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

Friday, August 25, 2023, 8:30 a.m.

WSI Board Room (In-Person), 1600 E Century Ave, Bismarck, ND

Click here to join the meeting

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA - *(Board Action)*

A. Pledge of Allegiance
B. Executive Summary
C. Welcome New Board Members

II. ACCEPTANCE OF MINUTES (July 21, 2023) – *(Board Action)*

III. EDUCATION (45 minutes) *(Information)*

A. Development of SD Investment Program - Mr. Matt Clark, SD State Investment Officer

IV. INVESTMENTS (90 minutes)

A. Summary of Investment Strategies *(Information)* – Investment Team
B. Benchmark/Hurdle Rate Consultant Approval[1] *(Board Action)* – Mr. Anderson

(Break)

V. GOVERNANCE (45 min)

A. Governance & Policy Review Committee Update *(Board Action)* – Dr. Lech, Ms. Murtha
B. Investment Committee Update *(Information)* – Treasurer Beadle, Mr. Anderson
C. Executive Review & Compensation Committee Update *(Information)* – Dr. Lech, Mr. Skor

VI. Quarterly Monitoring Reports (30 minutes) – *(Board Action)*

A. Quarterly & Annual Audit Activities Report (6/30) – Ms. Seiler
B. Quarterly Budget/Fiscal Conditions Report – Mr. Skor
C. Executive Limitations/Staff Relations – Ms. Murtha

VII. OTHER

Next Meetings:
Investment Committee – September 8, 2023, at 9:00 a.m.
SIB Securities Litigation – TBD
SIB GPR – September 14, 2023, at 10:00 a.m.
SIB Meeting – September 22, 2023, at 8:30 a.m.
SIB ERCC –September 27, 2023, at 10:00 a.m.

VIII. ADJOURNMENT

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[1] Executive Session pursuant to N.D.C.C. 44-04-19.2 and 44-04-18.4(6)(b) to discuss exempt proposal procurement information during a competitive bidding process.

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

August 25, 2023 – 8:30am CT

I. **Agenda:** The **August 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.

- Attendees are invited to join the Board Chair in the Pledge of Allegiance.
- Welcome new Board members.

II. **Minutes (Board Action):** The July 21, 2023, Board meeting minutes are included for review and approval.

III. **A. Board Education – Development of the South Dakota Investment Program (Information):** Mr. Clark from SDIC will provide a presentation on the development of the SD Investment Program. SD is recognized for its focus on internal investment management and robust internship program.

IV. **A. Summary of Investment Strategies (Information):** Members of the investment team will review investment program strategies currently overseen by the Investment Committee.

B. Benchmark/Hurdle Rate Consultant Approval (Board Action): This presentation will be held in executive session. Board members will be sent materials via a secure link prior to the meeting.

V. **A. Governance & Policy Review Committee (Board Action):** Meeting materials will be updated after the GPR Committee meets on August 24, 2023.

B. Investment Committee (Information): The Committee Chair and Mr. Anderson will provide the Board an update on recent committee activities.

C. Executive Review and Compensation Committee (Information): Meeting materials will be updated after the ERCC meets on August 24, 2023.

VI. **A-D. Reports (Board Action):** Staff will provide annual and quarterly monitoring reports for internal audit activities, quarterly budget/fiscal conditions, and executive limitations/ staff relations.

Adjournment.

NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
JULY 21, 2023, BOARD MEETING (IN-PERSON)

MEMBERS PRESENT:	Tammy Miller, Lt. Governor, Chair Dr. Rob Lech, TFFR Board, Vice Chair Thomas Beadle, State Treasurer, Parliamentarian Rep. Glenn Bosch, LBSFAB Joseph Heringer, Commissioner of Unv. & School Lands Cody Mickelson, TFFR Board Adam Miller, PERS Board Susan Sisk, Director of OMB Mona Tedford-Rindy, PERS Board
MEMBER ABSENT:	Sen. Jerry Klein, LBSFAB Art Thompson, Director of WSI
STAFF PRESENT:	Scott Anderson, CIO Eric Chin, Deputy CIO Derek Dukart, Investment Officer Rachel Kmetz, Accounting Mgr. Missy Kopp, Exec. Assistant George Moss, Sr. Investment Officer Sarah Mudder, Communications/Outreach Dir. Jan Murtha, Exec. Dir. Ann Nagel, Retirement Accountant Matt Posch, Sr. Investment Officer Emmalee Riegler, Procurement/Records Coor. Chad Roberts, DED/CRO Mike Schmitcke, Sr. Investment Accountant Sara Seiler, Internal Audit Supvr. Ryan Skor, CFO/COO Dottie Thorsen, Internal Auditor Lindsey Trotter, Legal Intern Nitin Vaidya, Chief Risk Officer Tami Volkert, Compliance Spec. Susan Walcker, Sr. Financial Accountant Jason Yu, Risk Officer Lance Ziettlow, Sr. Investment Officer
GUESTS:	Craig Chaikin, Callan Dean DePountis, Attorney General's Office Matt Gertken, BCA Research Scott Miller, PERS Prodosh Simlai, UND Members of the Public

<u>CALL TO ORDER</u>:

Lt. Gov. Miller, Chair, called the State Investment Board (SIB) regular meeting to order at 8:30 a.m. on Friday, July 21, 2023. 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, Rep. Bosch, Commissioner Heringer, Dr. Lech, Mr. Mickelson, Lt. Gov. Miller, Mr. Miller, Ms. Rindy and Ms. Sisk.

<u>ACCEPTANCE OF AGENDA</u>:

The Board considered the agenda for the July 21, 2023, meeting.

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

AYES: COMMISSIONER HERINGER, TREASURER BEADLE, MR. MILLER, MS. SISK, REP. BOSCH, MR. MICKELSON, DR. LECH, MS. RINDY AND LT. GOV. MILLER
NAYS: NONE
ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

<u>MINUTES</u>:

The Board considered the minutes of the May 19, 2023, SIB meeting.

IT WAS MOVED BY TREASURER BEADLE AND SECONDED BY REP. BOSCH AND CARRIED BY A VOICE VOTE TO APPROVE THE MAY 19, 2023, MINUTES AS DISTRIBUTED.

AYES: MR. MICKELSON, COMMISSIONER HERINGER, MS. RINDY, TREASURER BEADLE, DR. LECH, MS. SISK, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

<u>ELECTION OF OFFICERS AND COMMITTEE APPOINTMENTS</u>:

IT WAS MOVED BY COMMISSIONER HERINGER AND SECONDED BY MR. MILLER AND CARRIED BY A ROLL CALL VOTE TO CAST A UNANIMOUS BALLOT WITH LT. GOV. MILLER AS SIB CHAIR AND DR. LECH AS VICE CHAIR.

AYES: REP. BOSCH, COMMISSIONER HERINGER, MR. MICKELSON, MS. SISK, MS. RINDY, MR. MILLER, TREASURER BEADLE, DR. LECH, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

Lt. Gov. Miller appointed Treasurer Beadle as the Parliamentarian.

IT WAS MOVED BY DR. LECH AND SECONDED BY MS. SISK AND CARRIED BY A ROLL CALL VOTE TO CAST A UNANIMOUS BALLOT WITH MR. MILLER, TREASURER BEADLE, MR. MICKELSON, DINA CASHMAN, AND TODD VAN ORMAN AS AUDIT COMMITTEE MEMBERS.

AYES: TREASURER BEADLE, MR. MICKELSON, REP. BOSCH, COMMISSIONER HERINGER, MS. RINDY, DR. LECH, MR. MILLER, MS. SISK, AND LT. GOV. MILLLER
NAYS: NONE
ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

IT WAS MOVED BY MR. MILLER AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO CAST A UNANIMOUS BALLOT WITH DR. LECH, TREASURER BEADLE, AND MS. SISK AS GOVERNANCE & POLICY REVIEW COMMITTEE MEMBERS.

AYES: MS. RINDY, MR. MILLER, MR. MICKELSON, DR. LECH, REP. BOSCH, MS. SISK, COMMISSIONER HERINGER, TREASURER BEADLE, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

Lt. Gov. Miller appointed Sen. Klein, Dr. Lech, and Treasurer Beadle to the Executive Review & Compensation Committee.

Lt. Gov. Miller appointed Treasurer Beadle as chair, Commissioner Heringer as vice chair, and Dr. Simlai, Dr. Tian, Mr. Anderson, and Mr. Chin as members of the Investment Committee.

Lt. Gov. Miller appointed Commissioner Heringer, Mr. Thompson, and Ms. Rindy as members of the Securities Litigation Committee.

EDUCATION:

Country Risk:

Mr. Matt Gertken, BCA Research, provided Board education on geopolitics and markets. Mr. Gertken provided an overview of the geopolitical method, an explanation of geopolitical risk in relation to investments, and a discussion about the three major economies of the U.S., China, and the EU. Board discussion followed.

INVESTMENTS:

Legacy Fund Investment Policy Statement (IPS):

Mr. Anderson provided background on the Legacy Fund asset allocation project undertaken by the LBSAB. The Advisory Board worked with RVK to update the asset allocation in relation to the in-state investment program. After initiatives that were passed during legislative session earlier this year, adjustments were made to the in-state program and the earnings definition for the Legacy Fund. With these changes in place, the asset allocation was updated and the IPS was approved by the LBSAB and now requires approval by the SIB. Mr. Anderson reviewed the changes to the Legacy Fund IPS. Board discussion followed.

IT WAS MOVED BY MR. MILLER AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE LEGACY FUND IPS.

AYES: TREASURER BEADLE, MS. SISK, REP. BOSCH, COMMISSIONER HERINGER, DR. LECH, MR. MILLER, MR. MICKELSON, MS. RINDY, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

Quarterly Performance Review:

Mr. Anderson provided the performance review for the quarter ended March 31, 2023. Mr. Anderson reviewed market conditions for the quarter. PERS and TFFR returns were reviewed and an illustration of the benefit of active management was provided. Legacy Fund and WSI returns were reviewed. Board discussion followed.

IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE INVESTMENT PERFORMANCE REVIEW.

AYES: REP. BOSCH, MS. SISK, TREASURER BEADLE, COMMISSIONER HERINGER, DR. LECH, MR. MILLER, MS. RINDY, MR. MICKELSON, AND LT. GOV. MILLER
NAYS: NONE

ABSENT: SEN. KLEIN AND MR. THOMPSON
MOTION CARRIED

Legacy & Budget Stabilization Fund Advisory Board (LBSFAB) Update:

Agenda item VI. D. was moved up. Rep. Bosch provided an update form the LBSFAB meeting in June of 2023. The Advisory Board completed work on the Legacy Fund asset allocation and IPS. The Advisory Board is looking forward to implementation after all the work that has been done. Ms. Murtha thanked everyone involved in the effort to realize the potential for the Legacy Fund and in-state investment program. Board discussion followed.

Rep. Bosch left the meeting at 10:22 a.m.

The Board recessed at 10:22 a.m. and reconvened at 10:39 a.m.

GOVERNANCE:

Governance & Policy Review (GPR) Committee Update:

Dr. Lech provided an update from the June 20, 2023, and July 17, 2023, GPR meetings. The Committee discussed new Board member recommendations and the SIB Governance Manual review project. The Committee recommends providing the Governor's Office with characteristics of the two institutional investment positions instead of a slate of candidates. Board discussion followed.

IT WAS MOVED BY COMMISSIONER HERINGER AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE GPR COMMITTEE UPDATE.

AYES: MS. SISK, MS. RINDY, MR. MILLER, TREASURER BEADLE, MR. MICKELSON, COMMISSIONER HERINGER, DR. LECH, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: REP. BOSCH, SEN. KLEIN, AND MR. THOMPSON
MOTION CARRIED

Investment Committee (IC) Update:

Treasurer Beadle provided an update from the July 14, 2023, IC meeting. The IC reviewed the Legacy Fund IPS and received presentations on private market strategy, secondary guidelines, and bank risk. Mr. Anderson shared that the IC had received various strategy presentations which will be summarized in a presentation for the SIB at an upcoming meeting. Board discussion followed.

IT WAS MOVED BY DR. LECH AND SECONDED BY TREASURER BEADLE AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE SECOND READING AND FINAL ADOPTION OF AMENDED POLICY E-3 AND NEW EXHIBIT E-III.

AYES: DR. LECH, TREASURER BEADLE, COMMISSIONER HERINGER, MR. MILLER, MS. SISK, MR. MICKELSON, MS. RINDY, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: REP. BOSCH, SEN. KLEIN, AND MR. THOMPSON
MOTION CARRIED

Securities Litigation Committee (SLC) Update:

Ms. Murtha provided an update from recent SLC meetings. The Committee received updates from outside counsel on pending litigation, a securities litigation monitoring report, and discussed the Special Attorney General (AG) appointment process. There was not a defined process for the SLC to choose special AGs on behalf of the Board. Mr. DePountis conducted outreach with other plans to receive information on their processes. The Committee moved forward with a more formalized process and asked staff to prepare an RFP for approval at the September meeting for the purposes of establishing a securities litigation counsel roster.

IT WAS MOVED BY TREASURER BEADLE AND SECONDED BY COMMISSIONER HERINGER AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE SLC UPDATE.

AYES: MS. SISK, COMMISSIONER HERINGER, MR. MICKELSON, MS. RINDY, MR. MILLER, DR. LECH, TREASURER BEADLE, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: REP. BOSCH, SEN. KLEIN, AND MR. THOMPSON
MOTION CARRIED

QUARTERLY MONITORING REPORTS:

Investment Ends:

Mr. Chin reviewed the Quarterly Investment Ends Report for the quarter ended June 30, 2023. The Investment Team recommended a transition for the plan policy benchmarks from static to dynamic corridor weighting. The recommendation was approved by the IC and SIB. Strategies from each investment vertical have been provided to the IC. Several changes to the portfolio were recommended and approval was received from the IC. A quarterly monitoring report was provided. Board discussion followed.

TFFR Ends:

Mr. Roberts provided the TFFR Ends report for the quarter ended March 31, 2023. This report highlights exceptions to the normal operating conditions of the TFFR program. During the quarter there were changes to the federal income tax collection guidelines and a new withholding form. This resulted in an increase in calls and visits from TFFR members. Staff prepared and provided legislative testimony during the session. The actuarial audit was completed and an RFP for actuarial services was reviewed, approved, and issued. The Communications and Outreach Director, Sarah Mudder joined the agency. Board discussion followed.

Executive Limitations/Staff Relations:

Ms. Murtha provided an update on staffing. Two of the new FTEs that were granted as part of RIO's budget have been posted. The Sr. Investment Accountant position was posted internally and filled by Mr. Schmitcke. The Investment Accountant position which he vacated, will be posted soon. The other new position is the Fiscal/Investment Administrative Assistant which has been posted and closed. Interviews will be conducted soon. Ms. Murtha reviewed current projects, initiatives, Executive Director education activities, and staff presentations. There is a new Board member onboarding process that has been developed by the GPR Committee. The first session is scheduled for August 2, 2023. Board discussion followed.

IT WAS MOVED BY TREASURER BEADLE AND SECONDED BY DR. LECH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE QUARTERLY INVESTMENT ENDS, TFFR ENDS, AND EXECUTIVE LIMITATIONS/STAFF RELATIONS REPORTS.

AYES: MR. MICKELSON, COMMISSIONER HERINGER, MS. RINDY, TREASURER BEADLE, DR. LECH, MS. SISK, MR. MILLER, AND LT. GOV. MILLER
NAYS: NONE
ABSENT: REP. BOSCH, SEN. KLEIN, AND MR. THOMPSON
MOTION CARRIED

ADJOURNMENT:

With no further business to come before the SIB, Lt. Gov. Miller adjourned the meeting at 11:21 a.m.

Prepared by: Missy Kopp, Assistant to the Board

Investment Implementation

Matt Clark, State Investment Officer

South Dakota Investment Council

Presentation to North Dakota Retirement
and Investment Office Board Meeting
August 2023

Overview

Goal

- Add value over the long term

Business-like environment

Process

- Focus on long-term value
- Internal management of most assets
- Risk measurement for severe environments

People

- Recruited as interns from area universities and trained internally
- Research coverage redundancy to promote internal discussion and continuity
- Compensation linked to added value

Goal

Goal is to add value over long term versus index returns

- Difficult for most to outperform market index benchmarks
- Accomplishment provides most resources to meet needs
- Everyone must agree on goal to have chance to succeed

Daily efforts focus on drivers of success over the long term

- Common sense long-term contrarian culture
- Willingness to endure short-term underperformance
- Valuation competencies

Business-like environment

Focus on maximum risk-adjusted return

- Prohibition against social investing considerations (exception for sanctioned countries)

Long-term business plan

- Established under direction of Legislature in 1988 to create stable environment for internal management and alleviate turnover problems

Investment Council funded from assets under management

- Funding shifted from general fund to managed assets in 1988
- Emphasis on unit cost

Process

Focus on long-term value

- Only reliable way to add value long term is to buy when cheap, sell when expensive
- Many investors would rather focus on short-term market movements
- Need long-term value measures, patience, confidence, continuous preparation

Internal management

- Cost of internal management is lower than external active management cost
- Returns benefit from influence over internal staff to focus on long term
- Increased conviction comes from doing your own research
- Internal management is a lot more work than hiring outside managers

Risk management

- Risk measurement focused on equity-like and bond-like risk
- Conventional statistical risk measures are adjusted to reflect higher real-world frequency and magnitude of adverse outlier events
- Risk managed by broad diversification and avoiding expensive assets
- Strong financial condition important to help weather difficult periods

Long-term value measures

Believe long-term value is the present value of future cash flows

- Simple notion: Invest cash today → Get more back later

Research focus is on estimation of probability weighted cash flows

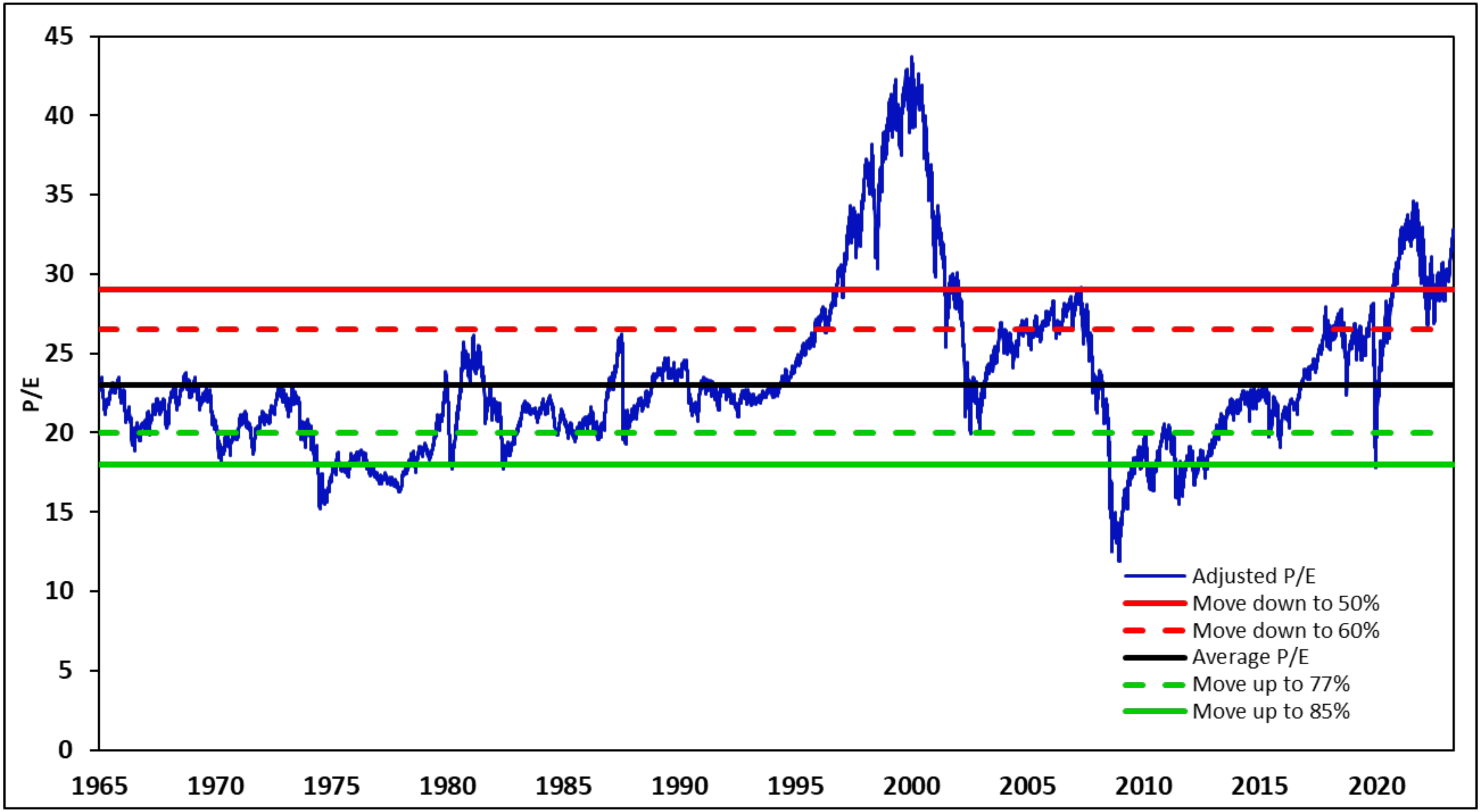
- Stocks: normal earnings, return on invested capital, normal growth rate
- Debt: probability of bankruptcy from cash flow volatility modeling process
- Inputs must reflect underlying economic reality

Risk assessment drives rate used to discount cash flows to present value

- Focus on risk in severe adverse markets

Simple P/E contrarian allocation example

P/E using smoothed earnings and adjusted for interest rates



People

Recruitment

- Intern program for top students from area universities
- Gauge aptitude for contrarian philosophy and cash flow modeling

Training

- Understand long-term contrarian philosophy
- Develop cash flow modeling capability

Research coverage redundancy

- Double coverage promotes internal discussion and continuity
- Analysts manage individual portfolios to heighten focus and accountability

Compensation

- Based on private sector comparable positions with targeted discount
- Linked to added value through incentive compensation component

Compensation linked to added value

Encourage retention of successful staff

- Team is most attractive to other organizations when winning
- Shifts compensation higher when people more sought after and down when losing

Incentives encourage performance

- Multiyear timeframes encourage investing for the long term
- Counters underperformance risk that can discourage efforts to add value

Incentives paid only for added value

Important to encourage added value in all markets

- Encourages adding value by reducing risk when markets expensive
- Added value in down markets more important than in up markets

INVESTMENT STRATEGY

INVESTMENT STAFF
Aug 25th, 2023

NORTH Dakota | Retirement & Investment
Be Legendary.

BACKGROUND

OVERVIEW

NORTH Dakota
Be Legendary.

RIO AT A GLANCE
As of December 31, 2022

$19.2 Billion
AUM across all Client Funds

28 Client Funds
Sovereign wealth, pension and insurance

43 Managers
Equity, Fixed Income, Private Equity, and Real Asset

INVESTMENT FOCUS
Global multi-asset public and private market fund of funds organization

OBJECTIVE
To maximize after cost return for risk at a prudent level of risk for the funds in our care

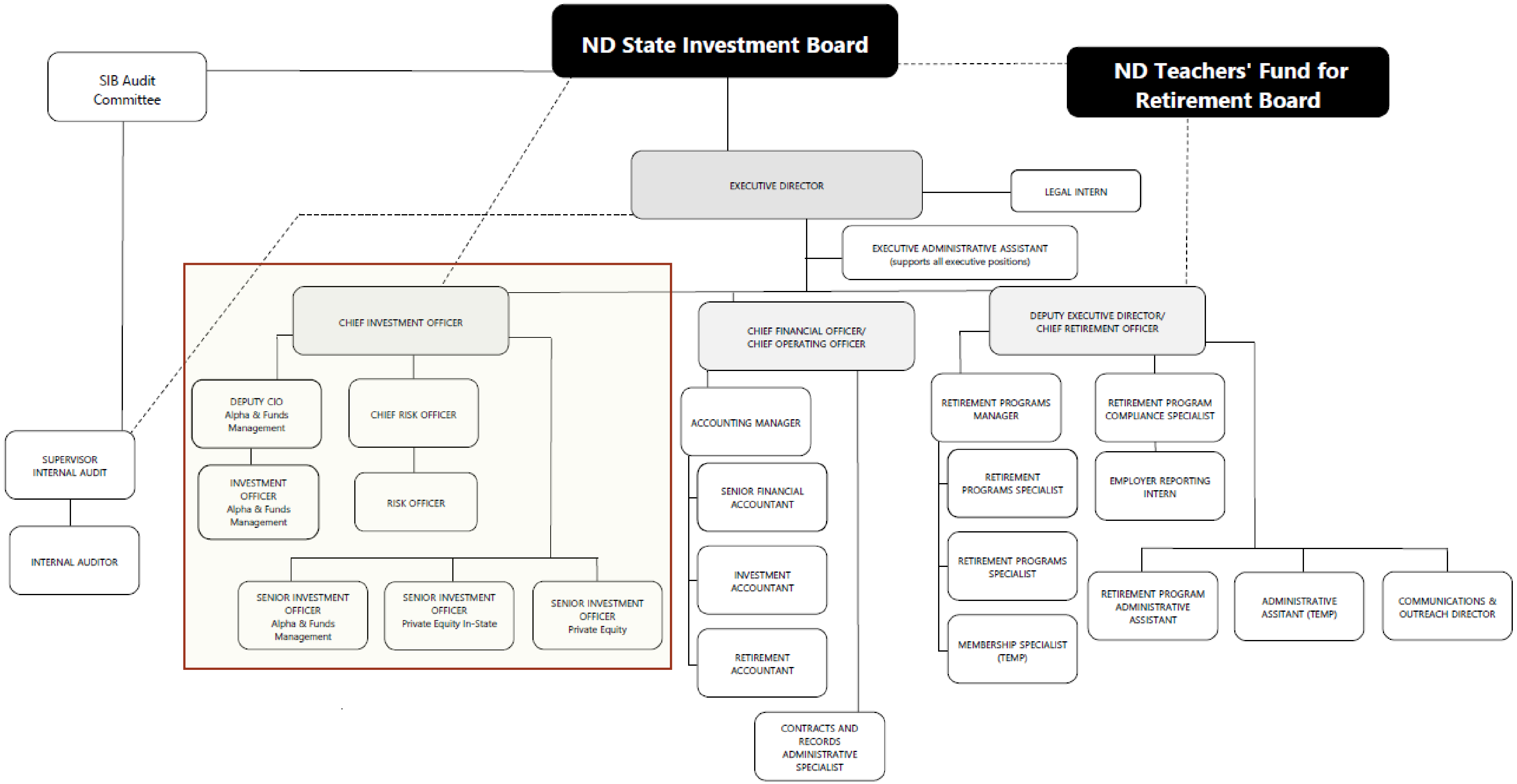
Global, Multi-asset

Advanced Funds Management

OUR COMMITMENT
- Client Focused
- Value Added Results
- Efficient Delivery

RETIREMENT AND INVESTMENT OFFICE

RETIREMENT AND INVESTMENT OFFICE



Investment Staff, August 25, 2023

INVESTMENT TEAM OVERVIEW

NORTH Dakota Be Legendary.

Scott M Anderson
Chief Investment Officer (CIO)

Eric Chin
Deputy CIO/Public Funds Mgt

Matt Posch
Senior IO/Public Funds Mgt

Derek Dukart
IO/Public Funds Mgt

George Moss
Senior IO/Private Funds Mgt

Lance Ziettlow
Senior IO/Private Funds Mgt

Nitin Vaidya
Chief Risk Officer

Jason Yu
Risk Officer

PUBLIC MARKETS FUNDS MANAGEMENT

PRIVATE MARKETS FUNDS MANAGEMENT

RISK ALLOCATION AND MANAGEMENT

EXPERIENCE: >18 YEARS AVERAGE INVESTMENT EXPERIENCE

- ASSET AND RISK ALLOCATION
- DIRECT PUBLIC AND PRIVATE INVESTMENT
- FUND AND PORTFOLIO MANAGEMENT
- MANAGER SELECTION
- FUND OF FUNDS MANAGEMENT
- QUANTITATIVE ANALYSIS
- RISK MANAGEMENT
- LIQUIDITY MANAGEMENT
- PENSION, ENDOWMENT AND INSURANCE
- PERFORMANCE MANAGEMENT
- OVERLAYS AND EXPOSURE MANAGEMENT
- MULTI-ASSET PORTFOLIO MANAGEMENT

Investment Staff, August 25, 2023

INVESTMENT STRATEGY

Investment Staff, August 25, 2023

WE BELIEVE

- Our mission is to deliver a high return per unit of risk; at a prudent level of risk for our client fund mandates; at an efficient cost
- Asset allocation is our chief source of efficient return (return/risk)
- Long term markets are efficient but there are short term inefficiencies that create opportunity for active return
- Active management improves return efficiency, but active return is rare so is allocated in appropriate proportions of risk
- Effective implementation is an important driver of lower cost, and lower risk; therefore, an important contributor to return efficiency
- Good investment decisions require fact based, reasoned judgements of experienced investment professionals regarding knowledge of compensated risks, investment process and return expectations in an analyst driven culture

OBJECTIVE AND STRATEGY

OBJECTIVE:	▪ To maximize after cost return for risk at a prudent level of risk for the funds in our care
STRATEGY:	▪ Develop valuable investment trade-offs of return, risk and cost with time horizon, scale, complexity, and make versus buy decisions as drivers ▪ Implement trade-offs as state-based investment decisions enabled by technology and integrated across investment teams that leverage direct versus external, and customized versus commodity decisions ▪ Evolve strategies to be backward compatible
WHY?	▪ We will have an advantage from diverse sources of market and business case information from our custom data as well as internal and external manager strategies. RIO will be differentiated with integrated optimization of state-based knowledge management decisions and implementation

EVOLVING INVESTMENT STRUCTURE

NORTH Dakota
Be Legendary.

1 PROCUREMENT AND IMPLEMENTATION

- EXECUTIVE DIRECTOR/CIO
  - DEPUTY CIO
    - CHIEF RISK OFFICER
    - INVESTMENT ANALYSTS

2 SELECTION AND PORTFOLIO STRUCTURE

- CHIEF INVESTMENT OFFICER
  - CHIEF RISK OFFICER
  - DEPUTY CIO/FUNDS MANAGEMENT
  - PRIVATE MARKETS

3 ADVANCED FUNDS MANAGEMENT

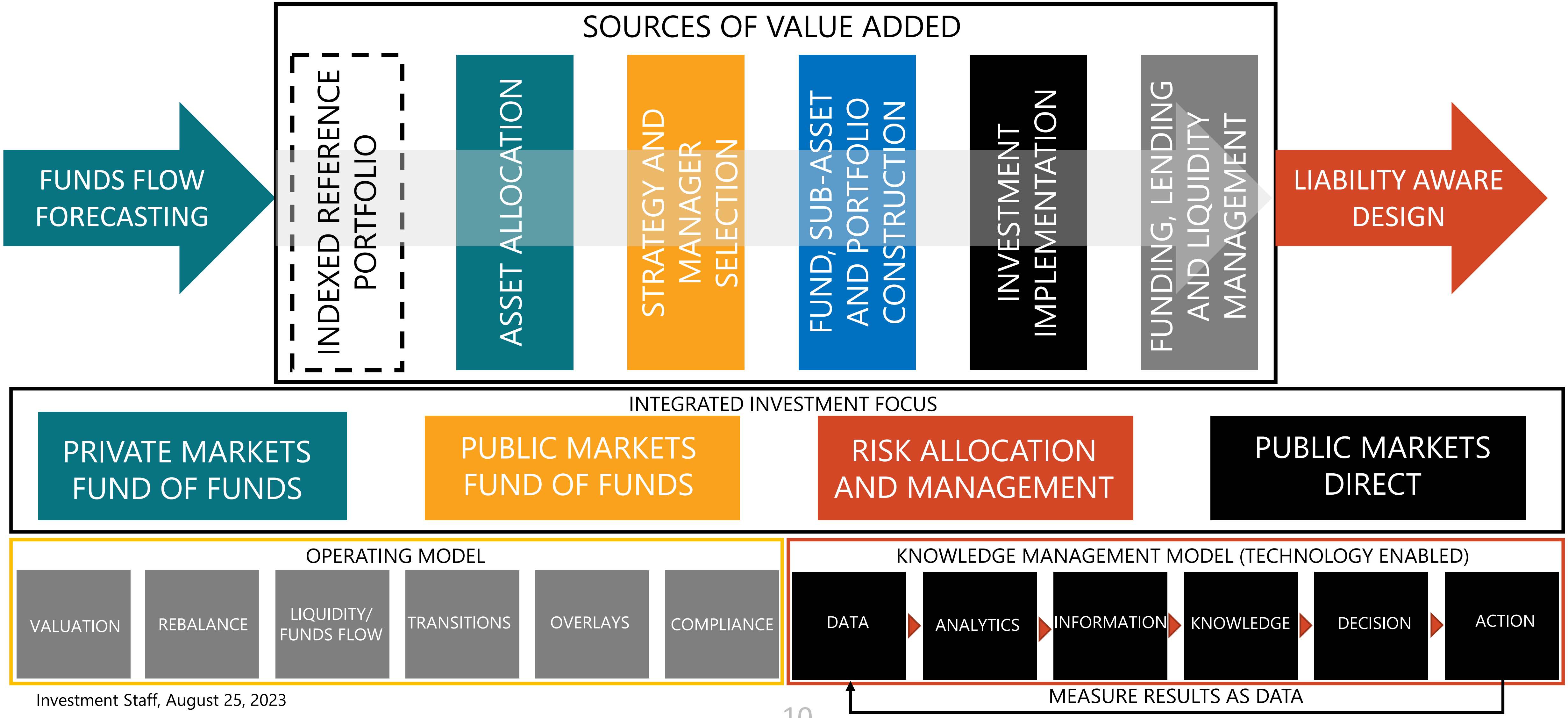
- CHIEF INVESTMENT OFFICER
  - CHIEF RISK OFFICER
  - DEPUTY CIO/FUNDS MANAGEMENT
  - PRIVATE MARKETS
  - PUBLIC MARKETS INTERNAL INVESTMENT MANAGEMENT

4 ASSET AND RISK ALLOCATION/ ACTIVE RETURN OPTIMIZATION

- CHIEF INVESTMENT OFFICER
  - ASSET AND RISK ALLOCATION
    - RESEARCH
    - EXPOSURE MANAGEMENT
    - RISK MANAGEMENT
  - PRIVATE MARKETS/ FUNDS MANAGEMENT
    - CO-INVESTMENT
  - PUBLIC MARKETS INTERNAL INVESTMENT MANAGEMENT
    - INDEXING
    - HIGH YIELD
    - SMALL CAP

- Increasing investment focus
- Increasing analyst driven culture
- Increasing knowledge/ collaboration
- Increasing specialization
- Increasing sophistication
- Increasing fund level/portfolio level harmonization
- Increasing risk management orientation
- Increased return/risk
- ***Backward compatible***

INVESTMENT TARGET MODEL-
Advanced Fund Of Funds Model



Investment Staff, August 25, 2023

SOURCES OF VALUE ADDED

NORTH Dakota
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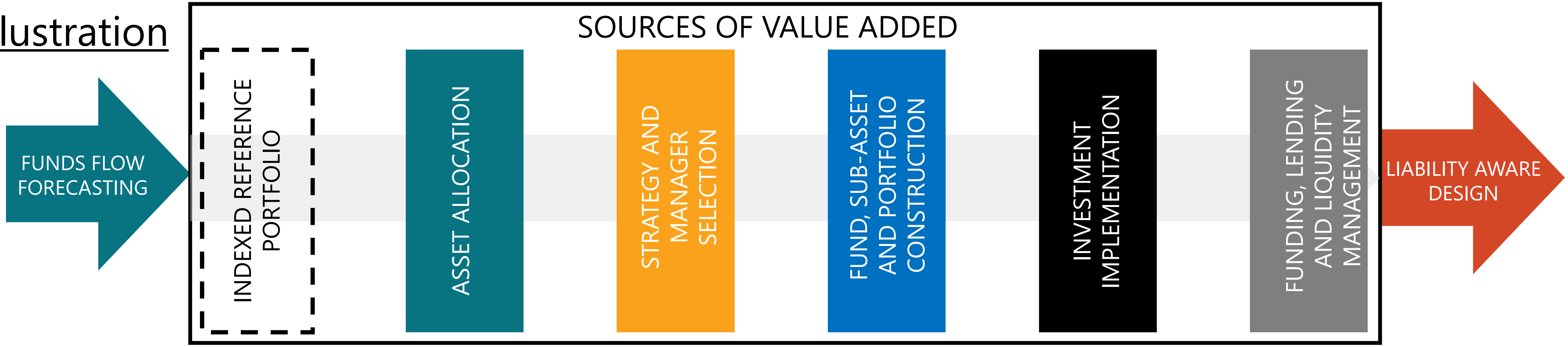
Illustration



Forecast funds flows for liquidity risk, cash, rebalancing and liquidity management	A minimum efficient allocation of 60% World Index and 40% Domestic Fixed Income	An enhanced allocation with private markets, leverage, a more refined sub-asset allocation and dynamic as options	Selection of a diversified set of the best strategies and managers that implement the asset allocation	Optimal systematic and idiosyncratic return per risk at an appropriate risk, manage dynamically as an option	Choose make versus buy and optimize cost of management, fees, incentives, implementation, operations and exposures	Find best return and costs for security lending, cash management, transaction finance and liquidity risk management	Reduce liability defeasance risk by understanding features of the liability and economic scenarios (local and global)
	VALUE ADDED:	> 100 BP	> 40 BP	> 10 BP	> 10 BP	> 5 BP	

INTERACTING DECISIONS

Investment Staff, August 25, 2023

INTEGRATED INVESTMENT FOCUS

North Dakota
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PUBLIC MARKETS DIRECT

PRIVATE MARKETS FUND OF FUNDS

FUNDS MANAGEMENT

Public Equity
- External Managers
- Internal Managers
- Index Funds

Public Fixed Income
- External Managers
- Internal Managers
- Index Funds

Private Markets
- Private Equity
- Private Debt
- Real Assets

Liquidity Portfolios

Overlay Portfolios

PUBLIC MARKETS FUND OF FUNDS

RISK ALLOCATION AND MANAGEMENT

Investment Staff, August 25, 2023

CAPABILITIES FOR SUCCESS

NECESSARY CAPABILITIES FOR SUCCESS

GOVERNANCE ✓	A governance hierarchy including a staff run investment committee with some delegation as well as board level investment expertise
TALENT MANAGEMENT	**Specific investment role recognition as well as a total rewards package that is competitive with similar investment organizations**
OPERATIONS (EARLIER PAGE)	Appropriate staffing and skills or outsourcing of critical investment accounting, transaction processing, and enterprise risk capabilities
DATA AND TECHNOLOGY INFRASTRUCTURE	**High frequency and high-quality data as well as infrastructure to support data throughput and processing speeds**
RESEARCH AND KNOWLEDGE MANAGEMENT (EARLIER PAGE)	A culture of research, learning, creativity and knowledge management supported by expectations, resources, and recognition

NEW CAPABILITY - PUBLIC MARKETS DIRECT

OPPORTUNITY

ENHANCED INDEXING AND PUBLIC MARKETS STRATEGIES	• Enhanced indexing; multi-asset capability; leverages expertise with index information; same active return for a lower active risk and cost than external managers for simple mandates
ENHANCED LIQUIDITY MANAGEMENT	• Overlay of cash generates additional return and enables more available cash • Buying and selling of liquidity
ENHANCED REBALANCING	• Rebalancing of exposures in shorter time frames • Rebalancing thru internal portfolios rather than managers – reducing transaction costs
EXPOSURE MANAGEMENT	• Separate manager active return from manager policy return to optimize cost and active return • Manage exposures to manage risks and generate returns
OPTIMAL IMPLEMENTATION	• Choose optimal instrument to implement policy exposures reduces cost, increases revenues, manages risk

INVESTMENT SYSTEMS STRATEGY GOALS

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Procure or develop databases, systems/tools and processes that allow NDRIO Investments team the ability to:

- Leverage high frequency data for portfolio management including daily allocation and cash management
- Create timely and high-quality portfolio and risk analytics, including visualization and presentation, for enhanced investment decision making
- Access and control its current and historical data irrespective of custodian relationship

TECHNOLOGY ENABLEMENT

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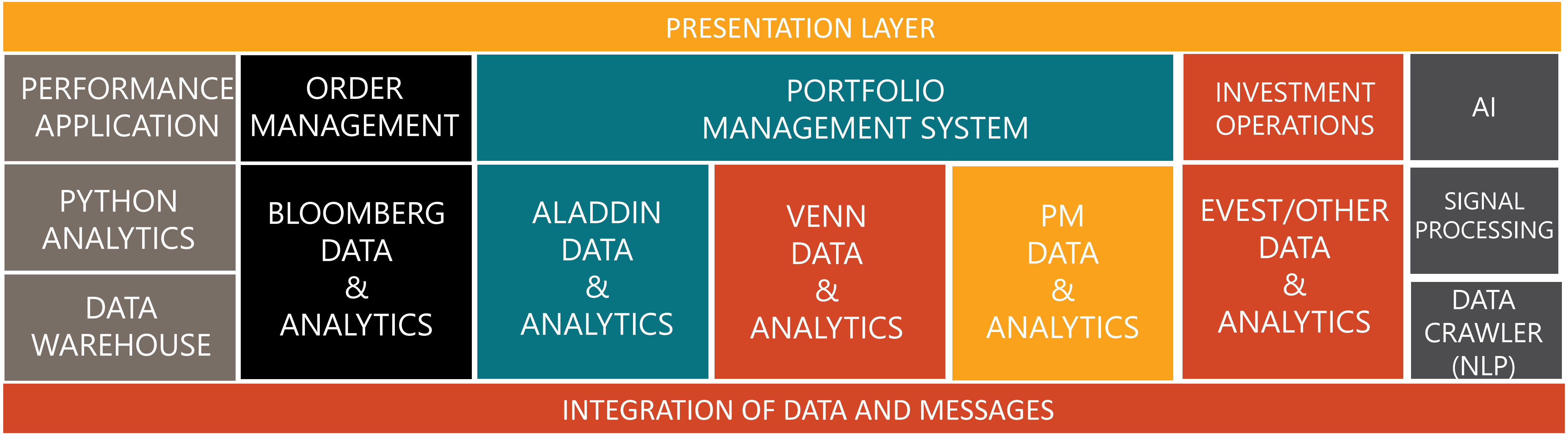
ILLUSTRATION

INTEGRATED DATA AND MESSAGES, SOFTWARE AS A SERVICE, AI/MACHINE LEARNING, ADVANCED ANALYTICS



RISK ALLOCATION AND MANAGEMENT

INVESTMENTS: RISK ALLOCATION AND MANAGEMENT
Model for Evaluating Outcomes

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Level of risk can result in outperformance, but is that a good result for right reasons or wrong reasons?

Assessment requires understanding the root drivers of the investment edge and market environment, identifying favorable and unfavorable cycles and attributing full-cycle results to skill, structural or market factors.

Good results for *wrong* reasons	**Good results for *right* reasons**
Poor results due to poor execution or unsound process	**Poor results for good reasons**

Note: Concept developed at Invesco with my guidance

Understanding Risk

Portfolio Risk Sources

Portfolio Structure

Liquidity
Concentration (position sizes, number of positions, correlation)
Leverage
Counterparty
Cash
Event risk
Tail risk/non-linear

Security

<u>Idiosyncratic</u>
Operational/Event risk
Liquidity
Balance sheet, Earnings, Legal, ESG
<u>Systematic</u>
Market sensitivity
Credit risk
Interest rate risk
Duration risk

Macro-Economic

Systematic
Inflation
US Dollar
Commodity Prices
GDP Growth
Credit risk
Interest rate risk
Correlation risk

Factor Exposures

Style
Quality
Valuation
Growth
Size
Dividend Yield
Country/Currency
Sector/Industry

INVESTMENTS: RISK ALLOCATION AND MANAGEMENT
Enhancing Investment Outcomes

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- Develops quantitative analysis and mitigates uncompensated risks to ensure an optimal return for risk at a prudent level of risk in all investment strategies
- Integrated in all investment decisions including allocation of risk capital, portfolio construction and investment manager selection and oversight. Validate investment adherence to optimal risk adjusted return objective.
- Use and develop best in class data sources, analytics and tools to identify risks, measure return per risk and manage risks.
- Provides risk communication and portfolio transparency to policy makers and investment teams.

ALPHA AND PUBLIC MARKET FUNDS MANAGEMENT

INVESTMENTS: ALPHA AND FUNDS MANAGEMENT
Sources of Excess Return

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FOUR KEY PILLARS TO GENERATE EXCESS RETURNS

MANAGER SELECTION

Identify best-of-breed managers that:
- Can generate risk-adjusted excess returns over a market cycle
- Have differentiated sources of alpha

PORTFOLIO CONSTRUCTION

- Create a portfolio of managers that have uncorrelated alpha sources
- Select strategies to optimize risk and return
- Size manager positions based on conviction

DYNAMIC ALLOCATION

- Dynamically adjust portfolio & exposures to capture inefficiencies in the market
- Portfolio tilts must be based on sound research
- Risk assessment is essential

IMPLEMENTATION & OPERATIONAL

- Improvements in implementation and processes can lead to alpha
- Examples include optimizing rebalancing, identifying cheaper products, fee reductions etc.

INVESTMENTS: ALPHA AND FUNDS MANAGEMENT
Manager Selection Process

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16,000+ Investment Products

Initial Screen of Investment Products:

Qualitative Characteristics
- Firm AUM
- Strategy AUM
- Team size
- Institutional AUM
- Retail AUM

Quantitative Characteristics
- Performance
- Information ratio
- Tracking error
- Standard deviation
- Excess returns

Identify 10-20 Candidates

Preliminary Investment Review
- Initial calls with manager
- Firm & process evaluation
- Peer comparison
- Consultant review
- Correlation to existing managers

Identify 3-5 Candidates

In-depth Review
- Onsite meetings with senior investment team
- Request for Information (RFI)
- Comprehensive analytics: performance, attribution, holdings & risk
- Fit within portfolio
- Operational DD

Identify Top Candidate

Top Candidate Managers Not Selected

Approval:
- Formal investment memo
- Internal approval by AFM Team, CIO, CRO
- IC approval

Manager Approved

Onboard:
- Legal review
- Final fee negotiations
- Reporting and transparency

Manager Onboarded

Top Prospects

AFM team monitors and maintains relationships with top prospects. Allows the team to quickly find suitable replacements if/when necessary

Manager Selection Process
- Disciplined, consistent & rigorous
- Backed by extensive research and due diligence
- Multiple layers of review and approval
- Risk is integral in the selection process

INVESTMENTS: ALPHA AND FUNDS MANAGEMENT
Portfolio Construction Process

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IDENTIFY BEST-OF-BREED MANAGERS

AFM Team identifies best-of-breed managers through a rigorous manager selection process

CREATE PORTFOLIO OF MANAGERS

Create a portfolio of managers that have uncorrelated sources of alpha

- Quantify portfolio exposures by factors, positions, correlated risks etc.
- Identify portfolio that benefits from strategy diversification but that is not overdiversified

Determine optimal exposure implementation

SIZE POSITIONS

Size managers appropriately considering:

- Conviction in strategy
- Market cycle and state
- Probability and magnitude of excess return generation
- Risk: including risk contribution and shared risk factors
- Optimize portfolio considering IR, TE, excess returns

MANAGE RISKS

Quantify risks and adjust portfolio accordingly:

- Liquidity
- Concentration
- Tail risks
- Systematic
- Inflation
- Factor
- Event
- Currency
- Others

DYNAMIC ALLOCATION

Incrementally shift portfolio to opportunistically capitalize on market opportunities

- Requires research backed theses
- Size allocation by probability of outcomes
- Evaluate risks

INVESTMENTS: ALPHA AND FUNDS MANAGEMENT
Dynamic Allocation Process

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TACTICALLY SHIFTING PORTFOLIO EXPOSURES CAN LEAD TO EXCESS RETURNS

Research → Identify Opportunity → Develop Plan → Implement Trade → Post Trade Review

DYNAMIC ALLOCATIONS ARE DRIVEN BY SOUND RESEARCH AND AN ESTABLISHED PROCESS

- Develop models, heuristics and frameworks to analyze markets
- Examples include: SPX valuation, growth/value cycle, high yield spread analysis

- Identify market inefficiencies through ongoing monitoring of markets
- Quantify upside/downside, probabilities and expected value

- Develop plan to capture inefficiency
- Evaluate opportunity in context of overall portfolio (e.g. risk)
- Size position appropriately
- Identify entry and exits and contingencies

- Implement trade
- Continual monitoring of trade/markets
- Follow plan, revaluate as new data comes in

- Post trade review
- Develop new heuristics frameworks and models from the trade

INVESTMENTS: ALPHA AND FUNDS MANAGEMENT
Implementation & Operational Alpha

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CONTINUAL IMPROVEMENTS IN IMPLEMENTATION AND OPERATIONAL PROCESSES CAN LEAD TO COST REDUCTIONS AND ALPHA

SOURCES OF IMPLEMENTATION ALPHA	OUTCOMES
Continual evaluation of fees and ongoing negotiation with managers	Fee negotiations can lead to fee reductions
Implement efficient transitions	Choosing to transition internally or via a transition manager can lead to lower transaction costs
Enhanced rebalancing	Sophisticated rebalancing models can take advantage of pockets of liquidity and reduce transaction costs
Appropriate implementation of exposures	Selecting the proper instrument (i.e. physical, ETF, or derivative) can lead to reduced costs and/or enhanced liquidity
Internal vs. external implementation	Replicating strategies internally can reduce third party manager fees

PRIVATE MARKETS FUNDS MANAGEMENT

DESIGN A STRUCTURE FOR SUCCESS

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PHASE	ACTIVITIES
1.0	**DATA GATHERING & ANALYSIS** • STAFFING: GEORGE MOSS (NOV '22), LANCE ZIETTLOW (MAR '23) ✓ • TECHNOLOGY PLATFORM FOR AGGREGATING AND ANALYZING THE ASSETS ✓ • BENCHMARKING • PACING MODELS FOR EACH STRATEGY AND EACH POOL
2.0	**OPTIMIZATION** • MOVE AWAY FROM EXTERNAL FUND-OF-FUNDS, AND TO THE EXTENT POSSIBLE BE CONSISTENT ACROSS POOLS • ADDRESS CONCERNS IN SUB-ASSET CLASSES • CONSIDER DEDICATED PRIVATE MARKET CONSULTANT
3.0	**ADVANCED FUNDS MANAGEMENT** • FULLY OPERATIONAL INTERNAL FUND-OF-FUNDS STRUCTURE • MANAGE LIQUIDITY AND EXPOSURES WITH PUBLIC MARKET PROXIES • BUILD OUT A COINVESTMENT PLATFORM

WE BELIEVE

- Private markets are a strategy, not an asset class.
- Illiquidity risk must be compensated for, and such an illiquidity premium is achievable.
- Private markets are less efficient than public markets leading to a wider dispersion of excess returns.
- Manager selection has a bigger impact vs. public markets as return dispersion and persistence are higher.
- The best managers follow a consistent process of fact based, reasoned judgements of compensated risks and return expectations.
- Certain private markets have long cycles of under/outperformance, which can be managed around, but in a more measured way vs. public markets.
- Accessing top-performing managers is crucial yet challenging and time consuming.

VALUE PROPOSITION

Buyout Illustration

	9.8%[1] INDEX RETURN	Illiquidity Premium	12.2%[2] ILLIQUID RETURN	Active Return	14.5%[3] POOLED RETURN	Superior Return	20.9%[4] TOP Q-TILE RETURN	
Gross Return	9.8%	2.4%	12.2%	2.3%	14.5%	6.3%	20.9%	
Cost	0.1%[5]		2.5%[6]		2.9%[6]		4.2%[6]	
Net Return	9.7%	0.0%	9.7%	1.9%	11.6%	5.1%	16.7%	
Risk	16.6%		16.6%		10.8%		10.8%[7]	16.6%[8]
Efficiency[9]	0.51		0.51	→	0.96	→	1.43	0.93

1. Russell 1000 Total Return Index (quarterly 2004-2022).
2. Hypothetical result that maintains the same efficiency at the same risk level.
3. Pooled return and risk information calculated from Burgiss Private i (quarterly 2004-2022). Pooled return is the time weighted return from the aggregate cashflow data for the funds tracked by Burgiss over that time period.
4. Median of top quartile outperformance vs. the pooled return from Burgiss Private i (2004-2022 vintages)
5. Cost based on the Vanguard Russell 1000 ETF.
6. Cost assumption based on 2% management fee and 20% carry with an 8% preferred return.
7. Assumes same risk as pooled return
8. Assumes same risk as the referenced index.
9. Efficiency: Sharpe Ratio which assumes a 1.24% risk-free return (3M T-bill 2004-2022).

STRATEGY

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- Through bottoms up analysis, seek to partner with the best managers globally that we can access.
- Seek consistency while also being cognizant of prevailing conditions.
- Develop valuable investment trade-offs of return, risk and liquidity with make-versus-buy decisions as drivers.
- Geographic exposures would roughly equate to the opportunity set.

Illustrative PM Allocation:

	Legacy*		Pension		Insurance	
	Current	New	Current	New	Current	New
Private Equity	1.7%	50 - 70%	27.3%	30 - 50%	0.0%	10 - 30%
Private Debt	23.8%	10 - 30%	17.7%	20 - 40%	0.0%	30 - 50%
Real Assets	67.2%	10 - 30%	52.9%	20 - 40%	80.5%	30 - 50%
Other/Opportunistic	7.4%	0 - 10%	2.1%	0 - 10%	19.5%	0 - 10%

High — Risk Tolerance — Low

* Assumes the 15% call on assets is reduced to 5% in 2024, and includes in-state investment program.

Investment Staff, August 25, 2023

Private Equity
- Primarily middle-market buyout
- <= 25% venture capital

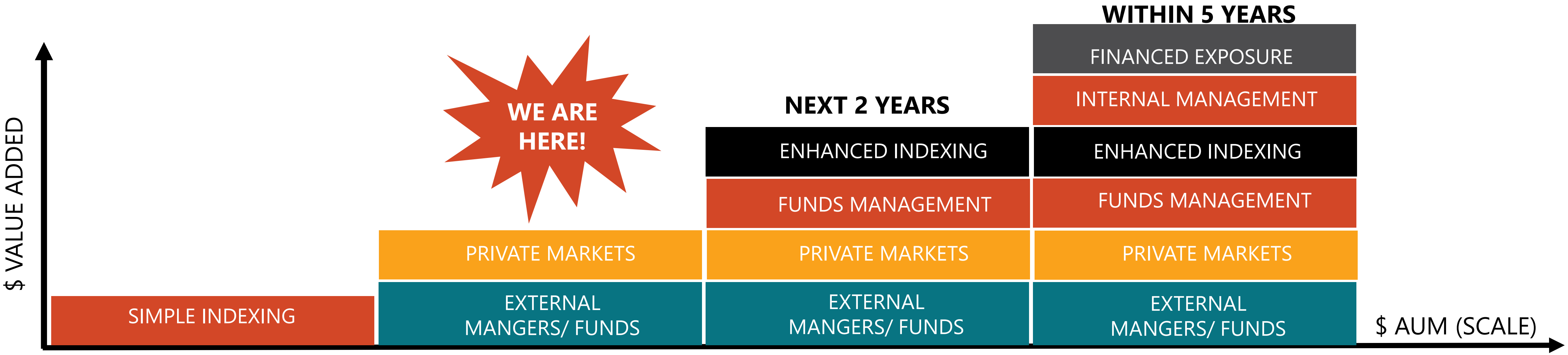
Private Credit
- Primarily senior/direct lending
- <= 25% distressed

Real Assets
- Focus on core/core-plus real estate, consider more value-add/opportunistic
- De-emphasize infrastructure and other real assets

Other/Opportunistic
- Compelling strategies in less developed markets (e.g., Healthcare Royalties)
- Investments with a relatively short window of opportunity that would not be a consistent allocation within the other strategies.

ROADMAP FOR SUCCESS

ROADMAP FOR SUCCESS



CAPABILITIES FOR SUCCESS

- DELEGATED AUTHORITY
- INCENTIVE COMP SYSTEM
- DIRECT INVESTMENT TEAM
- INDEPENDENT BENCHMARK CONSULTANT
- PRIVATE MARKETS BENCHMARK CORRIDOR
- FUND POOLING

- DAILY FUND VALUES AND RETURNS
- ADVANCED OPERATIONS
- AUDIT PROCESSES AND COMPLIANCE
- NEW INVESTMENT PROCESSES
- FUND AND LIQUIDITY MANAGEMENT
- DERIVATIVES OVERLAYS

- VALUATION AND EXPOSURE MANAGEMENT
- INVESTMENT DATA WAREHOUSE
- ORDER MANAGEMENT SYSTEM
- PORTFOLIO MANAGEMENT ANALYTICS
- INTEGRATED DATA AND MESSAGES
- KNOWLEDGE MANAGEMENT SYSTEM

Confidential materials will be sent to Board members via secure link.

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MEMORANDUM

TO: **SIB**
FROM: **Jan Murtha, Executive Director**
DATE: **August 24, 2023**
RE: **Governance & Policy Review Committee**

I. Summary of Actions

The SIB Governance & Policy Review Committee (GPR Committee) met on August 24, 2023 to discuss the following:

- SIB Governance Manual Review Project
- Future GPR committee topics

The Committee took the following actions:

- The committee approved a work plan to conduct a comprehensive review of the SIB Governance Manual for the upcoming fiscal year. It is anticipated that the committee will present all proposed amendments for first reading at the April 2024 SIB meeting, followed by Second Reading and Final Adoption at the May 2024 SIB meeting. This review is necessary given the creation of an internal investment management program and other governance updates.
- Additional information may be found at: State Investment Board Governance & Policy Review Committee | Retirement Investment Office (nd.gov)

BOARD ACTION REQUESTED: Board Acceptance.

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MEMORANDUM

TO: SIB
FROM: Scott Anderson, Chief Investment Officer
DATE: August 25, 2023
RE: Investment Committee Update

August 11, 2023, Investment Committee Meeting

The Investment Committee met Friday August 11, 2023. The meeting was called to order and there was an acceptance of the agenda followed by an acceptance of the minutes from the July 14, 2023, meeting.

The Investment Committee then proceeded into closed sessions for presentations of finalists for the Benchmark/Hurdle rate consultant RFP search, followed by Committee discussion. The recommendation will be brought to the full board for approval as required by the investment policy.

Mr. Vaidya and Mr. Anderson discussed the investment technology strategy in open session. The meeting then went into closed session to discuss the potential cost for the technology strategy as well as current vendor discussions.

Mr. Ziettlow and Mr. Moss discussed the status of the Timber portfolio buying interest in closed session. Lastly, the Private Equity portfolio was discussed in closed session followed by an open session motion and approval to increase the commitment of capital to the Altor investment which is scheduled to close at the end of the year.

https://www.rio.nd.gov/sites/www/files/documents/PDFs/SIB%20Investment/Board/Materials/sibinvestmat20230811.pdf

BOARD ACTION REQUESTED: Information Only.

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MEMORANDUM

TO: State Investment Board
FROM: Dr. Rob Lech, Chair and Ryan Skor, CFO/COO
DATE: August 25, 2023
RE: Executive Review and Compensation Committee Update

The Executive Review and Compensation Committee (ERCC) met Thursday, August 3rd, 2023. During the meeting, the committee elected Dr. Rob Lech as Chair and Treasurer Thomas Beadle as Vice-Chair. With the new Chair and Vice-Chair in place, the committee then reviewed its charter by going through its purpose and key responsibilities.

The committee then heard presentations from the finalist entities who offered proposals for RIO's Comprehensive Compensation Study RFP. Upon receiving the presentations and reviewing the proposals, the committee determined that requesting a BAFO (best and final offer) from each of the entities was the best course of action. As such, a BAFO was requested with a closing date of August 10th, 2023.

The committee met again on August 24th, 2023, to review the updated scores. After consultation with staff, the committee directed staff to begin contract negotiations with the entity most susceptible to award for the compensation study. The initial kickoff of the project will be scheduled once the contract is finalized, and final study results will be communicated to the full State Investment Board during a future board meeting.

Additional information can be found at: https://www.rio.nd.gov/state-investment-board-sib/state-investment-board-executive-review-compensation-committee

BOARD ACTION REQUESTED: Information only.

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MEMORANDUM

To: **State Investment Board (SIB)**

From: **SIB Audit Committee**

Date: **August 2, 2023**

RE: **Fiscal Year End Audit Committee Activities**
July 1, 2022 to June 30, 2023

The Audit Committee is a standing committee of the State Investment Board (SIB) authorized under the SIB Governance Policy B-6, Standing Committees. Its primary function is to assist the SIB in fulfilling its oversight responsibilities of the Retirement and Investment Office (RIO) internal and external audit programs, including the financial reporting process, internal controls, and compliance with laws, regulations, policies, and procedures.

The Audit Committee consists of five members selected by the SIB. Three members of the Audit Committee represent the three groups on the SIB (Teachers' Fund for Retirement (TFFR) Board, Public Employees Retirement System (PERS) Board, and elected and appointed officials). The other two members are selected from outside the SIB, that are both independent and financially literate. Members of the Audit Committee for the 2022 - 2023 fiscal year were:

Treasurer Thomas Beadle, Elected and Appointed Officials, Chair
Yvonne Smith, PERS Board, Vice Chair
Cody Mickelson, TFFR Board
Julie Dahle, External Member
Jon Griffin, External Member

The Audit Committee held four regular meetings for the fiscal year ended June 30, 2023. The meetings occurred: August 9, 2022, November 15, 2022, February 15, 2023, and May 11, 2023.

Activities of the Audit Committee during the past year included:

- The Committee approved a July 1, 2022 through June 30, 2023 Internal Audit work plan. Progress was monitored on a quarterly basis. Audit activities included:
  - <u>Executive Limitations Audit</u> was completed. The audit determined the Executive Director's level of compliance with SIB Governance Manual Executive Limitation policies (A-1 through A-11) for the calendar year ending December 31, 2022.
  - <u>State Investment Board Self-Evaluation</u> was administered by Internal Audit. The SIB requested Internal Audit's assistance in administering the self-evaluation and presenting the results. The SIB self-evaluation was presented on February 17, 2023 SIB meeting.
  - <u>Internal Audit Business Review</u> - The Supervisor of Internal Audit and the Executive Team developed an RFP to review and evaluate the needs of the Internal Audit division. The RFP was issued in September 2022, with Weaver & Tidwell, LLP being selected. The project kicked off in November 2022 with Internal Audit staff providing information and having weekly meetings. The final report was issued and presented to the Audit Committee by Weaver & Tidwell, LLP in May 2023.

- Payroll Audit –RIO management requested Internal Audit to perform a payroll audit for the period of January through August 2022. The payroll audit compared the payroll records, documentation, and the ND transparency website. The payroll audit encompassed new hires, temporary increases, promotions, legislative increases, any bonuses, and any other pay changes. The audit was issued on November 14, 2022.
- Employee Exit Review – The Internal Audit Division will do a post review of an employee's accounts if there is an abrupt resignation of an employee or if there is a separation of employment. A RIO staff member had separation of employment in January 2023. Internal Audit did a review of emails and various accounts. Internal Audit reviewed for open record requests, media inquiries, and any other open tasks that would need to be completed. The report was issued on February 7, 2023.
- RIO Onboarding and Offboarding Procedures – The Supervisor of IA is a committee member of the Onboarding and Offboarding Group. The group has been reviewing and enhancing RIO's current onboarding and offboarding procedures. Members of the working group are the Deputy Executive Director/Chief Retirement Officer, Chief Financial Officer/Chief Operating Officer, Executive Assistant, and Contracts/Records Administrative Assistant.
- TFFR File Maintenance Audit – Internal Audit reviewed system generated (CPAS) audit tables to ensure transactions initiated by staff are expected and appropriate given an individual's role with the organization. Member account information from Member Action Forms, Address Change Forms, Direct Deposit Authorization Forms, and Point of Contact Forms are reviewed to verify that contact and demographic information has been updated correctly. A sample of purchases, refunds, and deaths were reviewed as part of the of audit. The audit was issued on October 27, 2022.
- TFFR Model 2 Partial Review - This salary review only includes Model 2 Partial employers. IA selected one participant from forty-one employers to ensure model compliance. The review will also determine if the retirement salaries and contributions reported to TFFR by the participating employers are following the definition of salary as it appears in the North Dakota Century Code (N.D.C.C. § 15-39.1-04 (10)). Reported service hours and eligibility for TFFR membership are also verified. This review is currently in process.
- TFFR Pioneer Project – Stage 3 of the Pioneer project started in the previous fiscal year. Pilots 1 & 2 were completed during the fiscal year. Pilot 3 was completed in July 2023. Internal Audit staff participated in elaboration meetings.
- TFFR Actuarial Audit – TFFR Governance Manual requires the TFFR Board to hire an independent actuary to perform an actuarial audit. The Executive Director, Deputy Executive Director/Chief Retirement Officer and Supervisor of Internal Audit reviewed and scored the RFPs in August 2022. The TFFR Board selected from the finalists at their September 2022 meeting. The actuarial audit was completed and presented to the TFFR Board at their January 2023 meeting.
- TFFR Actuarial Services RFP – Staff has prepared a request for proposal (RFP) for actuarial and consulting services for the period starting July 1, 2023, ending June 30, 2025. The RFP includes in the scope of work an experience study expected to be performed in FY2024 as well as actuarial valuation, GASB 67 and 68 reporting, proposed legislation analysis and consulting services. The Executive Director, Deputy Executive Director/Chief Retirement Officer and Supervisor of Internal Audit reviewed and scored the RFPs in March 2023. The TFFR Board made a selection from the finalists at their April 2023 meeting.
- Internal Audit worked with staff on updating the Administrative Policy Manual. Policies were written and updated to ensure compliance with state and federal policies. RIO also adopted other federal and state policies as found on the ND State OMB website. This is a continual project.
- RIO's Internal Audit division provided assistance to our external audit partners, CliftonLarsonAllen, LLP (CLA), during the 2022-2023 and the 2023-2024 financial audits of the RIO as well as the GASB 68 Census Data Audits.
- Internal Audit staff continued to pursue networking and professional development opportunities via the IIA's local chapter and the APPFA (Association of Public Pension

Fund for Auditors). Staff attended a conference which covered a variety of topics (System Implementations, IIA Standards, External Managers, Data Analytics, Asset Allocations, and Information Security). Internal Audit staff also attended free webinars throughout the year as available.

- The Committee received the results of the RIO financial audit for the fiscal year ended June 30, 2022 from independent auditors, CliftonLarsonAllen, LLP. They issued an unmodified "clean" opinion.

- The Committee reviewed the RIO financial audit plan for fiscal year ended June 30, 2023 with independent auditors, CliftonLarsonAllen, LLP. Discussion included scope and approach for the audit to ensure complete coverage of financial information and GASB 68 Audit.

- The Committee adopted a detailed audit work plan and budgeted hours for fiscal year July 1, 2023 to June 30, 2024.

The above activities support the Committee's fulfillment of its oversight responsibilities. Please inform the Committee if there are special audits or activities the Board would like to have reviewed.

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MEMORANDUM

To: **State Investment Board**

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

Date: **August 16, 2023**

RE: **Audit Activities Quarterly Update**

The SIB Audit Committee met on August 2, 2023. The SIB Audit Committee reviewed and approved the 2022 – 2023 annual audit activities and an update on current audit activities.

The following were presented and approved:

1. 2022 – 2023 Audit Committee Report to the SIB
    a. Review and report of completed audits and audit activities in previous fiscal year
2. 2022 – 2023 Review of Audit Charter
    a. Required by charter
    b. Ensure Committee is meeting their responsibilities.
3. Internal Audit Business Process Review
    a. Next steps for Internal Audit maturity

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/sibauditmat20230802.pdf

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MEMORANDUM

TO: **State Investment Board**
FROM: **Ryan K. Skor, CFO/COO**
DATE: **August 16th, 2023**
RE: **Quarterly Budget/Financial Report**

Enclosed are the following budget and expense reports for the quarter ended June 30, 2023:

- Budget Appropriation Status
- Budget Appropriation Status (excluding PAS project)
- Expenditure Summary
- PAS Modernization Project Status
- Investment Expenditure Detail (as of 3/31/23)

With June 30, 2023, constituting the end of the 2021-2023 biennium, these budget and expenditure numbers are RIO's ending amounts. Beginning July 1, 2023, RIO began operating under its 2023-2025 biennium appropriation authority.

Section 6 of Senate Bill 2022 granted RIO authority to carryover the remaining unexpended costs related to its ongoing pension administration system project. As shown in the PAS Modernization Project Status report, RIO carried over $5,607,837 into the 2023-2025 biennium with the anticipation that the project will be completed during the biennium.

BOARD ACTION REQUESTED: Board Acceptance.

BUDGET APPROPRIATION STATUS

AS OF JUNE 30, 2023

	2021-2023 BUDGET	ADJUSTED APPROPRIATION	EXPENDITURES BIENNIUM TO DATE ACTUAL	BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	$ 5,103,977.00 *	$ 6,848,720.40	$ 5,801,640.04	$ 1,047,080.36	15.29%	0.00%
OPERATING EXPENDITURES	3,567,403.00 *	3,642,403.00	2,171,932.93	1,470,470.07	40.37%	0.00%
CAPITAL ASSETS	6,300,000.00	6,300,000.00	2,149,786.50	4,150,213.50	65.88%	0.00%
CONTINGENCY	100,000.00	100,000.00	85,831.81	14,168.19	14.17%	0.00%
TOTAL	$ 15,071,380.00	$ 16,891,123.40	$ 10,209,191.28	6,681,932.12	39.56%	0.00%

* 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 along with salary adjustments for additional internship program funding and target market equity adjustments.

BUDGET APPROPRIATION STATUS LESS PAS BUDGET AND EXPENSES

AS OF JUNE 30, 2023

	2021-2023 BUDGET	ADJUSTED APPROPRIATION	EXPENDITURES BIENNIUM TO DATE ACTUAL	BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	$ 5,053,977.00	$ 6,798,720.40	$ 5,801,640.04	$ 997,080.36	14.67%	0.00%
OPERATING EXPENDITURES	1,248,528.00	1,323,528.00	1,260,679.45	62,848.55	4.75%	0.00%
CAPITAL ASSETS	0.00	0.00	0.00	0.00	N/A	0.00%
CONTINGENCY	100,000.00	100,000.00	85,831.81	14,168.19	14.17%	0.00%
TOTAL	$ 6,402,505.00	$ 8,222,248.40	$ 7,148,151.30	1,074,097.10	13.06%	0.00%

EXPENDITURE SUMMARY

AS OF AND FOR THE QUARTER ENDED JUNE 30, 2023

CONTINUING APPROPRIATIONS	INVESTMENT	RETIREMENT	QUARTERLY TOTALS	FISCAL YEAR TO - DATE	BIENNIUM TO - DATE
INVESTMENT EXPENDITURES	$ 0	$ 0	$ 0	$ 57,663,705	$ 139,806,328
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0	63,570,820	63,570,820	254,169,145	498,874,240
2. REFUND PAYMENTS	0	1,875,037	1,875,037	7,920,124	15,062,485
TOTAL MEMBER CLAIMS	0	65,445,857	65,445,857	262,089,269	513,936,725
OTHER CONTINUING APPROPRIATIONS	32,053	405,949	438,002	967,305	1,814,654
TOTAL CONTINUING APPROPRIATIONS	32,053	65,851,806	65,883,859	320,720,279	626,916,374
BUDGETED EXPENDITURES					
1. SALARIES & BENEFITS					
SALARIES	512,679	245,719	758,397	2,513,591	4,221,726
OVERTIME/TEMPORARY	3,037	19,150	22,187	130,266	166,654
TERMINATION SALARY & BENEFITS	0	0	0	0	0
FRINGE BENEFITS	161,459	92,412	253,871	841,475	1,413,260
TOTAL SALARY & BENEFITS	677,175	357,281	1,034,455	3,485,332	5,801,640
2. OPERATING EXPENDITURES					
DATA PROCESSING	14,579	128,406	142,985	391,881	728,911
TELECOMMUNICATIONS - ISD	2,611	1,999	4,610	12,533	22,232
TRAVEL	4,427	14,055	18,482	33,355	71,888
IT - SOFTWARE/SUPPLIES	20	0	20	163	205
POSTAGE SERVICES	804	2,455	3,258	22,269	48,055
IT - CONTRACTUAL SERVICES	1,138	63,185	64,324	271,417	347,978
EQUIPMENT RENTS AND LEASES	0	0	0	5,183	5,183
BUILDING/LAND RENT & LEASES	11,977	12,654	24,631	89,882	199,152
DUES & PROF. DEVELOPMENT	8,935	16,224	25,160	40,938	61,645
OPERATING FEES & SERVICES	16,134	18,144	34,278	37,197	78,019
REPAIR SERVICE	0	0	0	230	884
PROFESSIONAL SERVICES	1,496	161,055	162,551	325,127	548,802
INSURANCE	0	0	0	1,240	2,432
OFFICE SUPPLIES	403	452	856	1,198	3,213
PRINTING	746	2,608	3,354	10,239	17,894
PROFESSIONAL SUPPLIES & MATERIALS	63	61	123	1,646	3,272
MISCELLANEOUS SUPPLIES	818	1,808	2,626	3,352	4,742
IT EQUIPMENT UNDER $5000	5,271	4,244	9,515	10,080	10,320
OFFICE EQUIP. & FURNITURE UNDER $5000	7,096	5,279	12,375	16,705	17,105
TOTAL OPERATING EXPENDITURES	76,519	432,626	509,146	1,274,635	2,171,933
3. CAPITAL ASSETS	0	360,945	360,945	1,214,874	2,149,787
4. CONTINGENCY	0	0	0	5,187	85,832
TOTAL BUDGETED EXPENDITURES	753,694	1,150,852	1,904,546	5,980,028	10,209,191
TOTAL EXPENDITURES	$ 753,694	$ 66,596,709	$ 67,788,405	$ 326,700,307	$ 637,125,565

PAS MODERNIZATION PROJECT STATUS

AS OF AND FOR THE QUARTER ENDED JUNE 30, 2023

PAS PROJECT - UNEXPENDED PORTION CARRIED FORWARD TO 2023-25 BIENNIUM

	2019-2021 Biennium Approved Budget	Carryover to 2021-2023 Biennium	2021-2023 Biennium Actual	Total PAS Project to Date	Carryover to 2023-2025 Biennium
TEMPORARY SALARIES	50,000	50,000	0	0	50,000
IT - DATA PROCESSING (NDIT PROJECT MGMT)	775,000	740,976	144,042	178,067	596,933
PROFESSIONAL SERVICES	1,875,000	1,577,901	767,211	1,064,310	810,690
CAPITAL ASSETS	6,300,000	6,300,000	2,149,787	2,149,787	4,150,214
TOTAL PAS PROJECT BUDGET	**9,000,000**	**8,668,876**	**3,061,040** *	**3,392,164**	**5,607,837**

* 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, 2023

	9/30/2022 Quarter	12/31/2022 Quarter	3/31/2023 Quarter	Fiscal Year to Date Totals	Prior Fiscal Year FY2022
Investment Manager Fees					
Pension Investment Pool	$ 8,306,566	$ 7,076,974	$ 8,444,054	$ 23,827,593	51,208,583
Insurance Investment Pool	1,441,906	1,547,404	1,479,310	4,468,620	7,177,871
Legacy Fund	9,014,965	9,139,143	8,863,021	27,017,129	42,407,348
PERS Retiree Health Credit Fund / Job Service ND Pension Fund	258,206	253,606	263,516	775,328	1,173,542
Total Investment Manager Fees	**$ 19,021,643**	**$ 18,017,126**	**$ 19,049,901**	**$ 56,088,670**	**101,967,343**
Investment Custodian Fees					
Pension Investment Pool	$ 153,688	$ 151,513	$ 149,135	$ 454,336	622,476
Insurance Investment Pool	64,496	64,376	62,107	190,979	285,792
Legacy Fund	151,518	153,982	158,646	464,145	669,033
PERS Retiree Health Credit Fund / Job Service ND Pension Fund	5,298	5,129	5,112	15,540	20,483
Total Investment Custodian Fees	**$ 375,000**	**$ 375,000**	**$ 375,000**	**$ 1,125,000**	**1,597,784**
Investment Consultant Fees					
Pension Investment Pool	$ 82,148	$ 53,617	$ 52,663	$ 188,427	250,823
Insurance Investment Pool	29,641	18,475	18,158	66,273	85,191
Legacy Fund	85,057	54,630	55,648	195,334	233,894
Total Investment Consultant Fees	**$ 196,845**	**$ 126,721**	**$ 126,468**	**$ 450,034**	**569,908**
Total Investment Expenses	**$ 19,593,489**	**$ 18,518,847**	**$ 19,551,369**	**$ 57,663,705**	**104,135,036**

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MEMORANDUM

TO: SIB
FROM: Jan Murtha, Executive Director
DATE: August 18, 2023
RE: Executive Limitations/Staff Relations

Ms. Murtha will provide a verbal update at the meeting on staff relations and strategic planning. Including updates on the following topics:

I. New Board & Committee Member Update

New members appointed by Governor Burgum to serve on the SIB:

- Peter Jahner
- Prodosh Simlai

In addition, an initial new board member education session was held in August with additional trainings to be scheduled.

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

Position Title*	Status
Sr. Investment Accountant	Position filled by internal candidate.
Investment Accountant (see above for vacancy)	Posting closed 8/7/23. Interviews pending.
Fiscal/Investment Administrative Assistant	Offer accepted. Anticipated start date Sept. '23
Retirement Accountant	Posting closes 8/28/23.
Intern positions	Postings pending filling of regular FTE's

*New FTEs granted by the 2023 Legislative Assembly. Remaining new FTEs related to the Internal Investment program are expected to be posted in 2nd Quarter 2024.

III. Current Project Activities/Initiatives:

- **TFFR Pioneer Project** – The TFFR Pioneer Project continues with implementation consistent with the project plan. The project is currently in an elaboration phase involving review of system components. The amount of time spent on the project by various staff members continues to vary 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 continues to coordinate with Northern Trust for additional functionality/capabilities.
- **Annual Audit Activities** – Staff has been coordinating activities with CLA to

complete external audit activities for this past fiscal year.

- **Audit Consultant Report:** Staff has created an Executive Steering committee comprised of the ED, CFO/COO, and IA Supervisor to oversee a project to implement recommendations from Weaver Consulting. Co-sourcing activities will be identified to pursue through an RFP process. A special meeting of the Audit committee will be convened to approve any related RFP and subsequent vendor selection.
- **Compensation Study RFP:** An RFP for a Compensation Study was issued for consultant services necessary to prepare and present an incentive compensation plan for approval to the Board and develop compensation goals for agency positions. The ERCC met on 8/3/23 and is scheduled to meet again on 8/24/23 to discuss the procurement.
- **Benchmark Consultant RFP:** An RFP was issued for an independent third-party consultant to provide benchmarking services. These services are necessary for the creation of an internal investment program. No responses were received by the initial or extended RFP deadline. Staff proceeded under an agency procurement exception allowed in century code to reach out to potential vendors to procure these services. The Investment Committee interviewed potential vendors in August. A recommendation will be presented to the full SIB at the August meeting.

IV. Board & Committee Presentations July 24, 2023, through August 25, 2023

Staff attended/provided or is scheduled to attend/provide the following presentations to Boards and Committees during the above referenced time period:

- **TFFR Retirement Education Workshop – 7/25/23**
- **Legislative Audit & Fiscal Review Committee – 7/26/23**
- **BND Interim Study Discussion – 7/27/23**
- **New Board & Committee Member Education – 8/2/23**
- **SIB Audit Committee – 8/2/23**
- **SIB ERCC – 8/3/23**
- **NASRA Conference – 8/5/23 -8/9/23**
- **TFFR GPR Committee – 8/10/23**
- **SIB Investment Committee – 8/11/23**
- **Legislative Retirement Committee – 8/22/23**
- **SIB ERCC – 8/24/23**
- **SIB GPR Committee – 8/24/23**
- **SIB meeting – 8/25/23**

V. Executive Director Education/Travel Activities

In the month of August, I attended one conference for the National Association of State Retirement Administrators (NASRA). RIO is a new member of this organization. This organization collects and provides information and education on public pension plan administration and public sector institutional investor topics, as well as the opportunity to learn from other states.

BOARD ACTION REQUESTED: Board Acceptance.

Board Leadership

July–August 2023 • No. 188

Innovative Approaches to Governance

EDITOR: NICHOLAS KING

Insurance in the Time of ESG

By Daniel J. Struck

Daniel J. Struck is a partner in the Chicago office of Culhane Meadows PLLC and the chair of the firm's Insurance Practice. In this article, he discusses how D&O insurers are responding to emerging ESG claims, and the practical steps that boards can take to minimize the risk to their directors and officers while mitigating expensive missteps.

In a previous article (*What We Talk About When We Talk About ESG*) we discussed some of the ambiguities surrounding discussions about ESG. Those ambiguities were centered around questions about the definition and scope of ESG; what makes a corporation successful from an ESG perspective; how material progress toward the achievement of ESG principles is measured; and whether there is any correlation between successful engagement in ESG initiatives and profitability or reduced corporate risk. We also reviewed some of the emerging regulatory and litigation risks associated with ESG. Given the ambiguities and uncertainties that are inherent in any discussion of ESG, even with the best of intentions it may well be impossible to satisfy every regulatory body or interested set of stakeholders. Nonetheless, doing nothing is not a viable option for business leaders and directors: ignoring stakeholders, investors, and regulators who urge that corporations engage in ESG initiatives is itself a way of taking a position concerning ESG programs and opens a corporation to a particular category of potential regulatory scrutiny and stakeholder claims.

Inside This Issue

3 What Comes Around, Goes Around: Boards Need to Get Succession Planning Right to Avoid Boomerang CEOs

8 What makes a valued independent board member

Where there is uncertainty and the possibility of regulatory investigations or stakeholder dissatisfaction, litigation frequently follows. Litigation risk is ameliorated through the tools of mitigation and risk transfer. In the previous article we discussed how adhering to good governance and decision-making practices can be used to mitigate ESG-related litigation risk. But given the ambiguity and controversy associated with ESG, even best practices likely will not eliminate the risk of ESG-related litigation. One of the essential tools in the risk-transfer toolbox is insurance. How are the available types of commercial insurance likely to respond to the still-developing risks associated with ESG initiatives?

As a general matter, insurance underwriters have tended to reward "good" ESG practices, viewing enterprises with robust ESG practices that are compliant with ESG goals as being good management liability risks. Similarly, at least in some segments of the investing and management world, it is taken as an accepted truth that ESG practices are an appropriate benchmark for investment and rating decisions. But as we discussed, the reality is a good deal more nuanced. ESG practices that are embraced by some investors likely will be viewed as counterproductive by others. Moreover, it is far easier to set high-sounding ESG goals than it may be to meet those goals. We are starting to see some of the emerging tendencies in ESG-related regulatory and litigation risk both in support of ESG principles and in backlash to ESG initiatives. It is far too early to predict whether ESG-related litigation and regulatory scrutiny is going to be a ripple, a tidal wave, or something in between. But it is possible to make predictions about how commercial insurance is likely

continued on page 2

ESG

continued from page 1

to respond to some of the categories of emerging ESG-related liability. As with any coverage discussion, the particular facts and circumstances matter, as does the type of coverage at issue. In addition, where a particular enterprise in in its ESG journey will have a substantial determinative effect on our discussion.

In the Labyrinth of Insurance

Litigation and regulatory investigations arising from or concerning ESG-related issues have the potential to involve multiple categories of commercial insurance coverage. The type of injury alleged, whether the allegations against an insured are brought in a litigation or a formal regulatory proceeding, the nature of the conduct that is alleged to have caused an injury, the nature of the relief sought, and the identity of the alleged perpetrator of an alleged injury are all relevant to identifying the potentially applicable insurance coverage. Potentially relevant categories of coverage include the following:

Directors and Officers Insurance: In the most general of terms, D&O insurance provides coverage for claims against insured persons and the insured business alleging that some wrongful act (an error or omission that constitutes a breach of duty) resulting in an injury was committed in the course of managing the business. These policies typically provide coverage for claims brought against individual insured persons in their insured capacity if they are not indemnified by the insured business, claims brought against insured persons in their insured capacity if they are indemnified by the insured business, and claims brought against the insured business. For public companies, the business itself is covered only for claims involving company securities—such as shareholder derivative actions, securities litigation, and securities-related investigations. D&O coverage for private companies is not restricted to securities claims. As is relevant to this discussion, D&O policies typically include exclusions or limitations to coverage for: criminal or fraudulent conduct; claims by insureds against other insureds; claims that are related to prior claims; claims involving circumstances that were known at the time the policy was purchased; claims involving circumstances that were known but not disclosed on the policy application; claims arising out of the provision of professional services or other specialized services; and claims arising out of actions taken outside of an insured person's insured capacity. The circumstances under which these exclusions and limitations are applicable may vary depending on the terms of the relevant insurance policies, and

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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small variations in wording can have substantial consequences.

Errors & Omissions/Professional Liability Insurance: To oversimplify, this broad category of insurance policies provides coverage for claims against insured persons and an insured business alleging that some wrongful act (an error or omission that constitutes a breach of some particular duty or standard of care) committed while acting in an insured capacity that resulted in an injury. This category of insurance coverage includes more than policies directed to specific professions such as lawyers, medical practitioners, engineers, and architects. E&O coverage is also written for business activities that require a particular standard of care such as banking, fund management, investment advice, and technology services. E&O policies contain exclusions and limitations on coverage similar to the corresponding exclusions and limitations in D&O insurance policies: crime and fraud, conduct outside an insured's capacity as an insured, prior claims, and prior knowledge.

Fiduciary Liability: This is a specialized category of E&O insurance applying to claims for alleged breaches of duty against insureds acting in a fiduciary capacity. Although certainly not limited to such, fiduciary liability insurance is typically thought of as covering the managers of pension and benefit plans in ERISA claim. The exclusions and limitations pertinent to fiduciary liability insurance policies are consistent with the general contours of the exclusions and limitations discussed above.

Employment Practices Liability: This category of commercial insurance coverage applies to claims for alleged wrongful acts in connection with employment practices. This type of coverage applies to claims for discrimination based on membership in a protected class or other improper employment-related policies. This type of policy typically covers claims brought by current and former employees as well as claims brought by employment applicants. This category of insurance policies may not provide coverage or may only provide limited coverage for wage and hour claims or claims involving errors in calculating pay or benefits.

General Liability: Commercial general liability (CGL) insurance covers an insured for claims brought by third parties for bodily injury, personal injury, and property damage. These policies are largely written on an "occurrence" basis, which means that coverage can reach back to policies that were in effect when the event that allegedly resulted in the relevant bodily injury or property damage to place. In the case of claims involving property damage or bodily injury alleged caused by emissions or toxic materials, it is possible that responsive coverage may reach back decades. However, CGL policies have contained "absolute" exclusions for bodily injury or property damage resulting from the exposure to pollutants/toxic chemicals since the mid-1980s and contained partial pollution exclusions for several decades before the institution of the "absolute" exclusions. As such, CGL policies are not likely to address remedial measures intended to prevent future carbon emissions or the dispersal of toxic materials. Nor are CGL policies likely to cover "voluntary" actions to remedy existing conditions. The personal injury component of CGL policies covers claims for alleged invasions of privacy, libel and slander, and similar injuries. However, CGL policies also contain broad exclusions for some of the common categories of commercial personal injury violations such as junk faxes and similar improper solicitations, inadequate privacy protections in processing credit card transactions, media publication, and injuries involving the disclosure of electronic data. Claims concerning the allegedly inappropriate use of biometric data are currently a topic of considerable dispute.

Other Specialized Insurance: Under the correct circumstances, it is possible that additional types of commercial insurance coverage may respond to ESG-related litigation or involve issues pertinent to ESG priorities. Among the potentially relevant categories of coverage are kidnap and ransom (which generally covers losses resulting from adverse events involving executives traveling abroad), media liability (covers claims for personal injuries including invasions of privacy and libel and slander for media companies subject to industry limitations under CGL coverage), and cyber risk (covers a mix of first-party loss and third-party liability coverage that may include technology professional liability, data and privacy liability, and data breach response costs).

This list of potentially responsible categories of insurance coverage is wide-ranging. This is because of the still-developing risks of liability that might result from ESG initiatives. Just as the concept of ESG encompasses an extremely broad, ambiguous, imprecisely defined cloud of environmental, social, and governance issues, the types of claims that can arise out of ESG efforts are similarly broad. Given the breadth of potential exposures, it will be important for businesses to survey their entire insurance portfolio when faced with ESG-related litigation.

Chronicle of Coverage Disputes Foretold

There are recurring patterns of facts and circumstances that give rise to ESG regulatory scrutiny and litigation. Given the challenges related to identifying ESG priorities, carrying out those priorities, and resolving the tensions between competing interests, there are a number of identifiable issues around which the challenges in instituting and managing a successful ESG program tend to coalesce. These recurring issues tend to result in particular kinds of ESG-related claims. We will attempt to identify some of the recurring issues that arise in relation to ESG programs and the types of claims that are associated with those issues and then attempt to map those claim types against the categories of insurance coverage that might respond to those claim types.

Nature of the Substantive ESG Goals: The breadth and

continued on page 6

What Comes Around, Goes Around: Boards Need to Get Succession Planning Right to Avoid Boomerang CEOs

By Dr. Joseph C. Santora

Dr. Joseph C. Santora is the founder of TST, Inc., a management consulting company, editor of the International Leadership Journal (internationalleadershipjournal.com), and an executive educator. In this article, he explores the critical role that boards play in an organization's succession planning.

"Boomerang" is defined by the *Oxford Learner's Dictionary* (n.d.) as "a curved flat piece of wood that you throw and that can fly in a circle and come back to you. Boomerangs were first used by Australian Aborigines as weapons when they were hunting." The word "boomerang" has also been extended to describe a corporate CEO or a business founder who leaves the CEO position, then returns as CEO to re-lead, reinvigorate, and reenergize the organization. Boomerang CEOs include CEO–founders Howard Schultz of Starbucks and Michael Dell of Dell, Inc., and corporate CEOs Bob Iger of Disney and A. G. Lafley of Procter & Gamble (see Table 1 below).

Schultz and Dell have made multiple trips to the CEO–founder altar. Katrina Lake of Stitch Fix and Schultz have both returned as interim CEOs with the intention of correcting problems, hiring successors, and then stepping down from their day-to-day duties. A. G. Lafley and, recently, Bob Iger have both returned as CEOs to save their companies. Despite their noble intentions, boomerang CEOs have not always improved their companies' financial performance. Bingham et al. (2020) found that, while boomerang founders Jobs and Schultz were able to improve the financial performance of their companies, Corporate CEO Lafley was not.

The Chapek–Iger Disney Succession Case

In November 2022, Disney executive chair Bob Iger was rehired as Disney's CEO to replace his successor Bob Chapek, in the hopes that Iger would improve the media powerhouse's position in the industry. Many business pundits, investors, and the media already knew what Chapek apparently did not—he was not Iger. After a 33-month tenure as CEO, Chapek was dismissed for a series of missteps in handling corporate competition, internal and external corporate politics, controversial and emotionally charged issues, and a dramatic decline in the financial performance of the company during his very brief time in office. Chapek's critical mistakes cost him his job. There was quite a bit of irony in the Chapek case, as Iger had "hand-picked" Chapek to be his successor. Also, despite an accumulation of serious missteps that caused the Disney board to question his leadership, the board still awarded Chapek a three-year contract extension on June 28, 2022—only to terminate him and rehire Iger five months later.

Is It the Board's Fault?

When a new CEO fails to lead, who is to blame? The problem may be the poor identification of senior-level talent who should be promoted to the CEO position. A good, competent vice president may be highly successful as a divisional leader but lack the "right stuff" to be a successful CEO. Some 55 years ago, Peter and Hull (1968) in their classic book, *The Peter Principle*, pointed out that an employee in a hierarchical organization rises to his or her level of incompetence. The Peter principle is displayed in full force when organizations promote ill-prepared internal and external executives as CEOs.

While executive succession is one of the primary concerns of any board of directors, unfortunately, many do not get it right. Many boards do not address the executive succession issue properly. CEO–chair policies and board-level politics may often obstruct the identification of a good successor. Furthermore, many incumbent CEOs simply refuse to say goodbye permanently, especially company founders and long-term CEOs who remain with companies much longer than they really should as consultants, board members, or board chairs.

Boards who retain former CEOS know they can always rely on a founder or a former CEO to retake leadership of a company. But boards must also remember that past performance is not a true indicator of successful future corporate performance. Successful leadership is not continually sustainable. Take, for example, Winston Churchill, the British prime minister, who enjoyed an 83% approval rate in May 1945 at the end of World War II in Europe (Larres, 2020). Churchill was the right person at the right time to lead Great Britain through some very tough times. However, only two months later, in July 1945, Churchill was voted out of office.

If boards are wedded to the "better the devil you know, than the devil you don't know" philosophy, and insist on internal successors, they need to establish a mechanism to identify the best candidates to replace the departing CEOs, rather than rely on former CEOs who may be standing by to return to their former positions. Boards should stand on their own rather than lean on accessible crutches such as former CEOs. Enlightened

Table 1
Boomerang Founders and Corporate CEOs: From Jobs to Iger

CEO	Company	Position	Departure	Successor CEO	Position and return	Departure	Successor	Impact of return
Katrina Lake*	Stitch Fix	Founder and CEO 2011	2021 Executive board chair	Elizabeth Spaulding 2021–2023	Interim CEO 2023	NA	Active interim CEO	NA
Bob Iger**	The Disney Company	CEO 2005	2020 Executive board chair	Bob Chapek 2020–2022	CEO 2022	NA	Active CEO	NA
Howard Schultz*	Starbucks	Purchased 1987 CEO and chair	2000	Orin Smith 2000–2005 Jim Donald 2005–2008 Kevin Johnson 2017–2022	CEO 2008–2017 Interim CEO 2022	2017 2023	Laxman Narasimha April 1, 2023	Financial performance rebound
Jack Dorsey*	Twitter	Co-founder 2006	2008 Fired	Evan Williams 2008–2010 Dick Costolo 2010–2015	CEO 2015	2021	Parag Agrawal 2021–2022	NA
Michael Dell*	Dell, Inc.	Founder and CEO 1984	2004 Chair	Kevin Rollins 2007	CEO 2007	NA	Purchased company 2013	NA
Steve Jobs*	Apple	Co-founder 1976	1985 Fired ***	Michael Scott (1977–1981) Michael Markkula (1981–1983) John Sculley (1983–1993) Michael Spindler (1993–1996) Gil Amelio (1996–1997) Steve Jobs (1997–2011)	CEO 2011	2011 Died in office	Tim Cook 2011–	Financial performance rebound
A. G. Lafley**	Procter & Gamble	President and CEO 2000	2009 Retired	Robert McDonald (2009)	CEO, president, and chair 2013	2015	David Taylor 2015–2021 Jon Moeller 2021–	No financial performance rebound

Note. *Founder. **Non-founder, corporate CEO. ***Jobs was not CEO until 1997.
Information from "Stitch Fix Founder Katrina Lake Returns as CEO: Here Are 5 Others Who Went Back to Run Their Former Companies," by A. York, January 6, 2023, Insider (https://www.businessinsider.com/boomerang-ceos-including-bob-iger-steve-jobs-jack-dorsey-2022-11?r=US&IR=T).
NB: Additional information was culled from multiple sources.

boards, despite any personal or professional attachments or relationships they may have with former CEOs, must recognize that former CEOs must regarded as just that—executives who may have made significant contributions to the company but who needed to depart when their tenures ended.

In fact, a former CEO who remains at corporate headquarters creates more harm than good. The temptation to become a boomerang CEO as a company's savior is ever-present and way too seductive (Santora & Bozer, 2017). In some cases, some Machiavellian undercurrents may even be present, wherein the retiring CEO may appear to strongly support or even handpick a successor while knowing full well that the heir apparent is neither ready to nor capable of leading the company. The board may ask the retired CEO to re-lead the company once more. It is the role of boards to thank departing CEOs for all their hard work, commitment, and contributions to the company, show them the door, and then close it firmly behind them. ■

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What makes a valued independent board member

By Lynn Nowicki Clarke

Dedication and a true commitment to the success of the shareholders who trust you is the foundation to being a great director. Your role is to provide useful and impactful advice and share your experience and expertise to help company management drive growth and profitability. While these principles seem rather obvious, it's always good to be reminded about how to add value to a board.

I also polled several experienced board members, asking them to share the top four behaviors or characteristics of great board members. Their answers coalesced to these top four:

- Respect for everyone in the board room and organization
- Humility, regardless of their personal successes
- Ask appropriate and useful questions to learn and probe
- Commit to helping all board members build trust with each other and as a team

Being a great and impactful director also requires thorough preparation as well as on-going, self-directed learning. For example, do you attend education programs on cyber? Or have you asked ChatGPT a question to understand how it works? Education is an important factor because it also helps you test your points of view, and if needed, have the courage to change your opinion.

Another important consideration is honestly assessing your ability to positively impact the business. Do you truly believe in the mission/vision of the company? Do your values mesh with company values and culture? Do you trust the shareholders and executives? If you join a board, then realize you don't share the same values, it's painful for all involved if you need to resign.

It's critical to understand what makes a director NOT be valued. Here are a few DON'T's:

- Don't ask "gotcha" questions
- Don't behave as though you're the CEO and have the right answers
- Don't dominate board conversations
- Don't act as though you prepared for the meeting, but really didn't
- Don't ask questions as a thinly veiled way to express your point of view

Being a great board member requires continual focus, education, and commitment. It's always good to remember that as directors, our job is to ensure the company is well managed, but not manage the company! ■

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diversity of issues that can be characterized as ESG priorities present a host of pitfalls for corporate boards trying to determine how to respond effectively to the call for greater ESG compliance. There is something to offend everyone in the bundle of environmental, social, and governance priorities that are grouped together in the ESG basket. Virtually no two lists of ESG concerns or priorities are identical. Some of the issues identified as ESG priorities are susceptible to wildly divergent interpretations. Indeed, favoring one ESG goal (e.g., phasing out of fossil fuels) may impair another ESG goal (encouraging economic development in poor but resource-rich nations). Some imprecision is inevitable when trying to identify the environmental-, social-, or governance-related value of a particular goal or activity. But due to the sensitive social and political nature of some ESG priorities, it should be no surprise if the adoption of largely symbolic social or political ESG goals results in controversy and scrutiny from unhappy stakeholders.

Disagreements about the identification of particular substantive ESG goals may take the form of so-called ESG backlash. Some of the more high-profile examples of backlash take the form of legislation or executive action expressing disapproval of making corporate decisions based on ESG criteria or pulling state or local investment or pension funds from fund managers that apply ESG considerations in making investment decisions. Even if these actions cause damage to a corporation, these are not claims or loss events that are likely to implicate commercial insurance.

However, disagreements about the identification of particular substantive ESG goals may also take the form of litigation by dissatisfied shareholders or fund beneficiaries. Mere dissatisfaction with a corporation's ESG priorities does not necessarily provide a justiciable basis for a shareholder claim or—in the case of a pension beneficiary—a viable ERISA claim. The solution to unhappiness with a corporation's prioritization of particular ESG goals is to invest with another corporation or fund manager or to move one's business elsewhere. To maintain a viable claim expressing disagreement with a corporation's selection of ESG goals, it is necessary to point to some resulting injury, most likely in the form of a drop in stock price or the frustration of some corporate purpose. A claim alleging a tangible injury, such as a drop in the price of a corporation's shares, as the result of a corporate action is the type of claim typically covered by a D&O policy. Similarly, a claim that purports to be brought for the benefit of a corporation, perhaps due to some frustration of corporate purpose, is a shareholder derivative suit that typically will be covered by a D&O policy. A claim brought by a beneficiary of a pension or benefits fund alleging that a corporate action caused a diminution in fund value typically would implicate fiduciary liability coverage.

Conceivably, if the selection of ESG goals had an adverse impact on the services provided by a corporation, E&O or professional liability coverage might be covered. In the case of an E&O claim, however, demonstrating that there is a connection between the objectionable ESG goal and the ability of the corporation to provide the relevant services that resulted in injury to the claimant may be difficult.

It also is conceivable that a claim concerning a particular ESG goal could trigger EPLI insurance if a claimant alleges that they were denied employment as a result of some quota or hiring target instituted in support of the ESG goal. Whether such a claim would be viable depends on the circumstances of the particular claim, but if an ESG goal involves hiring or employment practices, EPLI coverage should be reviewed and the availability of coverage should be taken into consideration.

As with any claim triggering D&O, fiduciary, E&O, or EPLI insurance coverage, depending on the particular facts and circumstances, the conduct and prior knowledge groups of exclusions may be relevant. If ESG-related litigation becomes commonplace, there also is a possibility that new exclusions specific to particular subject matters for claims may be introduced.

Commitment to ESG Goals: In a related vein, it is almost never possible to "accomplish" or "achieve" ESG. There are some ESG priorities that can be expressed in terms of a fixed benchmark, such as reducing emissions or becoming carbon neutral by some fixed date. Of course, setting a fixed goal is not the same thing as achieving that goal. A corporate promise to pursue an ESG goal is empty if there is no commitment to that goal. But many, if not most, ESG priorities are process-based or self-renewing: a pledge by a financial institution to institute lending practices that encourage economic development in blighted areas is not fulfilled if there is no operational follow-through; a promise not to purchase conflict minerals is not kept if the commitment is met in 2022 but not in 2023. In sum, there is a substantial difference between setting ESG aspirations and putting those aspirations into operational practice. Success in achieving ESG goals requires corporate commitment and willingness to make that commitment institutional. The setting of lofty ESG goals without doing the hard work necessary to make those goals an institutional habit is an invitation to scrutiny and claims against the institution setting but not achieving those goals.

As regulatory requirements concerning the reporting of some categories of ESG goals (for example climate change), and progress toward those goals are adopted, the failure to provide accurate disclosures or the failure to acknowledge that a goal was not met likely will provide a basis for regulatory scrutiny. For public companies, if the relevant scrutiny involves securities, D&O coverage may be implicated. For insured persons, coverage under a D&O claim is not limited to securities-related claims.

Litigation arising from the failure to fulfill ESG goals can take the form of stock price drop claims and derivative claims. Although in connection with a set of ESG-related issues, it is likely that those types of claims would be brought by shareholders or beneficiaries who are alleging that it was the failure to fulfill ESG targets that resulted in the alleged injury. Additionally, claims arising from the failure to fulfill ESG goals may involve allegations that claimants were induced to make investment decisions in reliance on materially false or misleading statements. Such claims are most likely to trigger D&O or fiduciary coverage depending on the circumstances of the claim.

Good Faith in Setting and Performing the ESG Goals: Related closely to the preceding discussion of commitment to an ESG goal, a key factor in predicting the likelihood that a corporate ESG program will be subject to scrutiny is the intent of a corporation in setting an ESG goal. If an enterprise's ESG goals are announced merely for the sake of positive publicity or inducing investment and there is no intent to institute practices in furtherance of those goals, regulatory scrutiny and litigation become much more likely. Material misrepresentations, whether they are about ESG goals or financial performance, will always be a source of claims against a corporation.

This coverage analysis for claims involving this obstacle to successful ESG implementation has much in common with the foregoing analysis involving claims arising from less than complete commitment to meeting ESG targets. In this context, however, the conduct and prior knowledge exclusions come to the forefront. It is particularly important to pay close attention to the conditions for the triggering of these exclusions.

This consideration also highlights some of the coverage issues that might arise for regulatory investigations. Not all regulatory investigations trigger insurance coverage, many management liability or E&O insurance policies distinguish between formal investigations (that typically are covered) and informal inquiries or investigations (that may not be covered). Particular attention should be paid to what constitutes

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a covered regulatory investigation. Coverage disputes also arise frequently concerning what constitutes covered damages. As a general matter, remedies such as a regulatory order directing corrective or remedial action, the adoption of internal controls, disgorgement, or the payment of fines or penalties are not likely to be treated as covered damages.

The Economic Impact of ESG Goals: Because we are discussing ESG priorities in a commercial context, either in connection with corporations setting environmental-, social-, or governance-related operational priorities and goals, or investment vehicles establishing environmental-, social-, or governance-related standards for investment decisions, the economic impact of ESG practices is a significant factor in assessing the risk associated with a particular set of ESG goals.

Disputes concerning the economic impact of ESG goals are likely to take the form of stock price drop or shareholder derivative claims for alleged breaches of fiduciary duties. As such, this category of claims has the potential to trigger D&O and fiduciary liability insurance.

Balancing Duties to Stakeholders and ESG Goals: Advocates of ESG initiatives often claim that enterprises that are committed to ESG practices are a good investment, have responsible management, and behave in a responsible manner that reduces corporate risk. The argument assumes that being a responsible corporate citizen by supporting and acting consistently with some set of environmental, social, and governance principles is an indicator of responsible and capable management. However, to some shareholders, fund beneficiaries, investors, and other stakeholders, the primary hallmark of responsible management is acting in the interests of stakeholders. ESG may be a nice feel-good activity, but the interest of many stakeholders is the return on investment. Traditionally, the responsibility of a fund manager toward the beneficiaries of a pension or benefit plan is to achieve a return on investment that allows for the maintenance of the fund and the payment of the targeted benefit. When there is tension between, whether real or perceived, the duties owed to stakeholders and the accomplishment of ESG goals, there is a heightened risk of stakeholder scrutiny and litigation.

Stakeholder objections that ESG programs are inconsistent with a corporation's obligations to its shareholders are likely to take the form of shareholder derivative claims or stock price drop claims. Depending on the identity of the claimant, such claims are likely to implicate either D&O or fiduciary liability insurance.

Wait and See

It is impossible to know if ESG initiatives will result in a substantial wave of litigation. Certainly, ESG initiatives pose substantial performance challenges for corporate insureds. ESG initiatives should not be launched solely for the sake of doing something. The assumption that companies that are launching ESG initiatives are good risks assumes that the corporate embrace of ESG is an indicator of corporate success and reduced liability and regulatory risk. Ultimately, that assumption may yet prove to be accurate. But ESG initiatives also may prove to be a magnet for litigation due to controversial choices or unmet goals. The failure to follow through on ESG goals or the inadequate commitment to stated goals are invitations to regulatory scrutiny and stakeholder litigation. Similarly, the selection of particularly controversial ESG goals or the selection of ESG goals that are disconnected from a corporation's business may be invitations to regulatory and stakeholder scrutiny. The prudent selection of ESG goals and diligent efforts in meeting those goals are the best means of preventing regulatory scrutiny and litigation. But if litigation is inevitable, barring some change in coverage terms, existing management and E&O liability insurance should be taken into consideration. In the near term, ESG initiatives may invite litigation, but ultimately, the responsible selection of ESG priorities and diligent efforts to achieve those priorities may yet prove to be a good indicator of corporate responsibility.

Companies eager to demonstrate their ESG bona fides have to beware of exposing themselves to accusations that they are exaggerating their ESG accomplishments. Optimistic goals to reduce emissions may be viewed as a material misstatement by regulators or investors if goals are not met. ESG should not just be a marketing tool. If a corporation or fund presents itself as ESG oriented, it is necessary to actually be ESG oriented.

The process of making ESG decisions, the complexity of evaluating the level of commitment to ESG initiatives, and the risks that are associated with ESG initiatives may be more challenging and nuanced than often is assumed. A clear-eyed approach and careful analysis in adopting appropriate ESG goals, as well the commitment to fulfill stated goals, are the bare minimum of a successful ESG program. There is no guarantee that there will be immediate payoffs or that realistic accomplishments will be viewed favorably by analysists or the investment market. If there is a payoff to ESG initiatives, it most likely will come in the form of leaving an entity better prepared to meet future challenges as the byproduct of careful planning and the commitment to continual improvement. In other words, an ESG-friendly culture is not much different than the kind of corporate culture that responsible and healthy boards always have fostered. It may be difficult to define or measure ESG precisely. The definitional and methodological sloppiness associated with much of the current discussion is unfortunate, but a board that is prepared to adopt to ESG demands is one that is prepared for the vicissitudes and changing circumstances that face any business enterprise. ■