

Friday, April 22, 2022, 8:30 a.m.
WSI Board Room (In-Person)

Teleconferencing: 701.328.0950 Participant Code: 163 253 958#

1600 E Century Ave, Bismarck, ND

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

- A. Executive Summary

II. ACCEPTANCE OF MINUTES (March 25, 2022)

III. BOARD EDUCATION (45 minutes)

- A. Fund Return & Risk – Mr. Anderson

IV. INVESTMENTS (30 minutes)

- A. Private Placement Opportunity Update¹
- B. Manager & Investment Portfolio Changes²

(Break)

V. GOVERNANCE (45 minutes)

- A. Legacy & Budget Stabilization Fund Advisory Board Update – Ms. Murtha
- B. Governance & Policy Review Committee Update – Ms. Murtha
- C. Securities Litigation Committee Member Appointment – Ms. Murtha
- D. Audit Committee Member Appointment – Ms. Murtha
- E. Executive Review Committee Update – Mr. Olson, Ms. Sauter

VI. Quarterly Monitoring Reports (15 minutes)

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

VII. OTHER (5 minutes)

Next Meetings:

Securities Litigation Committee – TBD

Governance & Policy Review Committee – April 21, 2022, and May 19, 2022 (tentative)

Executive Review Committee – April 28, 2022

Audit Committee – May 11, 2022

State Investment Board – May 20, 2022

VIII. ADJOURNMENT

¹ Executive session pursuant to NDCC 44-04-18.4(1) and 44-04-19.2 to discuss confidential commercial information and financial information.

² Executive session pursuant to NDCC 44-04-18.4(1), 44-04-19.1(9), and 44-04-19.2 to discuss confidential commercial information and contract negotiating strategy.

EXECUTIVE SUMMARY

SIB Regular Meeting

April 22, 2022 – 8:30am CT

- I. **Agenda:** The April 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 (Board Action):** The March 25, 2022, Board meeting minutes are included for review and approval.
- III. **A. Board Education – Fund Risk & Return (Information Only):** Mr. Anderson will provide the Board with education on fund risk and return. Return and risk are defined where compensated risk adds benefit when optimized and controlled in a well-constructed fund.
- IV. **A. Private Placement Opportunity Update (Board Action for Executive Session):** Staff will provide the Board an update on a private placement opportunity. Materials will be provided to the Board via a secure link.
B. Manager & Investment Portfolio Changes (Board Action for Executive Session): Materials will be provided to the Board via a secure link.
- V. **A. Legacy & Budget Stabilization Fund Advisory Board Update (Information Only):** Staff will provide the Board with an update on a presentation made to the Advisory Board regarding the Legacy Fund Asset Allocation Study project.
B. Governance & Policy Review Committee Update (Information Only): Staff will provide an update to the Board regarding the SIB GPR committee meeting currently scheduled for April 21, 2022.
C. Securities Litigation Committee Member Appointment (Chair to Appoint): Two Board member vacancies and one pending staff member vacancy to be filled.
D. Audit Committee Member Appointment (Board Action): One Board member vacancy to be filled.
E. Executive Review Committee Update (Information Only): Mr. Olson and Ms. Sauter will update the Board regarding the status of the Executive Director performance review.
- VI. **A-C. Reports (Board Action):** Staff will provide quarterly monitoring reports for investment ends, budget/financial conditions, and executive limitations/ staff relations.

Adjournment.

**NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
MARCH 25, 2022, BOARD MEETING (IN PERSON)**

MEMBERS PRESENT: Brent Sanford, Lt. Governor, Chair
Dr. Rob Lech, TFFR Board, Vice Chair
Thomas Beadle, State Treasurer
Jon Godfread, Insurance Commissioner
Joseph Herringer, Commissioner of Unv & School Lands
Bryan Klipfel, Director of WSI
Cody Mickelson, TFFR Board
Adam Miller, PERS Board
Mel Olson, TFFR Board
Yvonne Smith, PERS Board

STAFF PRESENT: Scott Anderson, CIO
Eric Chin, Deputy CIO
Connie Flanagan, CFO
Missy Kopp, Executive Assistant
Jayme Heick, Retirement Prog Spec
Jan Murtha, Exec Dir
Ann Nagel, Investment Accountant
Matt Posch, Investment/Compliance Officer
Emmalee Riegler, Contracts/Records Admin
Sara Sauter, Internal Audit Supvr
Rachelle Smith, Retirement Assistant
Stephanie Starr, Retirement Prog Spec
Dottie Thorsen, Internal Auditor
Tami Volkert, Employer Svs Coor
Susan Walcker, Senior Financial Accountant
Len Wall, NDI
Dr. Paul White, Chief Risk Officer

GUESTS: Nick Archuleta, ND United
Glenn Bosch, ND House
Dean DePountis, Attorney General's Office
Karlene Fine, Industrial Commission
Candace Johnson, Securities Commission
Jerry Kline, ND Senate
Rachel Kriege, Insurance Commission
Jan Lund, PERS
Scott Miller, PERS
Adam Montgomery, Securities Commission
Bryan Reinhardt, PERS
KX News - 2
Teleconference Guests - 9

CALL TO ORDER:

Lt. Gov. Sanford Chair, called the State Investment Board (SIB) regular meeting to order at 8:30 a.m. on Friday, March 25, 2022. The meeting was held in the Workforce Safety and Insurance Board Room, 1600 E Century Ave., Bismarck, ND.

The following members were present representing a quorum: Treasurer Beadle, Commissioner Godfread, Commissioner Heringer, Mr. Klipfel, Dr. Lech, Mr. Mickelson, Mr. Miller, and Mr. Olson

ACCEPTANCE OF AGENDA:

The Board considered the agenda for the March 25, 2022, meeting.

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

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

NAYS: NONE

MOTION CARRIED

MINUTES:

The Board considered the minutes of the February 25, 2022, SIB meeting and the March 3, 2022, SIB special meeting.

IT WAS MOVED BY MR. OLSON AND SECONDED BY MS. SMITH AND CARRIED BY A VOICE VOTE TO APPROVE THE FEBRUARY 25, 2022, AND MARCH 3, 2022, MINUTES AS DISTRIBUTED.

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

NAYS: NONE

MOTION CARRIED

BOARD EDUCATION:

Board Governance Architype and Strategy:

Mr. Anderson provided education on various governance architypes and how each model supports investment program strategy and growth. Good governance requires the time horizon and frequency decisions to match the timeline required to achieve a goal along with oversight to be independent of decisions and their implementation. Performance and risk management require short time horizons to be agile to changing environments, discipline to not act too frequently, and contingent planning. Board discussion followed.

INVESTMENTS:

Russian Entity investment Exposure Update:

Mr. Anderson provided an update on Russian entity exposure. The total Russian entity exposure across the Legacy Fund, the Pension Funds, and the Insurance Funds is about \$2.7 million based on estimates from manager discussions through March 15, 2022. The situation is very fluid as managers are exiting positions, prices change, and brokers/traders are halting transaction activity.

The Board recessed at 9:50 a.m. and reconvened at 10:04 a.m.

Private Market Opportunity Update:

IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO ENTER EXECUTIVE SESSION PURSUANT TO NDCC 44-04-18.4(1) TO DISCUSS CONFIDENTIAL COMMERCIAL AND FINANCIAL INFORMATION.

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

NAYS: NONE

MOTION CARRIED

The executive session began at 10:04 a.m. and ended at 10:26 a.m. In attendance were Board members, RIO staff, Dean Depoutis, and Insurance Department representative.

IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO APPROVE A WAIVER OF POLICY E5 TO ALLOW STAFF TO NEGOTIATE AND PREPARE A PRIVATE MARKET PLACEMENT TRANSACTION FOR SUBSEQUENT APPROVAL BY THE BOARD.

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

NAYS: NONE

MOTION CARRIED

Performance Update:

Mr. Anderson provided a performance update as of January 31, 2022. PERS and TFFR earned a net investment return of 12.98% and 12.75% respectively for the one-year period. For the 5-year period, PERS and TFFR earned a net investment return of 10.64% and 10.53% respectively. WSI and Legacy Fund earned a net investment return of 3.45% and 7.65% for the 1-year period and 6.83% and 8.79% for the 5-year period. Over 98% of the SIB Pension clients earned net returns which exceeded their respective policy benchmarks for the 5-year period. All of the SIB Non-Pension clients earned net returns which exceeded their respective policy benchmarks for the 5-year period.

Workforce Safety & Insurance (WSI) Investment Policy Statement (IPS):

Mr. Anderson reviewed the updated IPS for WSI. An asset allocation study was conducted by Callan and a revised asset allocation was approved by the WSI Board.

IT WAS MOVED BY MR. OLSON AND SECONDED BY COMMISSIONER GODFREAD AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE WSI IPS AS PRESENTED.

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

NAYS: NONE

MOTION CARRIED

GOVERNANCE:

Strategic Plan Presentation:

Ms. Murtha shared the RIO strategic plan presentation that she had previously provided to the Governor's office. All RIO staff had input into the process for the strategy review. NDIT asked RIO to participate in their model strategic planning process. NDIT staff facilitated the process and assisted with the creation of the presentation. The plan looks ahead five to ten years. Staff identified five core priorities: communication, infrastructure, organizational culture, talent management, and technology-enabled processes. The action plan places items into four categories: experimental, aspirational, incremental, and evolutionary. Part of the strategic review was a workforce plan which staff developed with HRMS.

Legacy & Budget Stabilization Fund Advisory Board Update:

Ms. Murtha shared an update on the information RIO staff provided to the Advisory Board on February 15, 2022. During that meeting, the Advisory Board awarded RVK with the Legacy Fund asset allocation study. Staff is working with RVK to coordinate the timing of a project kick-off presentation for the Advisory Board.

Governance & Policy Review (GPR) Committee Member Appointments:

Ms. Murtha discussed the new GPR Committee charter which outlines the process for appointing new members. The Committee is composed of three members who must be nominated and approved by a majority vote of the SIB.

IT WAS MOVED BY MR. OLSON AND SECONDED BY MR. KLIPFEL AND CARRIED BY A ROLL CALL VOTE TO NOMINATE DR. LECH, COMMISSIONER GODFREAD, AND TREASURER BEADLE TO THE GPR COMMITTEE.

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

Executive Review Committee (ERC) Update:

Ms. Sauter and Mr. Olson provided an update from the ERC. The ERC is working to develop a new format for the Executive Director's (ED) performance review. The ERC will meet in April to discuss the evaluation questions and structure and the survey will be sent to the Board by mid-April.

REPORTS:

Executive Limitations/Staff Relations:

Ms. Murtha shared an update on staffing, procurement activities, and strategic planning implementation. Ms. Connie Flanagan has announced her retirement effective June 30, 2022. RIO has submitted a request to HRMS to have Ms. Flanagan's position reclassified to reflect the Chief Operating Officer duties she has taken on in addition to the Chief Financial Officer duties. As soon as that request is completed, the position will be posted. Staff hope to have interviews completed in May so the new person can start in June to allow for training before Ms. Flanagan leaves. Staff anticipates having the new accounting manager position filled by June. The Chief Retirement Officer/Deputy ED position has been posted and closes at the beginning of April. Staff hope to have this position filled by June. The Legal Intern position has been filled for this summer. New staff who started in March include the Accounting Intern and TFFR Member Specialist.

IT WAS MOVED BY TREASURER BEADLE AND SECONDED BY COMMISSIONER GODFREAD AND CARRIED BY A VOICE VOTE TO ACCEPT THE EXECUTIVE LIMITATIONS/STAFF RELATIONS REPORT.

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

Quarterly TFFR Ends Report:

Ms. Murtha shared the TFFR Ends Report for the quarter ending December 31, 2021.

IT WAS MOVED BY TREASURER BEADLE AND SECONDED BY COMMISSIONER GODFREAD AND CARRIED BY A VOICE VOTE TO ACCEPT THE QUARTERLY TFFR ENDS REPORT.

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

ADJOURNMENT:

With no further business to come before the SIB, Lt. Gov. Sanford adjourned the meeting at 11:36 a.m.

Respectfully Submitted:

Lt. Governor Sanford, Chair
State Investment Board

Missy Kopp
Recorder

RETURN AND RISK

Scott M Anderson, CFA
April 22, 2022

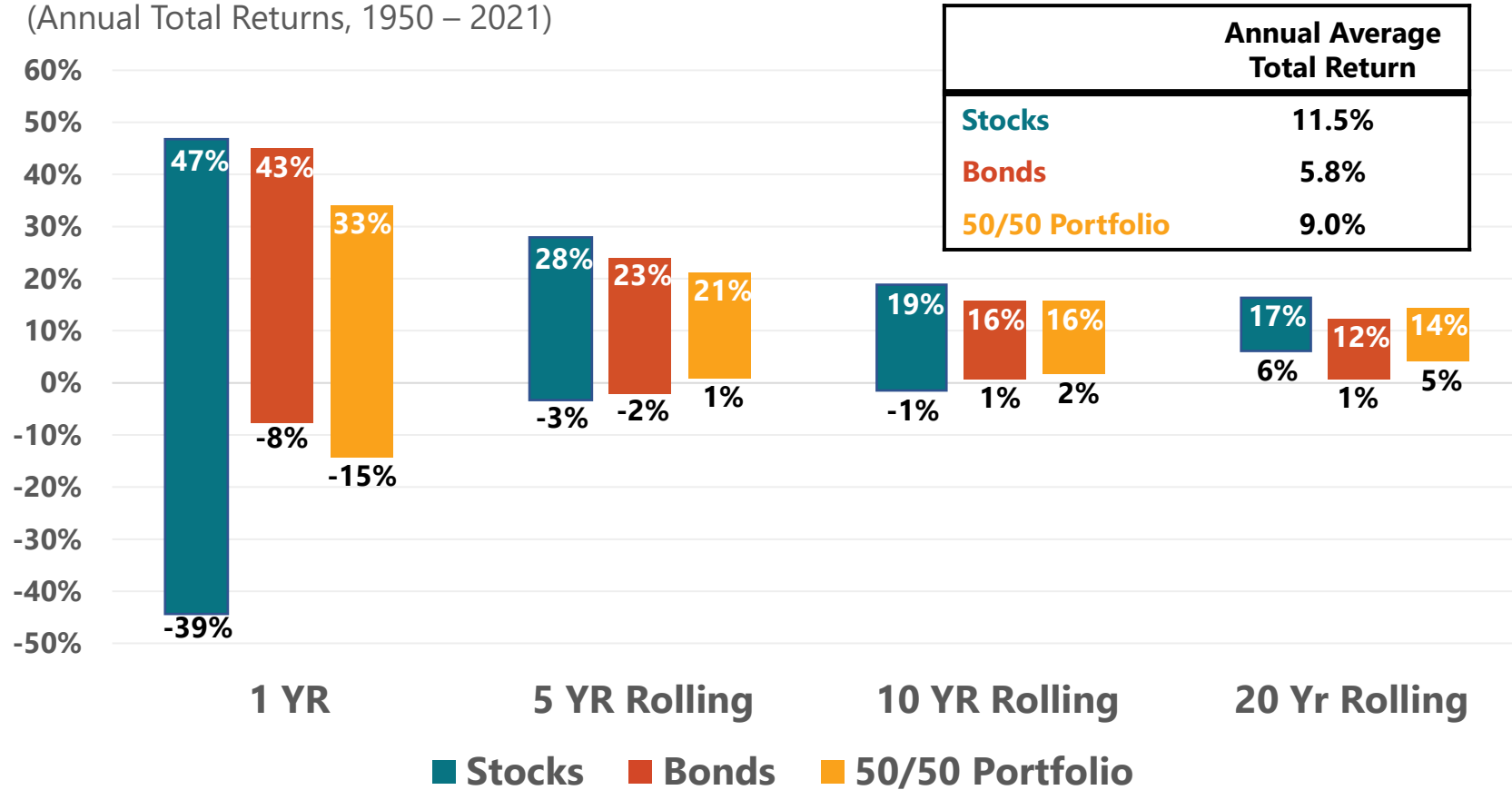
RETURN AND RISK

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

TIME, DIVERIFICATION AND UNCERTAINTY

Range of Stock, Bond and Blended Returns¹

(Annual Total Returns, 1950 – 2021)



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

VALUE OF AN INVESTMENT¹ - Formula

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

CASH FLOW(Year 1)

Investable cash after expenses and maintenance expenditures each Year

COST OF CAPTAL

Required return for an equal risk Investment

GROWTH RATE

Growth rate of the cash flow in time

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

VALUE OF AN INVESTMENT - Example

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

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

Example Cash Flow Growing at a 6% Rate

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

RETURN IS THE CHANGE IN VALUE

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

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

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

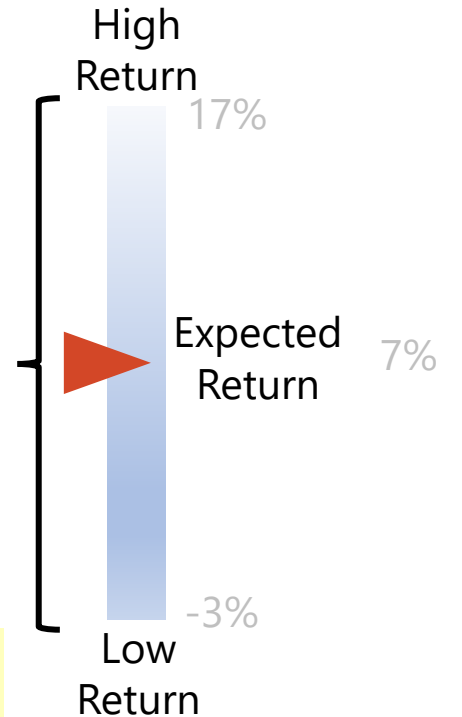
MARKET RISK - UNCERTAINTY OF RETURN¹

**Valuation
Uncertainty Drives
Return
Uncertainty!**

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



Uncertainty of
Return Outcome
or Risk



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

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

RETURN EFFICIENCY

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

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

Example:

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

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

RISK IS AN INVESTMENT

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



Return on Investment
or Cost

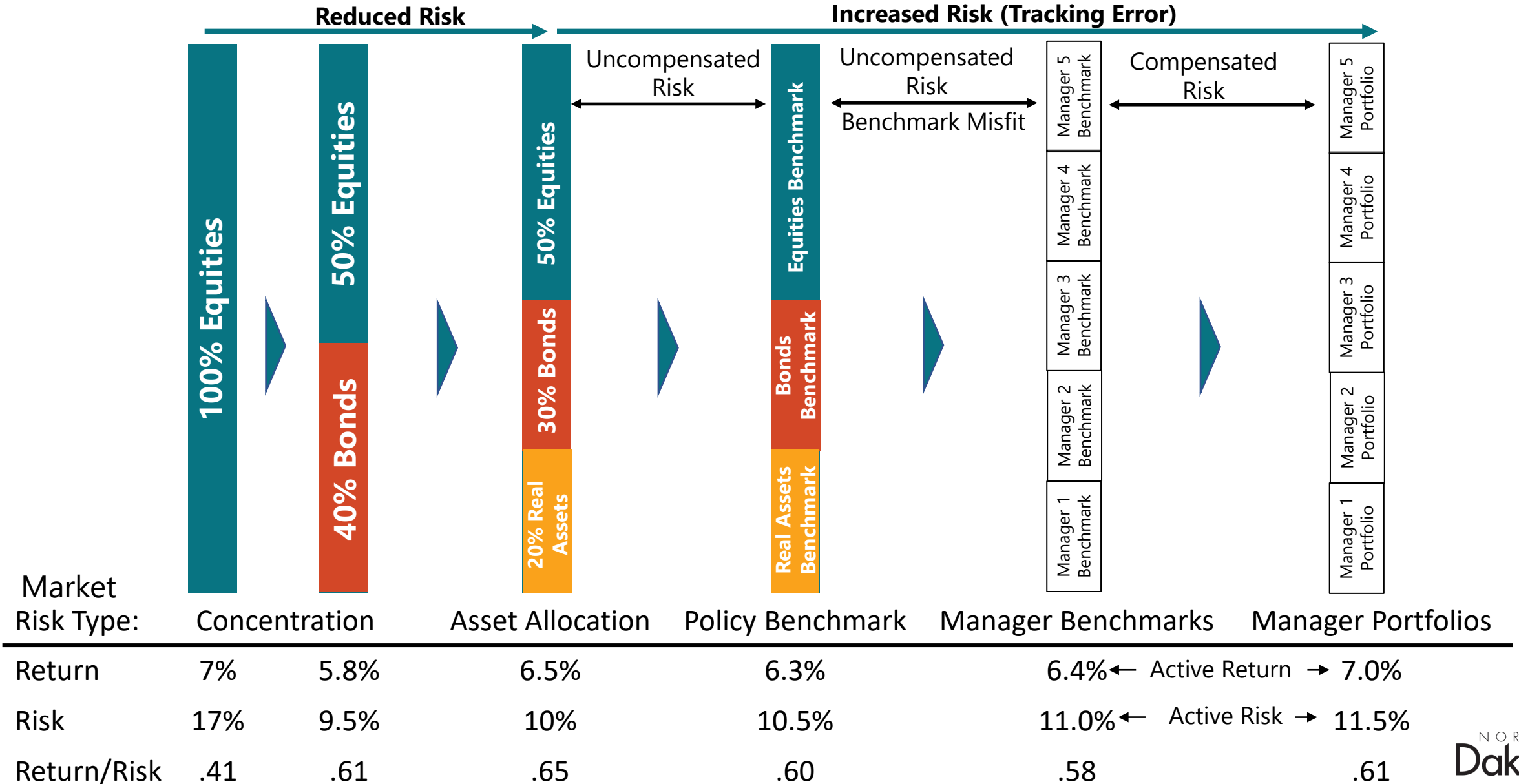
Return

Risk (Range if Returns)

Investment or Cost

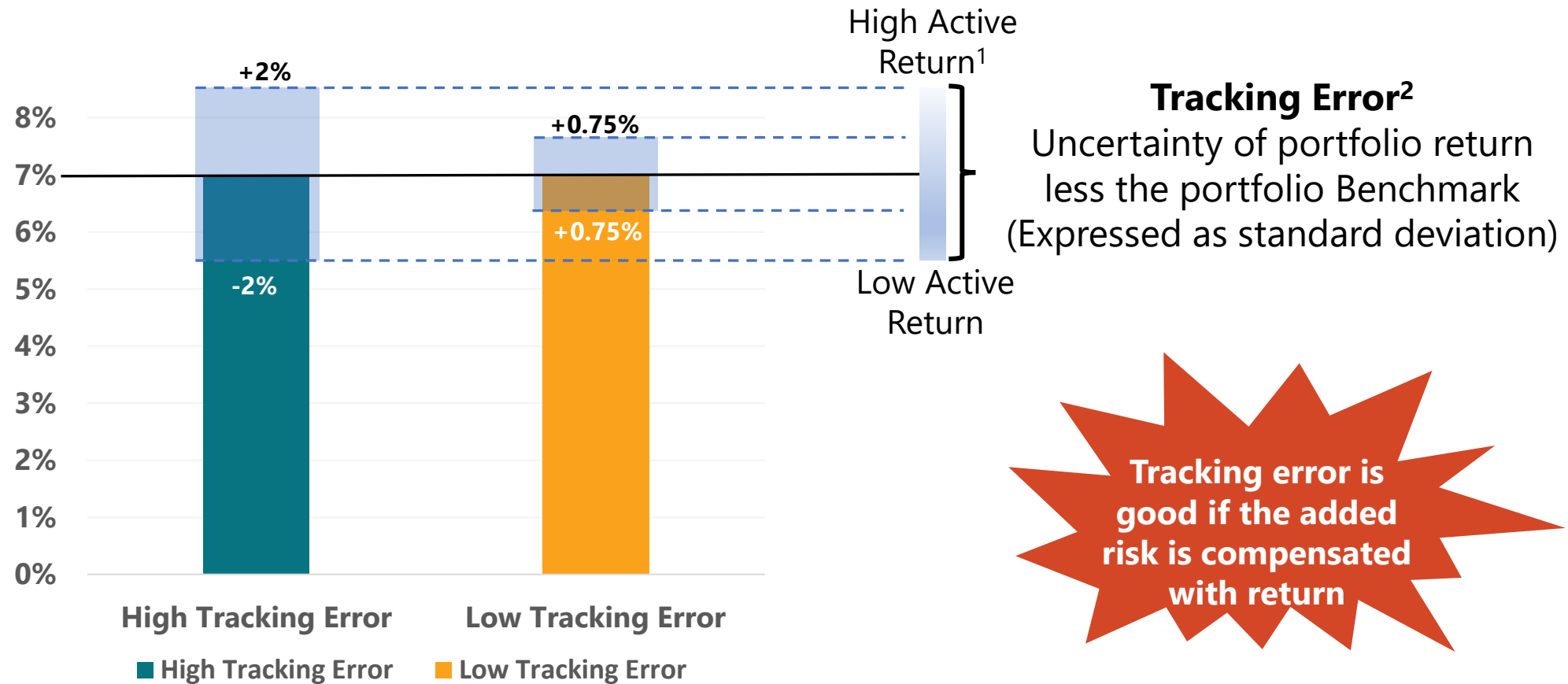
SOURCES OF RISK

Illustration



TRACKING ERROR

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



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

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

ACTIVE RETURN EFFICIENCY

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

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

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

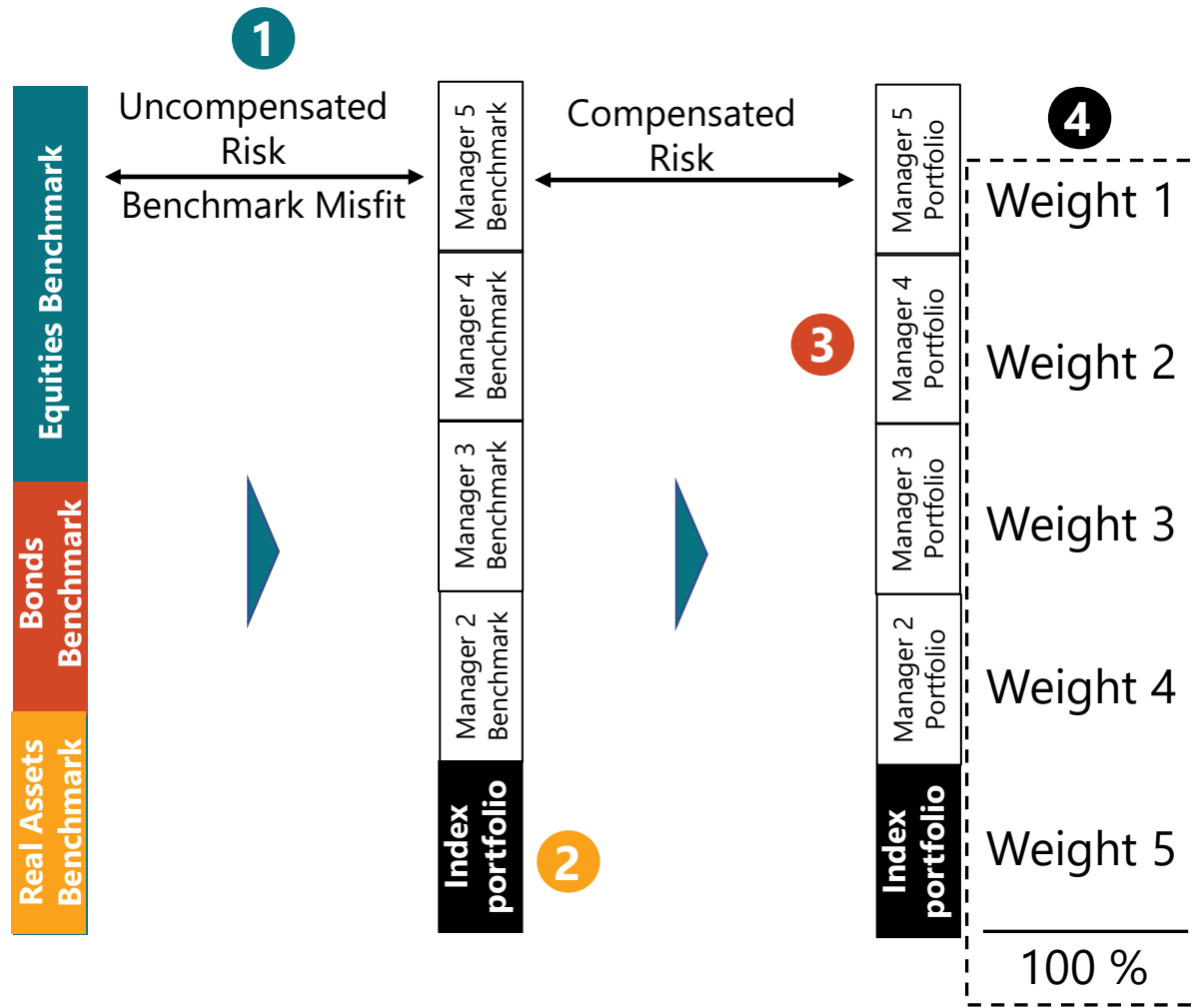
Skill to create active return is rare but a valuable investment!

TRACKING ERROR IS A GOOD INVESTMENT

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

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

FUNDS MANAGEMENT OPPORTUNITIES



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

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

OTHER RISKS AS FUTURE TOPICS TO DISCUSS

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

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

Executive session information will be send to Board members via secure link.

MEMORANDUM

TO: SIB
FROM: Jan Murtha, Executive Director
DATE: April 14, 2022
RE: Legacy and Budget Stabilization Fund Advisory Board Update

The Legacy and Budget Stabilization Fund Advisory Board met Friday April 8, 2022 (hereinafter “Advisory Board”). The link to the meeting and presentation materials is attached for your reference.

[Legacy and Budget Stabilization Fund Advisory Board - Interim Meeting Agenda - 04-08-2022 \(ndlegis.gov\)](https://ndlegis.gov)

During this meeting representatives from RVK provided a project kick-off presentation which outlined project scope, timing, and deliverables for consideration and discussion by the Advisory Board. RIO staff was also present to answer questions. Staff will provide a verbal update to the SIB regarding next steps at the April meeting.

BOARD ACTION REQUESTED: Information Only.

MEMORANDUM

TO: SIB
FROM: Jan Murtha, Executive Director
DATE: April 14, 2022
RE: GPR Committee Update

At its February meeting, the SIB approved the creation of a Governance & Policy Review (GPR) standing committee at the recommendation of the Audit Committee. At its March meeting, the SIB nominated and appointed three Board members to the committee.

The first meeting of the GPR committee is currently scheduled for Thursday, April 21, 2022 at 11:00amCT. Once the agenda and committee materials are finalized and distributed this memo will be updated with a link to those materials.

GPR committee members and RIO staff will be available to provide a verbal update to the SIB at its April meeting regarding the committee discussion.

BOARD ACTION REQUESTED: Information Only.

MEMORANDUM

TO: SIB
FROM: Jan Murtha, Executive Director
DATE: April 14, 2022
RE: Securities Litigation Committee Member appointment

I. Introduction

Currently there exist two vacant board member positions, and one pending staff member position on the Securities Litigation Committee.

At the October 2021 SIB meeting, upon the announcement of the impending resignation of then Land Commissioner Smith, Ms. Smith requested, and the Board Chair agreed, that the new Land Commissioner would be appointed to serve on the Securities Litigation Committee when that position was filled. Mr. Heringer was appointed to serve as Land Commissioner in March 2022.

Another Board member appointment is needed to fill the vacancy created by the departure of Mr. Troy Seibel. In addition, Ms. Flanagan has announced her retirement effective June 30, 2022, and staff recommends that Mr. Scott Anderson, CIO, be appointed as her replacement at this time.

II. Governance

SIB Governance Manual B-6 on Standing Committee states:

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

The committee charter states:

The Committee will consist of the Executive Director of RIO, one member of RIO fiscal or investment staff, RIO general counsel, and two members of the SIB appointed by the Chair. Membership on the Committee will be for one year or termination of term on the SIB. Vacancies will be filled by the SIB Chair at the first scheduled meeting following the vacancy. There will be no limit to the number of terms served on the Committee.

III. Request

Current Committee members are:

Board Member (Chair) - [Vacant](#)

Board Member (Vice Chair) - [Vacant](#)

Assistant Attorney General Dean DePountis

CFO Connie Flanagan – [requested to replace with CIO Scott Anderson](#)

Executive Director - Janylyn K. Murtha

BOARD ACTION REQUESTED. Chair to appoint.

MEMORANDUM

TO: SIB
FROM: Jan Murtha, Executive Director
DATE: April 14, 2022
RE: Audit Committee Member appointment

I. Introduction

Currently there exists one Board member vacancy on the Audit Committee. At the March 2022 SIB meeting, Dr. Lech was appointed to serve on the newly formed SIB – GPR committee. Dr. Lech requested that he be replaced on the Audit Committee. As Dr. Lech represented TFFR on the Audit Committee he must be replaced with another TFFR representative.

II. Governance

SIB Governance Manual By-Laws states in part:

Section 5-1-1. Audit Committee. The Audit Committee will consist of five members. They will be selected by the SIB. Three members of the committee will represent the three groups on the SIB (TFFR Board, PERS Board, and elected and appointed officials). The other two members will be selected from outside of the SIB and be auditors with at least a Certified Public Accountant (CPA) or Certified Internal Auditor (CIA) designation.

III. Request

Current Committee members are:

Ms. Yvonne Smith (Chair) - representing PERS members

[Vacant](#) (former Vice Chair) - representing TFFR members

Mr. Jon Griffin, MBA, BBA

Ms. Julie Dahle, MBA, CIA, CCBIA

State Treasurer Beadle - representing elected and appointed officials.

BOARD ACTION REQUESTED. Board to appoint.

MEMORANDUM

TO: State Investment Board

FROM: Mel Olson, Chair, Executive Review Committee

DATE: March 15, 2022

SUBJECT: Executive Director Performance Review

The Executive Review Committee will be meeting on April 28, 2022, to review the survey results and review the performance evaluation for the Executive Director.

The Executive Review Committee is looking at different approaches to facilitate the compensation of the Executive Director to the 50th percentile compared to other funds of like size with assets under management. The ND State Investment Board's Executive Director's current annual salary ranks in the middle of the 25th quartile and significantly below the 50th quartile in the salaries. The Executive Review Committee knows we all expect the Executive Director's performance to rank well above the 25th percentile.

Next Steps:

1. Complete the annual evaluation for the Executive Director.
2. Present any compensation recommendations.
3. Formulate a plan that increases the salary above the 50th percentile and closer to the SIB level of performance expectation for the Board to approve.

Quarterly Report on Ends Q1 2022

Investment Program

Quarter Highlights

During the quarter, Staff welcomed the new Chief Investment Officer, Scott Anderson, and the new Chief Risk Officer, Paul White, to the organization. Staff conducted an overall portfolio review to familiarize new team members with the existing portfolio and to develop a plan to optimize the portfolio going forward.

In February, Staff completed the RFP process to identify consultants for two projects for the Legacy Fund. The first project is to conduct an asset allocation study for the Legacy Fund specifically considering the ramifications of HB 1425. The second project is to develop a framework for the Legacy Fund's in-state investment program. The Legacy and Budget Stabilization Fund Advisory Board selected RVK for both projects.

Staff also held frequent calls over the quarter relating to a potential private market opportunity.

Portfolio Changes & Investment Consultant

In the third quarter of 2021, the SIB approved Arrowstreet Capital as an investment manager for the international sleeve of the Pension Trust, Insurance Trust, and the Legacy Fund. Contracting was finalized in January and funding of the accounts began in February.

At the February 15th Legacy and Budget Stabilization Fund Advisory Board meeting, the Legacy and Budget Stabilization Fund Advisory Board received presentations from three candidate consultants. The presentations related to the aforementioned asset allocation study and in-state investment program study. The Legacy and Budget Stabilization Fund Advisory Board selected RVK for both projects.

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.

Current Watch List

LSV

LSV was placed on the Watchlist in May 2019 for performance reasons. As of February 28, 2022, LSV managed nearly \$1.6 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 the outperformance continues but recommends keeping LSV on watch.

Epoch

Epoch was placed on the Watchlist in September 2020 for performance reasons. As of February 28, 2022, Epoch managed over \$320 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.

TOTAL EPOCH EQUITIES	>>>>>>>	\$	320,551,352	1-year	3-year	5-years	10-years
Epoch World Equities	Pension	\$	320,551,352	6.1%	10.2%	10.4%	9.4%
<i>Benchmark</i>			<i>MSCI World</i>	10.7%	14.4%	12.1%	10.7%
	<i>Pension</i>		<i>Relative performance</i>	-4.7%	-4.2%	-1.6%	-1.3%

TOTAL LSV EQUITIES	>>>>>>>	\$	1,579,636,535	1-year	3-year	5-years	10-years
LSV World Equities	Pension	\$	444,340,728	11.0%	10.8%	8.6%	-
<i>Benchmark</i>			<i>MSCI ACWI IMI</i>	6.9%	13.1%	11.2%	-
	<i>Pension</i>		<i>Relative performance</i>	4.1%	-2.4%	-2.5%	-
LSV U.S. Large Cap Value	Insurance	\$	80,251,985	15.2%	11.6%	8.9%	12.3%
LSV U.S. Large Cap Value	Legacy	\$	538,373,903	15.2%	11.5%	9.2%	-
<i>Benchmark</i>			<i>Russell 1000 Value</i>	15.0%	12.2%	9.5%	11.7%
	<i>Insurance</i>		<i>Relative performance</i>	0.2%	-0.6%	-0.5%	0.6%
	<i>Legacy</i>		<i>Relative performance</i>	0.2%	-0.7%	-0.3%	-
LSV International Value	Insurance	\$	53,649,349	6.9%	5.6%	5.1%	5.9%
LSV International Value	Legacy	\$	463,020,570	7.1%	5.7%	5.1%	-
<i>Benchmark</i>			<i>MSCI EAFE</i>	2.8%	7.8%	7.2%	6.2%
	<i>Insurance</i>		<i>Relative performance</i>	4.0%	-2.2%	-2.1%	-0.3%
	<i>Legacy</i>		<i>Relative performance</i>	4.3%	-2.1%	-2.1%	-

As of Feb. 28, 2022

NDRIO Investment Due Diligence Quarterly Monitoring Report

Jan-01-2022 to Mar-31-2022

Date	Firm	Reason For Call	Key Takeaways	Location	RIO Attendees
1/4/2022	State Street	Transition management overview	Overview on impact of transition management	Call	Matt Posch
1/6/2022	Northland	Private Market Call		Call	Matt Posch, Eric Chin
1/7/2022	Northern Trust	Biannual Portfolio Review		Call	Eric Chin, Matt Posch
1/10/2022	Northland	Private Market Call		Call	Eric Chin, Matt Posch
1/13/2022	Allspring Global	Catch up	Continues transition	Call	Eric Chin
1/14/2022	Axiom	Portfolio Update		Call	Eric Chin, Matt Posch
1/20/2022	Fiera Capital	Update call	Update on new ND team	Call	Matt Posch
1/20/2022	Stafford	Discuss Timber	Potential Timber Opportunity	Call	Eric Chin, Matt Posch
1/20/2022	London Company	Update call	Update on new ND team	Call	Matt Posch
1/20/2022	Riverbridge	Portfolio update		Call	Eric Chin, Matt Posch, Scott Anderson
1/21/2022	AlbaCore	Introduction	Prospect Manager	Call	Eric Chin
1/26/2022	Burgiss	Overview of services	Focus on alternatives monitoring	Call	Matt Posch
2/2/2022	Callan	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/2/2022	NEPC	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/3/2022	Goldman	Update	Interesting product to evaluate	Call	Eric Chin
2/3/2022	RVK	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/4/2022	Sun Mountain	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/7/2022	Aon	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/7/2022	Verus	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/8/2022	Bell Bank	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/8/2022	Meketa	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/9/2022	Meketa	RFP discussion	Asset allocation / in-state RFP search	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/17/2022	Russell Investments	Introduction and overview of services	Overview of services, transition management, completion indexes	Call	Matt Posch, Paul White
2/23/2022	Macquarie	Relationship discussion	Leverage Macquarie's platform	Call	Eric Chin
2/23/2022	Macquarie	MIP V Annual LPAC Meeting	Update on fund	Call	Eric Chin
2/24/2022	State Street	Introduction and overview of services	Overview of services such as transition management	Office	Matt Posch, Scott Anderson

2/24/2022 PGIM	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/24/2022 WAMCO	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
2/25/2022 Riverstone	Prospect	Prospect	Call	Eric Chin
2/28/2022 Vanguard	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin
2/28/2022 DFA	Russia/Ukraine	Discuss Russia Exposure	Call	Matt Posch, Eric Chin, Scott Anderson, Paul White
3/1/2022 Invesco	Update on Fund IV	Looking to expand fund cap	Office	Matt Posch, Eric Chin
3/2/2022 Arrowstreet	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin, Matt Posch, Paul White
3/4/2022 Northland	Private Market Call		Call	Matt Posch, Scott Anderson, Eric Chin, Paul White
3/4/2022 Antares	Prospect Manager	Prospect	Call	Eric Chin
3/7/2022 Barings	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
3/7/2022 WAMCO	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
3/7/2022 LSV	Russia/Ukraine	Discuss Russia Exposure	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
3/8/2022 Contrarian	Prospect Update	Prospect	Call	Eric Chin
3/9/2022 Blue Owl	Update on firm and strategy	Dyal V fundraising	Office	Matt Posch, Paul White
3/14/2022 S&P	Index Discussion	Index Construction	Call	Eric Chin
3/18/2022 RVK	Update call	Initial overview	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
3/18/2022 50 South	Portfolio Update	Continuing to explore new opportunities	Call	Matt Posch, Scott Anderson, Eric Chin
3/22/2022 Backstop	Overview of service	Document management service tailored to investment plans	Call	Eric Chin, Matt Posch, Scott Anderson, Paul White
3/28/2022 Barrow Hanley	Prospect	Prospect	Call	Eric Chin
3/29/2022 Cerberus	Update	Schedule Onsite	Call	Eric Chin
3/30/2022 L&C	Discuss Extension	Consider Extension	Call	Eric Chin

BUDGETING / FINANCIAL CONDITION

AS OF MARCH 31, 2022

	2021-2023 BUDGET	ADJUSTED APPROPRIATION	BIENNIUM TO DATE ACTUAL	EXPENDITURES		
				BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	\$ 5,103,977.00 *	\$ 6,841,839.00	\$ 1,628,887.78	\$ 5,212,951.22	76.19%	62.50%
OPERATING EXPENDITURES	3,567,403.00 *	3,642,403.00	489,629.04	3,152,773.96	86.56%	62.50%
CAPITAL ASSETS	6,300,000.00	6,300,000.00	0.00	6,300,000.00	100.00%	62.50%
CONTINGENCY	100,000.00	100,000.00	80,497.31	19,502.69	19.50%	62.50%
TOTAL	\$ 15,071,380.00	\$ 16,884,242.00	\$ 2,199,014.13	14,685,227.87	86.98%	62.50%

* 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.

The adjusted appropriation includes additional amounts appropriated during the Special Legislative Session in November 2021.

EXPENDITURE REPORT

AS OF AND FOR THE QUARTER ENDED MARCH 31, 2022

	<u>INVESTMENT</u>	<u>RETIREMENT</u>	<u>QUARTERLY TOTALS</u>	<u>FISCAL YEAR TO - DATE</u>	<u>BIENNIUM TO - DATE</u>
<u>CONTINUING APPROPRIATIONS</u>					
INVESTMENT EXPENDITURES	\$ 23,437,439	\$ 0	\$ 23,437,439	\$ 53,176,421	\$ 53,176,421
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0	60,819,933	60,819,933	183,461,028	183,461,028
2. REFUND PAYMENTS	0	1,627,933	1,627,933	5,131,149	5,131,149
TOTAL MEMBER CLAIMS	0	62,447,866	62,447,866	188,592,177	188,592,177
OTHER CONTINUING APPROPRIATIONS	179,792	1,380	181,173	321,379	321,379
TOTAL CONTINUING APPROPRIATIONS	23,617,231	62,449,247	86,066,477	242,089,977	242,089,977
<u>BUDGETED EXPENDITURES</u>					
1. SALARIES & BENEFITS					
SALARIES	295,272	158,048	453,321	1,205,958	1,205,958
OVERTIME/TEMPORARY	715	8,969	9,684	16,752	16,752
TERMINATION SALARY & BENEFITS	0	0	0	0	0
FRINGE BENEFITS	90,327	63,045	153,371	406,178	406,178
TOTAL SALARY & BENEFITS	386,314	230,062	616,376	1,628,888	1,628,888
2. OPERATING EXPENDITURES					
DATA PROCESSING	15,225	39,399	54,624	191,865	191,865
TELECOMMUNICATIONS - ISD	924	882	1,806	5,751	5,751
TRAVEL	4,006	125	4,132	10,788	10,788
IT - SOFTWARE/SUPPLIES	24	0	24	24	24
POSTAGE SERVICES	478	11,867	12,345	22,623	22,623
IT - CONTRACTUAL SERVICES	293	708	1,001	1,737	1,737
BUILDING/LAND RENT & LEASES	9,969	11,984	21,953	87,318	87,318
DUES & PROF. DEVELOPMENT	2,284	6,823	9,107	13,567	13,567
OPERATING FEES & SERVICES	1,143	1,352	2,495	11,685	11,685
REPAIR SERVICE	148	164	312	415	415
PROFESSIONAL SERVICES	0	16,213	16,213	131,918	131,918
INSURANCE	0	0	0	1,192	1,192
OFFICE SUPPLIES	335	455	790	1,138	1,138
PRINTING	89	5,743	5,831	7,219	7,219
PROFESSIONAL SUPPLIES & MATERIALS	125	641	765	1,626	1,626
MISCELLANEOUS SUPPLIES	516	106	622	763	763
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	35,560	96,460	132,020	489,629	489,629
3. CAPITAL ASSETS					
	0	0	0	0	0
4. CONTINGENCY					
	2,847	0	2,847	80,497	80,497
TOTAL BUDGETED EXPENDITURES	424,722	326,522	751,243	2,199,014	2,199,014
TOTAL EXPENDITURES	\$ 23,862,160	\$ 62,774,388	\$ 86,817,721	\$ 244,288,991	\$ 244,288,991

EXPENDITURE REPORT

AS OF AND FOR THE QUARTER ENDED MARCH 31, 2022

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
TEMPORARY SALARIES	50,000	0	50,000	0	0
IT - DATA PROCESSING (NDIT PROJECT MGMT)	775,000	34,025	740,975	12,674	46,699
PROFESSIONAL SERVICES	1,875,000	297,099	1,577,901	112,377	409,476
CAPITAL ASSETS	6,300,000	0	6,300,000	0	0
TOTAL PAS PROJECT BUDGET	9,000,000	331,125	8,668,875	125,051	456,176

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

INVESTMENT EXPENDITURE DETAIL
INVESTMENT EXPENSES FOR YEAR ENDED JUNE 30, 2022

	9/30/2021 Quarter	12/31/2021 Quarter	3/31/2022 Quarter	Fiscal Year to Date Totals
Investment Manager Fees				
Pension Investment Pool	\$ 15,688,873	\$ 13,068,398	\$ 36,508	\$ 28,793,779
Insurance Investment Pool	2,078,965	1,695,037.66	-	3,774,003
Legacy Fund	10,705,648	9,109,464.32	-	19,815,112
PERS Retiree Health Credit Fund / Job Service ND Pension Fund	301,967	302,091.58	-	604,058
Total Investment Manager Fees	\$ 28,775,454	\$ 24,174,992	\$ 36,508	\$ 52,986,953
Investment Consultant Fees				
Pension Investment Pool	\$ 84,167	\$ 57,037.29	\$ -	\$ 141,204
Insurance Investment Pool	29,710	18,532.45	-	48,242
Legacy Fund	2	19.17	-	21
Total Investment Consultant Fees	\$ 113,879	\$ 75,589	\$ -	\$ 189,468
Total Investment Expenses	\$ 28,889,332	\$ 24,250,580	\$ 36,508	\$ 53,176,421

MEMORANDUM

TO: State Investment Board
FROM: Jan Murtha, Executive Director
DATE: April 21, 2022
RE: Executive Limitations/Staff Relations

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

1. Retirements/Resignations/FTE's/Temporary Assistance:

Additional updates regarding ongoing discussions with HRMS related to classification and reclassification requests will be provided at the meeting.

Employee Title	Status
Deputy ED – Chief Retirement Officer	Posted February 2022, closed 4/4/22. Initial Interviews to be scheduled within 2-3 weeks of April Board meeting. Final interviews will be arranged with TFFR Search committee.
Chief Fiscal Officer	Anticipate Posting in April, Filling by June. Reclassification request was submitted to include Chief Operating Officer duties (CFO/COO) and increase grade. HRMS verbally denied the classification request. RIO anticipates posting the position at the current grade and appealing the reclass decision once finalized.
Legal Intern	Interviews Conducted March 2022. Offer has been accepted. Anticipated to fill this summer as part of UND Law School Externship Program, with final details to be worked out with student.
Investment #1	Authorized by HB 1506 in 2021 Legislative Special Session: JDQ created, classification request pending HRMS.
Investment #2	Authorized by HB 1506 in 2021 Legislative Special Session: JDQ created, classification request pending HRMS.
Investment #3	Authorized by HB 1506 in 2021 Legislative Special Session: JDQ created, classification request pending HRMS.
Investment #4	Authorized by HB 1506 in 2021 Legislative Special Session: JDQ created, classification request pending HRMS.
Investment Reclassification Request #1	Reclassification of current Investment Analyst position to support new organization structure. Reclassification request is pending HRMS.
Accounting #1	Authorized by HB 1506 in 2021 Legislative Special Session: JDQ created, classification request approved by HRMS and position is posted with closing date May 2, 2022.
Programs Coordinator	Authorized by HB 1506 in 2021 Legislative Special Session: JDQ requirements currently under review.

2. Current Procurement Activities including:

- **PAS Project** – The ESC awarded the vendor solution contract to Sagitec. Onsite formal project Kick-off meeting is scheduled for May 16 & 17 with staff.

3. Open Records & Media Requests

- Between 2/13/22 to 4/13/22 The agency received and responded to 18 open records requests and 24 other comments or inquiries. These include requests or comments received from both media and private individuals.

4. Email Accounts for Board Members (non-state employees)

- In ongoing efforts to improve cybersecurity, state email accounts will be provided to all SIB, TFFR, and committee members that are non-state employees.

BOARD ACTION REQUESTED: Board Acceptance.

BOARD LEADERSHIP

March–April 2022 • No. 180

INNOVATIVE APPROACHES TO GOVERNANCE

EDITOR: NICHOLAS KING

Navigating the Invisible: Measuring and Managing Behavioral Variability in Board Decision-Making

BY HUGH MASSIE

Hugh Massie is the CEO and founder of Atlanta-based DNA Behavior International and a champion of the practical application of behavioral insights. In this article, he discusses the often unseen and unmeasured behavioral issues that impact board decisions.

Most organizations don't resolve challenging issues because they cannot see them. It's generally not a lack of know-how. Rather, in scrutinizing board-level decisions, it is the behavioral differences behind the debate and the structure of the process that warrant closer examination.

Board members or other decision-making groups come together not to compromise strategic planning or operational decisions but to contribute fairly and wisely to high-stakes decision-making, fulfilling at least one facet of their fiduciary duties.

What may not be apparent to them is the unseen behavioral variability in making these decisions. To observers, it may appear as inconsistency, confusion, and lack of cohesion. In reality, the disorderliness reflects biases and random "noise", invisible and unwanted "guests" appearing in the guise of inherent behavioral styles people bring with them. These are

magnified when money or money decisions are involved.

Behavioral variability in decision-making and judgment is quantifiable. While many leaders would surmise there is 10–15% variability; research of 828 CEOs shows it is over 50% across many types of decisions. Think about the cost to your organization, considering both the errors and the corresponding fiduciary risks.

This costly behavioral variability remains invisible if it is not measured and remains unaddressed. This is where future board decision-making processes need careful structuring to obviate as much inherent behavioral variability as possible. Such variability may be brought into the boardroom by board members, executives, key experts, and others brought in to otherwise foster good governance.

Board Decision Variability

Variability means the tendency to shift or change. People are different; they approach decision-making from a range of standpoints. This isn't just about varying opinions on a subject. Rather, when provided with precisely the same information, individuals interpret what they hear, read and see, and arrive at decisions differently because of inherent natural behavioral style.

We all have inherent behavior characteristics, some of which we are aware and much of which we may be unaware. We also are all influenced by our own experiences, values,

continued on page 6

Inside This Issue

2 Mitigating disruption: How corporate boards are prioritizing business resilience during the pandemic

4 Board development in 2022: How the past year is impacting key decisions

Mitigating disruption: How corporate boards are prioritizing business resilience during the pandemic

BY CATHERINE ALLEN

Catherine Allen is the founder and chairman of the Board Risk Committee, a nonprofit organization dedicated to providing a trusted, noncompetitive, peer forum for the exchange of ideas, best practices, and topics of interest. She is also a member of Women Corporate Directors. In this article, she discusses the impact that the COVID-19 pandemic has had on corporate boards, and some of the ways they've responded to the crisis.

As the pandemic drags on, unforeseen disruptions are on the rise, and corporate boards are taking note of these new and ever-changing risks. Though these disruptions can look different from industry to industry, one central issue is clear: how quickly a company responds and recovers could make or break the business.

Sophisticated disruptions in areas such as supply chain, cybersecurity, geopolitical relations, and human capital management are exposing gaps in response strategies.

As a result, resilience and continuity planning have jumped to the top of the board agenda. This trend was the focus of a recent survey of more than 100 directors who are

members of Women Corporate Directors (WCD), the world's premier organization for women who serve on public and private corporate boards. The goal of the survey by WCD and Castellán, a leader in business continuity and operational resilience solutions, was to understand how and to what extent organizations and their boards of directors are approaching and prioritizing operational resilience and business continuity as the pandemic evolves.

Here are a few key takeaways:

1. Operational resilience and business continuity are the responsibility of the full board.

It's clear that board directors are prioritizing operational

When We Say...

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

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

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

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

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

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

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

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Publishing Editor: Samara Kuehne. Editor: Nicholas King.

Production Editor: Mary Jean Jones. Editorial Correspondence: Samara Kuehne, Email: skuehne@wiley.com.

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resilience and business continuity, as 60% of them stated that it is “consistently a board priority.” Furthermore, 44% of respondents agreed that the full board should be involved in resilience management and continuity planning, not just the risk and audit committees.

This is because resilience management involves integrating risk disciplines and removing artificial silos to proactively plan and test unified response strategies. All operational processes and business strategies need to be designed around resilience, and every decision must take risk into account.

To carry out these large-scale operational changes, C-level executives are increasingly being called on for further support as the liaisons between the board and the rest of the organization. Board members are having more robust conversations with management about the processes, practices, and plans in place, and enterprise-wide risk management dashboards and tracking systems are becoming more commonplace to keep everyone apprised of key performance indicators.

Achieving operational resilience and business continuity is a team effort, and leaders are invested in ensuring the future success of their companies.

2. The top threats to organizations include cybersecurity, human capital, and major business disruption.

It is no surprise that cybersecurity, both internal and external, ranked as the top concern (38%) considering the sudden switch to remote work at the height of the pandemic. Many organizations did not have the technical infrastructure nor security measures in place to handle this immediate shift. As a result, the ever-looming threat of cyberattack increased 10-fold, and IT teams scrambled to convert legacy systems and establish more robust security programs to protect enterprise data on and off company premises.

After cybersecurity, 17% of respondents ranked human capital management as a main threat due to factors such as employee workplace safety, labor shortages, talent retention, and workplace expectations. Organizations have struggled to prioritize health and safety while also maintaining a thriving workforce, which has put resilience and continuity to the test. In response, boards are focusing on strategies for DE&I, retention, training, and succession planning.

The third-highest threat, according to respondents, is major business disruption (13%). This pertains to mostly external threats, including economic disruption caused by the pandemic, weather, natural disasters, and terrorist attacks.

Other threats indicated in the survey were environmental change (9%) and supply chain disruptions (6%). About a third of respondents specified that an organization’s vulnerability to disruption is what makes these threats seem so imminent, and company leaders are hyper-aware of the need to mitigate those vulnerabilities.

3. Human capital management is also a strategic

opportunity for companies.

Although considered by many of the directors surveyed to be a major threat, 23% of respondents also cited human capital management as an area of opportunity for operational resilience and business continuity. By successfully navigating an evolving workforce, companies can be assured that their continuity strategies are effective.

For example, there are inherent risks with handling return to work, such as managing employee health and safety and the question of mandating vaccines. If companies can set a clear path forward and set a precedent now, they are more likely to be able to withstand future disruptions.

The ongoing pandemic has highlighted an invaluable lesson: One of the assets that is most vulnerable to disruption is workers, and companies need to be doing all they can to take care of their people. To that end, companies are working to replace lost labor with reinvigorated recruiting tactics as well as increased training and retention tactics.

Other opportunities that board members are seeing as drivers for future success include leveraging new technology such as the Cloud, AI, robotics, and digital automation (16%), business transformation (9%), addressing supply chain challenges (7%), and tackling crisis management plans (7%).

4. Directors expect to increase investment in resilience and continuity planning.

Almost 70% of respondents anticipate resilience and continuity to be allocated significantly more funding than in past years. The top threats that directors indicated in the survey will be the drivers of this investment.

As such, cybersecurity will be the largest focus, according to the survey. When asked more specifically which factors are driving increased spending in this area, 24% of respondents cited protecting against cyber threats, 16% cited real or perceived risk of some disruption to the organization, and 15% cited new or changing technology.

Human capital management, as mentioned above, is also a key area of investment as companies bolster their recruitment and retention efforts, as well as operational processes.

The increased spending directed toward building internal programs will ultimately reinforce companies’ defenses against external threats that could cause unforeseen disruptions.

Assessing your organization’s preparedness for disruption

Below are some helpful questions to establish a baseline for resilience and continuity planning. Your answers to these questions will be an important first step to determining the areas that need the most attention.

1. How resilient is your organization’s financial model (revenue-generating approach)?

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Board development in 2022: How the past year is impacting key decisions

BY SHAWN OGLESBEE

Shawn Oglesbee is a partner in the board services practice of retained executive search firm ON Partners. In this article, he discusses developments in corporate board rooms as organizations look to move beyond the current challenges facing them.

The past year has seen one of the most volatile business environments in memory. Political, social, economic, health, and regulatory factors combined to form the perfect storm, creating a turbulent path for boards and those in the C-suite to navigate.

As a result, bringing together the right executive leadership team to unlock a brand's potential has never been more critical, especially as the demand for leadership talent has increased moving into 2022. Building a board team with the right mix of experience and perspectives has arguably never been more important to an organization's success.

This year, as business volatility continues owing to a confluence of factors including high inflation, ongoing supply chain issues, labor shortages, and, of course, COVID, board directors must have a heightened attentiveness and develop closer interactions with C-level executives. For 18 months, boards have been adjusting to remote board work, and that includes time with the operating executives. With everyone one step removed from historical face-to-face contact and relationship building, it has been easier to let items slip that would have been addressed or picked up through the nuance of time spent together.

At the same time, however, board members must remember their position of oversight and the importance of viewing the business through a long-term lens. This skill has become more difficult during the COVID crisis, and lines between a day-to-day and long-term focus have blurred. While directors were dealing with a once-in-a-century pandemic and the ensuing business issues, it was all hands on deck for members to roll up their sleeves on immediate, often life-preserving operational issues outside of the customary scope of directors. As the existential issues have faded, moving back to long-range strategy and governance is clear.

Boards should do a full effectiveness assessment every two to three years—and this would be an ideal time, given the changes to which they have had to adjust in operating environment, not to mention the same forces for the company they oversee.

Supply Chain Front and Center

The supply chain crisis impacting US business since 2021 has contributed to the volatile environment. Less than two years ago, boards and C-suites were focused on risk

mitigation, triple sourcing, nearshoring, and how to bring more manufacturing to Mexico and Latin America. Turning the business world upside down, the pandemic has brought supply chain directly into the limelight as never before. Board and C-suite focus has dramatically shifted toward planning, as supply chains become more complex and port issues and container costs—which in some cases are up 400%—move front and center.

As a result, boards have been interacting much more closely with the senior executives running the operational supply chain side of the business. For B2C companies, “traditional” supply chain talent had to pivot and come up to speed quickly on the interconnectivity of supply chains, the intersection of the supply chain, new product development, sales and finance, and the use of new technologies and new partners.

The pandemic exposed weak leaders across the supply chain as well as many other functions, and many organizations remain focused on replacing those weak links. Leaders who are poised for success in the current environment, those who can run toward the fire and face ambiguity with energy, optimism, and inspiration, will continue to be in high demand. This has led to a 72% increase since 2019 in supply chain functional experts as new director hires for international product enterprises.

Building a More Diverse Board

Diversity continues to be a high priority for boards. As more professional retained searches occur vs. “personal network” board hires, the onboarding process and time to be fully open and trusted is lengthened. This has only been exacerbated by the pandemic, where the personal time to build rapport and deepen relationships has been diminished.

Also, fewer restrictions currently exist around “CEO or big P&L experience only may apply.” Formal board skill assessments are increasingly common as well, which results in targeting functional leaders in high demand such as sitting chiefs of marketing, digital, or security. In privately held growth companies, VCs and founders are landing independent directors earlier... post round B or C...not just in time for the S1 filing.

And somewhat surprisingly, many boards—including Fortune 500s—will continue to do at least one remote meeting going forward, even post-COVID. Ease of scheduling,

including for committee work, is a benefit. ESG processes and metrics are now being formalized at many major companies, which is likely to quickly trickle down to any company with over \$1 billion in revenue.

Operating partners (OPs) can be an interesting way to build more diverse boards. While the role is typically a step before retirement given the level of experience needed, OPs are working harder than ever before, balancing the role of coach with being deep in the weeds of three or four companies in a hyper-competitive environment.

When a PE firm hires an OP, he or she is likely to serve on several boards, so hiring a diverse candidate as an OP intrinsically creates several increasingly diverse boards.

To validate the diversity forces at work, our practice placed over 77% diverse candidates in 2020–21.

Higher Attention to Human Capital

A greater governance focus on human capital matters has boards taking a more hands-on approach for several reasons. There is an emphasis on the board's fiduciary duty to guarantee that the strength of the organization's workforce is a corporate asset. Also, boards are recognizing that they must be well versed in key issues that fit the corporate and social agenda such as remote work, return to work strategy, employee health and safety, employee engagement, and diversity, equity, and inclusion initiatives. And for companies focused on success for a decade or more ahead, attention to human capital is paramount.

Strategically, this is an ideal time to raise the bar if needed on the CHRO role. More than any other function, CFOs have firm and substantial connections to the board, but often no other member of the CEO's team is that integral to the board's work. The CHRO, through regular defined support to the compensation committee on management development, compensation, succession, etc., could be a big deal in the years just ahead, given the changing nature of employee–employer relationships. Boards have not seen that as such a strategic issue until now, and have often delegated that back to the CEO. The CHRO is a better choice.

Culture Front and Center

Increasingly, executives have been hedging one offer against another, which was until recently not common in the executive recruitment world. More and more, executives are sharing offers with other employers, then taking the best offer, and more offers are being declined. In this seller's market, potential employees can ask for—and get—just about anything.

This can be attributed to a transition to a hired-gun environment as a result of COVID, with executives saying, “I’ll do whatever you want for as long as you want as long as I can work from home and don’t have to come into the office.”

We’ve gone from an environment in which location/relocation and being in the office five days a week were requirements in 70% of executive searches to where it’s now just 20%. It has completely changed the recruitment game.

Increasingly, executives are feeling no real ties to their employer. They’ve never met their boss or his/her significant other, they’ve never been to a sales conference, and in many cases they’ve never met their team. So when the next big thing comes along, they figure, “why not, I really don’t know any of these people.”

As a result, culture is becoming a major issue for boards, CEOs, and HR to figure out—how to create and build one that helps retain employees when you’re not seeing people in person as much or at all. ■

RESILIENCE

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2. How resilient is your organization's customer demand for your products and services?
3. How resilient are your organization's product/service delivery channels (how you reach and deliver to your customers)?
4. How resilient are your organization's partners (and your supply chain in general)?
5. How resilient are your organization's other business capabilities (the processes and resources that contribute to product/service delivery)?
6. How demanding are your customers' expectations regardless of circumstance?
7. How confident are you that there aren't any vulnerabilities that you're unaware of (for example, single points of failure)?
8. How confident are you in your organization's ability to respond effectively to crisis or disruption (team, response capability, competencies)?
9. How confident are you in your organization's ability to communicate effectively with internal and external stakeholders throughout a crisis or disruption?
10. How confident are you in your organization's ability to recover in a timely manner following the onset of a crisis or disruption?

With no real end to the pandemic in sight, along with worsening climate conditions, geopolitical relations, social unrest, and threats of cyberattack as technology becomes more sophisticated, it is of utmost importance that corporate directors and company leaders make the necessary preparations to ensure a major disruption will not be disastrous to their businesses. In the face of these threats, our research shows that companies are taking operational resilience and business continuity very seriously, enabling their organizations to bend, but not break, when it matters most. ■

VARIABILITY

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beliefs, and education.

While some people have well-tuned intuitive radar, research has shown that it is only 28% accurate.² Nevertheless, most experienced leaders feel more empowered if they can exercise their intuition. Therefore, it would be better when faced with high-stakes decisions if decision-making groups such as boards have a structured framework to follow that does not eliminate the use of intuition, but defers it until there has been sufficient cognitive reflection involving a review of the complex data presented, along with independent expert input.

Adopting a more structured approach is essential for boards if more informed decisions are going to be made. Many boards need to rethink and reshape how they manage themselves in high-stakes decision-making and measure and manage human differences that may be costing their organization far more than imagined.

Three examples of alarming board decision variability shared with me recently:

In undertaking fundamental analysis of businesses, research indicates a 41% variability in valuations even though the same company description, cash flow, forecasts, accounts, and projections were provided to different analysts assessing the worth.³

Consider: How much could your company be overpaying for an acquisition or even leaving on the table in an asset sale?

Three leaders are interviewing a candidate for a senior position. One of the leaders wants to hire the candidate. One doesn't. One is undecided and wants more information. Each has the candidate, the resume, and references in front of them. Each understands the role to be filled and the credentials of the candidate. Research indicates there is a 38% variability in selection.⁴

Consider: Why do the interviewers arrive at different assessments of a candidate's performance capability? Why do they form different impressions from the start? What is the cost of making the wrong hire?

Forecasting revenues is always troublesome for companies, as different people naturally have different impressions of what could happen. Research has shown a 71% variability in sales forecasting, which is also similar in forecasting product and operational costs.⁵

Consider: What is the quality of information that is flowing through? Why are some people always over-estimating and others under-estimating the forecasts? What is the impact on resource allocation for the company and the structural pressure on the business and the team?

The answer to these questions lies in behavioral variability, which drives different interpretations of the same transaction.

As a board member, you have a fiduciary responsibility to ensure a behavioral variability study (i.e., an audit) is undertaken and better decision hygiene processes are implemented. And for implementation to be effective, it must be genuinely adopted top-down.

Without a thorough understanding of the invisible factors at play and their influence on the variability of judgment calls, decision-making will always be inconsistent or, worse, flawed.

Board's Ultimate Decisions Define Organization's Future

Those responsible for shaping the identity and future of an organization may only meet several times a year for short periods, compared with those in charge of day-to-day operations. Still, the board's decisions define the organization's long-term big picture.

Most board members are selected because of expertise, skills, or even reputation. Often, they are on many boards simply because of connections or industry knowledge. However, while their reputation may be known, their behavior and decision-making style seldom is.

It's fair to say that systemic biases, random noise, and ego will play a role; maybe even groupthink (the phenomenon that occurs when a group of individuals reaches a consensus without critical reasoning or evaluation) will surface and disrupt sound decision-making.

You can begin to see the melting pot of behavioral differences made up of the biases and triggers causing noisy reactions from different board members. These invisible contributors to decision-making need to be revealed, understood, and managed.

The primary barrier to addressing human behavior in a board room setting (as an example) is recognizing the consequences of not knowing the behavioral differences of each individual—and what is motivating their decision-making.

With the best will in the world, board members could all face the same problem, detail, or regulatory insight and yet come to completely different resolutions.

The most dominant behaviors in **group** settings that influence board dynamics:

- Authority Bias (the Driver)—commanding, needs to control the conversation.
- Group Think Bias (the Promoter)—wants to get the group to a consensus.
- Confirmation Bias (the Harmonizer)—willing to hang back, patient, does not confront.
- Status Quo Bias (the Protector)—content with the way things are.

These should (1) raise questions around decision-makers, and (2) lead you to seek input from skilled people

who can advise and measure behavioral variability in your organization.

The most dominant decision-making biases in **individuals** that influence board dynamics:

- Over Optimism Bias (the Driver)—pioneering individuals who may overestimate achieving specific goals or outcomes.
- Loss Aversion Bias (the Harmonizer)—patient people who have a lower risk appetite.
- Pattern Bias (the Protector)—structured individuals who excessively focus on the wrong data. Note, the opposite is the Instinctive Bias (the Promoter Traits).
- Anchored Bias (the Protector)—overly relying on pre-existing information, may be unwilling to change or think out of the box.

Add in random factors influencing board members on the particular day:

- Mood, whether it be good or bad
- Stress or fatigue
- Personal experiences, values, or beliefs
- Ego
- Ignorance

Then the debate gets underway....

Left-brain-anchored individuals with a fear of change clash with the “drivers” who will push for growth and transformation. Right-brain creative members are promoters who want more brainstorming. Those harmonizers who are more compliant and fearful of conflict will shrink from provocative discussions. Those drivers, motivated by their sense of self-importance, ego, and ambition, throw verbal grenades into the conversation.

But the risk to the decision-making process is this: Everyone becomes tired of rhetoric and simply concedes to the loudest voice in the room, merely to end the debate. This is where flawed decision-making is birthed.

Benefits of Addressing Board Behavioral Variability

Methodologies and technologies can be embedded inside existing business systems to directly reveal, make visible, measure, and manage behavioral impacts of human behavioral differences in decision-making.

If behavioral variability can be reduced, an organization could potentially experience benefits in:

1. Gross revenues
2. Cost savings
3. Productivity improvement
4. Risk management (governance)
5. Hiring and performance management
6. Business process execution

The impact of human behavioral variability is often

experienced at a substantial level when:

1. Different decision-makers make intuitive judgment calls concerning similar operational decisions required daily within the business without (a) appropriately set benchmarks and (b) understandable guidelines, and,
2. When groups make complex decisions (e.g., a board or a team) without a structured process to (a) reduce pre-judgments and impressions, (b) address false or inadequate information, and (c) align an appropriate balance of risk and reward.

The problem is that people with different behavioral styles and perspectives tend to capitulate to their intuition without enough cognitive reflection. They will naturally use pre-judgments or a preconceived notion of what they want the answer to be. Biases, egos, group think, and the loudest voice in the room will all be factors. This can lead to sub-optimal decisions, frustration, and ultimately side conversations that leave all expertise as groups/cliques formulating decisions in the margins.

Leaders and board members must accept that behavioral variability is a substantial, if invisible, problem. While behavioral variability cannot directly be seen in financial statements (just as a robust and sustainable culture cannot be seen), both bias and noise are ever-present and contribute to substantial organizational costs.

To measure, then reduce or eliminate behavioral variability caused by both bias and noise, a study must be undertaken to discover behavioral styles and look at existing decisions. Then, training and systemized processes can be designed and built to provide more structure.

It is essential to understand that diversity of opinion is healthy; behavioral variability can only undermine decision-making when individuals in a group, given the same facts and the exact regulatory requirements, make significantly different decisions without enough management and cross-checking.

Behavioral Variability in DEI

Boards have many fiduciary responsibilities, not least of which is the critical role they play in creating an organization that prioritizes, supports, and invests in diversity, equity, and inclusion (DEI).

The subject of DEI is highly topical as managing it in today's world is crucial to business growth, recruiting, and managing employment-related risk. Further, how DEI is managed by organizations is something that customers, suppliers, partners, regulators, and others specifically examine.

Given DEI is inherently about people and the exercise of judgment, there will naturally be a range of different views on the role it plays and how to manage it. Varied perspectives on what is already an emotionally charged topic could cause additional organizational risk if not properly managed.

Clear heads are needed from the board and from senior executives. They must have a greater awareness of different perspectives that come from their own behavioral style and experiences that may be influencing decisions they make about DEI.

Not to put too fine a point on it, but at first some may perceive a focus on behavior variability as a way to sideline DEI. To the contrary, by applying an objective, quantifiable approach to behavioral variability, a board (or team or organization) can maximize both DEI and the best possible decisions by every individual.

Behavioral Variability in Hiring

While boards are typically not involved in day-to-day hiring, there are key C-Suite players whose involvement is crucial to certain “hires.”

How does behavioral variability produce errors in candidate selection? In essence, different interviewers will have different responses to the same candidate having been given the same information. Psychological biases of the interviewer will often steer them to someone who is similar to themselves. (Again, letting that play out can result in same-hiring-same; decidedly not a healthful DEI approach.)

Members of the hiring panel being in a better disposition on interview day also can sway decisions. Likewise, they could form impressions from the rapport-building phase of the interview—senses and intuitions they carry through to decision-making depending upon what they happen to be focusing on or thinking about at that time.

Further, without any insight into the behaviors of the interviewers, it is possible that one member could acquiesce to the louder, more forceful member who steers the interview and final decisions.

The hiring process can be improved if there is a decomposition of the hiring process into interviews that focus on separate discovery goals and decisions about the candidates and about the experts used for each interview. That may mean the board plays a supervisory role, with only board members with relevant expertise involved in hiring.

Behavioral Variability in Change Management

Change management is challenging under the best of conditions—never more so than in the past two years, as leaders work hard to keep businesses afloat and employees engaged in the face of the continuing pandemic and changing economic conditions.

Introducing any change—especially ones of the magnitude of a global pandemic—requires shifting individual habits and behavior within the organization. For example, working remotely for some is exciting; for others, it brings a feeling of isolation. Add to that a wider use of new technology, which is

comfortable some, daunting to others.

Definitively knowing the different behavioral styles of all players is helpful so that their motivations and communication preferences are understood, enabling a personalized approach to each person and each communication.

Boards and senior executives will not succeed if change is forced. Thus, with customized questions that appeal to each person’s inner motivations (*purpose, passions, and values*), sustainable change can succeed. An essential aspect of understanding behavioral variability at a deeper level is that it provides management with insight into those who can manage change and could become peer-to-peer ambassadors for the introduction of changes. Bonus: Leaders who know how to communicate with greater empathy.

Revealing and Managing Behavioral Variability Differences

Acknowledge behavioral variability as a crucial element that can undermine a board’s high-stakes decision-making—unless efforts are taken to reveal, understand, and manage said variability.

Without accepting the consequences of failing to understand this variability, any form of discussion leading to important decisions is likely to be imperfect. It is essential to identify and measure the prevalence of bias and noise in your organization to understand how decision-makers reach their conclusions.

New, robust research and methodologies are available to more directly measure the financial impact of human behavioral differences (behavioral variability). Only by adopting and implementing such can prevalent behavioral causes that once seemed invisible be made highly visible and addressed.

Board-member value and contributions will be maximized, as will the follow-on, cascading benefits across the organization. ■

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Food for Thought

My own definition of leadership is this: The capacity and the will to rally men and women to a common purpose and the character which inspires confidence.

Bernard Law Montgomery