrated by the tremendous success of the WSI Fund. My concerns are making sure we hire a capable CIO/ED and that RIO has the employees to manage the dollars under their control.

■ I have no suggestions on improvement. I have primarily worked with Dave Hunter and Connie Flanagan in the past. Both have provided excellent customer service and are great to work. Even though we are a smaller organization/account, they still were attentive to our needs. I hope the next Executive Director to replace Dave Hunter has that same mindset for both the large accounts and the smaller accounts.

■ Is it possible to get the monthly results sooner? Currently, I wait to the end of the following month to get the preceding month.

## MEMORANDUM

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**TO:** State Investment Board  
**FROM:** Jan Murtha  
**DATE:** October 20, 2021  
**RE:** Executive Limitations/Staff Relations

Ms. Murtha will provide a verbal update to the SIB on agency efforts to address current and future organizational risk through strategic planning. Including updates on the following topics:

1. **Special Legislative Session:** Staff will provide an update on testimony before legislative committees related to additional FTE requests.
2. **Facility Move:** RIO is confirmed to move to the WSI space in November 2021.
3. **Current Procurement Activities including:**
  - **PAS Project** – The project is in the pre-award negotiation stage.
  - **Temporary Assistance for specialized services** – The agency issued an RFP for temporary assistance firms that can provide contract services for additional investment personnel.
4. **IT Unification:** Unification efforts continue to progress, with both internal and external progress meetings.
5. **Retirements/Resignations/FTE's/Temporary Assistance:** Staff will provide an update on current postings, initial results from the Engagement Pulse survey conducted this summer, and staff trainings.

**BOARD ACTION REQUESTED: Board Acceptance.**

**BUDGETING / FINANCIAL CONDITION**

**AS OF SEPTEMBER 30, 2021**

	2021-2023 BUDGET	ADJUSTED APPROPRIATION	BIENNIUM TO DATE ACTUAL	EXPENDITURES		
				BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	\$ 5,103,977.00 *	\$ 5,103,977.00	\$ 553,406.88	\$ 4,550,570.12	89.16%	87.50%
OPERATING EXPENDITURES	3,567,403.00 *	3,567,403.00	130,696.41	3,436,706.59	96.34%	87.50%
CAPITAL ASSETS	6,300,000.00	6,300,000.00	0.00	6,300,000.00	100.00%	87.50%
CONTINGENCY	100,000.00	100,000.00	0.00	100,000.00	100.00%	87.50%
TOTAL	<u>\$ 15,071,380.00</u>	<u>\$ 15,071,380.00</u>	<u>\$ 684,103.29</u>	<u>14,387,276.71</u>	<u>95.46%</u>	<u>87.50%</u>

\* In addition to the Capital Assets line, the salaries and benefit line includes \$50,000 and the operating expenditure budget includes \$2,318,875 for the TFFR Pension Administration System Project.

## EXPENDITURE REPORT

**QUARTER ENDED SEPTEMBER 30, 2021**

	INVESTMENT	RETIREMENT	QUARTERLY TOTALS	FISCAL YEAR TO - DATE	BIENNIUM TO - DATE
<u>CONTINUING APPROPRIATIONS</u>					
INVESTMENT EXPENDITURES	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0	61,476,743	61,476,743	61,476,743	61,476,743
2. REFUND PAYMENTS	0	1,544,627	1,544,627	1,544,627	1,544,627
TOTAL MEMBER CLAIMS	0	63,021,370	63,021,370	63,021,370	63,021,370
OTHER CONTINUING APPROPRIATIONS	29,544	484	30,028	30,028	30,028
TOTAL CONTINUING APPROPRIATIONS	29,544	63,021,854	63,051,398	63,051,398	63,051,398
<u>BUDGETED EXPENDITURES</u>					
1. SALARIES & BENEFITS					
SALARIES	212,538	206,551	419,090	419,090	419,090
OVERTIME/TEMPORARY	0	0	0	0	0
TERMINATION SALARY & BENEFITS	0	0	0	0	0
FRINGE BENEFITS	62,422	71,896	134,317	134,317	134,317
TOTAL SALARY & BENEFITS	274,960	278,447	553,407	553,407	553,407
2. OPERATING EXPENDITURES					
DATA PROCESSING	6,604	48,465	55,069	55,069	55,069
TELECOMMUNICATIONS - ISD	623	911	1,534	1,534	1,534
TRAVEL	1,804	613	2,417	2,417	2,417
IT - SOFTWARE/SUPPLIES	0	0	0	0	0
POSTAGE SERVICES	375	1,204	1,579	1,579	1,579
IT - CONTRACTUAL SERVICES	201	244	446	446	446
BUILDING/LAND RENT & LEASES	9,059	13,932	22,991	22,991	22,991
DUES & PROF. DEVELOPMENT	355	680	1,035	1,035	1,035
OPERATING FEES & SERVICES	664	667	1,331	1,331	1,331
REPAIR SERVICE	0	0	0	0	0
PROFESSIONAL SERVICES	697	42,116	42,813	42,813	42,813
INSURANCE	78	110	188	188	188
OFFICE SUPPLIES	30	56	86	86	86
PRINTING	0	335	335	335	335
PROFESSIONAL SUPPLIES & MATERIALS	336	495	831	831	831
MISCELLANEOUS SUPPLIES	20	22	42	42	42
IT EQUIPMENT UNDER \$5000	0	0	0	0	0
OTHER EQUIP. UNDER \$5000	0	0	0	0	0
OFFICE EQUIP. & FURNITURE UNDER \$5000	0	0	0	0	0
TOTAL OPERATING EXPENDITURES	20,846	109,850	130,696	130,696	130,696
3. CAPITAL ASSETS	0	0	0	0	0
4. CONTINGENCY	0	0	0	0	0
TOTAL BUDGETED EXPENDITURES	295,806	388,297	684,103	684,103	684,103
TOTAL EXPENDITURES	\$ 295,806	\$ 63,409,667	\$ 63,735,502	\$ 63,735,502	\$ 63,735,502



## EXPENDITURE REPORT

**QUARTER ENDED SEPTEMBER 30, 2021**

PAS PROJECT - UNEXPENDED PORTION CARRIED FORWARD TO 2021-23 BIENNIUM

	2019-2021 Biennium Approved Budget	2019-2021 Biennium Actual	Carryover to 2021-2023 Biennium	2021-2023 Biennium Actual *	Total PAS Project to Date
	RETIREMENT	RETIREMENT	RETIREMENT	RETIREMENT	RETIREMENT
TEMPORARY SALARIES	50,000	0	50,000	0	0
IT - DATA PROCESSING (NDIT PROJECT MGMT)	775,000	34,025	740,975	3,725	37,751
PROFESSIONAL SERVICES	1,875,000	297,099	1,577,901	41,113	338,212
CAPITAL ASSETS	6,300,000	0	6,300,000	0	0
<b>TOTAL PAS PROJECT BUDGET</b>	<b>9,000,000</b>	<b>331,125</b>	<b>8,668,875</b>	<b>44,838</b>	<b>375,963</b>

\* The amounts in the 2021-2023 actual column are included in the totals on the Expenditure Report on the previous page.

**Quarterly Report on Ends  
Q3 2021**

Investment Program

**Manager Research and Monitoring Highlights**

Over the quarter, Staff finished a quantitative international equity search and the Board approved staff's recommendation to hire Arrowstreet Capital. In addition, a pacing analysis for the Pension Pool's private equity program was completed. Staff also evaluated Adam's Street's 2021 Global Fund, which led to a commitment to this fund. Lastly, work has been in progress for the pricing of a private market investment opportunity.

**Portfolio Changes & Investment Consultant**

At the August 27<sup>th</sup> Board meeting, the Board approved Staff's recommendation to hire Arrowstreet Capital to manage a quantitative strategy in international equities for all three investment pools.

At the September 24<sup>th</sup> Board meeting, the Board approved a \$60 million commitment to Adams Street's 2021 Global Fund for the Pension Pool.

**Other**

Staff continues to conduct preliminary due diligence on prospect 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.

Staff attended meetings with many SIB client boards, sub-committees and/or legislative committees or representatives including TFFR, PERS, and WSI.

LSV and Epoch remain on the Watch List.

# NDRIO Investment Due Diligence Quarterly Monitoring Report

Jul-01-2021 to Sep-30-2021

Date	Firm	Reason For Call	Key Takeaways	Location	RIO Attendees
7/19/2021	Callan	2021 National Conference		Salt Lake City	Darren Schulz,Matt Posch
7/26/2021	Riverbridge Partners	Portfolio Update		Call	Eric Chin,Matt Posch
7/26/2021	Manulife	Intro to infrastructure fund	<i>Mid market US focused</i>	Call	Eric Chin,Matt Posch
7/27/2021	Herjavec Group	Networking meeting @ Pension Bridge	<i>Cybersecurity risk firm</i>	Call	Matt Posch
7/27/2021	Triton	Networking meeting @ Pension Bridge	<i>PE focused primarily on northern EU</i>	Call	Matt Posch
7/27/2021	Ardian	Networking meeting @ Pension Bridge		Call	Matt Posch
7/28/2021	GCM Grosvenor	Secondaries strategy		Office	Eric Chin,Matt Posch
7/28/2021	CVC Capital	Networking meeting @ Pension Bridge	<i>PE firm</i>	Call	Matt Posch
7/29/2021	LGT	Networking meeting @ Pension Bridge	<i>PE firm</i>	Call	Matt Posch
7/29/2021	Dyal	Fund V Overview	<i>Invests in other PE firms</i>	Office	Eric Chin,Matt Posch
8/16/2021	Arrowstreet	Diligence trip	<i>Final review prior to board recommendation</i>	Boston	Eric Chin,Matt Posch
8/19/2021	RCP Advisors	PE Overview	<i>PE firm focused on lower middle market buyouts</i>	Call	Matt Posch
8/25/2021	Vontobel	Global Equity Overview	<i>Quality focused growth fund</i>	Office	Matt Posch
8/26/2021	Acadian	Global Equity Overview		Call	Matt Posch
9/1/2021	Pretium	Introduction	<i>Residential real estate</i>	Call	Matt Posch
9/2/2021	SEI	Portfolio Review	<i>Benchmarks changed for Job Service in the past year</i>	Call	Eric Chin,Matt Posch
9/3/2021	Adams Street Partners	Portfolio Update	<i>Good performance across all funds</i>	Call	Eric Chin,Matt Posch
9/8/2021	Amundi	Catchup call		Call	Matt Posch
9/10/2021	Aristotle Capital	Global equities overview	<i>Global focusing on quality, valuation, and catalysts</i>	Call	Matt Posch
9/13/2021	Adams Street	2021 Global Fund	<i>Reviewed fund, similar to prior years</i>	Call	Eric Chin,Matt Posch
9/16/2021	VCM Sycamore	Portfolio Update	<i>Have underperformed index due to high volatility stocks in the index</i>	Call	Matt Posch
9/20/2021	LGT	Secondaries strategy update	<i>Strong performing secondaries funds</i>	Call	Matt Posch

ND State Investment Board Resolution  
In Appreciation of  
Land Commissioner Jodi Smith

WHEREAS, Land Commissioner Jodi Smith has served as a member of the SIB Board since 2017; and

WHEREAS, Land Commissioner Jodi Smith has diligently carried out her duties and responsibilities as a member of the SIB and fiduciary of the SIB Program; and

WHEREAS, Land Commissioner Jodi Smith has been a valued and dedicated member of the SIB in helping maintain the integrity and stability of the SIB Program.

NOW THEREFORE, BE IT RESOLVED that Land Commissioner Jodi Smith be duly recognized by the SIB for her years of unselfish dedication to the State of North Dakota through her service on the State Investment Board.

On Behalf of the SIB

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Lt. Governor Brent Sanford, Chair

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Votes

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Date





# BOARD LEADERSHIP

## INNOVATIVE APPROACHES TO GOVERNANCE

NUMBER 177, SEPTEMBER–OCTOBER 2021

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

## The Importance of Seeing Your Organization as Others Do

By Dave Coffaro

*Dave Coffaro provides strategic management consultation and executive coaching to for-profit and nonprofit businesses. In addition, he serves as board chair for the Second Harvest Food Bank of Orange County and as a director of Members Trust Company. In this article, Dave discusses the importance of organizational self-awareness in earning and sustaining relevance with stakeholders.*

At a recent law school graduation ceremony, the keynote speaker concluded her commencement address by asking doctor of jurisprudence candidates to raise their hand if they were above average in their class. Every student raised a hand; 100% self-identified as *above average*! The fact that it is arithmetically impossible for all students to demonstrate above-average performance is of secondary interest. A more compelling line of inquiry relates to human capacity for objectivity.

Research tells us our self-assessments tend toward inaccuracy; sometimes too favorable, other times too harsh. We see this when employees receive 360-degree feedback that surprises them (and it always does). The recipient's first reaction is to think through everyone that provided

feedback to find out who could have been so wrong with their assessment.

For most of us, individual self-objectivity is difficult to achieve. Is the dilemma different for organizations? Companies are complex social networks comprised of individuals, therefore subject to human conditions.

Many of the challenges associated with hearing how stakeholders—employees, customers, vendors, communities, or regulators—perceive how their organization mirrors individual reactions. Defensiveness, denial, rationalization, and derogating the feedback provider are common experiences. As a director, succumbing to this Pavlovian response elevates risk, jeopardizes governance, and exposes the firm to misreading or missing changes in its operating environment.

### Seeing Your Organization as Others Do Is Critical to Earning, Re-Earning, and Sustaining Relevance

In a business context, *relevance* refers to the pertinence, meaningfulness, or importance stakeholders ascribe to their engagement with an organization. The relationship between

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## RESOURCES

### Stanford University Webinar on Effective Data Visualization

Stanford University is offering a free, on-demand webinar titled *Effective Data Visualization in the Era of COVID-19*.

According to organizers, in times of crisis, such as the current pandemic, data collection and dissemination is critical for nonprofits and their boards to understand and explain the issues that their organizations face. But simply collecting data is not enough. In order to make use of that data, nonprofit staff and boards need to be able to put it into context and communicate it effectively to a broad audience—be it vendors, donors, regulators or other stakeholders—in a way that helps them quickly grasp complex information.

In this webinar, Stanford Associate Professor Kristin Sainani introduces basic concepts in data visualization, including how to graph different types of data, principles of effective data visualization, and how graphs can inform or mislead.

This free webinar can be accessed online at <https://stanford.io/3kxms2R>. ■



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- Food for Thought . . . . . 8



# How to Gain a Competitive Edge With a Smarter Approach to Board Diversity

By Adarsh Mantravadi

*Adarsh Mantravadi is general counsel and director of government strategy at OnBoard, an Indianapolis-based provider of board management software solutions serving more than 2,000 organizations and their 12,000 boards and committees in 32 countries worldwide. In this article, he discusses a roadmap for enhancing board diversity that is based on differences in perspectives and life experiences, as opposed to skin color, gender, culture, or nationality, which often tend to guide such strategies.*

As the demand for more diverse boards continues to heat up amid widespread social and political turmoil starting in 2020 and beyond, many corporate and nonprofit organizations want to make changes for better board effectiveness. Still, they're unsure what a smartly composed and diverse board looks like or how to get there.

A diverse board generally includes a range of people with differing views and life experiences, focusing on such factors as age, race, gender, educational background, and professional qualifications. When organizations take a smarter approach to diverse board composition, they also strive to create synergies in skills and experiences among board members to gain a competitive edge.

A truly diverse board working synergistically reflects shared social values for the organizations and communities they serve and makes a significant, measurable contribution to the effectiveness of boards across all sectors and industries.

This includes a board's ability to address risk from a more holistic standpoint. For instance, following the 2008 financial crisis, a Harvard Business Review report found bank boards composed of only banking experts were more likely to fail than more diverse boards. Why? Because they were more likely to experience:

- **Cognitive entrenchment**—expert

directors become less likely to change their perspective as they gain more experience and detailed knowledge in a specific area.

- **Overconfidence**—non-expert directors tend to be more skeptical, demand more analytics and reporting, and want more information before making any decisions.
- **Task conflict**—non-expert directors may defer too much to the judgment of experts and avoid challenging their assertions or considering alternatives.

Too often, board members are selected based on their relationships and connections rather than their diverse backgrounds or life experiences. In an era marked by “Big Data” and rapid digital transformation, today's boards need a solid governance strategy that keeps them in front of the competition and the next systemic threat.

## Assessing Diversity and Board Effectiveness

In our 2021 Board Effectiveness Survey, we examined board effectiveness and trending board matters among 300 board administrators, executives, and directors in six countries and a diverse array of industries.

Members noted how their boards plan to push for positive environmental, social, and governance

changes—and especially board diversity.

The survey found that in the 12 months from March 2020 to March 2021, less than a quarter (21%) of respondents rated their boards as very diverse, while 56% said they are somewhat diverse, and 23% said they are not diverse at all.

Nearly half (48%) said increasing board diversity is a serious strategic priority with specific actions planned, while another 39% said their boards discussed the issue but hadn't developed plans to address diversity.

Despite the growing importance of developing a more diverse board composition, the survey found few boards have effectively and successfully implemented strategic actions. So, are governing boards only providing lip service for diversity, equity, and inclusion, rather than striving for meaningful change beyond the boardroom table?

To address board diversity smartly, board directors must understand that board diversity extends beyond skin color, gender, culture, or nationality. Diversity can also mean a rich and varied set of professional experiences, a wider range of ages, and more accessibility for those with disabilities.

Many of today's corporations, institutions, and organizations also say they want to get more involved in helping solve societal issues, such as climate change, social injustice, police brutality, income inequality, and more. To do so, however, they must ensure their board composition more accurately reflects society's diversity.

## The Smarter Approach to Board Diversity

Board recruiters need to look for differences in perspectives and life experiences instead of focusing mainly on the optics. That involves following a roadmap that goes beyond your own network and actually reaching out to people with different backgrounds and experiences.

When planning your board's future, governance experts polled in our



board effectiveness survey suggest a threefold response:

- **Broadly define potential candidates.** There's no need to limit your pool based on personal connections. Indeed, the evidence suggests that a more holistic approach to board recruitment that seeks out diversity of race, age, gender, and experience produce better directors.
- **Identify skill gaps by charting the board's competencies across a skills matrix.** Chart your directors' competencies across a skills matrix customized for your organization; this tool can unbiasedly assess the current board across skills, background, and experience. Look for overlap, and analyze any gaps—as those gaps can reflect missing competencies that need to be addressed in future searches.
- **Conduct annual evaluations.** Roughly half of all companies now ask their directors to appraise each of their fellow directors to identify areas where additional expertise would be valuable and where protocols can be strengthened.

Surveying your board, identifying gaps by using a skills matrix and recruiting a diverse set of directors will create an environment that encourages open communications, honest evaluations, and strengthen your board's readiness to fill vacancies when they arrive. Boards should take into account and embrace change in board composition after careful and deliberate consideration.

It's also important for the entire board to discuss diversity and inclusion together to help the whole culture evolve. At least once a year set a few hours aside at the annual board retreat or other gathering and make sure every board member engages in discussions about the board's values and the challenges of increasing diversity and inclusion.

As more organizations demonstrate a willingness to show their

vulnerabilities and ask difficult questions about diversity and inclusion, the more open board members will become when evaluating their peers serving on the board.

According to the annual PwC survey of corporate directors, the motivation to remove a fellow board member has continued to grow sharply in recent years for the following reasons:

- Diminished performance because of aging (up 26%)
- Unprepared for meetings (up 36%)
- Lacks the expertise required (up 8%)

Essentially, the survey data show growing director dissatisfaction with their members' skills in the wake of major technological advances. Organizations need directors who are not intimidated by change, technology, and new modes of thinking, and instead bring a fresh perspective and willingness to consider other ideas: specifically leveraging the advantages technology provides.

Apprehension toward technology has become deadweight in boardrooms. It has hampered recruitment as the brightest leaders are reluctant to join boards that govern using less-effective systems that can slow down the ability to govern. The next generation of leaders, those who are filling the ranks as vacancies accelerate, expect their board of directors to take advantage of productivity and collaboration empowerment technologies such as board meeting solutions and the Big Data for enhanced decision-making.

Whether a board's strategy is to actively replace underperforming members, bringing additional voices to the table, or simply create a succession plan with an eye toward the future, it's critical that the future of your board's composition be considered today. As boards navigate difficult economic pressures, global competitions, an uncertain legal environment, and disruptive technologies, it's critical to get a plan in place and start to execute it immediately to best position your

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## 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. □



# The Ethics of Board Perseverance

By Christopher Gilbert, Ph.D.

*Christopher Gilbert, Ph.D., is co-founder of NobleEdge Consulting, a leadership development company that specializes in organization and management leadership ethics. In this article, he examines board communication using the same ethical lenses we use to examine our other actions.*

**B**elieve it or not the ENRON debacle hit the news over 20 years ago. But even this falling giant was replaced over succeeding years by TYCHO, WorldCom, Madoff, Countrywide, and others, many hitting new high points for losses. Then again, these fiascos meet the unethical, one-upmanship of more recent ignominies by Volkswagen, Boeing, Theranos, Wirecard, Purdue Pharma, and too many others.

Bottom line to the moral world: *Same old wine, brand new, slightly chipped bottles.*

Without detailing each of these tragedies individually, it is important to look for moral commonalities in their undoing—especially the role played by the boards in these sometimes multi-billion-dollar failures.

Let's start with this century's first extreme corporate ethical debacle: ENRON. Jeffery Gordon, JD, the co-director of Columbia Law School's Ira M. Millstein Center for Global Markets and Corporate Ownership, contends "...the principal governance failure of the Enron board was to approve a disclosure policy that made the firm's financial results substantially opaque to public capital markets, despite also approving a compensation strategy that made managerial payoffs highly sensitive to stock price changes and despite its unwillingness to engage in intense monitoring of business results and financial controls."<sup>1</sup>

The lingua franca here was the board's creation or approval of a code between the insiders that kept public outsiders, even the monitoring agencies, in the dark about actual organizational and financial activities. This is

not too uncommon, although it may be done more unwittingly than wittingly.

The other catalyst for failure was the board's hesitation to monitor business activities and financial outcomes seriously and consistently. This board was seemingly exercising the "retired on the job style" of oversight.

Beyond the obvious human resource and financial losses, one product of the ENRON board's ineffectiveness was passage of the Sarbanes-Oxley Act. This shifted governance authority away from board and management and toward shareholders. The success or failure of that strategy over the long term will probably not be determined for years. But it has led to many boards examining their own levels of scrutiny and proctoring.

Are there commonalities to these moral debacles that prove useful in moving forward?

Definitely!

For one thing, more often than not, those cheating are eventually caught. The oversight system does evince a moderate and long-term level of success. This is good news from a legal perspective, although law is a reactive stance to ethical problems.

The "is this legal?" oversight strategy bumps up against the moral quotient that where law tells us what we can do, it's ethics that tell us what we should do. That latter more proactive stance should be taken seriously by boards and senior managers focused on long-term success.

Examining these calamities through moral lenses at a more granular level, there are a number of ethical commonalities to their unraveling. The most obvious of these is a visible pattern of

company leadership essentially fooling the public and their boards into believing the company is honestly making money when it is not.

Even the outside overseers, accountants, and auditing firms don't detect anything amiss in cases where coded language used by corporate executives and others is too opaque. In fact, in some cases, the watchdogs were complicit in the company's ability to lie to the public and the board. At ENRON, it was as if someone not only yelled "Fire!" in a crowded theater, but the fireman present there hushed the message.

How does a publicly visible, publicly traded company being tracked by major financial markets steal billions while everyone's watching? Part of the answer is the human ability to stop weighing what's ethical and what's not, especially if there are personal benefits in not judging. After all, why would any oversight agency blow the whistle on its very lucrative major client? I am reminded of the Upton Sinclair quote, "It is difficult to get a man to understand something when his salary depends on his not understanding it." The same can go for women, I assume.

Another part of the answer to this question of ignoring the truth lies in lies—in particular, what is labeled *coded language*.

All of us use coded language. It's how we pass information and ideas quickly or say something more tactfully. Most of the time, it is not used for nefarious and unethical purposes.

We all speak in codes. A casual greeting such as, "Hi, how are you?" when you sweep past someone in a hallway is coded language. This greeting is rarely a question requiring a lengthy conversation about one's health and well-being. In our culture, these words simply mean, "Hello" or "Good day," and both parties who share this code move on.

There are times when our language does have an *unethical* intent. It is all too easy to break the shared code rules. I'll look at two of the many financial language codes that often get broken by the irresponsible.



One of the most pervasive ethical misuses in communication is using language that gives the listener a small portion, but not all of what we want them to know. This is called a *lie of omission*. A common example would be telling someone you were late for a meeting because there's always traffic at this time. Never mind that your stopping at the Starbucks up the street was the real delay. You just leave out or omit that part of the story to your advantage.

Volkswagen's engineers used lies of omission in their falsified reports about vehicle pollutant levels. So too, Boeing engineers and executives committed the same mistake in reporting airplane limitations as they rushed the 737Max to compete with the already successful Airbus A320Neo.

Another type of coded language is *misdirection*. This is deliberately using our well-shared code to say one thing, while knowing your words have another meaning.

The ENRON, TYCHO, Theranos et al. debacles are full of proven omissions and misdirections—it was their method of substituting *small t-truth* (the iffy or changeable facts) for *capital T-Truth* (the solid ground of the whole, unvarnished story).

On the surface, it appeared these corporations were complying with laws regarding financial transparency. They were communicating the information they were required to; they were just knowingly using a different code in their words than we rely upon.

Essentially, these company's executives were using financial language one way and hoped through omission and misdirection that we would understand it another way. Indeed, we did!

The Theranos board, whose members included Henry Kissinger, James Mattis, and George Shultz, were shown the numbers, but they were categorized in financial terms so that actual losses became "gains."

Stepping back to one of the most autopsied financial fraud cases, ENRON's financial reports were categorized to hide failures in one part of the company by reporting their

sale to other parts of the company and then qualifying the losses as profits. ENRON executives neglected to connect the losing businesses to their "profitable" holding companies. There's the omission.

In the case of Theranos, the lack of medical expertise of a board composed of ex-military and former diplomats was fully leveraged by company executives who misrepresented the success of their product and their production. The coded language in this case follows the Silicon Valley edict, "Fake it till you make it!" (By the way, that tradition both supports and legitimizes lies of omission and misdirection for start-ups and others).

So too, an atmosphere of silence and secrecy within the organization compounds a board's opportunities for transparent oversight. In the case of Theranos, erroneous financial reports on sources and uses of funds, and overly optimistic technology reports on the successes of product research and development are carefully constructed stories to mask reality. The culture of organizational opacity adds an additional layer of safety to the falsehoods.

The successful use of misdirection depends on how strongly we share the code. If you'll allow, let me provide a commonplace example of this form of code-busting.

Imagine in answer to your question, "How healthy is your dog?," I report I just had my beloved dog put to sleep. For listeners, there is a very strong code shared in the words "put to sleep." The real message in that code is very different than the literal meaning of the words.

The code tells us all this is a sad day and my dog is gone forever. But what if I am misdirecting your attention? What if I use these exact words to get you to think one thing while I am uttering another? What if my dog is not gone and the words "put to sleep" are meant to be taken literally, not in code? What if the whole truth is that I took my dog to the veterinarian where she received a shot for a better night's sleep and now she's up dashing around healthier than ever.

I spoke the truth. I did have my dog put to sleep. But unless I share the alternate meaning, I am relying on your coded interpretation to misdirect.

A number of the current organizational frauds were perpetrated on boards and shareholders by wittingly misdirecting stakeholders who interpret words and reports according to strongly shared financial codes. Essentially, they gained an advantage from illegal transactions that would not be seen as illegal because their words were interpreted using the strongly shared code.

In more technical terms, for instance, ENRON falsified its financial accounts by assigning losses to "unconsolidated partnerships" and near-worthless assets to "special purpose entities" with names like Raptors, Death Star, and Myass. Their misdirection ensured that their tremendous debts were seen by the financial markets as independent business firms agreeing to absorb ENRON's losses as investments. The bottom line: huge losses became huge profits on their books.

After my work with some boards, a version of the question, "Is this a sleeping dog moment?" has entered the vernacular of their oversight. It's a good question to ask, as long as the code of that story has been shared.

So too, a number of the currently indicted including the Trump organization, Telemedicine, and Nikola claim that they told us the truth and we just misunderstood. By law, organizations are only required to use certain financial words and categories; they are not legally required to determine how people interpret them.

Companies utilizing this methodology of miscommunication are able to convince themselves and us that they have fulfilled their financial disclosure obligations. Their financial language may be "accurate," but the interpretation is far different from the capital T-Truth that language is established to reveal.

There are codes being used and abused not only in high places of

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# Ethics

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business leadership, but also in our politics, media, diplomacy, and economics—nearly all facets of life. These codes are covert; answers about their exact meaning seem to change from response to response and person to person.

The outcome of all this obfuscation is a growing uncertainty about honesty and integrity. Codes are powerful ways to add to or subtract from trustworthiness. Language can obviously be used ethically, and it can be used unethically. Because communication requires action, we can examine communication using the same ethical lenses we use to examine our other actions. Our ethics are expressed not by what we say, but by what we do.

## Are Ethics Profitable?

So, what actions can a board take to minimize exposure to the current moral ineptitudes and shocking mistreatments that are so easily perpetrated? In three words, create, support, and monitor a strong business conduct process that advances a culture of ethics up and down the organization. Invest in an independent agency in addition to and apart from legal and financial oversight.

The financial results of making ethics an important and stated part of the corporate mission are impressive. In 2020, the top 100 most ethical companies outperformed the stock market. In fact, these companies earned a 13.5% premium over the large cap stocks that year.

Not only do the firms rated highest in ethics and social responsibility make more profit than those that are not, but in an annual survey started by Ethisphere magazine in the early 2000s comparing the top 100 most ethical companies to the bottom 100, greater levels of trust in an organization led to:

- a 22% increase in profitability,
- a 21% increase in productivity,
- a 37% decrease in employee absenteeism,
- a 41% decrease in quality defects,

and

- 65% less employee turnover.

The differences between the top 100 and bottom 100 are staggering! There's more than greater profit in making ethics and often some level of social responsibility a part of an organization's purpose.

## What Are the Foundations of a Successful Corporate Ethics Program?

There are five criterium to create, monitor, and support long-term ethical choice-making in an organization. In some cases, these might be seen as useful board paradigms.

1. **The longest shadow is cast from the top.** From CEO on down, senior management must live and breathe, that is fully support, any business conduct initiatives, such as ethics training programs, sustainability processes, social responsibility initiatives, etc. In some organizations, the CEO also takes on the spoken mantle of the chief ethics officer. In other organizations, lower members of senior management are assigned responsibility for business conduct planning and programs.
2. **Nothing about ethics or social responsibility is short term.** Ethics are not in our promises or our publicity or our plans, they reside in our actions. And actions, once taken, are forever a part of our reputation. Every consumer or client interaction holds the potential to build or erode trust. Focusing on the former for the long term separates the top organizations from those at the bottom in terms of profit, productivity, and potential. Ethics training and consulting work are not about information, it's about transformation. Programs focused on changing culture are the most successful.
3. **Compliance or legality is the tip of the iceberg when it comes to consistent ethical behavior.** Keep in mind that in all decisions and initiatives the law tells us

what we can do; ethics tells us what we should do. Successful business conduct programs build off the legal requisites, but focus beyond compliance to encompass actions based on what should be done for the company, the employees, the partners, the stakeholders, and essentially if the influence is big enough, for the world.

4. **Recognize there is an innate human desire to carry forward an ever-advancing civilization.** A bit heady, so let's simplify the philosophical concept with one question: Do you want our children to live in a worse world, the same world, or a better world than you now? No surprise, 96% of us who answer this say our children deserve a better world than ours. It is in our nature to be more tomorrow than we are today. We are hard-wired to progress. Every initiative of better business conduct, corporate responsibility, or sustainability is born from that very human desire.
5. **Finally, trust is the foundation of all human virtues.** Building—or at least not eroding trust—should be the focus of our personal and professional lives. One individual in an organization can make the difference in building or eroding trust with our clients, consumers, suppliers, vendors, distributors, partners—in short any of our stakeholders. One untrustworthy person, one time, in one minute, on one day can tear down decades of a great reputation. How can we not focus on trust and trustworthiness as a key element of any organization? □

## REFERENCE

1. Gordon, J.N. (2003). Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley. Retrieved from <https://ssrn.com/abstract=391363> or <http://dx.doi.org/10.2139/ssrn.391363>

Christopher Gilbert, PhD, co-founder of NobleEdge Consulting, specializes in organization and management leadership ethics.



He has traveled the globe focusing on sustainability, human capacity development, and business conduct programs while working with Fortune 500 companies, government, and nonprofit organizations, including the

Bill and Melinda Gates Foundation, where he worked on food security programs in sub-Saharan Africa.

His new book, "The Noble Edge: Reclaiming an Ethical World One Choice

at a Time," \$8.49 (e-book), \$17.95 (paperback), Morgan James Publishing, ISBN 978-1631954054, is available at Amazon and other booksellers. For more information, visit [nobleedgeconsulting.com](http://nobleedgeconsulting.com).

## Importance

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an organization and its stakeholders is always in motion. This requires leaders to stay attuned to stakeholders' perceptions, observations, and reactions to unintentional missteps by the business, adjusting course in alignment with vision when evidence puts relevance at risk.

Relevance has a finite shelf life, thus must continually be re-earned. The business world is in perpetual motion, even when we don't feel or recognize base-level evolution. Employee interests, expectations, and priorities shift. Customer needs, interests, and expectations evolve. Competition redefines the operating landscape. Motion is normal; speed can vary.

With this context, directors provide additional eyes and ears to scan the environment, identify subtle and dramatic changes, and ask management its interpretation of the evolving landscape, as well as what it means to the organization's relevance with its stakeholders.

There are cues and clues suggesting a shift in relevance. Although each organization tracks different metrics, general *leading indicators* that relevance may be at risk include changes in employee engagement or satisfaction, changes in customer engagement, satisfaction or loyalty metrics, increasing complaints, unfavorable online traffic (social media, online reviews, blogs), and slowing accounts-receivable turnover. *Lagging indicators* include decreasing employee productivity, increasing regrettable turnover, an uptick in customer attrition, decreasing repeat customer activities, or fewer new customers. Any of these cues or clues relevance may be waning is an invitation for directors to ask management about root cause, potential trends,

what intervention is needed, and when strategic adjustments will take place.

How Can Directors Override Natural Challenges to Seeing Their Organization as Others Do?

Organizational self-awareness means understanding stakeholders' perceptions of how the organization shows up. Here are five actions management and directors can take to gain a greater awareness of how stakeholders see the organization:

- **Feedback Assimilation Process.**

Most companies gather employee and customer engagement metrics. Interpreting and addressing the results are less ubiquitous. Develop *feedback assimilation processes* to override the tendency toward situational attribution (in other words, attributing the cause of perceptions to a situation or event outside the organization's control rather than an internal characteristic). This process defines *how* the organization will receive, hear, and interpret stakeholder feedback (who gets the input, how information is shared in its unvarnished form, what to do with the feedback, and how to distill feedback into actions aligned with the organization's future state vision).

- **Multiple Sources.** Draw upon multiple, comfortable, and safe channels to gather diverse observer input that yields actionable feedback. A single-channel approach (i.e., employee engagement surveys, Net Promotor Score) will miss opportunities with stakeholders uncomfortable in a chosen format. Peer-to-peer listening reviews, independent customer or user groups, advisory board members, and community influencers are examples of

channels through which more objective feedback can be accessed.

- **New Employee Download.**

Initial perspectives from your organization's new employees can produce actionable insights. When they arrive, new hires will see and hear things that capture their attention. Once they acclimate, these stand-out observations will lose their attention-grabbing newness, and then fade into business-as-usual patterns. Operationalize an approach of capturing the power of first impressions during an employee's first month on the job. Initial observations, documented and shared, provide a meaningful source of insight so you can see your organization as others do.

- **Promote a Safe Culture.**

Commit to receive feedback without judgment, blame, or retribution to the messenger. This includes observations from employees. Team members have an abundance of opportunities to identify and communicate potential issues (concerns heard from customers, possible safety issues), yet withhold information, fearing retribution. Ensure management protects people when issues are surfaced. "Shooting the messenger" damages a culture of self-awareness.

- **Distill Observations Into Actions.**

Knowing how stakeholders perceive your organization is a first step. Translating observations into action contributes to earning and sustaining relevance with stakeholders. Directors and management must balance

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## Importance

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distinguishing observations that push an organization away from its vision and dilute relevance from those that accelerate progress toward the vision. Determining which observations are directly translatable into actions is an art as well as a science. Feedback on what customers don't like is informative, but doesn't frame a picture of what they want. Stakeholder observations can simply represent a stimulus, guiding the organization toward a theme that requires further analysis. The next step following an unfavorable employee engagement survey may be a series of team-member listening sessions with management in the room to hear concerns and ask questions, for example: What would be a better approach? What would success look like in this situation? If you were in my position, how would you deal with this challenge?

Leaders focused on building and sustaining organizational self-awareness seek honest feedback from fans and critics, demonstrate authentic curiosity about how their organization is perceived by stakeholders, and sustain relevance by adjusting activities that interfere with the way others see

## Diversity

(continued from page 3)

organization and board to create long-term competitive advantage.

The onus now lies with every organization to seriously evaluate whether their board of directors is creating competitive advantage or staffed with insular or uninformed directors. The pressure will continue to mount, and as a new generation of leaders emerges, so too will changes in the boardroom. Decisions will be made by people who were born using technology and who are culturally comfortable with a new and more robust marketplace of ideas. □

them. Directors can play a valuable role in helping management develop and sustain organizational self-awareness as a guiding principle.

Losing relevance is unintentional and that's part of the problem—lack of intention to sustain relevance: out of sight, out of mind. Leaders often keep long lists of important priorities, yet overlook the essential elements of earning and sustaining relevance with their stakeholders. From a director's perspective, this tells us how important it is to guide organizations in continually refreshing their attunement to how stakeholders perceive the organization. □

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## FOOD FOR THOUGHT

"I have three precious things which I hold fast and prize. The first is gentleness; the second is frugality; the third is humility, which keeps me from putting myself before others. Be gentle and you can be bold; be frugal and you can be liberal; avoid putting yourself before others and you can become a leader among men."

Lao Tzu

## BOARD LEADERSHIP

INNOVATIVE APPROACHES TO GOVERNANCE

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