NORTH Dakota | State Investment Board
Be Legendary. RETIREMENT & INVESTMENT

Friday, December 16, 2022, 8:30 a.m.
Virtual Only
[Click here to join the meeting]

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

A. Executive Summary

II. ACCEPTANCE OF MINUTES (November 18, 2022)

III. INVESTMENTS (10 minutes)

A. Legacy Fund IPS – Mr. Anderson

IV. GOVERNANCE (20 minutes)

A. 2023 Legislative Session Update
   1. Board Composition Bill – Ms. Murtha
   2. 2021 Legislative Implementation – Mr. Anderson

V. Quarterly Monitoring Reports (20 minutes)

A. Quarterly Budget/Expense Report – Mr. Skor
B. Quarterly TFFR Ends – Mr. Roberts
C. Quarterly Internal Audit Report – Ms. Seiler
D. Executive Limitations/Staff Relations – Ms. Murtha

VI. OTHER (5 minutes)

Next Meetings:
Investment Committee – January 13, 2023, at 9:00 a.m. Virtual Only
SIB GPR Committee – January 26, 2023, at 10:00 a.m. Virtual Only
TFFR Board Meeting – January 26, 2023, at 1:00 p.m. Virtual Only
SIB Meeting – January 27, 2023, at 8:30 a.m. Virtual Only

VII. ADJOURNMENT

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

EXECUTIVE SUMMARY

SIB Regular Meeting

December 16, 2022 – 8:30am CT

I. **Agenda:** The **December Board Meeting will be Virtual Only; a link will be provided so that Board members and the public may join via video conference.** The board member video link is included in the email with the Board materials.

II. **Minutes (Board Action):** The November 18, 2022, Board meeting minutes are included for review and approval.

III. **Investments – Legacy Fund Investment Policy Statement (Board Action):** The Legacy & Budget Stabilization Fund Advisory Board finalized and approved amendments to the Legacy Fund IPS at its December 6, 2022, meeting. The amended IPS comes before the SIB for approval.

IV. **Governance – 2023 Legislative Session Update (Information Only):** Ms. Murtha will present to the Board the bill draft the SIB directed staff to file with Legislative Council regarding Board Composition. Mr. Anderson will review information relating to the implementation status of bills passed during the prior 2021 legislative session that were impactful to the SIB program. A one-page document containing program highlights that was provided to legislators is included for the boards reference.

V. **A-D. Reports (Board Action):** Staff will provide monitoring reports on quarterly budget/expenses, TFFR ends, internal audit activities and executive limitations/staff relations that were continued from the November SIB meeting.

Adjournment.

NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
NOVEMBER 18, 2022, BOARD MEETING (IN PERSON)

MEMBERS PRESENT:	Brent Sanford, Lt. Governor, Chair Dr. Rob Lech, TFFR Board, Vice Chair Thomas Beadle, State Treasurer Glenn Bosch, Legacy/Budget Stab. Adv. Board Rep Jon Godfread, Insurance Commissioner Joseph Herringer, Commissioner of Unv & School Lands Cody Mickelson, TFFR Board Adam Miller, PERS Board Claire Ness, PERS Board, Parliamentarian Mel Olson, TFFR Board Mona Rindy, PERS Board Alternate Art Thompson, Director of WSI
STAFF PRESENT:	Scott Anderson, CIO Eric Chin, Deputy CIO Derek Dukart, Investment Officer Jecca Geffre, Communications & Outreach Dir. Rachel Kmetz, Accounting Mgr. Missy Kopp, Exec Assistant George Moss, Sr. Investment Officer Jan Murtha, Exec Dir. Matt Posch, Sr. Investment Officer Emmalee Riegler, Contracts/Records Admin. Sara Sauter, Internal Audit Supvr. Ryan Skor, CFO/COO Dottie Thorsen, Internal Auditor Tami Volkert, Compliance Spec. Susan Walcker, Sr. Financial Accountant
GUESTS:	Jace Beehler, Governor's Office Alex Browning, Callan Craig Chaikin, Callan Dean DePountis, Attorney General's Office Paul Erlendson, Callan Richard Fong, Parametric Kelvin Hullet, BND Candace Johnson, Securities Commission Bryan Klipfel, Retiring Director of WSI Rachel Kriege, Insurance Dept Scott Miller, PERS Adam Montgomery, Securities Commission Dan Ryan, Parametric Colton Schulz, Insurance Department Clint Talmo, Parametric Members of the Public

CALL TO ORDER:

Lt. Gov. Sanford, Chair, called the State Investment Board (SIB) regular meeting to order at 8:30 a.m. on Friday, November 18, 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, Dr. Lech, Mr. Mickelson, Mr. Miller, Ms. Ness, Ms. Rindy, Lt. Gov. Sanford, and Mr. Thompson.

Mr. Olson was in attendance via Teams but was not able to unmute for votes.

ACCEPTANCE OF AGENDA:

The Board considered the agenda for the November 18, 2022, meeting.

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

AYES: COMMISSIONER HERINGER, TREASURER BEADLE, MR. MILLER, COMMISSIONER GODFREAD, MR. THOMPSON, MR. MICKELSON, MS. NESS, DR. LECH, MS. RINDY, AND LT. GOV. SANFORD
NAYS: NONE
ABSENT: MR. OLSON
MOTION CARRIED

Mr. Art Thompson, new WSI Director was welcomed to the SIB. Ms. Jecca Geffre, Communications and Outreach Director, Mr. Derek Dukart, Investment Officer, and Mr. George Moss, Senior Investment Officer were introduced to the Board.

The Board congratulated Mr. Klipfel on his retirement, thanked him for his many years of public service, and noted some of his many accomplishments over the course of his career with the state.

BOARD RESOLUTION:

ND State Investment Board Resolution
In Appreciation of
Bryan Klipfel

WHEREAS, Bryan Klipfel has served as the Director of WSI and a member of the State Investment Board since 2009; and

WHEREAS, Bryan Klipfel has diligently carried out his duties and responsibilities as a member of the SIB and fiduciary of the SIB Program; and

WHEREAS, Bryan Klipfel 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 Bryan Klipfel be duly recognized by the SIB for his years of unselfish dedication to the State of North Dakota through his service on the State Investment Board.

DATED this 18th day of November 2022

IT WAS MOVED BY COMMISSIONER GODFREAD AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE BOARD RESOLUTION.

AYES: MS. NESS, COMMISSIONER HERINGER, MR. MICKELSON, COMMISSIONER GODFREAD, MS. RINDY, MR. MILLER, TREASURER BEADLE, MR. THOMPSON, DR. LECH, AND LT. GOV. SANFORD
NAYS: NONE
ABSENT: MR. OLSON
MOTION CARRIEDMINUTES:

The Board considered the minutes of the October 28, 2022, SIB meeting.

IT WAS MOVED BY COMMISSIONER HERINGER AND SECONDED BY TREASURER BEADLE AND CARRIED BY A VOICE VOTE TO APPROVE THE OCTOBER 28, 2022, MINUTES AS DISTRIBUTED.

AYES: MR. MICKELSON, COMMISSIONER HERINGER, MS. RINDY, MR. THOMPSON, TREASURER BEADLE, DR. LECH, COMMISSIONER GODFREAD, MS. NESS, MR. MILLER, AND LT. GOV. SANFORD
NAYS: NONE
ABSENT: MR. OLSON
MOTION CARRIED

BOARD EDUCATION:

Exposure Overlays:

Mr. Fong, Mr. Ryan, and Mr. Talmo from Parametric provided an overview of how customized overlay strategies can be used for efficient fund level implementations, return enhancement, and risk mitigation. Board discussion followed.

INVESTMENTS:

Quarterly Performance Review:

Mr. Erlendson, Callan, provided a summary of the US economy in the third quarter of 2022. Even with high inflation, the real US GDP was up in the third quarter with an annualized growth rate of 2.6%. Contributors to inflation include housing, food, and transportation with housing taking over as the biggest weighted contributor. Mr. Erlendson also discussed the impact of currency on equity performance. Mr. Chaikin presented the performance update as of September 30, 2022. Each of the Trust's asset allocations were within policy ranges and cash flows were managed to rebalance towards strategic targets. Total Fund returns for PERS, WSI, Budget Stabilization, and Legacy Funds have each exceeded their respective benchmarks on a net-of-fee basis for the trailing five-year period. TFFR underperformed its target. The consolidated Pension Trust, PERS, and TFFR have outperformed peer funds for the quarter and are in the top quartile for the last 3, 5, and 10 years. Board discussion followed.

The Board recessed at 10:14 a.m. and reconvened at 10:38 a.m.

Multi-Asset and Fixed Income Products:

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), 44-04-19.1(9), AND 44-04-19.2 TO DISCUSS CONFIDENTIAL COMMERCIAL INFORMATION AND CONTRACT NEGOTIATING STRATEGY.

Executive session began at 10:39 a.m. and ended at 11:45 a.m. In attendance were staff, Board members, Mr. DePountis, Mr. Browning, Mr. Chaikin, and Mr. Erlendson.

Ms. Murtha stated that staff had received guidance regarding the desire to gather additional information as a result of the vendor capability assessment and will provide the Board with an update.

GOVERNANCE:

Investment Committee Update:

Treasurer Beadle provided an update from the November 10, 2022, Investment Committee meeting. The Committee received a presentation from staff regarding the equity portfolio review and an update on the equity transition to a new portfolio structure. Staff also provided information on RIO's compliance process.

Governance and Policy Review (GPR) Committee Update:

Dr. Lech provided an update on the GPR Committee meeting on November 16, 2022. The Committee reviewed policy amendments which were provided to the SIB for 2nd reading and final adoption today. Staff provided a presentation on the upcoming legislative session and asked for guidance before making the presentation to the SIB. Staff provided education on the proxy voting process.

IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE 2ND READING AND FINAL ADOPTION OF AMENDMENTS TO SIB GOVERNANCE MANUAL POLICIES B-5, B-7, E-1, E-2, E-3, E-4, E-5, E-7, E-8, E-9, E-10, AND EXHIBITS.

AYES: MS. RINDY, MR. MILLER, MR. MICKELSON, DR. LECH, MS. NESS, MR. THOMPSON, COMMISSIONER GODFREAD, COMMISSIONER HERINGER, TREASURER BEADLE, AND LT. GOV. SANFORD
NAYS: NONE
ABSENT: MR. OLSON
MOTION CARRIED

2023 Legislative Session Planning:

Ms. Murtha provided information about anticipated public policy issues that may arise and be impactful to the SIB program during the 2023 legislative session. Ms. Murtha asked the Board for guidance as staff prepare testimony for each of the anticipated issues. Staff provided the same presentation to the SIB GPR Committee and their recommendations have been included for the SIB. Ms. Murtha outlined the proposed process for keeping the Board informed throughout the legislative session. Staff will provide an informational legislation tracking matrix to the Board on a weekly basis. There will be a process established to communicate with the Board chair and the Board or a Committee when changes occur based on the level of changes or impact. The Board was asked to provide feedback on staff testimony on the In-State Investment Program, investment program changes, and retirement plan design changes and funding. The GPR Committee recommended that RIO submit an agency bill regarding SIB composition. Ms. Murtha reviewed the board composition options that were previously discussed and asked for Board feedback. Board members agreed on archetype one which includes the Governor (Lt. Governor), Treasurer, WSI Director, Land Commissioner, OMB Director, and two investment professionals as voting members and a Legacy and Budget Stabilization Fund Advisory Board representative as a non-voting member. The Insurance Commissioner would be removed and the number of PERS and TFFR representatives would be reduced from three to two for each respectively, which results in 11 voting members and 1 non-voting member. The Board directed staff to submit a bill to Legislative Council to propose changes to the Board composition as discussed.

IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A VOICE VOTE TO CONFIRM BOARD POSITIONS ON LEGISLATION AS DISCUSSED.

AYES: TREASURER BEADLE, MS. NESS, COMMISSIONER HERINGER, DR. LECH, MR. MILLER, COMMISSIONER GODFREAD, MR. MICKELSON, MS. RINDY, MR. THOMPSON, AND LT. GOV. SANFORD
NAYS: NONE
ABSENT: MR. OLSON
MOTION CARRIED

Securities Litigation Committee Appointment:

With the retirement of Mr. Klipfel, there is a vacancy on the SIB Securities Litigation Committee. The SIB Chair appoints members of this Committee. Lt. Gov. Sanford appointed Ms. Ness to the Securities Litigation Committee.

QUARTERLY MONITORING REPORTS:

All monitoring reports will be carried over to the December 16, 2022, meeting.

ADJOURNMENT:

With no further business to come before the SIB, Lt. Gov. Sanford adjourned the meeting at 12:30 p.m.

Prepared by:

Missy Kopp, Assistant to the Board

NORTH DAKOTA LEGACY FUND
INVESTMENT POLICY STATEMENT

1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS

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

2. FUND MISSION

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

3. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD

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

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

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

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

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

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

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

The Policies governing the investment of Legacy Fund assets fall into three categories.

- Those applicable to all investment for Legacy Fund assets.
- Those applicable to those assets – referred to here as the Core Legacy Fund (CLF) – that are not invested under the In-State Investment Program.
- Those assets defined under law made within the In-State Investment Program (ISIP)

A. Policies governing the investment of All Legacy Fund assets.

a. Risk Tolerance

~~**4. RISK TOLERANCE**~~

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

b. Investment Objectives

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

~~a.~~i. The legacy fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

~~b.~~ii. The legacy fund's risk, measured by the standard deviation of net returns, should not exceed 115 percent of the policy benchmark over a minimum evaluation period of five years.

~~c. The risk-adjusted performance of the legacy fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.~~

c. The Prudent Investor Rule

All investments and the investment strategy in its totality will adhere to the Prudent Investor Rule.

B. Policies specific to the Core Legacy Fund (CLF)

For the purpose of this Investment Policy the Core Legacy Fund is defined as all non in-state investments. The table below delineates the following key guidelines for the Core Legacy Fund:

d. The approved asset classes to be utilized.

e. The policy target allocations for each.

f. The application of a rebalancing program.

At its discretion, the SIB advised by the Legacy Board may adjust these targets on an interim or a long-term basis to account for (a) extreme market conditions, (b) the specific composition of Legacy Fund assets deployed via the In-State Investment Program (ISIP), a decision by the North Dakota State Legislature to withdraw and spend an amount above that consistent with capital preservation of the Legacy Fund assets up to but not exceeding 15% of the Fund.

~~5. POLICY ASSET MIX~~

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

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

~~Rebalancing of the fund to this target will be done in accordance with the SIB's rebalancing policy, but not less than annually. The SIB approved an 18-month implementation strategy which completed in January of 2015. On June 17, 2017, the Advisory Board acknowledged the transfer of the Bank of North Dakota Match Loan Certificates of Deposit Program ("BND CD") to the Legacy Fund in early 2017. The BND CD investment will be limited to the lesser of $200 million or 5% of the Legacy Fund (and represent a sector allocation within fixed income). The Advisory Board approved this future change in the Legacy Fund's asset allocation without exception. BND will be requested to guarantee a minimum 1.75% investment return. The minimum return requirement will be periodically reviewed in connection with the Legacy Fund's overall asset allocation framework. BND CD's are rated AA by S&P.~~

Asset Class	Policy Target	Policy Target Ranges	Additional Guidelines
Broad US Equity	30%	20% - 40%	Rebalanced with the total invested in-state equity AUM
Broad International Equity	20%	15% - 25%	
Fixed Income	35%	30% - 40%	Rebalanced with the total invested in-state fixed income AUM
Real Estate	5%	3% - 8%	
Diversified Real Assets	10%	7% - 13%	
In-state Fixed Income		0%-10%	minimum target of $400 million
In-state Equity		0% - 10%	minimum target of 3% growth investments

Rebalancing of the fund to these targets will done in accordance with the SIB's rebalancing policy.~~, but not less than annually.~~

C. Policies Specific to the In-State Investment Program

In 2021, House Bill 1425 (HB 1425) was approved by the North Dakota legislature and signed into law. It establishes a program for the investment of a portion of Legacy Fund assets within the state and empowers the State Investment Board advised by the Legacy and Budget Stabilization Fund Advisory Board ("Advisory Board") to execute that program.

The in-state investment program ("ISIP") provides specific direction that grants the SIB and the Advisory Board substantial latitude in the implementation of the program. Specifically, HB 1425 directs the SIB advised by the Advisory Board to:

- A target allocation of 10% to fixed income investments within the state, of which:
  - Up to 40% must be targeted for infrastructure loans, with the fixed net return to the legacy fund of 1.5%.
  - Up to 60%, with the minimum of $400 million, must be designated to the Bank of North Dakota's ("BND") certificate of deposit match program with an interest rate fixed at the equivalent yield of the United State treasury bonds having the same term, up to a maximum term of 20 years.
- A target allocation of 10% to equity investments in the state, of which at least 3% may be targeted for investment in one or more equity funds, venture capital funds, or alternative investment funds with a primary strategy of investing in emerging or expanding companies

in the state. Equity investments must:

- Be managed by qualified investment firms, financial institutions, or equity funds.
- Have a benchmark investment return equal to the 5-year average net return for the legacy fund, excluding in-state investments.

In addition to the policies covering all Legacy Fund assets noted above in Section 3.A. – risk tolerance, return objectives, and the Prudent Investor Rule – policies specific to the investments made within the ISIP include:

a. Specific to the assessment of acceptable risk and return targets for the ISIP in total and all ISIB investments, in-state investments should offer credible evidence that they will meet or exceed the forward expected returns of similar investments with similar levels of risk and liquidity present in the Core Legacy Fund.

b. All proposed investments will be made using third party asset managers. Direct investments by the SIB advised by the Advisory Board are not contemplated.

c. All investments must be subject to the same level of due diligence that similar investments considered for funding using Core Legacy Fund assets.

d. The Board at its discretion may choose to direct asset managers retained in the ISIP to utilize either equity, fixed income, convertible debt, debt with warrants or a combination of any of these securities to best meet the risk, return and prudency in the ISIP investments.

e. The Board will create and maintain an annual investment pacing schedule that – subject to the successful sourcing, due diligence and deal structuring that meets the Board's policy requirements for the ISIP, fluctuations in market values and distributions back to the Legacy Fund – will create the opportunity to commit funds at a rate such that the full amount of the equity capital limit for the ISIP set in statute (currently 10%) is reached within ten years.

f. The Board will direct asset managers retained in the ISIP to:

   i. require in the structuring of transactions that the State never becomes a majority equity owner of a business,

   ii. require that private capital provided by independent third parties always be invested alongside capital provided from Legacy Fund assets,

   iii. give strong preference for investments that provide the Board the ability to exit from the investment to recycle capital into new ISIP opportunities. The Board, to the extent prudent, will give special consideration to qualified and experienced institutional asset managers domiciled or having operating offices within the state for participation in implementation of the ISIP,

   ~~i.~~iv. capital provided to any one direct investment by an in-state portfolio fund manager ~~or entity~~ should not exceed $10 million, with two exceptions per fund commitment of up to ~~cannot exceed~~ $25~~10~~ million.

Target Allocation for the In-State Investment Program Assets

Asset Class	**Restrictions**	**Total Target**
Fixed Income	• Up to 40% for infrastructure loans • Up to 60% with a minimum target of $400 million to BND's CD match program	10%
Equity	• A minimum target of 3% in growth equity funds • Other eligible investments based on Advisory Board Guidelines	10%

~~6.~~4. RESTRICTIONS

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

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

For the purpose of this document, economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy. Also, for the purpose of this document, the exclusive benefit rule is met if the following four conditions are satisfied:

- The cost does not exceed the fair market value at the time of investment.
- The investment provides the legacy fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- Sufficient liquidity is maintained in the legacy fund to permit distributions in accordance with the terms of the plan.
- The safeguards and diversity that a prudent investor would adhere to are present.
- Where investment characteristics, including yield, risk, and liquidity, are equivalent, the Advisory Board's policy favors investments which will have a positive impact on the economy of North Dakota.

~~7.~~5. INTERNAL CONTROLS

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

~~8.~~6. EVALUATION AND REVIEW

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

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

- Changes in asset class portfolio structures, tactical approaches, and market values.
- Loss of principal, if any.
- Management costs associated with various types of investments.

- All material legal or legislative proceedings affecting the SIB. Compliance with this investment policy statement.
- An evaluation of the national economic climate.
- A forecast of the expected economic opportunities and dangers.
- Management of risk by the SIB.

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

Approved by:

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD
Chairman

Date: ___________

STATE INVESTMENT BOARD
Chief Investment Officer, RIO

Date: ___________

Approved by the LBSFAB: 2-16-2021; Approved by the SIB: 2-26-2021; Amended by LBSFAB 10-12-2022 and 12-6-2022; Approved by SIB ________.

Legislative Assembly
of North Dakota

BILL NO.

Introduced by

State Investment Board

A BILL for an Act to amend subsection 1 of section 21-10-01 of the North Dakota Century Code relating to membership of the state investment board.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

Section 1: AMENDMENT. Subsection 1 of section 21-10-01 of the North Dakota Century Code is amended and reenacted as follows:

1. The North Dakota state investment board consists of:
a. The governor;
b. The state treasurer;
c. The commissioner of university and school lands;
d. The director of workforce safety and insurance;
e. The ~~insurance commissioner~~director of office of management and budget;
f. ~~Three~~Two members of the teachers' fund for retirement board or the board's designees who need not be members of the fund as selected by that board;
g. Two ~~of the elected~~ members of the public employees retirement system board as selected by that board;
h. ~~One member of the public employees retirement system board as selected by that board~~Two members, each of whom by experience is familiar with institutional investments, appointed by the governor. One initial appointee shall serve a term of three years, and one initial appointee shall serve a term of five years. Subsequent appointees shall serve five-year terms; and
i. One member of the legacy and budget stabilization fund advisory board, as selected by that board, to serve as a nonvoting member.

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HB 1425

- The Legacy Fund in-state investment program and in-state investment manager preference is part of code.
- Requires up to 20% of Legacy Fund be directed toward in-state investments.
- 10% Fixed Income + 10% Equity
- BND is in-state fixed income manager with $191 million in capital committed.
- 50 South is in-state equity manager with $100 million in capital committed.
- With almost $300 million committed North Dakota has one of the largest in-state investment programs in the nation.
- The Legacy & Budget Stabilization Fund Advisory Board continues its work to improve the Legacy Fund asset allocation implementation.
- RIO continues its outreach to coordinate opportunities with in-state financial institutions.

HB 1380

- Created Legacy Earnings Fund
- Created a percent of market value (POMV) spending rule without amending definition of earnings.
- POMV of 7% for current biennium is $486 million.
- Earnings includes realized gains and losses. The amount of earnings available for transfer will be in flux through May 2023.

SB 2291

- Prohibits social investing i.e.: investment or divestment of funds for purposes other than the *exclusive benefit* of the beneficiaries of a fund.
- SIB client funds are managed by external managers.
- RIO staff meets with each manager biennially and confirms:
- Funds are managed for the *exclusive benefit* of client funds by maximizing total return for a prudent level of risk as set by a defined benchmark.
- Managers are instructed to vote proxies to maintain or improve shareholder value for the *exclusive benefit* of client fund.

ND Retirement & Investment Office

WHAT WE'RE PROUD OF

Agency Accomplishment
30+ Years of Unmodified Audit Opinions.

Agency Accomplishment
Investment Program more than Quadrupled since 2010.
High of nearly $20 Billion in Fiscal Year 2022 prior to transfer of Legacy earnings.

Agency Accomplishment
TFFR Plan projected to achieve 100% Funded Status by 2044.

WHAT WE DO

State Investment Program – SIB
The SIB ensures rigorous attention to all aspects of the investment program by following an established investment process that includes investment policy development/modification, implementation/monitoring, and evaluation.

Teachers' Fund for Retirement-
The TFFR Program provides ND educators with a financial foundation for the future that includes a secure and stable retirement.

HOW WE MEASURE SUCCESS

- Client & Member Satisfaction Surveys
- Excess Returns Net of Fees
- Attendance at Outreach Activities
- Awards & Recognition for Transparency & Excellence in Administration and Financial Reporting

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MEMORANDUM

TO:	**State Investment Board**
FROM:	**Ryan K. Skor, CFO/COO**
DATE:	**November 18, 2022**
RE:	**Quarterly Budget & Expense Report**

Enclosed are the following quarterly budget and expense reports for the quarter ended September 30, 2022:

- Budget Appropriation Status Report
- Expenditure Summary Report
- PAS Modernization Project Status Report

BOARD ACTION REQUESTED: Board Acceptance.

BUDGET APPROPRIATION STATUS

AS OF SEPTEMBER 30, 2022

	2021-2023 BUDGET		ADJUSTED APPROPRIATION	EXPENDITURES BIENNIUM TO DATE ACTUAL	BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	$ 5,103,977.00	*	$ 6,841,839.00	$ 3,023,054.81	$ 3,818,784.19	55.82%	37.50%
OPERATING EXPENDITURES	3,567,403.00	*	3,642,403.00	1,077,341.43	2,565,061.57	70.42%	37.50%
CAPITAL ASSETS	6,300,000.00		6,300,000.00	934,912.50	5,365,087.50	85.16%	37.50%
CONTINGENCY	100,000.00		100,000.00	83,531.81	16,468.19	16.47%	37.50%
TOTAL	$ 15,071,380.00		$ 16,884,242.00	$ 5,118,840.55	11,765,401.45	69.68%	37.50%

* 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 SEPTEMBER 30, 2022

	INVESTMENT	RETIREMENT	QUARTERLY TOTALS	FISCAL YEAR TO - DATE	BIENNIUM TO - DATE
CONTINUING APPROPRIATIONS					
INVESTMENT EXPENDITURES	$ 0	$ 0	$ 0	$ 0	$ 75,493,703
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0	63,866,807	63,866,807	63,866,807	308,571,902
2. REFUND PAYMENTS	0	2,115,833	2,115,833	2,115,833	9,258,193
TOTAL MEMBER CLAIMS	0	65,982,639	65,982,639	65,982,639	317,830,095
OTHER CONTINUING APPROPRIATIONS	805	24,322	25,127	25,127	872,476
TOTAL CONTINUING APPROPRIATIONS	805	66,006,962	66,007,767	66,007,767	394,196,274
BUDGETED EXPENDITURES					
1. SALARIES & BENEFITS					
SALARIES	289,078	212,603	501,682	501,682	2,209,817
OVERTIME/TEMPORARY	16,903	20,858	37,761	37,761	74,149
TERMINATION SALARY & BENEFITS	0	0	0	0	0
FRINGE BENEFITS	87,313	79,991	167,304	167,304	739,089
TOTAL SALARY & BENEFITS	393,294	313,453	706,747	706,747	3,023,055
2. OPERATING EXPENDITURES					
DATA PROCESSING	16,343	70,082	86,425	86,425	423,455
TELECOMMUNICATIONS - ISD	948	945	1,893	1,893	11,592
TRAVEL	3,235	1,772	5,007	5,007	43,540
IT - SOFTWARE/SUPPLIES	33	34	67	67	109
POSTAGE SERVICES	651	3,354	4,004	4,004	29,790
IT - CONTRACTUAL SERVICES	506	42,176	42,682	42,682	119,243
BUILDING/LAND RENT & LEASES	10,228	7,817	18,044	18,044	127,315
DUES & PROF. DEVELOPMENT	1,048	2,247	3,294	3,294	24,001
OPERATING FEES & SERVICES	354	722	1,076	1,076	41,898
REPAIR SERVICE	0	0	0	0	654
PROFESSIONAL SERVICES	0	9,529	9,529	9,529	233,204
INSURANCE	669	571	1,240	1,240	2,432
OFFICE SUPPLIES	11	119	130	130	2,145
PRINTING	4	595	599	599	8,254
PROFESSIONAL SUPPLIES & MATERIALS	166	528	694	694	2,321
MISCELLANEOUS SUPPLIES	81	30	110	110	1,500
IT EQUIPMENT UNDER $5000	6	58	65	65	305
OTHER EQUIP. UNDER $5000	0	0	0	0	0
OFFICE EQUIP. & FURNITURE UNDER $5000	0	0	0	0	399
TOTAL OPERATING EXPENDITURES	34,282	145,761	180,044	180,044	1,077,341
3. CAPITAL ASSETS	0	0	0	0	934,913
4. CONTINGENCY	2,887	0	2,887	2,887	83,532
TOTAL BUDGETED EXPENDITURES	430,463	459,214	889,678	889,678	5,118,841
TOTAL EXPENDITURES	$ 430,463	$ 66,441,854	$ 66,897,444	$ 66,897,444	$ 399,315,115

EXPENDITURE REPORT

AS OF AND FOR THE QUARTER ENDED SEPTEMBER 30, 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	47,737	81,763
PROFESSIONAL SERVICES	1,875,000	297,099	1,577,901	353,352	650,451
CAPITAL ASSETS	6,300,000	0	6,300,000	934,913	934,913
TOTAL PAS PROJECT BUDGET	**9,000,000**	**331,125**	**8,668,875**	**1,336,002**	**1,667,126**

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

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MEMORANDUM

TO: **State Investment Board**
FROM: **Chad R. Roberts, DED/CRO**
DATE: **October 24, 2022**
RE: **TFFR Ends Report 1st QTR 2023 ending September 30, 2022**

This report highlights exceptions to the normal operating conditions of the TFFR program for the period spanning July 1, 2022, through September 30, 2022.

Advertisement for the newly created position of Communications and Outreach Director was posted with an expected onboarding of late October or early November for the selected candidate.

Advertisement for the Accounting Intern for employer reporting was posted to replace the previous intern who completed college. Onboarding is expected to be in the late November early timeframe for the selected candidate.

Requirements sessions for the "Pioneer" project were completed in early September. Pilot 1, the first of four parts in the design phase, was begun in mid-September with an anticipated completion date of December 16, 2022.

A NDIT Business Analyst that supported RIO operations resigned in September to take another position. NDIT is supplementing the workload with additional assets until a replacement is hired. A replacement is expected to be in place in late November.

An RFP was issued for the actuarial audit and the vendor, GRS, was selected. A kickoff meeting was scheduled for early October to begin the study.

The TFFR GPR Committee met in September 2022 and established a 2023 workplan. Included in that workplan is a full review of the TFFR policy manual with the delivery of all recommended changes in 4th QTR of 2023 to the full TFFR Board of Trustees.

Executive Director Jan Murtha provided testimony at the September Retirement Committee regarding impact to TFFR plan relating to the proposed PERS defined benefit plan closure legislation.

BOARD ACTION REQUESTED: Board Acceptance.

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MEMORANDUM

TO: **State Investment Board**

FROM: **Sara Seiler, Supervisor of Internal Audit**

DATE: **November 16, 2022**

SUBJECT: **Audit Activities Quarterly Update**

The SIB Audit Committee met on November 15, 2022. The SIB Audit Committee reviewed and approved the first quarter audit activities and receive an update on current audit activities.

The following reports were presented and approved:

1. June 30, 2022, Fiscal Year Financial Statement Audit
    a. 2022 Financial Statement Audit Results
        i. Unmodified “clean” opinion
        ii. No material weaknesses were identified
        iii. No significant deficiencies were identified
    b. GASB 68 Schedule Audit
        i. Tested 12 separate employers, 137 total employees tested
            1. One employer with a finding – immaterial
        ii. Expected to issue final report end of 2022
2. Payroll Audit
    a. Reviewed agency’s payroll from time period January 2022-August 2022
    b. Recommendation
        i. Annual training for managers and staff on the Overtime Policy and procedures.
3. File Maintenance Audit
    a. Reviewed various retirement processes, transactions, and information for accuracy
    b. Recommendations
        i. Review death, purchases, refunds, and retirements for FY 2021 & 2022 for accuracy and documentation
        ii. Ensure all staff Is adequately cross trained on policies and procedures
4. Internal Audit Business Process
    a. Issued RFP to evaluate internal audit and its future needs
    b. Weaver & Tidwell, LLP was awarded the bid
        i. Kickoff is tentatively scheduled for November 2022

The following link has the committee materials that were presented for your reference:
https://www.rio.nd.gov/sites/www/files/documents/PDFs/SIB%20Audit/Board/Materials/sibauditmat20221115.pdf

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MEMORANDUM

TO: **SIB**
FROM: **Jan Murtha, Executive Director**
DATE: **November 9, 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**:

Employee Title	**Status**
TFFR Compliance Officer-Retirement Accountant.	2 FTE's attributed to the retirement program were reorganized effective November 2022 and represent the final phase of a reorganization plan that had been initiated in September 2021. The existing Employer Services Coordinator position was reorganized into a TFFR Compliance Officer position (with the same employee remaining in that FTE), and the vacant full-time Member Specialist position is pending reclassification into a Retirement Accountant position – currently pending HRMS review. The duties of the Membership Specialist position are currently being performed by a temporary employee. This reorganization was prompted by system improvements resulting from the Pioneer Project.
Chief Risk Officer	Interviews Scheduled.
Sr. Investment Officer	Starting November 2022.
Sr. Investment Officer	Offer Accepted, start date pending.
Investment Officer	Starting November 2022.
Risk Officer	Starting November 2022.
Communications/Outreach Director	Started November 7, 2023.
Accounting Intern	Offer pending.

2. **Current Project Activities/Initiatives:**

- **Legacy Fund Asset Allocation Study** – RVK continues its work on the Legacy Fund Asset Allocation Study and provided recommendations for changes to the Legacy Fund Investment Policy Statement (IPS) and recommendations regarding future program considerations at the October meeting. The Advisory Board will finalize it's requested changes to the IPS at its next meeting and those changes will be presented to the SIB thereafter.
- **TFFR PAS Project** (hereinafter TFFR "Pioneer Project")– The TFFR Pioneer Project continues with implementation consistent with the project plan. Currently the project is in an elaboration phase involving review of system components. The amount of time spent on the project by various staff members currently varies from 5 to 25 hours or more per week.
- **Northern Trust Initiative** – In an effort to enhance the infrastructure for the investment program the Investment and Fiscal teams are leading an initiative to coordinate with Northern

Trust for additional functionality/capabilities.

- **Audit Consultant RFP:** In September staff issued an RFP for Audit consultant services to assist with the development of additional internal audit business practices to support program evolution consistent with the agencies strategic plan. A notice of award has been issued and the finalization of the contract is currently pending.

3. RIO Board & Committee Presentations – November 1 through November 30, 2022

Staff provided or is scheduled to provide the following presentations to Boards and Committees during the above referenced time period.

- **SIB Investment Committee – 11/10/22**
- **TFFR GPR Committee – 11/10/22**
- **SIB Audit Committee – 11/15/22**
- **SIB GPR Committee – 11/16/22**
- **TFFR Board – 11/17/22**
- **SIB meeting 11/18/22**

BOARD ACTION REQUESTED: Board Acceptance.

Board Leadership

Innovative Approaches to Governance

November–December 2022 • No. 184

EDITOR: NICHOLAS KING

Employee (Mis)Behavior: What Directors Need to Know About Behavioral Economics

By Roger A. Bailey and Roger D. Blackwell

Roger A. Bailey is clinical assistant professor of marketing and director of the full-time MBA program at The Ohio State University. Roger D. Blackwell, Ph.D., is retired from The Ohio State. In this article, they discuss behavioral economics and how it applies to common challenges facing corporate boards.

The novelty of each new decade brings with it unique challenges and opportunities. For better or worse, this dynamic has tested the innovation (and the nerves) of business decision-makers for centuries. With the crippling effects of mass resignation, unceasing supply chain disruptions, and vacillating demand, it certainly feels like the 2020s have been leaning hard into the "worse" category. With that said, it is times like these, when high uncertainty is rivaled only by equally high stakes, that the purpose of a board of directors comes into crisp focus. While directors may not be making the decisions, they must be able to ask the right questions of those that are. Hence, now more than ever, directors must be equipped with state-of-the-art tools to better understand how organizations should respond to the world around them.

Proactive leaders analyze the current and forthcoming changes to their markets. What are the threats? Where are the opportunities? How are they uniquely prepared to respond? To this end, a solid understanding of economics is a bulwark against the effects of shocks and business cycles. When combined with field expertise, institutional knowledge, advances in data science, and years of experience, the application of economics can build structure and tractability in nebulous situations. However, traditional economic models often employ unrealistic assumptions that can limit the scope of their use. For example, humans are not always fully rational, they do not always consider all options, and rarely do they use of all available information when making decisions. Ironically, this is exactly why a board exists, as no single human could be held to a standard of these common assumptions from traditional economics! Yet, in a fortuitous coincidence, the recent expansion of behavioral economics has added significantly to understanding how humans operate and respond. These insights can easily be added to one's knowledge of traditional economics to improve economic intuition. To see this, consider a couple of the challenges that boards are currently facing.

Today's Business Pain Point: The Labor Market

One oft-discussed pain point in business today is the labor market. Any belief that the "great resignation" of COVID-19 would be followed by a "great recruitment" has long been dispelled. Organizations of all sizes are facing increasing difficulty identifying and hiring new talent. Many are also experiencing turnover across their ranks and prospective replacements that seek significantly more in terms of wages and benefits. To those

continued on page 6

Inside This Issue

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5 Calendar of Events

8 Research shows boards likely to continue with hybrid working environments

Director Resignation – What to Do When a Board Member Resigns?

By Joan M. McCallum

Joan M. McCallum is senior counsel at Chamberlain Hrdlicka in Atlanta. In this article, she discusses critical considerations for the resignation of a board member, and offers insight into the proactive steps to help avoid unnecessary confusion, expense and risk exposure when a board member resigns.

A corporation's board of directors is often composed of multiple individuals from various backgrounds with differing personalities and goals. This can create a wonderful environment that fosters the board's initiatives and steers the company in a positive direction for future growth. However, personalities may clash; members may disagree on methods, practices, and decisions of the board; and personal circumstances may arise which prompt a member of the board to resign before the expiration of their term. Hopefully, the resigning board member has given a head's up to their fellow board members about this decision, but a resignation can come when least expected. Understanding what to do when a board member resigns before this moment occurs can save the board, and the company, from a great deal of unnecessary confusion, expense, and risk exposure.

This article is intended to guide you through some of the key considerations and concerns with respect to each step of the process. However, the items below are merely a suggestion based on a generic set of facts—it is important to remember that the facts and circumstances for each resignation are unique. You will need to ensure any approach you take complies with terms of the company's governing documents (including its articles of incorporation and bylaws) and the requirements of applicable laws, rules, and regulations. For any director resignation, unless your company has a written resignation policy, you should strongly consider addressing the matter with the company's counsel (whether in-house or an external firm) prior to acting.

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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The Resignation

The first step the board should take in responding to a board member's resignation is to evaluate the nature of the resignation.

Is the resignation in writing?

The board should ensure the resigning member's resignation is submitted in writing. While this is often the case, circumstances may develop (for instance, a heated discussion during a board meeting) that prompt a board member to orally resign without submitting anything to the board in writing. This can create issues down the line, including disputes regarding the timing and/or basis for the member's resignation. If a director orally resigns, the board should request or require (if provided in the company's governing documents) that they promptly provide written notice of resignation.

The written resignation should identify the reason for the resigning member's departure as well as the effective date of the resignation.

The board should review the company's governing documents to determine if the resignation complies with any specific requirements in the company's articles of incorporation or bylaws.

Can the resignation be rescinded?

The board should consider whether the member's resignation may be rescinded. This consideration may be especially important in situations where the board member suddenly resigned, especially if they orally resigned. The board should determine if there is a written policy or procedure for considering a rescission and whether it is in the best interest of the company to accept a rescission.

Does the resigning member hold any other positions impacted by their resignation?

The board should consider whether the resigning member holds any other positions with the company. For instance, the resigning member may be an employee or officer of the company, hold a position with one or more committees of the board, act as trustee for a benefit plan, or be a contractor or consultant to the company.

If the resigning board member holds any other positions with the company, the board should decide whether the resignation provides that the outgoing board member is resigning from all such positions, or if the company needs to take any steps to actively remove them from such positions.

Grounds for Resignation

The reason for a director's resignation, particularly whether the resigning director is departing on good terms, is important. Not only will the basis impact the board's decision whether to accept the resignation, but it also may dictate whether and to what extent the company should take action to protect itself and its shareholders from any potential litigation or other risk exposure.

Is the board member's resignation a violation of their fiduciary duties?

Under most state laws and most company's governing documents, a board member is permitted to resign at will. A situation may come up, however, where a board member's resignation conflicts with their fiduciary duties to the company. What constitutes a director's fiduciary duties is largely governed by state law and is very fact-specific. For each resignation, controlling law should be carefully considered in determining whether a director's resignation breaches their duties of loyalty and care.

If a resignation is contrary to a board member's fiduciary duties, the board should consult company counsel to determine if the resignation should be rejected, what steps may be necessary to maintain the resigning member on the board and/or what legal action the board or the company's shareholders may take against the resigning board member.

Will the resignation create any significant issues for the board's future operation?

The board should determine if the departure of the resigning director will create any issues with the board's future operations and what steps can be taken prior to the effective date of the board member's resignation to avoid any such issues.

For instance, a company's governing documents may require a minimum number of directors, or require a director be appointed to represent each member of a class of the shareholders or some subset thereof. Situations may also arise where a director's resignation from to the board impacts residency or other legal requirements. The resignation of one director, in any of the foregoing circumstances, could hamstring the board or the company until a replacement director is appointed.

Is the board member resigning on good terms?

Often a resignation occurs for personal reasons, such as an unexpected family issue or unforeseen time commitment. However, if a board member is resigning on bad terms—whether a personality conflict with other members of the board, an allegation of misconduct, or otherwise—the board should consider what immediate actions are advisable to protect the company from future exposure regarding any claims that may be raised by or against the resigning board member.

The board should consider if litigation counsel should be consulted, if the company should send the resigning member a spoliation letter, and if other protective measures are advisable.

Identifying a Replacement Director

Upon notice of the board member's resignation, the board should promptly consult the company's governing documents and governing law to determine (1) whether the resigning board member should be replaced, (2) when the replacement

continued on page 4

director should be appointed, and (3) the method and manner for appointing a replacement.

If the board of directors elects not to replace the outgoing director, the board should consider the impact this decision will have on board dynamics. Does this shift the number of directors required for a quorum? Is there a change in the number of directors required for a controlling vote of the board?

If the resigning board member must be replaced, the board should consider when and how this will be accomplished, what vote (if any) will be required of the shareholders, and whether a special meeting of the shareholders may be called to appoint a new director, among other considerations.

In any event, once the board determines it is in the best interest of the company to accept the resignation of the outgoing member and/or the appointment of any replacement director, it must formally adopt its decisions through a vote or consent of the board, as the case may be.

Exit Interview

While a board member's resignation is never a pleasant moment, it may provide the board an opportunity to learn more about its strengths and weaknesses and how it can work to prevent future resignations. Scheduling an exit interview may provide the board an opportunity to further understand the reasons the board member made the decision to resign.

The board can consider asking whether the resigning director has any ideas for how the board can improve going forward, and what could have been done to make their experience on the board more positive. You may also consider asking whether the resigning member has any suggestions for future initiatives or opportunities they believe could better the company's interests.

While the information gathered during an exit interview can be helpful, the board should carefully consider any questions it asks and the manner and environment in which it asks them to avoid any claim by the resigning board member that the questions were allegedly inappropriate, hostile, or otherwise problematic.

Removing Access & Data Protection Concerns

At this point the board of directors has received a written notice of resignation and determined it is in the company's best interest to accept the resignation. Now the board should take reasonable steps to ensure the company's facilities, operating systems, communications, and confidential information are protected.

What access needs to be restricted or removed?

The board should create a list of all accounts, computer systems, notice lists, physical locations, or other items the resigning member has had access to and when and how this access should be restricted.

Such access could include, by way of example only:

- Building, parking deck, or other location access cards, passcodes, keys, etc.
- Website or domain access, social media account hosting, or control and other outward facing communications and accounts.
- Company email account(s).
- Company telephone numbers and fax lines.
- Computer system access (including personal access or any administrative access or power the resigning member may have held).

The board should also consider what lists or information the resigning member should be removed from. For instance, the resigning board member may be included in certain circulation or publication lists, notice lists, company letterhead, group email contacts, and the like. Once the board member has resigned, they should be immediately removed from all such lists.

The board will likely want to work with the company's intellectual property or information technology team in ensuring it is properly following the company's protocols for removal of access to company systems and devices.

Does confidential information need to be returned or destroyed?

The board should maintain a list or current understanding of the confidential information each board member receives or has access to because of their position as a director. This information may include not only the company's confidential information, but also the confidential information of the company's directors, officers, employees, consultants, vendors, clients, or other associates. Any such confidential information should be returned or destroyed in accordance with the company's or the board's policies and procedures, the company's governing documents, and applicable law.

If the resigning board member received access to, or copies of, any third party's confidential information, the board should also consider whether there is a contract between that third party and the company and whether there is any particular law, rule, or regulation that may include specific requirements for the return or destruction of such information.

The board may also want to consider if the resigning director should sign any acknowledgement regarding the return or destruction of confidential information, and whether the resigning member is (or should be) party to a confidentiality agreement with the company.

Are there any reporting or other legal requirements that must be complied with?

To the extent the resigning member has been provided with copies of or access to any personal protected information of any of the company's employees, vendors, clients, or other associates, the company should determine if there are any reporting or other applicable legal requirements. For instance, the California Consumer Privacy Act (CCPA) creates numerous consumer privacy rights and obligations on the part of the company to properly collect, retain, preserve, and destroy certain personal information. If the company is subject to the CCPA, and the board member had access to personal information covered by the CCPA, the company may be subject to monetary fines if it fails to comply with the requirements of the CCPA.

Communications Regarding the Resignation

Whether and how the board member's resignation is communicated to the company's shareholders or the larger public is dictated not only by company interest and the company's governing documents, but also by applicable law. If, for instance, the company's shares are freely traded on the stock exchange, the company may be required, within a specific time following the resignation, to disclose the board member's resignation on its Form 8-K or other filings with the U.S. Securities and Exchange Commission.

Any formal communication from the company to its shareholders or the general public should take into account any advice from the company's counsel.

The board should also be cautious about how any communications may impact the company or the shareholder's view of the company. Such communications are not limited to public statements. They may include the simple act of removing the resigning board member's profile from a webpage, their name or affiliation with the company from LinkedIn or other social media sites, or their name from company letterhead or other printed materials. If the resigning board member was a primary point of contact for any person or group of persons, the board should also carefully consider when and how those persons should be informed of the board member's resignation.

Other Considerations

There are numerous other considerations when faced with a director's resignation. The board should take time to determine what roles the resigning member held, the agreements to which they are or were party, and the consideration and benefits provided or owed to them.

Before the resigning member departs, the company should make sure it has fully executed copies of any agreements to which the resigning member is a party. Such agreements may include release agreements, confidentiality agreements, restrictive covenant agreements, or indemnity agreements. The board should also consider whether the board member will continue to be covered by any insurance policies the company may have in place (including directors' and officers' coverages) and what notice, if any, must be provided to the company's insurance carriers.

Board members may receive, as part of their compensation for serving on the board, equity incentives or options. The board should consider how the board member's resignation impacts any such equity (or equity-like) grants. Such considerations may include, without limitation, whether the resignation accelerates vesting of awards, deadlines for exercising options, or the timing of payments owed to the resigning board member.

As with most aspects of life, the best defense is a good offense. It is best practice to adopt a written policy that outlines the steps and considerations in responding to a board member's resignation. The written policy should consider the matters addressed above in light of your company's governing documents and provisions of applicable laws, rules, and regulations. These policies are relatively inexpensive when prepared proactively and can save the company from a great deal of heartache, confusion, and expense when a resignation occurs. ■

Joan M. McCallum is senior counsel at Chamberlain Hrdlicka in Atlanta. Her practice focuses on general corporate counseling and compliance, corporate governance, securities offerings, complex business transactions, including strategic acquisitions, divestitures, and mergers, and representing borrowers and lenders in commercial loan transactions. She can be reached at (404) 658-5424 or joan.mccallum@chamberlainlaw.com.

Calendar Of Events

Dec. 1–2

Conference Board DE&I Conference

New York Marriott at the Brooklyn Bridge, 333 Adams Street, Brooklyn, New York, 11201 USA

The Conference Board will host its 2022 Diversity, Equity, & Inclusion Global Conference Dec. 1–2 in New York City. According to organizers, this event serves as a platform for DEI practitioners worldwide to share their work and discuss race, social justice, neurodiversity, women's health, disability, allyship, and others.

Attendees will share their experiences and strategies for creating workplaces committed to inclusion, equity, and belonging. Workshops and sessions will focus on topics such as:

- Today's DEI: Moving forward in an era of social and political unrest.
- Board diversity: How the regulatory landscape impacts board efforts.
- Metrics: Making sure you are measuring real change.
- Managing DEI throughout the talent cycle.
- Confronting ageism in hiring, retention and promotion.

Registration fees range up to $2,895.

For more information, visit https://bit.ly/3nHsRvH. ■

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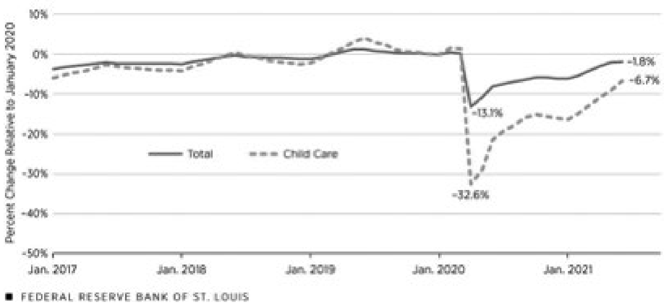
versed in economics, this should come as no surprise. Labor force participation in the U.S. has been decreasing steadily for decades and (obviously) decreased sharply during COVID-19. According to the Bureau of Labor Statistics, the participation rate is still down significantly in 2022, and for multiple reasons. Though health concerns are still having an effect, child care has become an important problem for potential workers. The effects of COVID-19 on child care were severe, and the industry has not yet recovered. The following graphic from the Federal Reserve Bank in St. Louis shows the change in child care employment relative to total employment.



While the child care industry makes up only a small percentage of U.S. GDP, its externalities can affect every corner of the economy. For many seeking to reenter the workforce, child care is an obvious bottleneck. These "missing" childcare workers decrease the availability and increase the cost of this service, preventing reentry of other workers. Combined with continuing health concerns, it is no wonder that labor force participation is still below 2019 levels.

Outside of the labor force participation rate, the size of the potential labor force is also declining. According to the 2020 census, the population of 16–24-year-old people has decreased for the first time on record. Hence, not only is the share of the "labor pie" decreasing, but the entire pie is also shrinking with it! As the supply of labor decreases and demand for labor ramps back up, the economic model of supply and demand would lead to the expectation of inflation in wages and a tight labor market. With that said, the reality of the situation is more nuanced, and the costs may be greater (or at least different) than they appear.

COVID-19 Changed Workers' Priorities and Expectations

The pandemic appears to have changed workers' priorities and their expectations of employers. Employees are seeking more flexible schedules, reduced hours, and the option to work remotely. So why the sudden changes? It is not as if these options were unknown to workers pre-COVID, and they certainly understood the potential benefits of flexibility or reduced work hours. After all, vacation time and paid leave are staples of employment benefits. To gain some insight, we can apply some concepts from behavioral economics. One explanation for why workers were not demanding such changes in the past is "status quo bias," sometimes called "inertia." This well-documented behavior describes the tendency for people to stick to the current paradigm, even when a better option might exist. Most workers (and employers) had grown accustomed to the status quo, and rather than considering alternatives, stuck to their routines instead. Upon the disruption caused by COVID, the routine was thrown into chaos, nullifying the status quo and causing workers to reconsider their options. In fact, data from Prudential's most recent Pulse of the American Worker Survey indicates that 68% of the surveyed workers described the flexibility to work both in person and remotely as the ideal employment model.

The sudden increase in the demand for flexibility can also be ascribed to what is described as the "endowment effect" by behavioral economists. Researchers have discovered that once a person possesses something, they tend to value it higher than they would otherwise. This is a special case of "loss aversion" discussed below. A famous experiment by Daniel Kahneman, Jack Knetsch, and Richard Thaler used coffee mugs and other goods of equal value to demonstrate this behavior. What they found is that people who were given (endowed with) a coffee mug would, on average, demand twice as much to give up the mug as they would have offered to get the mug if they did not own it. This behavior has been studied countless times and has been replicated for both humans and primates.

The significant challenges during COVID required organizations to offer their employees additional flexibility in hours and/or remote work options. The endowment effect suggests that once workers "owned" this flexibility, they valued it more than they would have before. Hence, a bit of behavioral economic knowledge would lead one to expect the post-COVID increase in the demand for this work structure. The data backs up this conclusion, as the Pulse of the American Worker survey found that 87% of the employees that worked remotely during the pandemic would like to continue working remotely at least one day per week. Obviously, leaders that understood the likelihood of this outcome going into the pandemic would be more successful at hiring/retaining talent in the aftermath!

How to Respond to this "New Normal"?

So how should leaders respond to what many are calling the "new normal" in the labor market? First and foremost, it requires an acceptance that the labor market may indeed have changed (and might therefore warrant a new approach). Without this, leadership can be just as susceptible to status quo bias, or in this case, managerial complacency. Given that the situation of every organization is as unique as its employees, potential solutions must be tailored to leverage strengths. This begins with an assessment of the situation. What does the organization need from its employees, and how might the employees be able to create value to meet these needs in new ways? For example, if reduced work hours are in high demand for an organization, then consider the increased productivity required for this to be achievable.

Any potential solution must include a circumspective consideration of behavior. As was ever the case, new employment terms warrant carefully designed performance metrics that align employee incentives with the needs of the organization. Moreover, be careful to consider the effects beyond the numbers typically presented to directors. Salary and benefits are not always the cause of talent loss. As the saying goes, employees leave more often for lack of praise than lack of raise (though the current market appears to require both). These labor changes are not going away, so directors must be ready for tough conversations with respect to managerial action (or inaction) on this front.

Another issue threatening organizations is the supply chain bottlenecks that continue to plague the U.S. economy. Difficulties in sourcing raw materials and intermediate goods have left manufacturers with stockpiles of incomplete product and retailers with seemingly unpredictable stockouts. The natural result is organizations that are not rebounding from COVID as quickly as they had hoped, and a global economy that still faces serious challenges over the coming year.

As industries faced lockdowns and loss of their workforce, the supply chain ground to a halt for many during the pandemic. Given the labor force challenges discussed above, it is easy to see why a simple restoking of the fires of industry has been no easy task. Though a simple understanding of labor would suggest that the economy needs only to replace workers to get production back on track, a behavioral approach would also consider the value lost in company culture, intrinsic motivation, and continuity. These behavioral concerns have added additional costs in the supply chain and have exacerbated the problem for many organizations. The result is the significantly decreased supply of goods and services.

Supply Reduction is Not the End of the Problem

Of course, the reduction in supply is not the end of the problem. Add to this the rapid post-COVID increase in demand for products and services, and the result is the high inflation experienced in the U.S. economy, a clear conclusion from traditional economic analysis. Given the causes of this inflationary cycle, this challenge has been exceptionally difficult to solve. While monetary policy tools such as increasing interest rates can reduce borrowing and effectively cool demand, this can also have effects on the supply side that worsen the problem. Even as firms look to increase production and overcome supply chain bottlenecks, the subsequent decrease in demand could have managers tapping the brakes. Moreover, increasing interest rates lead to an increase in the cost of borrowing, further hurting organizations that are attempting to fix their supply chain problems. This is especially true for smaller businesses. In short, the supply side problem is still begging for solutions.

A seasoned leader knows that problems bring opportunity, and innovation that captures these opportunities is often the source of extremely profitable growth in organizations and economic power. So where is the innovation in solutions for the supply side problems above? Behavioral economics can once again provide both understanding and direction for leaders. For example, one reason that business leaders and politicians alike may shy away from trying bold solutions to the current situation comes in the form of "loss aversion."

To understand loss aversion, suppose you are walking to dinner, and you find $100 on the sidewalk, but unfortunately, the bill falls from your pocket shortly thereafter. Upon discovering the loss, a "fully rational" person would behave the same as before they had found the money. This is because they are in the exact same financial situation. However, many people would actually feel worse than before they had found the money, and this could affect their choices at dinner and beyond. This is an example of loss aversion, wherein the effect of losses is greater than the effect of equivalent gains. As a result of this bias, when business leaders (and politicians) are faced with decisions that lead to the possibility of losses or gains, the possible losses loom much larger in the decision than they should. As innovation frequently includes a risk of loss, it is easy to see why loss aversion can be the enemy of progress.

Another potential explanation for a lack of innovation comes in the form of "availability bias." Traditional economics would typically assume that decision-makers would use all the information made available to them in making decisions, but behavioral researchers have shown a tendency for people to make decisions based upon the information that is most easily recalled at the time of the decision. It is easy to recall what has been done in the past. When combined with the aforementioned status quo bias, this can result in a lack of innovation in thinking, decisions, and solutions.

So how can managers address these challenges? First, remember that for every problem there is typically a simple solution…and it is likely terrible. Complicated problems tend to require multifaceted solutions. Second, an organization must learn to embrace some level of uncertainly in outcomes. If solutions are to be found, employees must be motivated to seek them out. This means creating a culture that recognizes

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and rewards innovation. After all, behavior that is rewarded is behavior that is repeated. Lastly, employees should not be unfairly punished when promising opportunities go south. Humans have a tendency toward hindsight bias, a belief that an outcome should have been foreseen regardless of the circumstances that led up to it. A bad outcome does not necessarily mean that a wrong decision was made, and employees should be incentivized to weigh risk against potential gains in the future success of the organization rather than focusing only on avoiding all risk!

Conclusion

While directors may not be driving the car, they do serve as the guard rails. Organizations are made up of people, and understanding people requires an understanding of behavior. To this end, the tools from both traditional and behavioral economics can been extremely useful in guiding directors to ask the rights questions of leadership to keep the organization on track. ■

The authors co-wrote a new book, Objective Prosperity: How Behavioral Economics Can Improve Outcomes for You, Your Business, and Your Nation*, available from Amazon and other book sellers. Roger Bailey, Ph.D., is clinical assistant professor of marketing and director of the full-time MBA program at The Ohio State University. Roger Blackwell, Ph.D., is co-author of* Consumer Behavior*, which has been translated into multiple languages and used in many countries. Prior to his retirement from The Ohio State, Blackwell served on the boards of 14 public corporations and currently serves on the boards of several private companies.*

News

Research shows boards likely to continue with hybrid working environments

Recent research conducted by board management software firm Boardable shows that despite the COVID-19 pandemic easing, nonprofit boards will likely continue to do their work in both remote and in-person settings—otherwise known as a hybrid working environment.

In its report, *2022 Board Trends that Shape Our Future*, the company explained that advancements in information technology and the spread of high-speed internet access have led to an increase in remote work across the board, especially with the younger, up-and-coming generations that have grown up as "digital natives" with ready access to Internet and wireless technologies. As these people take a greater and greater presence on nonprofit boards, their heightened level of comfort with doing board business online via Zoom and similar platforms will spur more organizations to keep such options available.

Most nonprofits adopted remote work and board operations out of necessity during the pandemic, but many expected a return to in-person work and meetings as the crisis receded. Research, however, shows that the workforce still has a preference for telecommuting and the freedoms and flexibility it offers. Those serving on nonprofit boards have also taken note of those advantages, and many would like to see it continue.

Advantages aside, experts do note some downsides to remote board work—namely, a lack of communication and clear chain of command, and a limited capability to follow up and make sure that board members stay on top of their work and time-critical tasks. To help nonprofit leaders address some of these challenges, Boardable offers the following tips:

• **Keep board members accountable.** According to Boardable, nonprofit executive directors and board leaders should "make follow-up items actionable and record important decisions in your meeting minutes." Key to this is designating a minute-taker ahead of time and sharing expectations and ground rules, the company said. Everyone should have a clear understanding of the most pertinent details of the meeting, such as who is assigned what task and the time frame for completion of those tasks, votes in favor of or against a motion, abstentions, and the format that should be used.

• **Have a "source of truth" for board documents.** According to Boardable, nonprofits can avoid having board members request they resend documents, board packets, and other materials by making use of a secure, online document center.

"Attendees should know where to find and access meeting materials, bylaws, and other important documents, and this will cut down on time digging through emails and looking for the correct attachments," the company says in its report.

• **Make the best use of technology.** With the technology tools that nonprofit leaders have at their disposal, they shouldn't have to chase down board members and email multiple reminders to keep them in the loop and progressing with their tasks, Boardable says. Instead, a good board management platform can do these things for you through a suite of tools that provide visibility on the priorities and tasks at hand, keeping everyone informed on where things stand.

"Members are more inclined to report on their specific tasks if they can see projects and their progress on achieving set goals," the company said.

For more information, visit https://boardable.com. ■