



# ND STATE INVESTMENT BOARD MEETING

Friday, January 23, 2015, 8:30 a.m.  
Workforce Safety & Insurance  
1600 East Century Ave, Bismarck, ND

## AGENDA

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

**II. ACCEPTANCE OF MINUTES (November 21, 2014)**

**III. APPOINTMENT OF PARLIAMENTARIAN**

**IV. INVESTMENTS**

- A. Asset and Investment Overview - Mr. Hunter (enclosed) (5 min)
- B. Novarca and Callan Fee Study Update - Mr. Hunter (enclosed) (5 min) **Board Action**
- C. Infrastructure Update - Mr. Schulz (enclosed) (5 min)

**V. ADMINISTRATION**

- A. 2015-16 Board Meeting Schedule - Mr. Hunter (enclosed) (5 min) **Board Action**
- B. Executive Review & Survey Update - Mr. Hunter (enclosed) (10 min) **Board Action**

**VI. QUARTERLY MONITORING (enclosed) (15 min) Board Acceptance**

- A. Budget and Financial Condition - Ms. Flanagan
- B. Executive Limitations / Staff Relations - Mr. Hunter
- C. Investment Program - Mr. Schulz
- D. Retirement Program - Ms. Kopp
- E. Watch List Update - Mr. Schulz

**VII. GOVERNANCE**

- A. Legislative Update - Mr. Hunter (10 min)
- B. Investment Policy Statements - Mr. Hunter (enclosed) (10 min) **Board Acceptance**
- C. Potential New SIB Clients - Mr. Hunter (enclosed) (10 min) **Board Approval**

===== **BREAK** =====

- D. Governance Process Review - Mr. Hunter (enclosed) (30 min)
- E. Open Records and Open Meetings Education - Ms. Murtha (to follow) (30 min)

**VIII. OTHER**

Next Meetings: SIB meeting - February 27, 2015, 8:30 a.m. - Workforce Safety & Insurance  
SIB Audit Committee meeting - February 27, 2015, 1:00 p.m. - Workforce Safety & Insurance

**IX. ADJOURNMENT**

**NORTH DAKOTA STATE INVESTMENT BOARD  
MINUTES OF THE  
NOVEMBER 21, 2014, BOARD MEETING**

**MEMBERS PRESENT:** Mike Sandal, Vice Chair  
Clarence Corneil, Parliamentarian, TFFR Board  
Lance Gaebe, Land Commissioner  
Mike Gessner, TFFR Board  
Adam Hamm, Insurance Commissioner (TLCF)  
Rob Lech, TFFR Board  
Kelly Schmidt, State Treasurer  
Yvonne Smith, PERS Board  
Cindy Ternes, WSI designee  
Tom Trenbeath, PERS Board

**MEMBERS ABSENT:** Drew Wrigley, Lt. Governor, Chair

**STAFF PRESENT:** Terra Miller-Bowley, Supvr Audit Services  
Eric Chin, Investment Analyst  
Connie Flanagan, Fiscal & Invt Op Mgr  
Bonnie Heit, Assist to the SIB  
David Hunter, ED/CIO  
Fay Kopp, Deputy ED/CRO  
Cody Schmidt, Compliance Officer  
Darren Schulz, Deputy CIO  
Susan Walcker, Invt Acct

**OTHERS PRESENT:** Donald Anderson, Northern Trust  
Vikram Bhaskar, Grosvenor  
Elliott Donnelley, Novarca  
Jeff Engleson, Land Dept.  
Levi Erdmann, Land Dept.  
Paul Erlendson, Callan Associates  
Ashby Monk, Novarca  
Patricia Somerville-Koulouris, Northern Trust  
Claire Ness, Attorney General's Office  
Tim Porter, BND  
Bryan Reinhardt, PERS  
Michael Rose, Grosvenor  
Ed Schafer, former Governor of ND  
Marcel Staub, Novarca  
Thomas Welsh, Novarca

**CALL TO ORDER:**

Mr. Sandal called the State Investment Board (SIB) meeting to order at 8:30 a.m. on Friday, November 21, 2014, at the Brynhild Haugland Room, State Capitol, Bismarck, ND.

**AGENDA:**

**IT WAS MOVED BY MS. TERNES AND SECONDED BY MR. GESSNER AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE NOVEMBER 21, 2014, MEETING AS DISTRIBUTED.**

**AYES: COMMISSIONER GAEBE, TREASURER SCHMIDT, MR. SANDAL, COMMISSIONER HAMM, MR. CORNEIL, MS. TERNES, MR. GESSNER, MR. TRENBEATH, MR. LECH, AND MS. SMITH**

**NAYS: NONE**  
**MOTION CARRIED**  
**ABSENT: LT. GOVERNOR WRIGLEY**

**MINUTES:**

**IT WAS MOVED BY MR. TRENBEATH AND SECONDED BY MR. CORNEIL AND CARRIED ON A VOICE VOTE TO APPROVE THE OCTOBER 24, 2014, MINUTES AS DISTRIBUTED.**

**AYES: MR. GESSNER, COMMISSIONER GAEBE, MS. SMITH, MS. TERNES, TREASURER SCHMIDT, MR. LECH, COMMISSIONER HAMM, MR. CORNEIL, MR. TRENBEATH, AND MR. SANDAL**

**NAYS: NONE**  
**MOTION CARRIED**  
**ABSENT: LT. GOVERNOR WRIGLEY**

**INVESTMENTS:**

Asset/Performance Review - Mr. Hunter updated the SIB on the assets they manage on behalf of their clients as of September 30, 2014. Assets under management grew by approximately 19 percent or \$1.53 billion in the last year. The Pension Trust posted a net return of over 9.8 percent with gains of \$416 million. The Insurance Trust generated a net return of 5.3 percent with gains of \$198 million. The Legacy Fund's net return was 3.8 percent and increased by \$1.1 billion during the last 12 months. SIB client assets approximated \$9.6 billion at September 30, 2014, based on unaudited valuations.

Novarca Fee Study - Novarca representatives reviewed their background which is to assist pension funds, endowments, and foundations reduce/recoup excess fees paid to the financial industry. Novarca reviews portfolios, identifies areas for improvement, optimizes the cost structures, and monitors the savings. The firm reduces/recoups costs by striving to optimize the cost structures within the existing allocation and within the existing roster of investment managers, brokers, and custodians. The firm works on contingency and there are no upfront costs. The firm invoices only if and when savings are realized and fees come from what would have been paid to the financial industry. Staff recommended the SIB contract with Novarca to perform a comprehensive review of only the private equity strategies at this time.

**IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. LECH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION AND PROCEED WITH LEGAL COUNCIL THE NEGOTIATION OF LEGAL DOCUMENTATION TO INCLUDE A CONTINGENT FEE STRUCTURE AND STRICT TERMS OF CONFIDENTIALITY WITH NOVARCA.**

**AYES: MS. SMITH, COMMISSIONER HAMM, MR. GESSNER, COMMISSIONER GAEBE, MR. TRENBEATH, MR. CORNEIL, MR. SANDAL, TREASURER SCHMIDT, MS. TERNES, AND MR. LECH**

**NAYS: NONE**  
**MOTION CARRIED**  
**ABSENT: LT. GOVERNOR WRIGLEY**

Callan Fee Study - Mr. Erlendson reviewed the results of Callan's fee study for fiscal year ending June 30, 2014. The fee study indicated results are favorable but there are areas where additional savings could be realized.

Mr. Hunter stated there are additional fee savings that will be reflected in the next fiscal year that have not yet taken affect which should improve the fee analysis.

IT WAS MOVED BY MR. GESSNER AND SECONDED BY MS. TERNES AND CARRIED BY A ROLL CALL VOTE TO ACCEPT CALLAN'S FEE STUDY REPORT.

AYES: TREASURER SCHMIDT, MR. GESSNER, COMMISSIONER HAMM, MS. TERNES, COMMISSIONER GAEBE, MS. SMITH, MR. LECH, MR. SANDAL, MR. TRENBEATH, AND MR. CORNEIL

NAYS: NONE

MOTION CARRIED

ABSENT: LT. GOVERNOR WRIGLEY

Northern Trust Securities Lending - Representatives of Northern Trust reviewed the firm's security lending program and the steps which would need to be taken to implement a program for the SIB. Staff recommended the SIB approve implementation of the securities lending program as outlined by Northern Trust. Callan representatives reviewed securities lending options with the SIB at their October 24, 2014, meeting and recommended the SIB implement the common industry approach which is an 80/20 split as long as the program structure is an overnight intrinsic indemnified US Treasury REPO with the commensurate indemnity for operational and borrower default risk.

IT WAS MOVED BY COMMISSIONER GAEBE AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION TO MOVE FORWARD WITH THE LEGAL AGREEMENT PROCESS FOR THE NORTHERN TRUST SECURITIES LENDING PROGRAM.

AYES: MS. SMITH, MR. SANDAL, MR. CORNEIL, MR. GESSNER, MR. LECH, MR. TRENBEATH, MS. TERNES, COMMISSIONER HAMM, COMMISSIONER GAEBE, AND TREASURER SCHMIDT.

NAYS: NONE

MOTION CARRIED

ABSENT: LT. GOVERNOR WRIGLEY

Legacy & Budget Stabilization Fund Advisory Board - Mr. Hunter stated he met with the Legacy and Budget Stabilization Fund Advisory Board (LBSFAB) on October 28, 2014, and provided an investment update on the Legacy Fund and the Budget Stabilization Fund as of August 31, 2014. Mr. Hunter also reviewed the investment policy statements for both funds and also reviewed the Bank of North Dakota (BND) Match Loan CD Program and discussed the BND's request to increase the size of the Match Loan CD Program within the Budget Stabilization Fund. Mr. Hunter stated the LBSFAB recommended the SIB consider making available an additional \$50 million from the Budget Stabilization Fund for investment in the BND Match Loan CD Program. The LBSFAB also requested the Budget Stabilization Fund investment policy statement be reviewed by RIO to identify any possible provisions which may be in conflict with the recommendation. Following a review by legal counsel, two formats were composed in relation to the BND proposal. Mr. Hunter indicated both options are reasonable given the Legislative Council has stated the Budget Stabilization Fund is projected to increase by \$133 million in the next biennium. He also indicated the \$50 million increase is then deemed reasonable from a liquidity perspective as it will allow the three existing managers within the Budget Stabilization Fund (Babson Capital, JP Morgan, and the BND) to each represent approximately one-third share of the overall investment allocation.

The SIB took no action on the matter as the SIB's policy is to have investment policy statements approved by their respective clients prior to the SIB's consideration and implementation.

The next meeting of the LBSFAB has been scheduled for December 1, 2014, and Mr. Hunter will report back to the SIB, at their January 23, 2015, meeting.

The SIB recessed at 10:30 a.m. and reconvened at 10:37 a.m.

Grosvenor Infrastructure - Grosvenor representatives provided an update on their firm and personnel since Credit Suisse sold its Customized Fund Investment Group business unit to Grosvenor Capital Management in early January 2014.

Representatives also reviewed the Customized Infrastructure Strategies II Fund which they are currently seeking commitments. Staff recommended committing assets up to \$30 million of the Pension Trust and up to \$75 million of the Legacy Fund.

**IT WAS MOVED BY MR. GESSNER AND SECONDED BY MR. TRENBEATH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION AND COMMIT UP TO \$30 MILLION OF THE PENSION TRUST ASSETS AND UP TO \$75 MILLION OF THE LEGACY FUND ASSETS TO GCM GROSVENOR CUSTOMIZED INFRASTRUCTURE STRATEGIES II FUND SUBJECT TO SUCCESSFUL CONTRACT NEGOTIATIONS.**

**AYES: MR. TRENBEATH, TREASURER SCHMIDT, MR. CORNEIL, COMMISSIONER GAEBE, MR. LECH, MR. SANDAL, COMMISSIONER HAMM, MR. GESSNER, MS. SMITH, AND MS. TERNES**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: LT. GOVERNOR WRIGLEY**

**MONITORING:**

Callan Investment Review - Mr. Erlendson reviewed performance of the Pension Trust and the Insurance Trust for the quarter ending September 30, 2014.

**IT WAS MOVED BY MR. TRENBEATH AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT CALLAN'S INVESTMENT MEASUREMENT SERVICE QUARTERLY REPORTS FOR THE PENSION TRUST AND INSURANCE TRUST FOR THE PERIOD ENDING SEPTEMBER 30, 2014.**

**AYES: MS. TERNES, MR. CORNEIL, COMMISSIONER HAMM, TREASURER SCHMIDT, COMMISSIONER GAEBE, MR. TRENBEATH, MR. LECH, MR. SANDAL, MS. SMITH, AND MR. GESSNER**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: LT. GOVERNOR WRIGLEY**

**GOVERNANCE:**

Legislative Update - Mr. Hunter stated investment updates were given on the Budget Stabilization Fund and Legacy Fund for the period ending August 31, 2014, to the LBSFAB on October 28, 2014. Staff also presented to the Employee Benefits Program Committee on October 29, 2014, and provided an overview of the SIB program/process, assets under management, and fiscal year activity.

Audit Committee Report - Mr. Hunter and Mr. Gessner updated the SIB on the SIB Audit Committee's activities for the period of July 1, 2013 to June 30, 2014.

CliftonLarsonAllen completed their audit of RIO's financial statements for the fiscal year ended June 30, 2014, and have issued an unmodified, clean, opinion.

Ms. Miller-Bowley updated the SIB on the preliminary review of the Executive Director/CIO's level of compliance with SIB Governance Manual Executive Limitations Policies A-1 through A-11. Ms. Miller-Bowley stated Audit Services is satisfied with the Executive Director/CIO's compliance at this time and a full Executive Limitations audit is scheduled to begin in January 2015.

Mr. Gessner stated Ms. Karol Riedman has replaced Mr. Lonny Mertz on the Audit Committee. Ms. Riedman is the Chief Audit Executive for the Office of Internal Audit of the ND Department of Health.

Mr. Gessner also stated the State Auditor's Office will issue a Request for Proposal on November 28, 2014, to solicit proposals from qualified CPA firms for the financial audit of the Retirement and Investment Office. CliftonLarsonAllen has been conducting the audit for the past three years.

Mr. Gessner also indicated GASB 67 and 68 statements are being implemented and there will be more information shared with the SIB on how these statements affect the school districts who report to Teachers' Fund for Retirement (TFFR).

Mr. Gessner thanked staff for all of their work on the financial audit report to achieve the positive results from CliftonLarsonAllen.

**IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. LECH AND CARRIED BY A VOICE VOTE TO ACCEPT THE SIB AUDIT COMMITTEE ACTIVITIES REPORT WHICH ALSO INCLUDED RIO'S FINANCIAL AUDIT REPORT BY CLIFTONLARSONALLEN FOR THE FISCAL YEAR ENDED JUNE 30, 2014.**

**AYES: COMMISSIONER HAMM, MS. TERNES, MR. CORNEIL, MR. SANDAL, TREASURER SCHMIDT, MR. GESSNER, MS. SMITH, COMMISSIONER GAEBE, MR. LECH, AND MR. TRENBEATH**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: LT. GOVERNOR WRIGLEY**

Investment Policy Statement Amendments - Mr. Hunter reviewed revised investment policy statements previously reviewed and approved by the clients for the Legacy Fund and the following PERS' Funds - PERS Main Plan, Job Service, Group Insurance Account, and Retiree Health Insurance Credit Fund.

**IT WAS MOVED BY MR. CORNEIL AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE REVISED INVESTMENT POLICY STATEMENT FOR THE LEGACY FUND, AND THE FOLLOWING PERS' STATEMENTS - PERS MAIN PLAN, JOB SERVICE, GROUP INSURANCE, AND RETIREE HEALTH INSURANCE CREDIT FUND.**

**AYES: MR. LECH, TREASURER SCHMIDT, MR. CORNEIL, COMMISSIONER GAEBE, MR. TRENBEATH, MR. SANDAL, COMMISSIONER HAMM, MR. GESSNER, MS. SMITH, AND MS. TERNES**

**NAYS: NONE**

**MOTION CARRIED**

**ABSENT: LT. GOVERNOR WRIGLEY**

PIMCO Update - Staff and SIB members - Treasurer Schmidt, Mr. Sandal, Ms. Smith, and Ms. Ternes met with PIMCO representatives on October 2, 2014, at the Retirement and Investment Office. Mr. Hunter and Mr. Schulz also conducted an on-site visit with PIMCO representatives at their headquarters in Newport Beach, CA. on November 6, 2014. Staff recommended that PIMCO remain on watch list status and also recommended no changes to existing mandates nor will they recommend PIMCO for any new mandates until they are comfortable with the internal changes at the firm.

The SIB concurred with staff recommendation and there was no action taken on the update.

Staff Update - Mr. Hunter introduced Mr. Eric Chin who joined the Retirement and Investment Office as an Investment Analyst effective November 10, 2014. Mr. Hunter stated the office is now fully staffed.

Mr. Corneil announced he has elected to resign from the Teachers' Fund for Retirement Board and the State Investment Board effective November 21, 2014. Mr. Corneil has been serving on the Teachers' Fund for Retirement Board since July 18, 2002, and the State Investment Board since September 17, 2004. Mr. Corneil thanked the leadership of RIO and the entire SIB and stated he has enjoyed serving the people of the State of North Dakota and will miss the educational elements that come with serving as a trustee. Mr. Sandal and the SIB thanked Mr. Corneil for his service and stated they will miss him.

**OTHER:**

Next scheduled meetings:

SIB Meeting - January 23, 2015, 8:30 a.m. - Workforce Safety & Insurance  
SIB Audit Committee Meeting - February 27, 2015, 1:00 p.m. - Workforce Safety & Insurance

**ADJOURNMENT:**

With no further business to come before the SIB, Mr. Sandal adjourned the meeting at 12:25 p.m.

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Mr. Mike Sandal, Vice Chair  
State Investment Board

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Bonnie Heit  
Assistant to the Board

# State Investment Board

## Asset and Investment Overview

January 23, 2015

Dave Hunter, Executive Director / CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

# State Investment Board – Client Assets Under Management

| <b>Fund Name</b>                          | <b>Market Values<br/>as of 11/30/14 <sup>(1)</sup></b> | <b>Market Values<br/>as of 6/30/14 <sup>(2)</sup></b> | <b>Market Values<br/>as of 11/30/13 <sup>(1)</sup></b> |
|---|--|---|--|
| <b>Pension Trust Fund</b>                 |  |   |  |
| Public Employees Retirement System (PERS) | 2,353,913,410  | 2,332,744,037   | 2,174,798,672  |
| Teachers' Fund for Retirement (TFFR)      | 2,055,222,683  | 2,061,684,912   | 1,944,568,118  |
| Job Service of North Dakota Pension       | 97,453,588   | 97,825,769  | 94,857,787   |
| City of Bismarck Employees Pension        | 79,555,315   | 78,804,326  | 73,974,386   |
| City of Grand Forks Employees Pension     | 56,901,009   | 57,896,611  | 53,067,972   |
| City of Bismarck Police Pension           | 34,917,582   | 34,643,204  | 32,481,532   |
| Grand Forks Park District                 | 5,930,708  | 5,938,993   | 5,576,048  |
| City of Fargo Employees Pension           | 9,656  | 9,702   | 36,938,922   |
| <b>Subtotal Pension Trust Fund</b>        | <b>4,683,903,951</b>                                   | <b>4,669,547,555</b>                                  | <b>4,416,263,437</b>                                   |
| <b>Insurance Trust Fund</b>               |  |   |  |
| Legacy Fund                               | 2,801,453,348  | 2,215,941,142   | 1,616,640,669  |
| Workforce Safety & Insurance (WSI)        | 1,711,609,807  | 1,703,987,980   | 1,625,359,960  |
| Budget Stabilization Fund                 | 591,689,863  | 586,199,881   | 587,002,206  |
| PERS Group Insurance Account              | 44,004,670   | 37,425,567  | 39,625,943   |
| City of Fargo FargoDome Permanent Fund    | 40,657,614   | 41,775,992  | 38,320,722   |
| State Fire and Tornado Fund               | 25,064,927   | 29,223,707  | 28,434,501   |
| Petroleum Tank Release Compensation Fund  | 7,149,293  | 7,092,998   | 6,905,201  |
| State Risk Management Fund                | 6,750,838  | 6,948,162   | 6,555,052  |
| State Risk Management Workers Comp Fund   | 6,119,599  | 5,965,322   | 5,612,437  |
| ND Association of Counties (NDACo) Fund   | 3,482,331  | 3,445,373   | 2,878,635  |
| State Bonding Fund                        | 3,297,515  | 3,268,991   | 3,174,443  |
| ND Board of Medical Examiners             | 2,139,344  | 1,889,897   |  |
| Bismarck Deferred Sick Leave Account      | 859,839  | 849,818   | 803,612  |
| Insurance Regulatory Trust Fund           | 646,659  | 1,146,038   | 1,101,313  |
| Cultural Endowment Fund                   | 372,425  | 364,979   | 355,366  |
| <b>Subtotal Insurance Trust Fund</b>      | <b>5,245,298,072</b>                                   | <b>4,645,525,847</b>                                  | <b>3,962,770,060</b>                                   |
| PERS Retiree Insurance Credit Fund        | 93,393,860   | 90,360,366  | 81,913,480   |
| <b>Total Assets Under SIB Management</b>  | <b>10,022,595,883</b>                                  | <b>9,405,433,768</b>                                  | <b>8,460,946,978</b>                                   |

<sup>(1)</sup> 11/30/14 and 11/30/13 market values are unaudited and subject to change.

<sup>(2)</sup> 6/30/14 market values as stated in the Comprehensive Annual Financial Report.

- ▶ SIB Client Assets Under Management grew by approximately 18.5% or \$1.56 billion in the last year.
- ▶ The Pension Trust posted a net return of over 7.9%, while the Insurance Trust generated a 5.6% net return in the last year. Investments were responsible for gains of \$349 million for the Pension Trust and \$222 million for the Insurance Trust.
- ▶ Legacy assets increased by 73% (or \$1.2 billion) primarily due to tax collections, while net returns were 4.8% for the year ended November 30, 2014.
- ▶ SIB client assets approximated \$10 billion based on unaudited valuations as of November 30, 2014.

# Preliminary Capital Markets Snapshot – Jan.19, 2015

**Equity Returns were “A Tale of Two Halves”** - All major asset classes posted positive results during the 1<sup>st</sup> Half of 2014. During the 2<sup>nd</sup> Half of 2014, the U.S. equity markets continued to perform well, while the international equity markets declined significantly.

|                                  | 2014   |      |        |        |             |               |           |
|----------------------------------|--------|------|--------|--------|-------------|---------------|-----------|
|                                  | Q1     | Q2   | Q3     | Q4     | 1st Half    | 2nd Half      | Full Year |
| S&P 500                          | 1.81   | 5.23 | 1.13   | 4.93   | <b>7.14</b> | <b>6.11</b>   | 13.69     |
| Russell 1000                     | 2.05   | 5.12 | 0.65   | 4.88   | <b>7.27</b> | <b>5.56</b>   | 13.24     |
| Russell 2000                     | 1.12   | 2.05 | (7.36) | 9.73   | <b>3.19</b> | <b>1.65</b>   | 4.90      |
| Russell 3000                     | 1.97   | 4.87 | 0.01   | 5.24   | <b>6.94</b> | <b>5.25</b>   | 12.56     |
| MSCI EAFE (International Equity) | 0.66   | 4.09 | (5.88) | (3.57) | <b>4.78</b> | <b>(9.24)</b> | (4.90)    |
| MSCI EM (Emerging Markets)       | (0.37) | 6.71 | (3.36) | (4.50) | <b>6.32</b> | <b>(7.71)</b> | (1.88)    |
| MSCI ACWI (Global Equity)        | 1.21   | 5.23 | (2.20) | 0.52   | <b>6.50</b> | <b>(1.69)</b> | 4.71      |
| MSCI ACWI ex US                  | 0.61   | 5.25 | (5.19) | (3.81) | <b>5.89</b> | <b>(8.81)</b> | (3.44)    |
| Barclays Aggregate               | 1.84   | 2.04 | 0.17   | 1.79   | <b>3.93</b> | <b>1.96</b>   | 5.97      |
| Barclays Corporate High Yield    | 2.98   | 2.41 | (1.87) | (1.00) | <b>5.46</b> | <b>(2.85)</b> | 2.45      |
| Citi Non-US World Gov't          | 3.22   | 2.64 | (5.38) | (2.91) | <b>5.95</b> | <b>(8.14)</b> | (2.68)    |
| Barclays US TIPS                 | 1.95   | 3.81 | (2.04) | (0.03) | <b>5.83</b> | <b>(2.07)</b> | 3.64      |
| Barclays Global Inflation Linked | 2.79   | 3.60 | (2.76) | (0.14) | <b>6.49</b> | <b>(2.89)</b> | 3.41      |
| NCREIF Total Index               | 2.74   | 2.91 | 2.63   | 2.63   | <b>5.73</b> | <b>5.34</b>   | 11.37     |

**Preliminary 12/31/14 Update** – The Pension and Insurance Trusts generated net investment returns of less than 1% for the six-months ended 12/31/14 largely reflective of the overall weakness in the global capital markets.

## AGENDA ITEM IV. B.

**TO:** State Investment Board

**FROM:** Dave Hunter, Executive Director/CIO

**DATE:** January 23, 2015

**SUBJECT:** Novarca and Callan Fee Study Update

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### **Recommendation:**

After further review and discussion with Novarca, the SIB is requested to approve RIO's recommendation to expand the scope of the Novarca fee study to include other higher cost investments strategies such as World Equity. This recommendation is still subject to satisfactory negotiation of legal documentation including a contingent fee structure and strict terms of confidentiality. The terms of the revised engagement will focus on the specified equity mandates with no explicit upfront fees or costs. All fees paid, if any, will be based on a percentage of documented cost reductions.

### **Background:**

On November 21, 2014, the SIB approved RIO's recommendation to work with Novarca to perform a comprehensive review of our private equity strategies noting that private equity has historically been one of the most expensive investment options and the only sector with an average fee in excess of 1% for the fiscal year ended June 30, 2014 (at 2.55%).

### **Novarca:**

Novarca International Ltd. ("Novarca") was founded in Switzerland in 2006 and consists of 30 partners and associates across Europe, Asia and the US. They "have advised and analyzed over \$600 billion of assets and have built a comprehensive proprietary database of best practices" based on client relationships with "institutional investors such as pension funds, sovereign wealth funds, corporates and family offices with over \$1.5 trillion in assets under management". Based on extensive discussion with the investment consultant community and other U.S. public pension plan peers, Novarca is unique within the traditional investment consultant community by deploying a more forensic approach which relies heavily upon a review of legal documentation and transactional cost studies.

### **Callan Fee Review:**

Callan provided the results of its comprehensive review of our investment manager fee structures at the last SIB meeting. RIO summarized Callan's results as a financial dashboard on the following page. Based on discussion with Novarca and review of Callan's fee study results, RIO recommends the scope of Novarca's fee review be expanded to include World Equity at this time.

**Callan Fee Study  
Financial Dashboard  
As of January 19, 2015**

|  |
|--|
| Blue - 4th Quartile (Best or Lowest Fee Level) |
| Green - 3rd Quartile (Good)                    |
| Orange - 2nd Quartile (Below Average)          |
| Yellow - 1st Quartile (Highest Fee Level)      |

| Column A                       | Column B  | Column C | Column D | Column E   |  |
|--------------------------------|---|----------|----------|------------|--|
|                                | ----- ND SIB -----  |          |          | All        | n.a. or n.m. = not available or not meaningful   |
|                                | Asset Based   | All-In   | Callan   | Strategies | bp = basis point (1 basis point = 1/100th of 1%)   |
|                                | Pricing   | Pricing  | Median   | Quartile   | <b>RIO Commentary</b>  |
| <b>PENSION TRUST:</b>          |   |          |          |            |  |
| World Equity                   | 0.70%   | 0.79%    | 0.42%    | 1st        | <b>Fees lowered in 3Q/2014; expect lower fees this year.</b>   |
| Domestic Large Cap Equity      | 0.21%   | 0.30%    | 0.47%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Domestic Small Cap Equity      | 0.65%   | 0.53%    | 0.64%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Developed International Equity | 0.32%   | 0.32%    | 0.64%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Emerging Markets Equity        | 0.42%   | 0.42%    | 0.96%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Investment Grade Fixed Income  | 0.27%   | 0.66%    | 0.28%    | 1st        | Excess returns (5.7% net vs 4.0% index) justify "All-In Pricing".  |
| Non-Invest. Grade Fixed Income | 0.50%   | 0.72%    | 0.39%    | 1st        | <b>Fees lowered in 3Q/2014; expect lower fees this year.</b>   |
| International Fixed Income     | 0.35%   | 0.35%    | 0.34%    | 1st        | Fees lowered in 4Q/2014; ND fees only 1 bp higher than median.   |
| Real Estate                    | 0.67%   | 1.01%    | 0.86%    | 1st        | Excess returns (15.3% net vs 11.3% index) justify "All-In Pricing".  |
| Timber                         | n.m.  | 0.38%    | n.a.     | n.a.       | Note 1: Callan Fee Study states "The infrastructure and timber universes are too small to make an appropriate fee comparison." |
| Infrastructure                 | n.m.  | 0.89%    | n.a.     | n.a.       |  |
| Private Equity ("P/E")         | Callan NDSIB Fee Analysis (page 22) states "management fees for NDSIB's P/E portfolio ... are in line with industry norms." |          |          |            |  |
| Cash                           | 0.14%   | 0.14%    | < 0.20%  | n.a.       | Callan notes that fees "are well within industry norms".   |
| <b>INSURANCE TRUST:</b>        |   |          |          |            |  |
| Domestic Large Cap Equity      | 0.23%   | 0.22%    | 0.47%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Domestic Small Cap Equity      | 0.33%   | 0.36%    | 0.71%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| International Equity           | 0.40%   | 0.40%    | 0.64%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Domestic Fixed Income          | 0.18%   | 0.34%    | 0.24%    | 1st        | Excess returns (6.9% net vs 4.0% index) justify "All-In Pricing".  |
| Inflation Protected - Bonds    | 0.16%   | 0.16%    | 0.19%    | 3rd        | ND SIB fees are only 1 bp higher than the Callan 1st quartile.   |
| Inflation Protected - All      | n.m.  | 0.41%    | n.a.     | n.a.       | See Note 1 above for timber and infrastructure commentary.   |
| Real Estate                    | 0.82%   | 0.82%    | 0.89%    | 4th        | ND SIB fees are in the lowest or best quartile.  |
| Short-Term Fixed Income        | 0.12%   | 0.12%    | 0.15%    | 3rd        | ND SIB fees are only 2 bps higher than the Callan 1st quartile.  |
| Cash & Cash Equivalents        | 0.13%   | 0.13%    | < 0.20%  | n.a.       | Callan notes that fees "are well within industry norms".   |

**RIO SUMMARY: Overall fees are reasonable, although investment manager fees are comparatively higher in the Pension Trust than the Insurance Trust. During the past year, the RIO and SIB has been successful in reducing overall investment management fees from 0.65% to 0.51% which is significant. RIO will continue to work with Callan and our managers on additional fee reductions particularly within World Equity, Non-Investment Grade bonds and P/E.**

**TO:** State Investment Board (“SIB”)  
**FROM:** Darren Schulz, Deputy CIO, Retirement and Investment Office (“RIO”)  
**DATE:** January 23, 2015  
**SUBJECT:** Infrastructure Update  
**ACTION:** None (Informational)

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At the November SIB meeting, the State Investment Board approved making capital commitments of up to \$30 million on behalf of the pension trust and up to \$75 million on behalf of the Legacy Fund to GCM Grosvenor Customized Infrastructure Strategies II (“CIS II”), a commingled multi-manager infrastructure fund that invests in a global portfolio of core and core-plus infrastructure assets. CIS II is a follow-on fund to CIS I, following a similar investment approach to the predecessor fund, which is an existing investment within the pension and insurance trusts. Following Board approval, a legal contract review was completed and the anticipated first close is expected to occur in January.

In addition to infrastructure commitments to Grosvenor, Staff will be making additional subscriptions to the existing J.P. Morgan Infrastructure Investments Fund (IIF) within the pension and insurance trusts, an open-end global infrastructure fund focusing on core and core-plus infrastructure assets in the U.S., Canada, Western Europe and Australia. Unlike closed-end investments, the open-ended structure of the vehicle provides more immediate exposure to a mature portfolio with an expected yield of 5 to 7 percent. Subscriptions in the amount of \$30 million for the pension trust and \$75 million for the Legacy Fund were submitted for entrance in the fourth quarter IIF queue.

**TO:** State Investment Board  
**FROM:** Dave Hunter, Executive Director/CIO  
**DATE:** January 19, 2015  
**SUBJECT:** State Investment Board Meeting Schedule for 2015-16  
**ACTION:** **BOARD APPROVAL REQUESTED**

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**Recommendation:**

**RIO requests the SIB approve the proposed board meeting schedule for the period from July 1, 2015 to June 30, 2016.** As in prior years, the meetings are held on the fourth Friday morning of each month with the exception of November and December. The November meeting has historically been moved up to the third Friday (due to Thanksgiving), while no meeting has been scheduled in December in recent years (due to Christmas). Two changes are proposed and include: 1) conducting an extended governance day retreat in July of 2015 (to be offset by the elimination of the June 2016 meeting); and 2) moving the March 2016 meeting up to the third Friday so as to not occur on Good Friday.

**State Investment Board 2015-16 Meeting Schedule**

July 24, 2015 (Retreat)

August 28, 2015

September 25, 2015

October 23, 2015

November 20, 2015

December – No Meeting

January 22, 2016

February 26, 2016

March 18, 2016

April 22, 2016

May 27, 2016

**BOARD ACTION REQUESTED**

To: State Investment Board  
From: Dave Hunter, Executive Director / CIO  
Date: January 19, 2015  
RE: **Executive Director / CIO Survey Updates**

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**SIB Review of the Executive Director / CIO:**

RIO's Supervisor of Audit Services, Terra Miller-Bowley, is in the process of finalizing the Executive Limitations Audit for 2014 and will present the findings to the SIB Audit Committee and SIB at the February meetings. Terra Miller-Bowley is also coordinating the timeline for the Executive Director / CIO Survey which can be administered by the Executive Review Committee if mandated by the SIB. **If it pleases the SIB, the Executive Director recommends that the SIB make a motion to reinstate the Executive Review Committee in order to administer the Executive Review Survey of the ED/CIO over the next month.** If approved, the SIB could then appoint the Executive Review Committee members and confirm the timeline for the anticipated survey distribution and summary.

**Executive Director / CIO Employee Opinion Survey Summary:**

Overall, I am pleased to report that we had **100% participation** in the ED/CIO employee opinion survey. I am also thankful to report that **78% of the survey responses indicated that they "Agree" or "Strongly Agree"** with the ED/CIO effectiveness, for which I am sincerely grateful. If there was one theme or recommendation which came through the survey, it was in the area of office communication and the desire for **"more openly sharing information throughout the entire organization"**. I take all constructive comments and recommendations to heart. As a result, I have instituted **monthly office meetings throughout 2015** and will continue to request additional feedback and constructive comments to continue to improve upon our overall effectiveness, including my own.

Attachments: Executive Director / CIO Employee Opinion Survey

**MEMORANDUM**

**TO: David Hunter, Executive Director/CIO (ED/CIO)  
State Investment Board (SIB)**

**FROM: Terra Miller Bowley, Supervisor of Audit Services**

**DATE: January 23, 2015**

**SUBJECT: North Dakota Retirement and Investment Office (RIO)  
Employee Opinion Survey – ED/CIO**

On December 16, 2014 the RIO initiated a survey of employees. The purpose of the survey was to provide employees with the opportunity to evaluate the ED/CIO in three key areas – leadership, communication, and valuing employees. The survey was administered via SurveyMonkey and all responses were anonymous. The survey consisted of nine multiple-choice questions and one open-ended question. A summary of results follows.

Leadership

Employees believe that the ED/CIO provides a clear sense of direction and purpose for the organization and have confidence in his ability to lead the RIO. An overwhelming majority of employees believe the ED/CIO leads by example with integrity. Employees would like to see the ED/CIO take an increased leadership role within the organization and continue to build confidence in his abilities through actions.

Communication

Communication with the organization presents the greatest area of opportunity. Employees do believe that the ED/CIO is receptive to the opinions of others and is open to changing his position. However, employees do feel that there is a lack of information being shared regarding the organization as a whole. Employees would also like more openness with regards to communication.

Executive Director/CIO – Valuing Employees

Employees overwhelmingly indicate that the ED/CIO genuinely cares about employees and treats each and every employee with respect. Employees feel that the ED/CIO does a respectable job of obtaining input from all team members. However, employees would like to see the ED/CIO make additional efforts to obtain input from employees at all levels of the organization.

Ultimately the responses provided indicate that employees of the RIO are ready for change and willing to participate in the process, looking for strong independent leadership, and greater organization wide communication. Employees are overall happy to have Mr. Hunter at the helm and look forward to him putting his own stamp on the organization.

**BUDGETING / FINANCIAL CONDITION**

AS OF DECEMBER 31, 2014

|                        | 2013-2015<br>BUDGET    | ADJUSTED<br>APPROPRIATION | BIENNIUM TO<br>DATE ACTUAL | EXPENDITURES        |                       |                            |
|------------------------|------------------------|---------------------------|----------------------------|---------------------|-----------------------|----------------------------|
|                        |                        |                           |                            | BUDGET<br>AVAILABLE | % BUDGET<br>AVAILABLE | % OF BIENNIUM<br>REMAINING |
| SALARIES AND BENEFITS  | \$ 3,772,504.00        | \$ 3,772,504.00           | \$ 2,399,626.71            | \$ 1,372,877.29     | 36.39%                | 25.00%                     |
| ACCRUED LEAVE PAYMENTS | 71,541.00              | 71,541.00                 | 42,734.46                  | 28,806.54           | 40.27%                | 25.00%                     |
| OPERATING EXPENDITURES | 973,324.00             | 973,324.00                | 593,404.13                 | 379,919.87          | 39.03%                | 25.00%                     |
| CONTINGENCY            | 82,000.00              | 82,000.00                 | 61,987.33                  | 20,012.67           | 24.41%                | 25.00%                     |
| TOTAL                  | <u>\$ 4,899,369.00</u> | <u>\$ 4,899,369.00</u>    | <u>\$ 3,097,752.63</u>     | <u>1,801,616.37</u> | <u>36.77%</u>         | <u>25.00%</u>              |

## EXPENDITURE REPORT

QUARTER ENDED DECEMBER 31, 2014

|  | <u>INVESTMENT</u> | <u>RETIREMENT</u> | <u>QUARTERLY<br/>TOTALS</u> | <u>FISCAL YEAR<br/>TO - DATE</u> | <u>BIENNIUM<br/>TO - DATE</u> |
|--|-------------------|-------------------|-----------------------------|----------------------------------|-------------------------------|
| <u>CONTINUING APPROPRIATIONS</u>                 |                   |                   |                             |                                  |                               |
| INVESTMENT EXPENDITURES<br>(SEE ATTACHED DETAIL) | \$ 5,961,042.13   | \$ 0.00           | \$ 5,961,042.13             | \$ 15,591,346.78                 | \$ 37,843,198.12              |
| MEMBER CLAIMS                                    |                   |                   |                             |                                  |                               |
| 1. ANNUITY PAYMENTS                              | 0.00              | 41,933,867.98     | 41,933,867.98               | 83,860,858.98                    | 241,456,822.51                |
| 2. REFUND PAYMENTS                               | 0.00              | 1,332,571.40      | 1,332,571.40                | 1,909,879.83                     | 6,639,264.12                  |
| TOTAL MEMBER CLAIMS                              | 0.00              | 43,266,439.38     | 43,266,439.38               | 85,770,738.81                    | 248,096,086.63                |
| OTHER CONTINUING APPROPRIATIONS                  | 65,646.96         | 95,670.16         | 161,317.12                  | 207,908.56                       | 501,362.66                    |
| TOTAL CONTINUING APPROPRIATIONS                  | 6,026,689.09      | 43,362,109.54     | 49,388,798.63               | 101,569,994.15                   | 286,440,647.41                |
| <u>BUDGETED EXPENDITURES</u>                     |                   |                   |                             |                                  |                               |
| 1. SALARIES & BENEFITS                           |                   |                   |                             |                                  |                               |
| SALARIES   | 168,082.42        | 182,779.77        | 350,862.19                  | 669,701.19                       | 1,774,720.59                  |
| OVERTIME/TEMPORARY                               | 0.00              | 0.00              | 0.00                        | 0.00                             | 2,950.00                      |
| TERMINATION SALARY & BENEFITS                    | 0.00              | 0.00              | 0.00                        | 0.00                             | 0.00                          |
| FRINGE BENEFITS                                  | 50,231.57         | 70,819.33         | 121,050.90                  | 227,931.38                       | 621,956.12                    |
| TOTAL SALARY & BENEFITS                          | 218,313.99        | 253,599.10        | 471,913.09                  | 897,632.57                       | 2,399,626.71                  |
| 2. ACCRUED LEAVE PAYMENTS                        | 0.00              | 5,590.88          | 5,590.88                    | 5,590.88                         | 42,734.46                     |
| 3. OPERATING EXPENDITURES                        |                   |                   |                             |                                  |                               |
| DATA PROCESSING                                  | 2,687.29          | 17,536.36         | 20,223.65                   | 32,702.92                        | 110,342.21                    |
| TELECOMMUNICATIONS - ISD                         | 983.59            | 1,500.17          | 2,483.76                    | 4,373.22                         | 15,446.78                     |
| TRAVEL   | 7,030.85          | 10,520.69         | 17,551.54                   | 34,171.54                        | 60,082.18                     |
| IT - SOFTWARE/SUPPLIES                           | 2,655.20          | 4,002.07          | 6,657.27                    | 6,743.17                         | 9,031.05                      |
| POSTAGE SERVICES                                 | 797.34            | 3,033.99          | 3,831.33                    | 19,858.69                        | 59,642.76                     |
| IT - CONTRACTUAL SERVICES                        | 196.98            | 11,248.43         | 11,445.41                   | 13,729.60                        | 115,449.60                    |
| BUILDING/LAND RENT & LEASES                      | 5,024.04          | 8,130.82          | 13,154.86                   | 40,514.58                        | 120,182.24                    |
| DUES & PROF. DEVELOPMENT                         | 247.00            | 3,043.00          | 3,290.00                    | 16,790.00                        | 29,039.71                     |
| OPERATING FEES & SERVICES                        | 626.34            | 653.19            | 1,279.53                    | 5,899.93                         | 23,856.60                     |
| REPAIR SERVICE                                   | 0.00              | 0.00              | 0.00                        | 0.00                             | 144.25                        |
| PROFESSIONAL SERVICES                            | 731.23            | 1,518.77          | 2,250.00                    | 5,065.00                         | 18,327.00                     |
| INSURANCE  | 175.87            | 305.97            | 481.84                      | 481.84                           | 1,095.37                      |
| OFFICE SUPPLIES                                  | 79.56             | 595.67            | 675.23                      | 829.86                           | 2,392.04                      |
| PRINTING   | 981.64            | 2,726.58          | 3,708.22                    | 7,916.72                         | 21,061.18                     |
| PROFESSIONAL SUPPLIES & MATERIALS                | 407.18            | 346.09            | 753.27                      | 753.27                           | 1,696.87                      |
| MISCELLANEOUS SUPPLIES                           | 90.70             | 187.60            | 278.30                      | 387.14                           | 1,086.48                      |
| IT EQUIPMENT UNDER \$5000                        | 0.00              | 0.00              | 0.00                        | 3,967.66                         | 4,527.81                      |
| OTHER EQUIPMENT UNDER \$5000                     | 0.00              | 0.00              | 0.00                        | 0.00                             | 0.00                          |
| TOTAL OPERATING EXPENDITURES                     | 22,714.81         | 65,349.40         | 88,064.21                   | 194,185.14                       | 593,404.13                    |
| 3. CONTINGENCY                                   | 0.00              | 0.00              | 0.00                        | 0.00                             | 61,987.33                     |
| TOTAL BUDGETED EXPENDITURES                      | 241,028.80        | 324,539.38        | 565,568.18                  | 1,097,408.59                     | 3,097,752.63                  |
| TOTAL EXPENDITURES                               | \$ 6,202,070.93   | \$ 43,590,978.76  | \$ 49,954,366.81            | \$ 102,667,402.74                | \$ 289,538,400.04             |

**INVESTMENT EXPENDITURE DETAIL**

**FEES PAID DURING THE QUARTER ENDED DECEMBER 31, 2014**

**FOR QUARTER ENDED 3/31/14**

**PENSION REAL ESTATE**

JP Morgan (Special & Strategic) 343,340.43

**PENSION INTERNATIONAL FIXED INCOME**

UBS 82,672.67

**TOTAL FOR QUARTER ENDED 3/31/14 426,013.10**

**FOR QUARTER ENDED 6/30/14**

**PENSION REAL ESTATE**

JP Morgan (Special & Strategic) 352,794.83

**PENSION INTERNATIONAL FIXED INCOME**

UBS 88,549.10

**PENSION EMERGING MARKETS**

JP Morgan 49,402.31

**TOTAL FOR QUARTER ENDED 6/30/14 490,746.24**

**FOR QUARTER ENDED 9/30/14**

**PENSION DEVELOPED INTERNATIONAL EQUITY POOL**

Capital Guardian 117,889.38

Wellington 180,846.83

**TOTAL PENSION INTERNATIONAL EQUITY 298,736.21**

**PENSION GLOBAL EQUITY POOL**

Epoch 481,037.66

LSV 103,271.00

**TOTAL PENSION GLOBAL EQUITY 584,308.66**

**PENSION BELOW INVESTMENT GRADE FIXED**

Loomis Sayles 277,538.24

**PENSION INVESTMENT GRADE FIXED INCOME POOL**

PIMCO 213,683.47

State Street 10,468.66

Western Asset 42,533.33

**TOTAL PENSION INVESTMENT GRADE FIXED INCOME 266,685.46**

**PENSION INFRASTRUCTURE POOL**

JP Morgan 295,436.63

**PENSION LARGE CAP EQUITY POOL**

LA Capital 228,971.80

**PENSION REAL ESTATE**

Invesco 144,932.47

**PENSION INTERNATIONAL FIXED INCOME**

Brandywine 116,735.75

UBS 91,288.36

**TOTAL PENSION INTERNATIONAL FIXED INCOME 208,024.11**

**PENSION PRIVATE EQUITY**

Adams Street Partners 11,341.00

**PENSION CASH**

Northern Trust 16,187.06

**INSURANCE FIXED INCOME POOL**

**INVESTMENT EXPENDITURE DETAIL**

**FEES PAID DURING THE QUARTER ENDED DECEMBER 31, 2014**

|   |            |                                 |
|---|------------|---------------------------------|
| Prudential  | 95,361.91  |                                 |
| State Street  | 18,782.07  |                                 |
| Wells   | 246,715.52 |                                 |
| Western Asset   | 177,160.82 |                                 |
| <b>TOTAL INSURANCE FIXED INCOME</b>                         | <hr/>      | 538,020.32                      |
| <br><b><u>INSURANCE LARGE CAP EQUITY POOL</u></b>           |            |                                 |
| LA Capital  | 169,098.53 |                                 |
| LSV   | 160,483.00 |                                 |
| <b>TOTAL INSURANCE LARGE CAP</b>                            | <hr/>      | 329,581.53                      |
| <br><b><u>INSURANCE SMALL CAP EQUITY POOL</u></b>           |            |                                 |
| Research Affiliates   |            | 69,692.34                       |
| <br><b><u>INSURANCE INT'L EQUITY</u></b>                    |            |                                 |
| Capital Guardian  | 242,256.73 |                                 |
| LSV   | 270,054.00 |                                 |
| <b>TOTAL INSURANCE INT'L EQUITY</b>                         | <hr/>      | 512,310.73                      |
| <br><b><u>INSURANCE DIVERSIFIED REAL ASSETS</u></b>         |            |                                 |
| JP Morgan   | 202,143.26 |                                 |
| Western Asset   | 86,769.96  |                                 |
| <b>TOTAL INSURANCE DIVERSIFIED REAL ASSETS</b>              | <hr/>      | 288,913.22                      |
| <br><b><u>INSURANCE REAL ESTATE</u></b>                     |            |                                 |
| Invesco   | 87,267.84  |                                 |
| JP Morgan   | 424,955.00 |                                 |
| <b>TOTAL INSURANCE REAL ESTATE</b>                          | <hr/>      | 512,222.84                      |
| <br><b><u>INSURANCE SHORT TERM FIXED</u></b>                |            |                                 |
| Babson  |            | 90,981.90                       |
| <br><b><u>LEGACY FUND SHORT TERM FIXED</u></b>              |            |                                 |
| Babson  |            | 80,689.28                       |
| <br><b><u>PERS RETIREE HEALTH INSURANCE CREDIT FUND</u></b> |            |                                 |
| SEI   |            | 63,382.10                       |
| <br><b><u>CONSULTANT</u></b>                                |            |                                 |
| Adams Street  | 37,762.00  |                                 |
| Callan  | 188,564.89 |                                 |
| <b>TOTAL CONSULTANT</b>                                     | <hr/>      | 226,326.89                      |
| <br><b>TOTAL FOR QUARTER ENDED 9/30/14</b>                  |            | <hr/> <b>5,044,282.79</b>       |
| <br><b>TOTAL FEES PAID DURING QUARTER ENDED 12/31/2014</b>  |            | <hr/> <b>5,961,042.13</b> <hr/> |

# **NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE**

## **QUARTERLY MONITORING REPORT**

**Quarter Ended December 31, 2014**

### **STAFF RELATIONS**

The Executive Limitation “Staff Relations” deals with the treatment of staff at RIO. The executive director “shall not cause or allow any condition or any communication which is unfair, undignified, or disrespectful.” This Executive Limitation lists six specific limitations that range from personnel policies to exit interviews. All the limitations are intended to protect staff from unfair, undignified, or disrespectful treatment by management.

**During the past quarter, there were no exceptions to this Executive Limitation.**

Based on responses to an anonymous survey of all RIO employees on December 16, 2014, the Executive Director / CIO “treats employees with respect” and “shows genuine concern for team members”.

Denise Weeks, Retirement Programs Specialist, resigned from RIO on December 19, 2014, to pursue an opportunity in the private sector.

RIO is scheduled to interview five qualified candidates (as determined by HRMS) on January 21, 2015, to fill this important position.

Terra Miller-Bowley, Supervisor of Audit Services, provided Denise Weeks the opportunity to complete an employment termination questionnaire and exit interview prior to her departure.

RIO staff has been kept informed on the status of the positions.

**Quarterly Report on Ends  
Q2:FY15**

Investment Program

Continuing due diligence conducted on following:

|                      |               |
|----------------------|---------------|
| PIMCO                | DFA           |
| Bank of North Dakota | TIR           |
| Capital Group        | UBS           |
| JP Morgan            | Declaration   |
| Grosvenor            | Goldman Sachs |
| Callan               | Western Asset |
| Adams Street         | SEI           |
| Babson               |               |

Initial due diligence conducted on the following:

|                                 |                 |
|---------------------------------|-----------------|
| AQR                             | Novarca         |
| Hamilton Lane                   | TCW             |
| Angelo Gordan                   | Bell State Bank |
| Real Asset Portfolio Management |                 |
| Thornburg                       |                 |
| Apollo                          |                 |
| Magnetar                        |                 |
| Evercore                        |                 |

Callan Associates completed a custody and securities lending review of Northern Trust and presented its findings to the State Investment Board at the October SIB meeting.

Callan Associates completed a fee study of the pension and insurance trusts, the results of which were presented to the State Investment Board at the November SIB meeting.

At the November SIB meeting, the Board approved the retention of Novarca to perform a fee analysis of the private equity managers within the pension trust, subject to successful contract negotiations.

The State Investment Board approved at the November SIB meeting the initiation of a conservative securities lending program to be offered by Northern Trust.

At the November SIB meeting, the State Investment Board approved making capital commitments of up to \$30 million for the pension trust and up to \$75 million for the

Legacy Fund to Grosvenor Customized Infrastructure Strategies II. A legal contract review was completed in December and the first close is expected to occur in January.

The transition of the Western Asset Mortgage Backed Securities mandate within the pension trust investment grade fixed income sub-asset class to JP Morgan (Columbus) was completed in the second fiscal quarter.

Staff continued to progress with the implementation of the new strategic asset allocation for the Legacy Fund, which is expected to be completed in January 2015.

Staff attended meetings with the following entities: TFFR Board, NDPERS Board and Investment Subcommittee, North Dakota Insurance Department, City of Bismarck, City of Grand Forks. Grand Forks Park District, Legacy and Budget Stabilization Fund Advisory Board, Legislative Employee Benefits Committee and Legislative Government Finance Committee.

Staff continues to conduct preliminary due diligence on possible managers/products for future consideration.

Staff continues to monitor each client's asset allocation monthly and makes rebalancing decisions based on rebalancing policy and cash flow requirements.

Staff obtained a temporary performance-based fee structure for the PIMCO Unconstrained Bond mandate within the pension trust, which will result in fee savings as compared to the standard fee schedule should performance not exceed the expected return target of LIBOR plus 400 basis points.

## Quarterly Monitoring Report on TFFR Ends Quarter ended December 31, 2014

### Retirement Program

This report highlights exceptions to normal operating conditions.

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- TFFR's actuary presented 2014 annual actuarial valuation report and funding projections to TFFR Board and the Legislative Employee Benefits Programs Committee.
- TFFR filed a technical corrections bill for the 2015 legislative session. The bill contains technical changes to comply with federal statutes. The bill was given a favorable recommendation by the Interim Legislative Employee Benefits Programs Committee.
- TFFR, PERS, and the State Auditor's Office are continuing to develop a collaborative plan to implement the new GASB pension reporting standards with the assistance of plan actuaries, plan auditors, and trainer/consultant. GASB training for all TFFR and PERS employers and auditors was held December 11, 2014 in Bismarck. The training was attended by over 100 individuals representing school districts, state, county, and city governments, and several audit firms. The training session was recorded and available on the TFFR and PERS websites.
- TFFR staff is working with external auditor and State Auditor's Office to conduct census data testing of TFFR employers as part of the GASB 68 implementation. Seventeen TFFR employers were selected for audit. TFFR's external auditor will be visiting these employers to perform onsite audit work in January 2015.
- TFFR received 2014 Public Pension Standards Award for Funding and Administration. This award is designed to recognize and commend public employee retirement systems that meet professional standards for pension plan funding and administration.
- Clarence Corneil resigned from the TFFR Board in November 2014 after serving twelve years. Governor Dalrymple appointed Mike Burton, a retired teacher from Fargo, to complete Mr. Corneil's term which expires June 30, 2017.

## Agenda Item VI. E.

**TO:** State Investment Board (“SIB”)  
**FROM:** Darren Schulz, Deputy CIO, Retirement and Investment Office (“RIO”)  
**DATE:** January 23, 2015  
**SUBJECT:** Watch List Manager Meeting Updates  
**ACTION:** None (Informational)

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Following a meeting with PIMCO representatives Stephanie King, SVP, Michael Chandra, EVP, and Yinyin Wu, Account Manager, on October 2<sup>nd</sup> in Bismarck, RIO Staff conducted an on-site due diligence meeting at PIMCO’s corporate offices in Newport Beach. The purpose of the meeting was to gain a further understanding of the events leading to Bill Gross departure from PIMCO on September 26<sup>th</sup> and the expected impact on our specific investment strategies. Additionally, PIMCO provided a portfolio review of all SIB strategies: MBS, Unconstrained, DISCO II and BRAVO II. Staff will continue to closely monitor our existing investment strategies and any ensuing firm developments.

RIO has held conference calls with Timberland Investment Resources (“TIR”) personnel during November in advance of a Timber strategy review in early-2015. Additionally, RIO Staff and Treasurer Schmidt attended a meeting with Mark Seaman and Tom Johnson in Bismarck on December 10<sup>th</sup> to review the Springbank portfolio, which has a management and incentive fee agreement that will terminate on 6/30/2015. TIR will be presenting to the State Investment Board at the February meeting.

**TO:** State Investment Board (“SIB”)  
**FROM:** Darren Schulz, Deputy CIO, Retirement and Investment Office (“RIO”)  
**DATE:** January 23, 2015  
**SUBJECT:** UBS International Fixed Income Watchlist Recommendation  
**ACTION:** Approval to add UBS Global Bond ex-US to the Watchlist

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**Recommendation:**

Staff recommends to the State Investment Board that the UBS Global Bond ex-U.S. fixed income strategy with the pension trust be added to the Watchlist due to persistent underperformance relative to its benchmark.

**Background:**

As of December 31, 2014, UBS managed a \$105 million non-U.S. fixed income mandate within the pension trust. Benchmarked to the Barclays Global Aggregate Ex-USD Bond Index, the strategy is an actively managed portfolio that invests in primarily investment grade non-U.S. fixed income securities, such as government, government related, supranational, corporate, and securitized debt. The strategy’s guidelines restrict non-investment grade (high yield) securities to a maximum allocation of 10%. The mandate is intended to serve as a low tracking error complement to the other pension trust non-U.S. fixed income manager, Brandywine Global Opportunistic Fixed Income.

On a net of fee basis, the UBS Global ex-U.S. Bond mandate has underperformed its benchmark, the Barclays Global Aggregate ex USD Index, in absolute and risk-adjusted terms over the following annualized time periods:

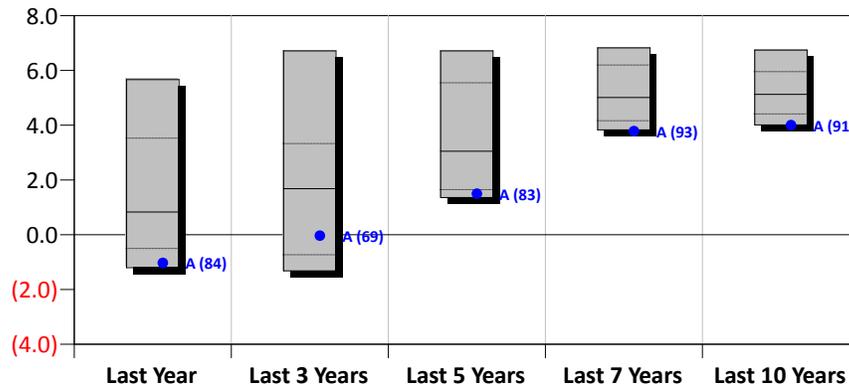
**UBS Global ex-US Bond**

Net of Fee Return vs. Barclays Global Aggregate ex USD Index

|                             | <b>1 Year</b> | <b>3 Years</b> | <b>5 Years</b> | <b>7 Years</b> | <b>10 Years</b> |
|-----------------------------|---------------|----------------|----------------|----------------|-----------------|
| ND Pen-UBS Intl FI          | (1.20)        | (0.31)         | 1.20           | 3.48           | 3.67            |
| Barclays:Gbl Agg ex USD     | (0.81)        | 0.14           | 1.68           | 3.60           | 4.17            |
| Excess Return               | (0.39)        | (0.45)         | (0.48)         | (0.12)         | (0.50)          |
| Risk Adjusted Excess Return | (0.41)        | (0.45)         | (0.50)         | (0.18)         | (0.53)          |

Additionally, performance of the UBS Global Bond ex-U.S. strategy has ranked in the third and bottom quartile relative to its peer universe, as measured against the Callan Non-Fixed Income Style composite:

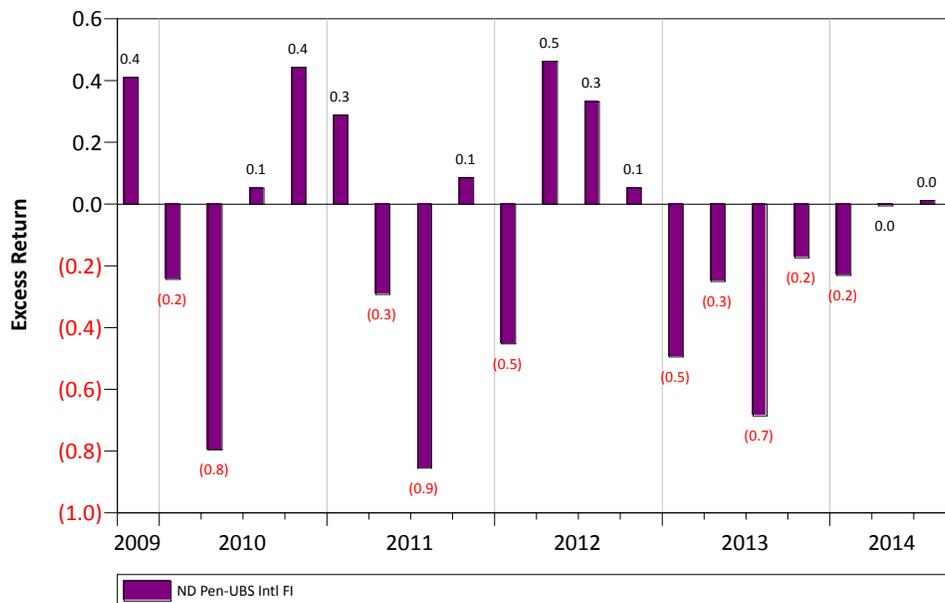
**Returns  
for Periods Ended September 30, 2014  
Group: CAI Non-U.S. Fixed-Inc Style**



|                           |                   |               |             |             |             |
|---------------------------|-------------------|---------------|-------------|-------------|-------------|
| 10th Percentile           | 5.67              | 6.72          | 6.72        | 6.82        | 6.74        |
| 25th Percentile           | 3.49              | 3.29          | 5.51        | 6.16        | 5.92        |
| Median                    | 0.84              | 1.69          | 3.05        | 5.02        | 5.13        |
| 75th Percentile           | (0.54)            | (0.76)        | 1.61        | 4.13        | 4.38        |
| 90th Percentile           | (1.20)            | (1.32)        | 1.36        | 3.83        | 4.01        |
| <b>ND Pen-UBS Intl FI</b> | <b>• A (1.07)</b> | <b>(0.07)</b> | <b>1.46</b> | <b>3.75</b> | <b>3.97</b> |

Viewing relative performance through the lens of consistency, the UBS Global Bond ex-U.S. Fund has underperformed the benchmark in 55% of the quarters over the prior five years; recent underperformance is even more persistent as illustrated below:

**Net of Fee Excess Return Relative To Barclays:Gbl Agg ex USD  
for 5 Years Ended September 30, 2014**



Recent performance has been negatively impacted by the following:

- A short duration position in developed markets relative to the benchmark in an environment of declining long-term rates;
- High yield exposure, which underperformed higher quality bonds; and
- An underweight to Spain due to political challenges.

Staff will continue to closely monitor performance and provide updates to the Board, as appropriate.

# NDSIB Watch List

*PIMCO data as of 9/30/14*

| PIMCO Disco II (Ins.) |         | \$76,796,455       |        |
|-----------------------|---------|--------------------|--------|
|                       | Returns | Index <sup>1</sup> | Excess |
| 1 Year                | 11.38   | 3.96               | 7.42   |
| 2 Year                | 17.43   | 1.10               | 16.33  |
| Inception*            | 20.30   | 2.43               | 17.86  |

\*Funded 10/07/2011

| PIMCO Disco II (Pen.) |         | \$85,423,973       |        |
|-----------------------|---------|--------------------|--------|
|                       | Returns | Index <sup>1</sup> | Excess |
| 1 Year                | 11.36   | 3.96               | 7.40   |
| 2 Year                | 17.42   | 1.10               | 16.32  |
| Inception*            | 20.54   | 2.43               | 18.11  |

\*Funded 10/07/2011

| PIMCO Bravo II (Ins.) |         | \$17,720,786       |        |
|-----------------------|---------|--------------------|--------|
|                       | Returns | Index <sup>1</sup> | Excess |
| Inception*            | 22.09   | 3.96               | 18.14  |

\*Funded 10/01/2013 (6th Close)

| PIMCO Bravo II (Pen.) |         | \$17,720,786       |        |
|-----------------------|---------|--------------------|--------|
|                       | Returns | Index <sup>2</sup> | Excess |
| Inception             | 22.09   | 7.19               | 14.90  |

\*Funded 10/01/2013 (6th Close)

| PIMCO MBS (Pen.) |         | \$175,732,873      |        |
|------------------|---------|--------------------|--------|
|                  | Returns | Index <sup>4</sup> | Excess |
| 1 Year           | 3.36    | 3.78               | (0.43) |
| 2 Year           | 0.69    | 1.26               | (0.57) |
| Inception*       | 1.74    | 1.90               | (0.16) |

\*Funded 3/31/2012

| PIMCO Unconstrained (Pen.) |         | \$93,810,011       |        |
|----------------------------|---------|--------------------|--------|
|                            | Returns | Index <sup>3</sup> | Excess |
| 1 Year                     | 1.39    | 0.23               | 1.16   |
| 2 Year                     | 0.33    | 0.26               | 0.07   |
| Inception*                 | 2.76    | 0.30               | 2.46   |

\*Funded 3/12/2012

*TIR data as of 9/30/14*

| TIR Teredo |         | \$63,866,004       |        |
|------------|---------|--------------------|--------|
|            | Returns | Index <sup>5</sup> | Excess |
| 1 Year     | 6.64    | 10.38              | (3.73) |
| 3 Year     | 3.09    | 7.37               | (4.29) |
| 5 Year     | 5.33    | 3.58               | 1.75   |
| Inception* | 10.43   | 6.85               | 3.58   |

\*Funded 06/12/2001

*UBS data as of 9/30/14*

| UBS        |         | \$105,201,153      |        |
|------------|---------|--------------------|--------|
|            | Returns | Index <sup>7</sup> | Excess |
| 1 Year     | (1.20)  | (0.81)             | (0.39) |
| 3 Year     | (0.31)  | 0.14               | (0.45) |
| 5 Year     | 1.20    | 1.68               | (0.48) |
| Inception* | 6.69    | 6.36               | 0.33   |

\*Funded 07/01/1989

| TIR Eastern Timber |         | \$74,373,317       |        |
|--------------------|---------|--------------------|--------|
|                    | Returns | Index <sup>6</sup> | Excess |
| 1 Year             | 9.89    | 3.44               | 6.45   |
| 3 Year             | 5.69    | 3.52               | 2.16   |
| 5 Year             | 4.00    | 4.39               | (0.40) |
| Inception*         | 3.98    | 4.60               | (0.62) |

\*Funded 10/14/2008

| TIR Springbank |         | \$119,442,642      |         |
|----------------|---------|--------------------|---------|
|                | Returns | Index <sup>5</sup> | Excess  |
| 1 Year         | 0.22    | 10.38              | (10.15) |
| 3 Year         | (2.60)  | 7.37               | (9.97)  |
| 5 Year         | (5.35)  | 3.58               | (8.93)  |
| Inception*     | 7.41    | 8.29               | (0.88)  |

\*Funded 09/20/2004

- <sup>1</sup> Barclays Aggregate Index
- <sup>2</sup> Barclays High Yield 2% Index
- <sup>3</sup> Libor 3-Month
- <sup>4</sup> Barclays Mortgage Index
- <sup>5</sup> NCREIF Timberland Index
- <sup>6</sup> Barclays Global Inflation Linked
- <sup>7</sup> Barclays Global Agg. Ex US

*Note: All returns are net of fees.*

## **SIB Legislative Bill Tracking Status Report As of January 22, 2015**

### **1. SB2022 – RIO Budget Bill (Support)**

1/06/2015 – Introduced, first reading, referred to Appropriations Committee

1/14/2015 8:30 am – Committee Hearing - Senate Appropriations

Dave presented testimony (Fay and Connie also attended); there were general investment related questions but no specific budget related questions

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### **2. HB1063 – Relating to modifications to investment policies for and funds under management of the State Investment Board (“administrative changes”) (Support)**

This is the administrative changes bill submitted by the SIB. It clarifies existing language in Chapter 21-10, corrects an incorrect paragraph reference and updates the list of statutory funds under SIB management

1/06/2015 – Introduced, first reading, referred to House Government and Veterans Affairs Committee.

1/08/2015 9:30 am – Committee Hearing - House Government and Veterans Affairs

Dave provided testimony in support of the bill.

1/09/2015 – Reported back, do pass, 14-0-0

1/12/2015 – Second reading, passed, 92-0

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### **3. SB2039 – ...relating to a public employee retirement stabilization fund and funds managed by the state investment board. (Monitor)**

This bill would create the public employee retirement stabilization fund for the purpose of addressing any unfunded retirement obligations of the main state employee retirement plan and put the supervision of the investment of the fund under the SIB.

1/06/2015 – Introduced, first reading, referred to Senate Education Committee.

1/12/2015 – Committee Hearing – 10:15 am

Dave attended but did not provide testimony

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### **4. HB1066 – Relating to the balance of and transfers to the budget stabilization fund. (Monitor)**

This bill would clarify the timeframe in which the balance is reviewed and would allow the biennial transfers between this fund and the general fund to be netted to avoid liquidating assets and subsequently reinvesting them.

1/06/2015 – Introduced, first reading, (emergency) referred to House Appropriations.

1/20/2015 – Committee Hearing – 9:00 am

Dave attended and answered questions of the committee

1/20/2015 – Reported back, do pass, 23-0-0

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**5. HB1033 – Relating to definitions for the legacy fund, the legacy fund principal balance, and a transfer of legacy fund earnings. (Monitor)**

This bill defines key terms related to the Legacy Fund, including “earnings” and “principal”; requires OMB to calculate the 15% of the principal balance that may be spent each biennium after 6/30/2017; requires the earnings of the fund after 6/30/17 become part of the principal until certain thresholds are met.

1/06/2015 – Introduced, first reading, referred to House Appropriations Committee

1/20/2015 – Committee Hearing – 3:15 pm

Dave attended but did not provide testimony.

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**6. SB2038 – Relating to a defined contribution retirement plan for state employees... (Monitor)**

Among other things specific to PERS administration, this bill would close the existing PERS defined benefit plan to new entrants effective January 1, 2016.

1/06/2015 – Introduced, first reading, referred to Senate Government and Veterans Affairs Committee

1/22/2015 – Committee Hearing – 9:00 am

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**7. HB1329 – Relating to the membership of the state investment board. (Monitor)**

This bill adds two additional members to the State Investment Board; “one member appointed by the majority leader of the senate, one member appointed by the majority leader of the house of representatives”.

1/13/2015 - Introduced, first reading, referred to House Political Subdivisions Committee

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**8. HB1250 – Relating to the publishing of minutes of boards and commissions. (Monitor)**

This bill would require each governing body to which the governor appoints any member to publish on the governor’s office website the minutes of each meeting within sixty days after the meeting.

1/13/2015 – Introduced, first reading, referred to House Political Subdivisions Committee

1/23/2015 – Committee Hearing – 9:00 am

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**9. HB1053 – Relating to centralized desktop support services through ITD (Monitor)**

This bill would require certain state agencies not specifically exempted (RIO is not exempted) to obtain centralized desktop support services from the state Information Technology Department (ITD).

1/06/2015 – Introduced, first reading, referred to House Government and Veterans Affairs Committee

1/15/2015 – Committee Hearing – 8:30 am

1/19/2015 – Referred to Appropriations

**TO:** State Investment Board  
**FROM:** Dave Hunter, Executive Director/CIO  
**DATE:** January 19, 2015  
**SUBJECT:** SIB Legislative Update

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**Summary:** RIO intends to update the attached SIB Legislative Bill Tracking Status Report at the end of each business week throughout the 64<sup>th</sup> Legislative Session.

\*\*\*\*\*

**SIB Legislative Bill Tracking Status Report  
As of January 19, 2015**

**1. SB2022 – RIO Budget Bill (Support)**

1/06/2015 – Introduced, first reading, referred to Appropriations Committee

1/14/2015 8:30 am – Committee Hearing - Senate Appropriations

Dave presented testimony (Fay and Connie also attended); there were general investment related questions (RIO organizational chart, SIB/TFFR board members, client and manager lists) but no specific budget related questions.

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**2. HB1063 – Relating to modifications to investment policies for and funds under management of the State Investment Board (“administrative changes”) (Support)**

This is the administrative changes bill submitted by the SIB. It clarifies existing language in Chapter 21-10, corrects an incorrect paragraph reference and updates the list of statutory funds under SIB management

1/06/2015 – Introduced, first reading, referred to House Government and Veterans Affairs Committee.

1/08/2015 9:30 am – Committee Hearing - House Government and Veterans Affairs

Dave provided testimony.

1/09/2015 – Reported back, do pass, 14-0-0

1/12/2015 – Second reading, passed, 92-0

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**3. SB2039 – ...relating to a public employee retirement stabilization fund and funds managed by the state investment board. (Monitor)**

This bill would create the public employee retirement stabilization fund for the purpose of addressing any unfunded retirement obligations of the main state employee retirement plan and put the supervision of the investment of the fund under the SIB.

1/06/2015 – Introduced, first reading, referred to Senate Education Committee.

1/12/2015 – Committee Hearing – 10:15 am

Dave attended but did not provide testimony

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**4. HB1066 – Relating to the balance of and transfers to the budget stabilization fund. (Monitor)**

This bill would clarify the timeframe in which the balance is reviewed and would allow the biennial transfers between this fund and the general fund to be netted to avoid liquidating assets and subsequently reinvesting them.

1/06/2015 – Introduced, first reading, (emergency) referred to House Appropriations.

1/20/2015 – Committee Hearing – 9:00 am

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**5. HB1033 – Relating to definitions for the legacy fund, the legacy fund principal balance, and a transfer of legacy fund earnings. (Monitor)**

This bill defines key terms related to the Legacy Fund, including “earnings” and “principal”; requires OMB to calculate the 15% of the principal balance that may be spent each biennium after 6/30/2017; requires the earnings of the fund after 6/30/17 become part of the principal until certain thresholds are met.

1/06/2015 – Introduced, first reading, referred to House Appropriations Committee

1/20/2015 – Committee Hearing – 3:15 pm

---

**6. SB2038 – Relating to a defined contribution retirement plan for state employees... (Monitor)**

Among other things specific to PERS administration, this bill would close the existing PERS defined benefit plan to new entrants effective January 1, 2016.

1/06/2015 – Introduced, first reading, referred to Senate Government and Veterans Affairs Committee

1/22/2015 – Committee Hearing – 9:00 am

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**7. HB1329 – Relating to the membership of the state investment board. (Monitor)**

This bill adds two additional members to the State Investment Board; “one member appointed by the majority leader of the senate, one member appointed by the majority leader of the House of Representatives”.

1/13/2015 - Introduced, first reading, referred to House Political Subdivisions Committee

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**8. HB1053 – Required use of centralized desktop services. (Monitor)**

This bill will require designated state agencies to use centralized desktop support services rather than information technology personnel which are located onsite today.

1/06/2015 – Introduced, first reading, referred to Senate Government and Veterans Affairs Committee

1/15/2015 – Committee Hearing – 8:30 am

Rich Nagel, RIO Supervisor of Information Systems, attended but did not provide testimony

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**SIB Legislation:**

[\\nd.gov\rio\rio-admin\RIO\55 \(LEG\) LEGISLATION\2015\Legislative Updates\SIB\SIB bill Status Report-initial.docx](\\nd.gov\rio\rio-admin\RIO\55 (LEG) LEGISLATION\2015\Legislative Updates\SIB\SIB bill Status Report-initial.docx)

**ND Legislative website:**

<http://www.legis.nd.gov/assembly/64-2015/regular>

## AGENDA ITEM VII. B.

**TO:** State Investment Board

**FROM:** Dave Hunter, Executive Director/CIO

**DATE:** January 23, 2015

**SUBJECT:** Job Service, Legacy & Budget Stabilization Fund Investment Policies

**ACTION:** **BOARD ACCEPTANCE REQUESTED**

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### **Background:**

RIO staff reviewed the investment policy statements of the Legacy & Budget Stabilization Funds and PERS Job Service pension plan with their respective advisory committees or boards over the past few months. The Legacy and Budget Stabilization Fund Advisory Board (“Advisory Board”) unanimously approved the proposed revisions to their investment policy statements on December 1, 2014. The PERS board unanimously approved their revisions on January 5, 2015. The proposed changes are highlighted below:

Legacy Fund: One sentence was inserted to make it clear the approved asset allocation policy of 50% equity, 35% fixed income and 15% real assets will be implemented over an 18 month period (between August 2013 and January 2015).

Budget Stabilization Fund: The investment policy was revised to incorporate recent fund contributions (Section 1) and performance standards (for return and risk) were restated to be consistent with current terminology (Section 4). The guidelines were revised to clarify that the Advisory Board serves the role previously provided by the Office of Management and Budget while noting that the asset allocation to the Bank of North Dakota Match Loan CD Program was stated in percentage terms to be 35% (Section 5). The guidelines were also revised to incorporate current investment restrictions and restated to be consistent with terminology adopted by other SIB clients.

Job Service: Given that this pension plan is fully funded (140%) with few active participants (< 20), the PERS board approved a de-risking strategy. The first step involves a reduction in the expected return assumption to 7% from 8% by replacing higher volatility strategies with lower volatility strategies although there is no change to the overall 40% equity and 60% fixed income asset allocation at this time. The proposed changes are expected to reduce portfolio volatility, as measured by standard deviation, by 25% (from 10% to 7.5%) along with a meaningful decrease in management fees. RIO intends to work with PERS to develop a formal de-risking glide path which is expected to be fully implemented over the next 12-to-18 months in order to reduce funded status volatility and management fees.

### **Recommendation:**

RIO recommends the SIB accept the investment policy statements recently approved by the respective Legacy and Budget Stabilization Fund Advisory Board and PERS Board.

## NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

**LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD**

Monday, December 1, 2014  
Medora Room, State Capitol  
Bismarck, North Dakota

Representative Keith Kempenich, Chairman, called the meeting to order at 3:20 p.m.

**Members present:** Representatives Keith Kempenich, Gary Kreidt; Senators Jerry Klein, Carolyn C. Nelson; Citizen Members Ryan Rauschenberger, Pam Sharp

**Members absent:** Eric Hardmeyer

**Others present:** See [Appendix A](#)

**It was moved by Representative Kreidt, seconded by Senator Klein, and carried on a voice vote that the minutes of the October 28, 2014, meeting be approved as distributed.**

**BUDGET STABILIZATION FUND INVESTMENT POLICY STATEMENT**

At the request of Chairman Kempenich, Mr. David J. Hunter, Executive Director and Chief Investment Officer, Retirement and Investment Office, provided information ([Appendix B](#)) regarding proposed changes to the investment policy statement of the budget stabilization fund.

Mr. Hunter said the Retirement and Investment Office (RIO) provided an update to the State Investment Board (SIB) in November 2014, regarding proposed changes to the investment policy statement of the budget stabilization fund and the advisory board's recommendation to increase the fund's investment in the the Bank of North Dakota Match Loan CD Program. He said based on discussion with SIB and as a result of the advisory board's recommendation, RIO recommends the investment policy statement for the budget stabilization fund be revised to include a 35 percent asset allocation limit for the Match Loan CD Program. He said based on the Office of Management and Budget preliminary revenue forecast and a preliminary 2015-17 biennium budget outlook prepared by the Legislative Council ([Appendix C](#)), an estimated \$134 million may be deposited into the budget stabilization fund at the end of the 2013-15 biennium. He said if the additional funds are deposited into the fund, the balance in the fund will total approximately \$714 million and the recommendation to allocate 35 percent of the fund's assets to the Match Loan CD Program will be consistent with the advisory board's recommendation, approved in October 2014, to increase the funding allocated to the Match Loan CD Program from \$200 million to \$250 million.

Mr. Hunter said RIO recommends the following changes to the investment policy statement of the budget stabilization fund:

- **Section 1. Fund Characteristics and Constraints** - The first paragraph is revised to incorporate recent contributions into the budget stabilization fund.
- **Section 4. Standards of Investment Performance** - The first paragraph is revised to incorporate current performance standards and restated to be consistent with current terminology.
- **Section 5. Policy and Guidelines** - The first paragraph is revised to provide the asset allocation of the budget stabilization fund is established with input from the Legacy and Budget Stabilization Advisory Board rather than the Office of Management and Budget and a statement is added to provide a 35 percent asset allocation limit for the Match Loan CD Program. The guidelines are also revised to incorporate current investment restrictions and restated to be consistent with terminology adopted by other investment clients of SIB.

Mr. Hunter said RIO's legal counsel indicated that if the advisory board approves the 35 percent asset allocation limit on the Match Loan CD Program investment, the proposed change regarding economically targeted investing would not be necessary.

Representative Kreidt said the 35 percent asset allocation limit on the Match Loan CD Program investment seems appropriate.

**It was moved by Representative Kreidt, seconded by Senator Klein, and carried on a roll call vote that the Legacy and Budget Stabilization Fund Advisory Board adopt for incorporation into the budget stabilization fund investment policy statement the changes, excluding the proposed change related to economically targeted investing, recommended by the Retirement and Investment Office relating to fund characteristics and constraints, standards of investment performance, and policy and guidelines.** Representatives Kempenich and Kreidt, Senators Klein and Nelson, Mr. Rauschenberger and Ms. Sharp voted "aye." No negative votes were cast.

### **LEGACY FUND INVESTMENT POLICY STATEMENT**

At the request of Chairman Kempenich, Mr. Hunter reviewed proposed changes to the investment policy statement of the legacy fund ([Appendix D](#)). He said RIO recommends the following changes to the investment policy statement of the legacy fund:

- **Section 6. Policy Asset Mix** - A provision is added to recognize the 18-month implementation strategy for the asset allocation policy approved by the State Investment Board.

**It was moved by Senator Nelson, seconded by Senator Klein, and carried on a roll call vote that the Legacy and Budget Stabilization Fund Advisory Board adopt for incorporation into the legacy fund investment policy statement the changes recommended by the Retirement and Investment Office relating to policy asset mix.** Representatives Kempenich and Kreidt, Senators Klein and Nelson, Mr. Rauschenberger and Ms. Sharp voted "aye." No negative votes were cast.

### **STATUS OF THE BUDGET STABILIZATION FUND AND LEGACY FUND**

At the request of Chairman Kempenich, Mr. Hunter provided information ([Appendix E](#)) regarding the market value of the budget stabilization fund and the legacy fund. He said market value of the budget stabilization fund as of September 30, 2014, was \$587.1 million, of which \$8.4 million (1.4 percent) is invested in cash equivalents, \$104.2 million (17.7 percent) is invested in certificates of deposit at the Bank of North Dakota, and \$474.5 million (80.8 percent) is invested in short-term fixed income securities with Babson Capital and JP Morgan. He said as of September 30, 2014, market value of the legacy fund totaled \$2.52 billion.

### **ADVISORY BOARD DISCUSSION AND STAFF DIRECTIVES**

Chairman Kempenich said in November 2014, a group of public and private leaders and citizens convened by the Great Plains Institute issued policy recommendations regarding future uses of legacy fund assets.

Senator Nelson suggested the advisory board receive a copy of the report. Chairman Kempenich asked the Legislative Council staff to email the report to the advisory board.

In response to a question from Senator Klein, the Legislative Budget Analyst and Auditor said the interim Government Finance Committee has recommended the earnings of the legacy fund continue to accumulate as part of the principal of the fund until certain criteria are met.

**It was moved by Senator Klein, seconded by Representative Kreidt, and carried on a voice vote that the meeting be adjourned, subject to the call of the chair.**

No further business appearing, Chairman Kempenich adjourned the meeting at 3:40 p.m.

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Sheila M. Sandness  
Senior Fiscal Analyst

ATTACH:5

**BUDGET STABILIZATION FUND**  
**D**  
**INVESTMENT POLICY STATEMENT**

**1. FUND CHARACTERISTICS AND CONSTRAINTS.**

The Budget Stabilization Fund (Fund) is a special fund created in 1987 under Chapter 54-27.2 of the North Dakota Century Code used to deposit general fund moneys in excess of appropriations. Notwithstanding the provisions of sections 54-27.2-01 and 54-27.2-02, \$124,936,548 was required to be transferred by the state treasurer to the budget stabilization fund from the general fund on July 1, 2009 along with \$61,414,562 on July 1, 2011 and \$181,060,584 on July 1, 2013. ~~These~~This transfers ~~will provide for a total of \$324,936,548 over \$580 million~~ in the budget stabilization fund ~~for the biennium beginning July 1, 2009 and ending June 30, 2011~~as of July 1, 2014. The state investment board shall supervise investment of the budget stabilization fund in accordance with chapter 21-10.

Any interest or other budget stabilization fund earnings must be deposited in the fund. Any amounts provided by law for deposit in the fund and any interest or earnings of the fund which would bring the balance in the fund to an amount greater than five percent of the current biennial state general fund budget, as finally approved by the most recently adjourned special or regular session of the legislative assembly, may not be deposited or retained in the fund but must be deposited instead in the state general fund.

If the director of the office of management and budget projects that general fund revenues for the biennium will be at least two and one-half percent less than estimated by the most recently adjourned special or regular session of the legislative assembly, and if the governor orders a transfer, the state treasurer shall transfer the appropriate funds from the budget stabilization fund to the state general fund to offset the decrease in general fund revenues. The amount transferred from the budget stabilization fund upon order of the governor may not exceed the difference between an amount two and one-half percent below the general fund revenue projections for the biennium and the general fund revenue projections for the biennium by the director of the office of management and budget.

**2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB).**

The Fund is charged by law under NDCC 21-10-02.1 with the responsibility of establishing policies on investment goals and asset allocation of the Fund. The SIB is charged with implementing these policies and asset allocation and investing the assets of the Fund in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07.

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

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory, not advisory. In accordance with this Investment Policy Statement, the Fund's assets may be invested directly or through collective investment vehicles.

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

The SIB will implement changes to this policy as promptly as is prudent.

### 3. INVESTMENT OBJECTIVES.

The investment objectives of the Fund reflect the relatively unknown life-span and the moderate risk tolerance of the Fund. Operating and statutory considerations shape the Fund's policies and priorities as outlined below:

Objective: Sufficient liquidity is to be maintained to meet known or anticipated financial obligations and preserve the value of the surplus. Cash equivalent investments will be used to achieve this objective.

### 4. STANDARDS OF INVESTMENT PERFORMANCE.

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

- a. The Fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.
- b. The risk-adjusted performance of the Fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

~~The Fund's investment objectives and liquidity constraints give rise to an asset allocation that is considered the most likely to achieve the results desired. For evaluation purposes, the following performance targets will apply:~~

- ~~a. The Fund should produce a rate of return that meets or exceeds the portfolio policy index.~~
- ~~b. The annual standard deviation of total returns for the Fund should not exceed that of the policy portfolio.~~

## 5. POLICY AND GUIDELINES.

The asset allocation of the Budget Stabilization Fund is established by the SIB, with input from the ~~Office of Management and Budget~~ Legacy and Budget Stabilization Advisory Board. Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the fund:

|                                   |                |
|-----------------------------------|----------------|
| Short-term Fixed Income & BND CDs | Minimum of 90% |
| Bank Loans w/floating yield       | Maximum of 5%  |
| Absolute Return Strategies        | Maximum of 5%  |

Bank of North Dakota Match Loan Certificates of Deposit Program ("BND CD") limit of 35%.

Rebalancing of the Fund to this target will be done in accordance with the SIB's rebalancing policy.

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

- a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
- b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.
- c. All assets will be held in custody by the State Investment Board's master custodian or such other custodians as are acceptable to the State Investment Board.
- d. No funds shall be borrowed excluding a SIB approved securities lending program.
- e. No unhedged short sales or speculative margin purchases shall be made.
- f. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

For the purpose of this document, Social Investing is defined as *"The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."*

g.e.—Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule. ~~prohibited unless the investment meets the Exclusive Benefit Rule.~~

For the purpose of this document economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the Exclusive Benefit Rule is met if the following four conditions are satisfied:

- (1) The cost does not exceed the fair market value at the time of investment.
- (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
- (4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the Fund's policy favors investments which will have a positive impact on the economy of North Dakota.

## 6. EVALUATION AND REVIEW.

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards. Evaluation will be conducted quarterly by the SIB through its review of funds participating in the Insurance Trust.

Money managers will be evaluated by the SIB quarterly. In-state meetings will be held with the money managers at least annually.

Approved by:

LEGACY AND BUDGET STABILIZATION  
FUND ADVISORY BOARD  
OFFICE OF MANAGEMENT AND BUDGET

STATE INVESTMENT BOARD

Representative Keith Kempenich  
Chairman  
Pam Sharp  
Director of OMB

Steve CochraneDavid Hunter  
Executive Director/CIO, RIO

Date: \_\_\_\_\_

Date: \_\_\_\_\_

To be reviewed by the NDSIB:  
1/23/15

Approved by the Legacy and  
Budget Stabilization Fund  
Advisory Board: 12/1/2014

## **NORTH DAKOTA LEGACY FUND**

### **INVESTMENT POLICY STATEMENT**

#### **1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS**

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

#### **2. FUND MISSION**

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

#### **3. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD**

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

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

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

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

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

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

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

#### **4. RISK TOLERANCE**

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

#### **5. INVESTMENT OBJECTIVES**

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

- a. The legacy fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.
- b. The legacy fund's risk, measured by the standard deviation of net returns, should not exceed 115 percent of the policy benchmark over a minimum evaluation period of five years.
- c. The risk-adjusted performance of the legacy fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

#### **6. POLICY ASSET MIX**

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

| <b>Asset Class</b>                | <b>Policy Target Percentage</b> |
|-----------------------------------|---------------------------------|
| <b>Broad US Equity</b>            | <b>30%</b>                      |
| <b>Broad International Equity</b> | <b>20%</b>                      |
| <b>Fixed Income</b>               | <b>35%</b>                      |
| <b>Core Real Estate</b>           | <b>5%</b>                       |
| <b>Diversified Real Assets</b>    | <b>10%</b>                      |

Rebalancing of the fund to this target will be done in accordance with the SIB's rebalancing policy, but not less than annually. [The SIB approved an 18-month implementation strategy which began in August of 2013. The stated allocation is expected to be fully implemented in January of 2015.](#)

## 7. RESTRICTIONS

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

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

For the purpose of this document, economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the exclusive benefit rule is met if the following four conditions are satisfied:

- The cost does not exceed the fair market value at the time of investment.
- The investment provides the legacy fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- Sufficient liquidity is maintained in the legacy fund to permit distributions in accordance with the terms of the plan.
- The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity, are equivalent, the board's policy favors investments which will have a positive impact on the economy of North Dakota.

**8. INTERNAL CONTROLS**

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

**9. EVALUATION AND REVIEW**

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

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

- Changes in asset class portfolio structures, tactical approaches, and market values.
- Loss of principal, if any.
- Management costs associated with various types of investments.
- All material legal or legislative proceedings affecting the SIB.
- Compliance with this investment policy statement.
- An evaluation of the national economic climate.
- A forecast of the expected economic opportunities and dangers.
- Management of risk by the SIB.

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

**Approved by:**

**LEGACY AND BUDGET STABILIZATION  
FUND ADVISORY BOARD**

**STATE INVESTMENT BOARD**

\_\_\_\_\_

\_\_\_\_\_

**Representative Keith Kempenich  
Chairman**

**David Hunter  
Executive Director / CIO**

**Date:** \_\_\_\_\_

**Date:** \_\_\_\_\_

## RETIREMENT PLAN FOR EMPLOYEES OF JOB SERVICE NORTH DAKOTA

### INVESTMENT POLICY STATEMENT

#### 1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS.

The Retirement Plan for the Employees of Job Service North Dakota (Plan) is a defined benefit retirement plan for the eligible employees hired before October 1, 1980. There have been no new entrants to the plan since October 1, 1980. The plan provides retirement benefits, disability benefits and survivor benefits consistent with the written Plan document. Until October 1, 1993, annuities were purchased from the Travelers for retirees, since that date retiree benefits are paid from Plan assets. Annual cost of living adjustments for all Plan pensioners including annuitants with the Travelers are paid from Plan assets. The NDPERS Board (the Board) is the Plan Administrator and administers the Plan in accord with Chapter 52-11 of the North Dakota Century Code.

Job Service North Dakota as the employer contributes 4% of the active participant's salary as a contribution 'on behalf of the employee' and the active participants pay 3% of their salary into Plan assets.

Each year the Plan has an actuarial valuation performed. The current actuarial assumed rate of return on assets is 8-07.0%.

#### 2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB)

Aggregate plan contributions plus earnings, minus allowable expenses constitute the Fund. The Board is charged by NDCC chapters 54-52, 21-10-01, and 39-03.1 to establish policies for the investment goals and asset allocation of the Fund. The State Investment Board (SIB) is charged with implementing the asset allocation as promptly and prudently as possible in accordance with the Board's policies by investing the assets of the Fund in the manner provided in the prudent investor rule, which provides:

*Fund fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. The retirement funds belonging to the teachers' fund for retirement and the public employees retirement system must be invested exclusively for the benefit of their members and in accordance with the respective funds' investment goals and objectives. (NDCC 21-10-07)*

The SIB may delegate investment responsibility of the Fund or any portion of the Fund to professional money managers. Where a money manager has been retained, the SIB's role in determining investment strategy is supervisory not advisory.

The SIB may at its discretion, pool the assets of the Fund with another fund or funds having similar investment objectives and time horizons in order to maximize returns and minimize costs. In pooling fund assets the SIB will establish asset class pools it deems necessary to achieve the specific quality, diversification, restrictions, and performance objectives subject to the prudent investor rule and the objectives of the funds participating in the pools.

The SIB is responsible for establishing the selection criteria, determining the performance measures, and retaining all fund money managers. SIB is also responsible for the selection and retention of any

investment consultants that may be employed in the investment of the Fund assets.

### **3. DELEGATION OF AUTHORITY**

Management responsibility for NDPERS funds not assigned to the North Dakota State Investment Board (SIB) in Chapter 21-10 of the North Dakota Century Code (NDCC) is hereby delegated to the SIB, which must establish written policies and procedures for the operation of the NDPERS funds, consistent with this investment policy.

Such procedures must provide for:

1. The definition and assignment of duties and responsibilities to advisory services and persons employed by the SIB pursuant to NDCC 21-10-02.1(1) (a).
2. Investment diversification, investment quality, qualification of money managers, and amounts to be invested by money managers pursuant to NDCC 21-10-02.1(1)(e). In developing these policies it is understood:
  - a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
  - b. The use of derivatives will be monitored to ensure that undue risks are not taken by the money managers.
  - c. All assets must be held in custody by the SIB's master custodian or such other custodians as are selected by the SIB.
3. Guidelines for the selection and redemption of investments will be in accordance with NDCC 21-10-02.1(1) (d).
4. The criteria for making decisions with respect to hiring, retention, and termination of money managers will be clearly defined. This also includes selecting performance measurement standards, consultants, report formats, and frequency of meetings with money managers.

All participants in the investment process must seek to act responsibly as custodians of the public trust.

### **4. INVESTMENT GOALS.**

The investment objectives of the Plan have been established by the Plan's Administrator upon consideration of its strategic objectives and a comprehensive review of current and projected financial requirements.

Objective #1: To maintain a level of surplus sufficient to eliminate the need for future contributions;

Objective #2: To achieve a rate of return which exceeds the rate of inflation, as measured by the Consumer Price index (CPI), by 3.0 or more percentage points per year (based on current actuarial assumptions of 7.50% return and 52-to-3% inflation), over a complete market cycle; and

Objective #3: As a secondary objective, to maximize the Plan's surplus to increase future benefit payments.

## 5. INVESTMENT PERFORMANCE OBJECTIVE

The NDPERS Board will seek to make investments that generate sufficient return to meet the goals outlined in this policy. The objectives established in this section are in accordance with the fiduciary requirement in federal and state law.

It is in the best interest of NDPERS and its beneficiaries that performance objectives be established for the total Fund. It is clearly understood these objectives are to be viewed over the long term and have been established after full consideration of all factors set forth in this Statement of Investment Goals, Objectives and Policies.

- a) The funds rate of return, over the long term should equal that of the policy portfolio which is comprised of policy weights of appropriate asset class benchmarks as set by the SIB.
- b) The annual standard deviation of total returns for the Fund should not materially exceed that of the policy portfolio by more than 15%.
- c) Over 5-year and longer periods the fund should match or exceed the expected rate of return projected in the most recent asset/liability study without exceeding the expected risk for the period as measured by standard deviation by more than 15%.

## 6. ASSET ALLOCATION

The NDPERS Board as plan Administrator establishes the asset allocation of the Fund, with input from consultants and SIB staff. The current asset allocation is based upon the asset/liability study completed by SEI Consultants in ~~December~~[February 2009](#)~~14~~. That study provided an appraisal of current cash flow projections and estimates of the investment returns likely to be achieved by the various asset classes.

In recognition of the Plan's objectives, projected financial status, and capital market expectations, the following asset allocation options were deemed appropriate for the Fund:

~~Domestic Large Cap Equity --25~~24%  
~~Domestic Small Cap Equity --6~~%  
~~Global International Equity --9~~16%  
~~Domestic Fixed Income --47~~%  
~~International Fixed Income --5~~%  
~~U.S. High Yield Bonds --8~~3%  
~~Emerging Markets Debt --3~~%  
~~Core Fixed Income --19~~%  
~~Limited Duration Fixed Income --19~~%  
~~Diversified Short Term Fixed Income --10~~%  
~~Short Term Corporate Fixed Income --6~~%

Rebalancing of the Fund to this target allocation will be done in accordance with the SIB's rebalancing policy, but not less than annually.

## **7. RESTRICTIONS**

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

- a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
- b. Derivatives use will be monitored to ensure that undue risks are not taken by the money managers.
- c. All assets will be held in custody by the SIB's master custodian or such other custodians as are acceptable to the SIB.

Social Investing is defined as *"The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."*

- d. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

Economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

- e. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule.

The Exclusive Benefit Rule is met if the following four conditions are satisfied:

- (1) The cost does not exceed the fair market value at the time of investment.
- (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
- (4) The safeguards and diversity that a prudent investor would adhere to are present.

## **8. INTERNAL CONTROLS**

The SIB must have a system of internal controls to prevent losses of public funds arising from fraud or

employee error. The controls deemed most important are the separation of responsibilities for investment purchases from the recording of investment activity, custodial safekeeping, written confirmation of investment transactions, and established criteria for broker relationships. The annual financial audit must include a comprehensive review of the portfolio, accounting procedures for security transactions and compliance with the investment policy.

## 9. EVALUATION

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards.

An annual performance report must be provided to the Board by the State Investment Officer at a regularly scheduled NDPERS Board meeting. The annual performance report must include asset returns and allocation data as well as information regarding all significant or material matters and changes pertaining to the investment of the Fund, including:

- Changes in asset class portfolio structures, tactical approaches and market values;
- All pertinent legal or legislative proceedings affecting the SIB.
- Compliance with these investment goals, objectives and policies.
- A general market overview and market expectations.
- A review of fund progress and its asset allocation strategy.

In addition, the State Investment Officer shall review with the Board the procedures and policies established by the SIB relating to this statement of investment goals, objectives, and policies.

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**J. Sparb Collins**  
Plan Administrator and Trustee  
Retirement Plan for Employees of  
Job Service North Dakota

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**David Hunter**  
Executive Director  
North Dakota Retirement and Investment Office

Date: \_\_\_\_\_

Date: \_\_\_\_\_

**BOARD ACTION REQUESTED**

To: State Investment Board

From: Dave Hunter, Executive Director / CIO

Date: January 19, 2015

RE: **Potential New SIB Clients - Tobacco Prevention & Control Trust and ND Land Board**

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**Background:**

In compliance with NDSIB Governance Policy E-13, RIO is providing the SIB with information regarding two potential new clients. Staff was contacted by Jeanne Prom, Executive Director, Samantha Doll, Business Manager, and Robert Yost, Account Budget Specialist III, of the **Tobacco Prevention and Control Trust Fund** regarding its investment fund. The Tobacco Trust funds are currently invested in short-term cash with the Bank of North Dakota and earning approximately 6 to 10 bps per annum. They are interested in contracting for investment services with the SIB as allowed under NDCC 21-10-06 and as recommended in a recent audit.

The Tobacco Trust fund has a market value of approximately \$45 million as of December 31, 2014 and is projected to exceed \$50 million over the next two years prior to declining by approximately \$8 million per year between 2018 and 2023. RIO staff met with Ms. Prom, Ms. Doll and Mr. Yost over the past month to discuss their investment objectives and risk tolerance and the possible benefits of developing a formal investment policy statement and engaging with the SIB for investment services. Staff will be providing additional information as follow-up if the SIB concurs.

Based on the initial discussions, internal staff administrative capacity would not be materially affected by this \$45 million fund and the client's goals and risk tolerances, however, the non-tobacco investment requirement does not fit within the existing Insurance Trust structure.

RIO was also contacted by Lance Gaebe, Commissioner, Jeff Engleson, Director, and Levi Erdmann, IT Director, of the **Department of Trust Lands** to explore options for shared management of Permanent Trust Investments which approximate \$3.5 billion including 38.5% equity, 11.5% real assets, 22% absolute return, and 28% fixed income.

**RIO Recommendation:**

As required by Governance Policy E-13, RIO is asking for SIB approval to move forward with the possible contracting for investment services with the Tobacco Control and Prevention Trust Fund while exploring options for shared management of the Land Boards Permanent Trust Investments.

## **POLICY TYPE: INVESTMENTS**

### **POLICY TITLE: ACCEPTING NEW CLIENTS**

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NDCC 21-10-06 states *“The state investment board may provide investment services to, and manage the money of, any agency, institution, or political subdivision of the state, subject to agreement with the industrial commission. The scope of services to be provided by the state investment board to the agency, institution, or political subdivision must be specified in a written contract. The state investment board may charge a fee for providing investment services and any revenue collected must be deposited in the state retirement and investment fund.”*

When a request is received by staff from a potential new investor requesting investment services from the State Investment (SIB), the following steps shall be followed.

1. Staff will conduct initial discussions with the potential client regarding type of fund, risk tolerance, size of fund, services to be provided, costs, etc.
2. Staff will recommend that an Asset/Liability study be conducted by the potential client if one has not been done recently. This discussion will include a description of the asset classes available for investment with the SIB to be included in their study.
3. If the potential client is still interested in participating in the SIB program, staff will bring the preliminary request to the SIB for acceptance. It shall be the policy of the SIB to take the following into consideration when determining if a new investor request will be accepted.
  - a. Internal staff administrative capacity.
  - b. Compatibility of new investor’s goals and risk tolerances with the existing SIB program structure.
  - c. Whatever other factors the SIB determines to be appropriate to the decision.
4. If the SIB chooses to accept the preliminary request, staff will provide the necessary template documents to the potential client for review and completion. These documents include a contract for services and investment guidelines.
5. Once documentation is completed, staff will request to have the issue included on the Industrial Commission’s agenda for their approval. Copies of all documentation will be provided for their review.
6. If approved by the Industrial Commission, final documentation will be presented to the SIB for final acceptance.
7. If accepted, staff will work with the new client to set up transfer of funds and implementation of asset allocation as directed. All new clients will be brought in as of the last day of a calendar quarter.
8. Fees will be charged with the intention of covering all associated costs as described in RIO Fiscal Management procedure “Investment Fee Allocations”.

**Policy Implemented:** November 20, 2009

## Agenda Item VII. D.

**TO:** State Investment Board  
**FROM:** Dave Hunter, Executive Director/CIO  
**DATE:** January 19, 2015  
**SUBJECT:** SIB Governance Manual Review

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As directed by SIB Governance Manual Policy B-7 Section 4.C, the SIB conducted an annual review of the governance manual on September 26, 2014. Based on Board member discussion during this annual review, the Executive Director proposed a section by section review of the governance manual over the next six months which will culminate in a “Governance Day Offsite” scheduled July 24, 2015. The Governance Day Offsite is intended to take the place of a regularly scheduled SIB meeting, but is expected to be expanded in length to allow for a deeper and more holistic discussion of overall Board governance policies.

|              |                            |
|--------------|----------------------------|
| January 2015 | Governance Process         |
| February     | Board Staff Relationship   |
| March        | Executive Limitations      |
| April        | Ends                       |
| May          | Investments and Guidelines |
| June         | By-Laws and Century Code   |
| July         | Governance Day Offsite     |

RIO does not recommend any changes to the SIB Governance Manual at this time noting that the governance manual was reviewed in its entirety in September. However, RIO believed the SIB welcomed a second review of the governance manual at upcoming board meetings to ensure all SIB members are given another opportunity to raise questions or make suggestions to further enhance our existing governance structure and/or policy.

The following 14 pages represent Section B. of the SIB Governance Manual on “Governance Process”. RIO intends to review Board Staff Relationship and Executive Limitations over the next two meetings.

**B. GOVERNANCE PROCESS**

|  | <u>PAGE</u> |
|--|-------------|
| Governance Commitment .....                | B-1         |
| Governing Style .....                      | B-2         |
| Board Job Description.....                 | B-3         |
| Chairperson's Role .....                   | B-4         |
| Board Committee Principles .....           | B-5         |
| Standing Committees .....                  | B-6         |
| Annual Board Planning Cycle .....          | B-7         |
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*EXHIBITS*

|  |            |
|--|------------|
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|--|------------|

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: GOVERNANCE COMMITMENT**

The board, on behalf of benefit recipients and the other clients, who have entrusted their funds to us, will:

- Lead the North Dakota Retirement and Investment Office (RIO) with a strategic perspective.
- Rigorously attend to its investment and oversight role.
- Continually improve its capability as a body to define values and vision.

**Policy Implemented:** June 23, 1995.

The board will govern with an emphasis on:

- Outward vision rather than an internal preoccupation.
- Encouragement of diversity in viewpoints.
- Strategic leadership more than administrative detail.
- Clear distinction of board and executive director roles.
- Collective rather than individual decisions.
- Future rather than past or present.
- Proactivity rather than reactivity.

The board will:

1. Cultivate a sense of group responsibility. The board, not the staff, will be responsible for excellence in governing. The board will be an initiator of policy, not merely a reactor to staff initiatives. The board will use the expertise of individual members to enhance the ability of the board as a body, rather than to substitute the individual judgments for the board's values.
2. Direct, control, and inspire the organization through the careful establishment of the broadest written policies reflecting the board's values and perspectives. The board's major focus will be on the intended long-term impacts outside the operating organization (*Ends*), not on the administrative or programmatic means of attaining those effects.
3. Enforce upon itself whatever discipline is needed to govern with excellence. Discipline will apply to matters such as attendance, policy-making principles, respect of roles, and ensuring the continuity of governance capability.
4. After speaking with one voice, self-police any tendency to stray from adopted board governance policies. The board will allow no officer, member, or committee of the board to hinder or be an excuse for not fulfilling its commitments. The board respects the right of any member, as an individual, to publicly disagree with an adopted board policy. Board members will accurately portray board policies and decisions.
5. Promote continual board development through orientation and mentoring of new members in the board's governance process and through periodic board discussion of process improvement. The board shall not delegate new member governance orientation to the executive director or any staff member.
  - A. A board mentor, who is knowledgeable and who will assume responsibility for assisting the new members, will be assigned by the chairperson.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: GOVERNING STYLE**

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- B. The new board member should read and study Chapter 21-10, North Dakota Century Code (Section J of the SIB Policy Governance Manual which governs the activities of the boards represented on the SIB: Teachers' Fund for Retirement Board, Public Employees Retirement Systems Board, and the State Investment Board).
- C. The board should receive a glossary of terms used by the retirement and pension fund industry; i.e. Callan Associates Inc. - Glossary of Terms.
- D. Newly appointed or elected board members should become familiar with the Carver Model of Governance, since the SIB directs its activities by this model. They should read Boards That Make a Difference and study the policy manuals that have been developed by the SIB and TFFR Board.
- E. The board members must understand their roles as trustees and fiduciaries, the Prudent Investor Rule, and Procedural Prudence.

A "new trustee book bag" containing the Retirement and Investment Office's Comprehensive Annual Financial Report (CAFR) and reference materials relating to board governance, fiduciary conduct, and investment management concepts and terminology and other appropriate materials will be made available to new trustees.

- F. The executive director will provide the SIB with a list of periodicals available which would provide current information on pension issues. The board members will review and request subscriptions to appropriate periodicals.
- 6. Monitor and regularly discuss the board's process and performance. Self-monitoring will include comparison of board activity and discipline to policies in the *Governance Process* and *Board-Staff Relationship* categories.
  - 7. Observe Robert's Rules except where the board has superseded them.

**Policy Implemented:** June 23, 1995.

**Amended:** June 28, 1996; November 19, 1999, January 26, 2001.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: BOARD JOB DESCRIPTION**

The function of the board is to make certain contributions that lead RIO toward the desired performance and ensure that it occurs. The board's specific contributions are unique to its trusteeship role and necessary for proper governance and management.

Consequently, the "products" or contributions of the board shall be:

1. The link between the SIB, its investment clients, and benefit recipients.
2. Written governing policies that, at the broadest levels, address:
  - A. *Ends*: Organizational products, impacts, benefits, outcomes, recipients, and their relative worth (what good for which needs at what cost).
  - B. *Executive Limitations*: Constraints on executive authority which establish the prudence and ethics boundaries within which all executive activity and decisions must take place.
  - C. *Governance Process*: Specification of how the board conceives, carries out, and monitors its own task.
  - D. *Board-Executive Director Relationship*: How authority is delegated and its proper use monitored: the executive director's role, authority, and accountability.
3. The assurance of executive director performance against above policies 2a and 2b.
4. Legislation necessary to achieve the board's *Ends*.

**Policy Implemented:** June 23, 1995.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: CHAIRPERSON'S**

The chairperson's primary responsibility is to insure the integrity of the board's process. The chairperson is the only board member authorized to speak for the board other than in specifically authorized instances.

1. The duty of the chairperson is to see that the board operates consistent with state law, administrative rules, and its own policies.
  - A. The board agenda will be the responsibility and be coordinated by the chairperson.
  - B. Meeting discussion content will only be those issues which, according to board policy, clearly belong to the board and not the executive director, or in a board member's opinion, may deal with fiduciary responsibilities.
  - C. Deliberation will be fair, open, and thorough, but also efficient, timely, orderly, and brief.
  - D. The chairperson shall appoint a parliamentarian.
2. The authority of the chairperson consists in making decisions that fall within the topics covered by board policies on *Governance Process* and *Board-Executive Director Relationship*, except where the board specifically delegates portions of this authority to others. The chairperson is authorized to use any reasonable interpretation of the provisions in these policies.
  - A. The chairperson is empowered to chair board meetings with all the commonly accepted authority of that position (e.g., ruling, recognizing).
  - B. The chairperson has no authority to make decisions about policies created by the board within *Ends* and *Executive Limitations* policy areas. Therefore, the chairperson has no authority to supervise or direct the executive director.
  - C. The chairperson may represent the board to outside parties in announcing board-stated positions and in stating chairperson decisions and interpretations within the area delegated to the chairperson.
  - D. The chairperson is authorized, in consultation with the RIO Executive Director, to grant approval for international travel by SIB members and to keep the board informed on travel requests.
  - E. The chairperson is authorized, in consultation with the RIO Executive Director, to grant approval for domestic due diligence visits by SIB members and it shall be the responsibility of the traveling board member to report to the SIB on the results of the due diligence visits.

**Policy Implemented:** June 23, 1995.

**Amended:** August 17, 2001, September 25, 2009.

## **POLICY TYPE: GOVERNANCE PROCESS**

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### ***POLICY TITLE: BOARD COMMITTEE PRINCIPLES***

Unless specifically provided by governance policy, board committees will be assigned so as to minimally interfere with the wholeness of the board's job and so as never to interfere with delegation from board to executive director. Board committees will be used sparingly.

1. Board committees are to help the board do its job, not to help the staff do its job. Committees ordinarily will assist the board by preparing policy alternatives and implications for board deliberation. Board committees are created to advise the board, not the staff.
2. Board committees may not speak or act for the board except when formally given such authority for specific and time-limited purposes. Expectations and authority will be carefully stated in order not to conflict with authority delegated to the executive director.
3. Board committees cannot exercise authority over staff however committees will make requests of staff through the executive director unless staff is assigned to the committee. Because the executive director works for the full board, he or she will not be required to obtain approval of a board committee before an executive action. In keeping with the board's broader focus, board committees will normally not have direct dealings with current staff operations.
4. Board committees are to avoid over-identification with the committee's assignment. Therefore, a board committee which has helped the board create policy will not be used to monitor organizational performance on that policy.
5. This policy applies only to committees which are formed by board action, whether or not the committees include non-board members. It does not apply to committees formed under the authority of the executive director.
6. The chairperson will appoint board committees authorized by the board. The operational life span of a board committee will be defined at the time of appointment.

**Policy Implemented:** June 23, 1995.

**Amended:** November 22, 1996.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: STANDING COMMITTEES**

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The board's standing committee is that which is set forth in this policy as follows:

1. Audit Committee
  - A. The audit committee shall operate under the terms of a charter approved by the board.

**INTRODUCTION**

An Audit Committee has been established as a standing committee of the State Investment Board (SIB). The Audit Committee will assist the SIB in carrying out its oversight responsibilities as they relate to the Retirement and Investment Office (RIO) internal and external audit programs, including financial and other reporting practices, internal controls, and compliance with laws, regulations, and ethics.

The primary objective of the internal audit function is to assist the SIB and management in the effective discharge of their responsibilities. To this end, internal auditing will furnish them with analyses, appraisals, recommendations, and pertinent information concerning the activities reviewed.

Functions and units within RIO will be reviewed at appropriate intervals to determine whether they are effectively carrying out their responsibilities of planning, organizing, directing, and controlling in accordance with SIB and management instructions, applicable laws, policies, and procedures, and in a manner consistent with both the RIO objectives and high standards of administrative practice.

**POLICY OF THE STATE INVESTMENT BOARD**

The audit staff shall have full, free, and unrestricted access to all RIO activities, records, property, and personnel relative to the subject under review. The audit function will be conducted in a manner consistent with acceptable professional standards and coordinated with others to best achieve the audit objectives and the RIO objectives.

The Internal Audit Services Unit is responsible for developing and directing a broad, comprehensive program of internal auditing within RIO. The Internal Audit Services Unit will report administratively to management and functionally to the Audit Committee of the SIB.

The RIO unit supervisors are responsible for seeing that corrective action on reported weaknesses is either planned or taken within 30 days from the receipt of a report disclosing those weaknesses if known or applicable. The unit supervisors are also responsible for seeing that a written report of action planned or completed is sent to the executive director. If a plan for action is reported, a second report shall be made promptly upon completion of the plan.

**Policy Implemented:** June 23, 1995.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: ANNUAL BOARD PLANNING CYCLE**

To accomplish its job outputs with a governance style consistent with board policies, the board will follow a biennial agenda which (a) completes a re-exploration of *Ends* policies annually and (b) continually improves its performance through attention to board education and to enriched input and deliberation.

1. A biennial calendar will be developed.
2. The cycle will conclude each year on the last day of June in order that administrative budgeting can be based on accomplishing a one-year segment of the most recent board long-range vision.
  - A. In the first three months of the new cycle, the board will develop its agenda for the ensuing one-year period.
  - B. Scheduled monitoring will be used to evaluate and adjust the annual agenda as needed.
3. Education, input, and deliberation will receive paramount attention in structuring the series of meetings and other board activities during the year.
  - A. To the extent feasible, the board will identify those areas of education and input needed to increase the level of wisdom and forethought it can give to subsequent choices.
  - B. A board education plan will be developed during July and August of each year.
4. The sequence derived from this process for the board planning year ending June 30 is as follows:
  - A. July: Election of officers, appoints audit committee, plan annual agenda, begin to develop board education plan, and new board member orientation.
  - B. August: Investment Director review of investment results, establish investment work plan, add investment education to education plan, and continue new board member orientation.
  - C. September: Annual Review of Governance Manual.
  - D. October: Annual meeting for evaluation of RIO vs. *Ends* policies and annual board evaluation.
  - E. November: Investment Director report on investment work plan.
  - F. January: During second year of the biennium, begin to develop *Ends* policies for the coming biennium for budget purposes.
  - G. February: Investment Director report on investment work plan.  
Evaluation of Executive Director.
  - H. March: During first year of biennium, set budget guidelines for budget development.
  - I. May: Investment Director report on investment work plan.

**Policy Implemented:** June 23, 1995; November 19, 1999.

**Amended:** September 26, 2014.

## **POLICY TYPE: GOVERNANCE PROCESS**

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### ***POLICY TITLE: BOARD MEMBERS ' CODE O F CONDUCT***

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The following will be the Code of Ethical Responsibility for the SIB:

1. SIB members owe a duty to conduct themselves so as to inspire the confidence, respect, and trust of the SIB members and to strive to avoid not only professional impropriety but also the appearance of impropriety.
2. SIB members should perform the duties of their offices impartially and diligently. SIB members are expected to fulfill their responsibilities in accord with the intent of all applicable laws and regulations and to refrain from any form of dishonest or unethical conduct. Board members should be unswayed by partisan interest, public sentiment, or fear of criticism.
3. Conflicts of interest and the appearance of impropriety shall be avoided by SIB members. Board members must not allow their family, social, professional, or other relationships to influence their judgment in discharging their responsibilities. Board members must refrain from financial and business dealings that tend to reflect adversely on their duties. If a conflict of interest unavoidably arises, the board member shall immediately disclose the conflict to the SIB. A board member must abstain in those situations where the board member is faced with taking some official action regarding property or a contract in which the board member has a personal interest. Conflicts of interest to be avoided include, but are not limited to: receiving consideration for advice given to a person concerning any matter over which the board member has any direct or indirect control, acting as an agent or attorney for a person in a transaction involving the board, and participation in any transaction involving for which the board member has acquire information unavailable to the general public, through participation on the board.

“Conflict of Interest” means a situation in which a board member or staff member has a direct and substantial personal or financial interest in a matter with also involves the member’s fiduciary responsibility.

4. The board should not unnecessarily retain consultants. The hiring of consultants shall be based on merit, avoiding nepotism and preference based upon considerations other than merit that may occur for any reason, including prior working relationships. The compensation of such consultants shall not exceed the fair value of services rendered.
5. Board members must abide by North Dakota Century code 21-10-09, which reads: “No member, officer, agent, or employee of the state investment board shall profit in any manner from transactions on behalf of the funds. Any person violating any of the provisions of this section shall be guilty of a Class A misdemeanor.”
6. Board members shall perform their respective duties in a manner that satisfies their fiduciary responsibilities.
7. All activities and transactions performed on behalf of public pension funds must be for the exclusive purpose of providing benefits to plan participants and defraying reasonable expenses of administering the plan.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: BOARD MEMBERS' CODE OF CONDUCT**

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8. Prohibited transactions. Prohibited transactions are those involving self-dealing. Self-dealing refers to the fiduciary's use of plan assets or material, non-public information for personal gain; engaging in transactions on behalf of parties whose interests are adverse to the plan; or receiving personal consideration in connection with any planned transaction.
9. Violation of these rules may result in an official reprimand from the SIB. No reprimand may be issued until the board member or employee has had the opportunity to be heard by the board.
10. Board Members are required to affirm their understanding of this policy annually, in writing, and must disclose any conflicts of interest that may arise (See Exhibit B-I).

**Policy Implemented:** June 23, 1995.

**Amended:** January 22, 1999, February 25, 2011, January 27, 2012.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: ADMINISTRATION OF FIDUCIARY AUTHORITY**

The board is responsible for:

1. Proper exercise of fiduciary investment authority by RIO.
2. The determination of policies.
3. The investment and disposition of property held in a fiduciary capacity.
4. The direction and review of the actions of all officers, employees, and committees in the exercise of the board's delegated fiduciary authority.

**Policy Implemented:** June 23, 1995.

**POLICY TYPE: GOVERNANCE PROCESS**

**POLICY TITLE: POLICY INTRODUCTION/AMENDMENT/PASSAGE**

New policies or policy amendments may be proposed by the Executive Director or a Board member. All new policies or amendments may be submitted to the Board's Legal Counsel for drafting in the approved style.

Upon request of the Executive Director or a Board member a new policy or amendment shall be placed on the Board's agenda for action as follows:

1. Introduction and first reading. A brief explanation or summary of the new policy or amendment shall be presented to the Board. Upon approval of introduction and first reading, the measure shall be placed on the agenda of the next scheduled meeting of the Board for second reading and adoption. When appropriate, the measure shall be distributed to interested parties.
2. *Second reading and adoption. Interested parties and the public shall be allowed an opportunity to comment on the policy or amendment before final action by the Board. The measure shall take effect immediately following second reading and adoption by the Board, unless a different effective date is stated.*
3. Amendments. Amendments may be proposed at any time before final adoption of the measure. Upon determination by the Board that adoption of an amendment constitutes a substantive change that significantly changes the meaning or effect of the measure, the Board shall continue consideration of second reading and adoption to the next meeting to permit further review and comment.

Emergency measures. The Board may, upon determination that an emergency or other circumstances calling for expeditious action exists, waive the requirement of a second meeting and immediately approve second reading and adoption following introduction and first reading.

**Policy Implemented:** February 27, 2009

**Memorandum**

**To: State Investment Board**

**From: RIO Compliance Officer**

**Date: July 1, 20--**

**RE: Annual Affirmation of Code of Conduct Policy**

Governance Process Policy B-8, *Board Members' Code of Conduct*, which is attached to this memorandum, details the Code of Ethical Responsibility for the SIB. Item #10 of this policy indicates that each Board Member is required to reaffirm their understanding of this policy annually and disclose any conflicts of interest. Therefore, please read and sign the statement below to comply with this requirement.

"I have read and understand SIB Governance Process Policy B-8 *Board Members' Code of Conduct*. I have disclosed any conflicts of interest as required by this policy."

Name (printed) \_\_\_\_\_

Signature\_\_\_\_\_

Date\_\_\_\_\_

Detail of any conflicts of interest (if any):

# NORTH DAKOTA STATE INVESTMENT BOARD

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North Dakota Open Meetings Law Update

# OPEN MEETINGS LAW UPDATE - TOPICS

- Excluding the Audience - N.D.A.G. 2014-O-19
- Personal Electronic Devices and Public Business - N.D.A.G. 2014-O-20
- Informal Committees - N.D.A.G. 2013-O-12

# EXCLUDING THE AUDIENCE - N.D.A.G. 2014-O-19

- Facts
  - SBHE held an open meeting
  - Board President requested audience to leave room
  - Audience was informed they had the right to stay, that this was “just a request”
- Violation: A violation occurred
- Observations
  - Mindfulness/ Presumption of law
  - Exception example: N.D.C.C. § 44-04-19.2(6)
  - Best Practices /Importance of citing authority

# PERSONAL ELECTRONIC DEVICES AND PUBLIC BUSINESS – N.D.A.G. 2014-O-20

- Facts
  - Request for records from Tax Department; Commissioner's personal devices may contain applicable records
  - Commissioner inaccessible at time of request
  - Department responded noting that records stored on Commissioner's personal devices were presently inaccessible
  - Records reviewed for response once accessible
- Violation: No violation occurred
- Observations
  - Mindfulness/ recorded information on public business
  - Best Practices/ Use of personal electronic devices for public business

# INFORMAL COMMITTEES - N.D.A.G. 2013-O-12

- Facts
  - 3 of 8 members of SBHE met with 10 NDUS presidents
  - Assumed 3 members would share results of meetings with SBHE
  - SBHE did not delegate authority to members for meetings
- Violation: No violation occurred
- Observations
  - Mindfulness/ delegated authority creates a committee
  - Best Practices/ Clarity

ANY QUESTIONS ?

**OPEN RECORDS AND MEETINGS OPINION  
2014-O-20**

DATE ISSUED: November 21, 2014

ISSUED TO: Office of State Tax Commissioner

**CITIZEN'S REQUEST FOR OPINION**

This office received a request for an opinion under N.D.C.C. § 44-04-21.1 from Chad Nodland asking whether the Office of State Tax Commissioner provided proper responses to an open records request.

**FACTS PRESENTED**

On September 8, 2014, Mr. Chad Nodland, editor of NorthDecoder.com, sent an email to Joe Morrissette, Deputy Tax Commissioner, requesting "[a]ny records of communications to or from anybody who works in the North Dakota Tax Department ... relating in any way to the events" involving the Tax Commissioner's leave of absence.<sup>1</sup> Mr. Morrissette provided responsive documents to Mr. Nodland on September 11, 2014, and invited Mr. Nodland to contact him with any questions.<sup>2</sup> Mr. Nodland asked if the responsive records included communications to/from the Commissioner.<sup>3</sup> Mr. Morrissette explained that information technology resources were utilized to access the Commissioner's state email account and emails responsive to the request were produced. However, Mr. Morrissette also explained that the Commissioner was inaccessible at the time and the Office of State Tax Commissioner

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<sup>1</sup> Email from Chad Nodland, Editor, NorthDecoder.com, to Joe Morrissette, Deputy Tax Comm'r, (Sep. 8, 2014, 9:38 AM). After several email exchanges between Mr. Nodland and Mr. Morrissette regarding the bulk of responsive records, Mr. Nodland ultimately narrowed his request to communications between managers, supervisors, and division directors of the Tax Department. See Emails between Chad Nodland, Editor, NorthDecoder.com, and Joe Morrissette, Deputy Tax Comm'r (Sep. 8, 2014)

<sup>2</sup> Email from Joe Morrissette, Deputy Tax Comm'r, to Chad Nodland, Editor, NorthDecoder.com (Sep. 11, 2014, 12:29 PM).

<sup>3</sup> Email from Chad Nodland, Editor, NorthDecoder.com, to Joe Morrissette, Deputy Tax Comm'r (Sep. 12, 2014, 9:20 AM).

(Department) did not have access to any messages or emails stored on the Commissioner's personal devices.<sup>4</sup> Mr. Morrissette further explained that the Department did not deny that the Commissioner's personal devices might contain records that would be considered public. Rather, the Department was not able to access the Commissioner's personal devices or contact him due to his voluntary leave of absence in order to receive inpatient medical treatment at an undisclosed facility at the time of the request.<sup>5</sup>

### ISSUE

Whether the Office of State Tax Commissioner violated the open records law when it did not produce records that were inaccessible at the time of a records request.

### ANALYSIS

All recorded information regarding "public business" in the possession of a public entity is open to the public unless otherwise specifically provided by law.<sup>6</sup> The Office of State Tax Commissioner is a public entity subject to the open records law and its employees, including the Tax Commissioner, are also subject to the open records law.<sup>7</sup> The definition of "record" includes:

recorded information of any kind, regardless of the physical form or characteristic by which the information is stored, recorded, or reproduced, which is in the possession or custody of a public entity or its agent and which has been received or prepared for use in connection with public business or contains information relating to public business.<sup>8</sup>

The above definition includes emails in the possession of employees of a public entity related to public business, regardless of whether the emails are stored at home, on a

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<sup>4</sup> See Email from Joe Morrissette, Deputy Tax Comm'r, to Chad Nodland, Editor, NorthDecoder.com (Sep. 12, 2014, 10:28 AM).

<sup>5</sup> Email from Joe Morrissette, Deputy Tax Comm'r, to Chad Nodland, Editor, NorthDecoder.com (Sep. 15, 2014, 12:53 PM).

<sup>6</sup> N.D.C.C. § 44-04-18.

<sup>7</sup> See N.D.C.C. § 44-04-17.1(13) (definition of "public entity"), see also N.D.A.G. 2014-O-10.

<sup>8</sup> N.D.C.C. § 44-04-17.1(16) (definition of "record") (emphasis added).

OPEN RECORDS AND MEETINGS OPINION 2014-O-20

November 21, 2014

Page 3

private computer, or sent/received from a personal email address.<sup>9</sup> Likewise, this definition would include text messages in the possession of employees of public entities that relate to public business.<sup>10</sup>

The Department does not deny that emails, texts, or other recorded information containing public business on personal devices, such as cell phones or home computers, are subject to open records law. The Department, however, was not able to produce some of these records because at the time of the request, the Department could not access the records. In order to provide the records, the public entity must have a means to access the records. Although rare, there are situations in which records may not be available for immediate production for various reasons. Here, an employee's personal devices were inaccessible for an undetermined amount of time because the employee was on a leave of absence receiving inpatient medical treatment.<sup>11</sup> The Department never refused to produce the records but rather produced all records in its possession at the time of the request and explained to Mr. Nodland why it was unable to provide all of the Commissioner's records.<sup>12</sup>

The Department performed its due diligence under the open records law in attempting to produce all responsive records in its possession at the time of the request and agreed to turn over any other records when they became accessible.<sup>13</sup> I therefore do not find the Department's response to Mr. Nodland's request to be a violation of the open records law.<sup>14</sup>

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<sup>9</sup> See N.D.A.G. 2014-O-10; N.D.A.G. 2013-O-08; N.D.A.G. 2008-O-07; N.D.A.G. 2007-O-06.

<sup>10</sup> N.D.C.C. § 44-04-17.1(16) (definition of "record" includes recorded information of any kind regardless of physical form related to public business).

<sup>11</sup> Letter from Joe Morrissette, Deputy Tax Comm'r, to Sandra Voller, Asst. Att'y Gen. Sep. 30, 2014).

<sup>12</sup> The records accessible from the Commissioner's state email account were provided.

<sup>13</sup> As soon as the Commissioner was accessible, the Department fully responded to the request and no additional records were found. See Email from Donnita Wald, Gen. Counsel for the Office of State Tax Comm'r, to Chad Nodland, Editor, NorthDecoder.com (Oct. 9, 2014, 2:59 PM).

<sup>14</sup> I find the Department's response to Mr. Nodland to be a correct reply under the unique circumstances of this case. The Department produced the records it had in its possession as soon as possible instead of waiting for the Commissioner to become available to fully respond to the request.

CONCLUSION

The department provided all records accessible at the time of the request and agreed to turn over all remaining records as soon as it could access the personal electronic devices on which the records were stored. The department did not violate the open records law.

Wayne Stenehjem  
Attorney General

sld/vkk

**OPEN RECORDS AND MEETINGS OPINION  
2014-O-19**

DATE ISSUED: November 21, 2014

ISSUED TO: State Board of Higher Education

**CITIZEN'S REQUEST FOR OPINION**

This office received a request for an opinion under N.D.C.C. § 44-04-21.1 from Rob Port asking whether the State Board of Higher Education violated N.D.C.C. § 44-04-19 by asking people to leave the room during an open meeting.

**FACTS PRESENTED**

The State Board of Higher Education (SBHE) held a retreat on July 30 and 31, 2014.<sup>1</sup> During the retreat, the SBHE met with a representative from the Association of Governing Boards, Dr. Tom Meredith, to discuss certain issues plaguing the SBHE and possible solutions.<sup>2</sup> Before the consultation, president of the SBHE, Dr. Kirsten Diederich, upon recommendation of Dr. Meredith, made the following announcement:

We are going to request, I know that this is an open meeting, but as a follow-up to yesterday's discussion with Tom Meredith, he had requested that perhaps he could have a follow-up with the board members. There will be no business, but he wanted to go through some of the issues that he discussed yesterday. So we would like to be board only. We will have our legal counsel here to be sure that we are not conducting business of any type. But it would be our request that you give us a little time to be with Tom alone. However, you have the right to stay if you like. So . . . just a request. So if those of you that are not board members could go out and maybe just enjoy yourself a little bit more. It won't take very long...but thank you.<sup>3</sup>

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<sup>1</sup> Agenda, NDUS St. Bd. of Higher Ed., July 30 and 31, 2014.

<sup>2</sup> See Letter from Murray G. Sagsveen, NDUS Chief of Staff, to Sandra Voller, Asst. Att'y Gen.'s (Aug. 15, 2014).

<sup>3</sup> Id.; see also Audio tape, N.D. St. Bd. of Higher Ed. Retreat (July 31, 2014) (on file with NDUS).

After the announcement, the SBHE, along with its legal counsel, consulted with Dr. Meredith for approximately 45 minutes. The discussion was recorded and reviewed by this office.

#### ISSUE

Whether the SBHE violated N.D.C.C. § 44-04-19 by asking that only Board members be present for a consultation.

#### ANALYSIS

Unless otherwise provided by law, all meetings of a public entity must be open to the public.<sup>4</sup> The law is violated if a person is denied access to a meeting unless the access is due to lack of physical space.<sup>5</sup> “Denial can be explicit or constructive.”<sup>6</sup>

The SBHE offers several arguments why it believes it was not a violation of the law to request anyone other than Board members be present for a consultation regarding problems the SBHE was having and how it could improve the performance of its duties. I will address each argument in turn.

First, the SBHE argues that the request to leave was not a mandate, rather, those attending were given the choice to stay or leave, and the announcement therefore did not violate the open meetings law.

In 2007, I found it to be a violation of the open meetings law when a district’s school board told a parent that it “preferred” their daughter not attend a meeting.<sup>7</sup> Although the District asserted that the parents and daughter could have insisted on attending but voluntarily chose not to, making such a suggestion violated the open meetings law

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<sup>4</sup> N.D.C.C. § 44-04-19.

<sup>5</sup> N.D.C.C. § 44-04-19(1).

<sup>6</sup> N.D.A.G. 2007-O-05; N.D.A.G. 98-O-16.

<sup>7</sup> N.D.A.G. 2007-O-05.

because the statement had a “chilling effect” on the student’s willingness to attend the meeting.<sup>8</sup>

Similarly here, it is unlikely the people attending the meeting felt they had a real choice to stay when the president of the SBHE requested they leave the meeting. A suggestion or request by a governing body that a person leave a meeting has a chilling effect on a person’s right to attend the meeting and is a violation of the open meetings law.<sup>9</sup>

Second, the SBHE argues that the training provided by Dr. Meredith was not “board business.” In fact, President Dietrich assured those who were asked to leave that “[w]e will have our legal counsel here to be sure that we are not conducting business of any type.”<sup>10</sup>

As I have repeatedly explained, the definition of “public business” is broad and encompasses “all matters that relate or may foreseeably relate in any way to the performance of the public entity’s governmental functions.”<sup>11</sup> “Public business includes all stages of the decision-making process from information gathering to final action.”<sup>12</sup>

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<sup>8</sup> Id. The 2007 opinion recognized several Attorney General opinions from various jurisdictions in which public entities asked members of the public to “voluntarily excuse themselves” from the meetings and “that a request to leave can be a powerful tool for coercing a person to waive the person’s right to attend a meeting because the person may understand that by remaining, it may antagonize board members and influence their decision.” Such actions have a “chilling effect upon the exercise of the individual’s right to be present during” the open meeting and were violations of the open meetings law.

<sup>9</sup> Furthermore, as this office has explained multiple times, regardless of how uncomfortable it might be for a governing body to receive unfavorable information during an open meeting, the public has a right to hear a report as it is given to the governing body. See N.D.A.G. 2010-O-13 and N.D.A.G. 2004-O-21. Therefore, a governing body cannot ask people to leave solely because it is not comfortable with their presence

<sup>10</sup> Letter from Murray G. Sagsveen, NDUS Chief of Staff, to Sandra Voller, Asst. Att’y Gen.’s (Aug. 15, 2014). This is a similar argument to one made by the SBHE in a recent opinion in which the SBHE was interviewed by the Higher Learning Commission. See N.D.A.G. 2014-O-13. N.D.C.C. § 44-04-17.1(12) (definition of “public business”). The SBHE has continually been warned about having conversations relating to its public business without complying with the open meetings law. See N.D.A.G. 2014-O-13; N.D.A.G. 2013-O-07; N.D.A.G. 2013-O-06.

<sup>11</sup> See N.D.C.C. § 44-04-17.1(12) (definition of public business).

<sup>12</sup> N.D.A.G. 2004-O-02; N.D.A.G. 98-O-08; see also N.D.A.G. 98-F-16;.

Here, the SBHE and consultant discussed several issues that plagued the SBHE and how the SBHE could improve to adequately do its job. Such topics are undoubtedly the SBHE's "public business." Furthermore, when a quorum of a governing body is present and receives training that pertains to its public business, it is a meeting subject to the open meetings law.<sup>13</sup> Therefore, it is clearly "board business" when a quorum of the SBHE receives information or training from a consultant regarding the performance of its public duties and functions.

Third, the SBHE argues that no open meeting violations took place because no person from the public was deprived of access to the meeting. Only SBHE members, its legal counsel, and NDUS employees, specifically the president and chancellor's staff, were at the meeting and no members of the public or press were present.<sup>14</sup> Therefore, the Board argues the SBHE "has the right to ask its employees to temporarily step into another room to allow a consultant to speak bluntly about improving board governance."<sup>15</sup>

Although the open meetings law does not preclude a reasonable application of personnel policies, such as the requirement that annual leave be used to attend meetings, no such option or reasoning was given during the announcement requesting everyone to leave the room.<sup>16</sup> President Dietrich's statement was not addressed to employees. On its face, the statement by the President was clearly addressed to anyone in attendance. It may be convenient, after the fact, to point out that only employees left the meeting. However, for the purpose of this opinion, this office must consider whether the SBHE effectively closed a meeting without statutory authority. When President Dietrich requested that any person who was not a board member leave, she closed the meeting without statutory authority.

Finally, the SBHE argues that Mr. Port has no standing to bring a complaint because he was not denied any information nor has he been harmed because he was not actually

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<sup>13</sup> N.D.A.G. 2004-O-02.

<sup>14</sup> Letter from Murray G. Sagsveen, NDUS Chief of Staff, to Sandra Voller, Asst. Att'y Gen.'s (Aug. 15, 2014).

<sup>15</sup> Id.

<sup>16</sup> If the SBHE wished to exercise its right to regulate the participation of its staff during business hours, it could have made such a statement and required those wishing to stay to take annual leave. However, no such reasoning or option was presented and I do not believe this was the actual intent of the SBHE when it made the announcement. In its announcement, the SBHE did not draw a distinction that it was requesting the attendees to leave because they were employees versus regular members of the public. This argument appears to be merely an attempt by the SBHE to justify its actions.

present at the meeting.<sup>17</sup> The law provides that “[a]ny interested person may request an attorney general’s opinion to review...a denial of access to a meeting.”<sup>18</sup> The open meetings law does not require the person to be present at the meeting to make a request. Mr. Port is an “interested person” by the very fact that he is a member of the general public and has requested an opinion. As long as a request meets the time requirements found in N.D.C.C. § 44-04-21.1, a request may be made to this office.

As provided above, I find the actions taken by the SBHE to deny the public access to an open meeting to be a violation of the open meetings law. The SBHE often seems to devote an inordinate amount of time creating unsupportable legal arguments to justify violations of the open records and meetings law after the fact. Its arguments regarding legal standing and its quibbling about a perceived distinction between “a request for an opinion” and “an open meeting complaint” are examples. Devoting the same efforts to assure compliance before violations occur could go a long way to avoid these unnecessary and embarrassing incidents in the future.

#### CONCLUSION

The SBHE violated the open meetings law when it requested people leave the room during an open meeting.

#### STEPS NEEDED TO REMEDY VIOLATION

The SBHE must amend its meeting minutes to provide a detailed account of what was discussed during the consultation. The recording of the consultation must be provided to anyone requesting, free of charge.

I am concerned with the SBHE’s continual attempts to dismiss the duty to follow the statutory requirements of the open meetings law. It appears that the repeated warnings and opinions issued by this office finding the SBHE to be in violation of the law and

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<sup>17</sup> Letter from Murray G. Sagsveen, NDUS Chief of Staff, to Sandra Voller, Asst. Atty. Gen. (Aug. 15, 2014). In its response for information to this office, the SBHE attempted to provide several other arguments in defense of its actions. For example, the SBHE argues that “Mr. Port did not request an opinion. Instead he simply stated: ‘I would like to file an open meeting complaint.’” Therefore, the SBHE argues it was not appropriate for this office to issue an opinion. This office is able to deduce from Mr. Port’s email filing an open meeting complaint that he wished for this office to issue an opinion. Such attempts by the SBHE to further escape its responsibilities under the open meetings law are without merit.

<sup>18</sup> N.D.C.C. § 44-04-21.1.

even training provided by this office to the SBHE and its legal staff, are not enough to make the SBHE follow its duties under the open meeting law.

The law requires a public entity to provide the legal authority for an executive session. If any executive session is anticipated, the legal authority must be included in the meeting notice and announced at the meeting. If the need for an unanticipated executive session arises during a regular meeting, an announcement during the meeting is necessary. For the next year, any notice of a meeting of the SBHE that includes notice of an executive session must include an explanation of why the executive session is necessary and why the statutory authority is appropriate. In instances where the executive session was not anticipated during a regular meeting, after the meeting the same explanation and legal authority must be posted on the NDUS website.

Failure to amend its minutes with a detailed account of the consultant's discussion within seven days of the date this opinion is issued will result in mandatory costs, disbursements, and reasonable attorney fees if the person requesting the opinion prevails in a civil action under N.D.C.C. § 44-04-21.2.<sup>19</sup> It may also result in personal liability for the person or persons responsible for the noncompliance.<sup>20</sup>

Wayne Stenehjem  
Attorney General

sld/vkk

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<sup>19</sup> N.D.C.C. §44-04-21.1(2).

<sup>20</sup> Id.

**OPEN RECORDS AND MEETINGS OPINION  
2013-O-12**

DATE ISSUED: August 6, 2013

ISSUED TO: State Board of Higher Education

**CITIZEN'S REQUEST FOR OPINION**

This office received separate requests for an opinion under N.D.C.C. § 44-04-21.1 from Ryan Johnson, reporter for The Forum, and Nick Smith, reporter for the Bismarck Tribune, asking whether the State Board of Higher Education violated open meeting laws by holding meetings not open to the public.

**FACTS PRESENTED**

On June 12, 2013, three members of the State Board of Higher Education (SBHE), President Duaine Espegard, Vice President Kirsten Diederich, and Mr. Terry Hjelmstad, met with ten of the eleven North Dakota University System (NDUS) presidents, individually, on the campus of Bismarck State College.<sup>1</sup> The purpose of the meetings was for the SBHE to gain information and perspective from the president by “engag[ing] in a dialogue about their individual institutional priorities, the challenges they see in the system as a whole, and their recommendations regarding important characteristics and goals for the next chancellor.”<sup>2</sup> “It was assumed that the three members who participated in the meetings would share their findings with the [SBHE] at a later date.”<sup>3</sup>

Mr. Ryan Johnson and Mr. Nick Smith each allege that the June 12, 2013, meetings were subject to the state’s open meeting laws.

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<sup>1</sup> See Letter from Kirsten Diederich, Vice President of SBHE, to Attorney General’s office (June 28, 2013) (on file with author).

<sup>2</sup> See Memorandum from SBHE Chair, Vice Chair, and Trustee to SBHE Trustees and NDUS President (June 20, 2013) (on file with author).

<sup>3</sup> See Letter from Kirsten Diederich, Vice President of SBHE, to Attorney General’s office (June 28, 2013) (on file with author).

## ISSUE

Whether the meetings involving three of the eight members of the SBHE and NDUS presidents on June 12, 2013, were subject to open meeting laws.

## ANALYSIS

All meetings of a public entity must be open to the public unless otherwise specifically provided by law.<sup>4</sup> A “meeting” is defined as a “formal or informal gathering ... of [a] quorum of the members of the governing body of a public entity regarding public business.”<sup>5</sup> A “quorum” means “one-half or more of the members of the governing body, or any smaller number if sufficient for a governing body to transact business on behalf of the public entity.”<sup>6</sup>

The SBHE is subject to open meeting laws because it is the governing body of a public entity, the NDUS.<sup>7</sup> A “[g]overning body also includes any group of persons, regardless of membership, acting collectively pursuant to authority delegated to that group by the governing body.”<sup>8</sup> Under this definition, “any group of persons” delegated authority to perform any function on behalf of a governing body, including fact gathering, reporting or recommending action, as well as taking action, is subject to the state’s open meeting laws.<sup>9</sup> Thus, committees of a governing body have the same requirements to notice its meetings and prepare minutes because they are subject to the open meeting laws.

Because the SBHE is an eight-member board, a gathering of three SBHE members would generally not constitute a quorum.<sup>10</sup> However, a gathering of three members would be subject to the open meeting laws if the members were meeting pursuant to authority delegated to them by the SBHE.<sup>11</sup>

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<sup>4</sup> N.D.C.C. § 44-04-19.

<sup>5</sup> N.D.C.C. § 44-04-17.1(9).

<sup>6</sup> N.D.C.C. § 44-04-19.1(15).

<sup>7</sup> N.D.A.G. 2013-O-07; N.D.A.G. 2013-O-06; see also N.D. Const. art. VIII, § 6; N.D.C.C. §§ 15-10-01, 44-04-17.1(12)(a).

<sup>8</sup> N.D.C.C. § 44-04-17.1(6) (definition of “governing body”).

<sup>9</sup> Id. N.D.A.G. 2009-O-12; N.D.A.G. 2009-O-05; N.D.A.G. 2007-O-13; N.D.A.G. 2006-O-03.

<sup>10</sup> Four members is a quorum of the SBHE. N.D.A.G. 2013-O-07; N.D.A.G. 98-O-05.

<sup>11</sup> N.D.A.G. 2009-O-12; see also N.D.A.G. 2009-O-05 (“regardless of the label given to a group of persons, as long as there is a delegation of authority from the governing body, it is a committee”).

According to the SBHE, it never delegated authority to Mr. Espegard, Ms. Diederich, or Mr. Hjelmstad to meet with the University presidents.<sup>12</sup> Rather, Ms. Diederich explains that it was Mr. Espegard and she who privately discussed the idea of meeting with the presidents “after listening to ... [a] consultant who led the [SBHE’s] training” during the SBHE’s annual retreat, held on June 2-3, 2013, in Medora, North Dakota.<sup>13</sup> Shortly after the retreat, Ms. Diederich received an e-mail from Minot State University president, Mr. David Fuller, which, among other things, requested the SBHE to “enlist the support of the presidents and the campuses” and to “arrang[e] a time for all the presidents to meet alone and discuss the current situation and to entertain suggestions for the [SBHE] and the NDUS.”<sup>14</sup> Ms. Diederich responded that she and Mr. Espegard had already discussed meeting with the presidents and relayed her hope to set up the meetings in the near future.<sup>15</sup> Ms. Diederich and Mr. Espegard scheduled the ten meetings on June 12, 2013, with the NDUS presidents.<sup>16</sup> Ms. Diederich and Mr. Espegard decided to invite the incoming SBHE vice-president, Mr. Hjelmstad, to the meetings but did not inform any other board members or even NDUS staff of the scheduled meetings.<sup>17</sup> Ms. Diederich, in her response to this office, explained that “[i]t was assumed that the three members who participated in the meetings would share their findings with the [SBHE] at a later date.”<sup>18</sup>

Attorney General’s opinions under N.D.C.C. § 44-04-21.1 must be based on the facts given by the public entity. Accordingly, this office cannot question the written assurance from the SBHE that at no time did the entire SBHE consent or otherwise delegate authority to three members to meet with NDUS presidents. I, therefore, conclude that the June 12, 2013, meetings between three SBHE members and NDUS presidents, were not “meetings” subject to open meeting laws because neither a quorum of the SBHE nor a committee thereof was present.

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<sup>12</sup> See Letter from Kirsten Diederich, Vice President of SBHE, to Attorney General’s office (June 28, 2013) (on file with author). A member of my office reviewed the detailed draft minutes from the June 2, 2013, meeting during the Medora retreat and found no indication of a delegation of authority.

<sup>13</sup> See Letter from Kirsten Diederich, Vice President of SBHE, to Attorney General’s office (June 28, 2013) (on file with author).

<sup>14</sup> See E-mail from David Fuller, President, Minot State University (June 5, 2013) (on file with author).

<sup>15</sup> See E-mail from Kirsten Diederich, SBHE Vice President, to David Fuller, President, Minot State University (June 5, 2013) (on file with author).

<sup>16</sup> See Letter from Kirsten Diederich, Vice President of SBHE, to Attorney General’s Office (June 28, 2013).

<sup>17</sup> Id.

<sup>18</sup> Id.

CONCLUSION

The meetings involving three SBHE members and the NDUS presidents on June 12, 2013, were not subject to open meeting laws.

Wayne Stenehjem  
Attorney General

slv/vkk



# BOARD LEADERSHIP

INNOVATIVE APPROACHES TO GOVERNANCE

NUMBER 136, NOV.–DEC. 2014

[www.boardleadershipnewsletter.com](http://www.boardleadershipnewsletter.com)

## A Systems Approach to Governance

by Karl Sommers

### Introduction

**T**HE PURPOSE of this article is to answer the question: What is a governance system? Readers of *Board Leadership* are quite familiar with Policy Governance® as a governance system, but what makes this approach to governing a system? By what criteria should one judge whether governance is a system? And if it is indeed a system, by what criteria should one judge how well it is working?<sup>1</sup>

### What Is a system?

#### Definition

A system is defined as a set of components that work together for the overall objectives of the whole.<sup>2</sup>

We use mechanical and electronic systems in our daily lives and the natural world is filled with living systems.

In this article, we'll focus on human systems that are necessary for groups and organizations to function effectively. The primary focus here will be on the effective functioning of the whole system, and not just each of the parts.

#### Levels

James Grier Miller describes eight levels of living systems,<sup>3</sup> as shown in Table 1, on page 2.

The usual organizational focus is on Levels 3 through 7. Each level is composed of the preceding levels as subsystems. This is similar to the nested set principle in Policy Governance. Organizational work begins with Level 3, an individual person. For a group to be effective in its work, each individual person must also be able to contribute effectively. When working with organizational issues, it is important to first be clear on what level we're working with. A board of directors is a group (Level 4) composed of individuals (Level 3). A board functions on behalf of an organization (Level 5) and its owners, who can be outside the organization (Level 6).

#### Systems Characteristics

Twelve characteristics of living systems have been identified from the work of the Society for General Systems Research.<sup>4</sup> The first six of these describe the functioning of a system within its environment. It may be useful to view a diagram of these concepts, where the dotted line depicts the boundary for a system that is open to its environment.

1. **Holism**—Living systems are whole entities with unique characteristics. The whole system

(continued on page 2)

## EVENTS

### BOARDSOURCE

Throughout the year, BoardSource organizes a range of webinars and training events for US nonprofit board leaders. For more information, see <http://bit.ly/BdSourceEvents>

### NATIONAL COALITION FOR DIALOGUE & DELIBERATION (NCDD)

NCDD also regularly provides useful training events. For more information, see <http://ncdd.org/events/ncdd2014>

DECEMBER 10, 2014

### Policy Governance: A Systemic Perspective— with Gene Bellingier

— Webinar 11:30 a.m.–1:30 p.m. EST

For board members, staff, consultants, researchers, and others who are interested in examining the Policy Governance® approach from a systemic perspective. This will be a presentation and Q&A session with Gene Bellingier, who is a passionate Systems Thinker, coauthor of *Beyond Connecting the Dots: Modeling for Meaningful Results*, host of the Systems Thinking World discussion group on LinkedIn, and developer of SystemsWiki. This event is \$50 for

(continued on page 6)

### ALSO IN THIS ISSUE

FIVE KEY WORDS FOR EFFECTIVE GOVERNANCE ..... 4

HANDLING NEW TOPICS FOR THE BOARD'S ATTENTION ..... 7

# A Systems Approach

(continued from front page)

- is able to achieve more than the sum of its parts.
- 2. **Open systems**—Living systems are open to their environment. This means they exchange information, energy, or material with their environments. In contrast, a closed system is one that is isolated from its outside environment.
- 3. **Boundaries**—Living systems have defined boundaries that separate them from their environments. Relatively closed systems have rigid impenetrable boundaries, whereas relatively open systems have more permeable boundaries between themselves and a broader higher-order system.
- 4. **Input/Output**—Living systems receive inputs from their environment, transform these inputs in some way with various processes, and send outputs back into their environment.
- 5. **Feedback**—Living systems require feedback to continue living. Information about system outputs feeds back as inputs into the system, leading to changes in transforming inputs to outputs. Feedback enables achieving more effective future outputs; it is essential for stimulating learning and change.
- 6. **Multiple outcomes**—Living systems pursue multiple outcomes. For example, in social systems, multiple outcomes stem from the fact that they are composed of people with personal as well as group objectives.

All living systems also have standard internal relationships and dynamics, which are described by six additional characteristics. These reflect what actually goes on inside the system (the box labeled throughputs/processes; see Figure 1).

- 7. **Equifinality**—Living systems are capable of using different means to reach their desired outcomes.

**Table 1: The Eight Levels of Living Systems**

| Level | Name         | Description  |
|-------|--------------|--|
| 1     | Cell         | The basic unit of life   |
| 2     | Organ        | Grouping of cells that perform a specific function within bodies |
| 3     | Individual   | Person   |
| 4     | Group        | Team, department, family   |
| 5     | Organization | Company, nonprofit, government agency                            |
| 6     | Community    | City, neighborhood   |
| 7     | Society      | Country, state, province, tribal group                           |
| 8     | Earth        | Everyone on the planet   |

Equifinality reflects the principle that the same results can be achieved with different initial conditions and through different means and pathways.

- 8. **Entropy**—Living systems have the natural tendency to run down over time. They slowly break down, deteriorate, and eventually die.
- 9. **Hierarchies**—Living systems are hierarchical. Any given system is composed of lower-order systems (subsystems) and is itself part of a higher-order system (suprasystem).
- 10. **Relationships**—Living systems have interrelated components. Systems that work optimally have their elements coordinated to maximize the power of the whole.
- 11. **Dynamic equilibrium**—Living systems tend to reach a steady state in which continuous inflows of materials, energy, information,

and feedback produce a dynamic yet steady state. In this state, they tend to resist change.

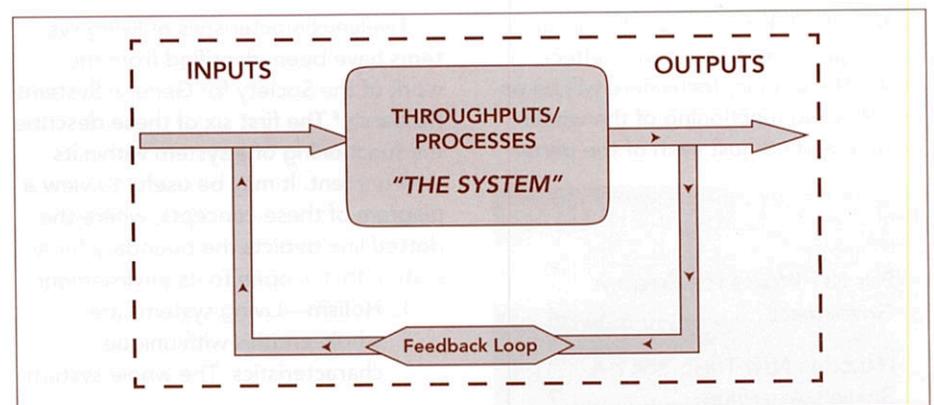
- 12. **Internal elaboration**—Living systems tend to move in the direction of greater differentiation, complexity, and higher levels of potential effectiveness.

## What Is Governance?

The key concepts embodied in governance are directing and controlling. The purpose of governance is to see to it that an entity achieves what it should achieve while avoiding unacceptable behaviors and situations.<sup>5</sup>

The function of governance is necessary at each of the eight levels of living systems. It is fascinating to ponder the role of governance as applied to an individual person, and how each of the 12 systems characteristics applies to a

**Figure 1: Internal Relationships and Dynamics of Living Systems**



person. The same could be said about groups, organizations, and communities. The focus of this article is on the role of governance as applied to organizations.

Since each of the levels in an organization includes the lower levels, there are numerous collaborations, collisions, and relationships among, within, and between levels. The diagram in Figure 2 attempts to illustrate the “collision of systems” between levels. The farther out one travels through these rings, the more complex the system is because more relationships occur. In this diagram, I’ve chosen to substitute the word *environment* for *community*. Governance for an organization occupies the Organization to Environment ring, where Environment would certainly include owners.

### What Is a Governance System for an Organization?

If governance of an organization is to be a system, it should at least satisfy the first six characteristics of living systems. An effective governance system will not only satisfy the first six characteristics, but also strive to achieve best practices in relation to the six internal characteristics. These characteristics as applied to effective governance are described in Table 2 along with the criteria for each. A governance system should satisfy all six of the criteria.<sup>6</sup> □

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### Notes

1. The systems concepts in this article stem from the work of the Society of General Systems Research founded in 1954 by Ludwig von Bertalanffy, an Austrian biologist, who is often referred to as the father of General Systems Theory. James Grier Miller’s book *Living Systems* (1978, revised 1995) made a significant contribution to this field. The International Society for the Systems Sci-

**Figure 2: The “Collision of Systems” Between Levels**



**Table 2: Governance System Criteria**

| #  | Characteristic    | Criteria  |
|----|-------------------|---|
| 1. | Holism            | A governance system sees the whole entity as its primary concern (Level 5). It speaks as a team with one clear voice to that entity (Level 4).  |
| 2. | Open systems      | A governance system assures that it is open to its ownership and its environment so that information can be exchanged.  |
| 3. | Boundaries        | A governance system has a clearly defined boundary between itself and management or operations. In addition, a governance system establishes controls by setting behavioral boundaries that clarify what is not acceptable.   |
| 4. | Input/Output      | A governance system takes inputs from its owners and the environment and sees to it that these are transformed into customer value as it sets the direction for the future.   |
| 5. | Feedback          | A governance system receives feedback in the form of actual performance against acceptable measures based on delegated authority and responds to it. Feedback is critical to stimulating learning and effecting positive change to ensure that future goals are achieved. |
| 6. | Multiple outcomes | A governance system enables the pursuit of multiple outcomes through clear delegation. Those most impacted by an action have a voice in setting the most appropriate goals to achieve the desired customer value.   |

ences ([www.iss.org](http://www.iss.org)) carries on this work today.

2. Stephen G. Haines, *The Manager’s Pocket Guide to Systems Thinking & Learning* (San Diego, CA: Centre for Strategic Management, 1998).

3. James Grier Miller, *Living Systems* (New York, NY: McGraw-Hill, 1978, revised 1995).

4. Fremont E. Kast and James E. Rosenzweig, “General Systems The-

ory: Applications for Organization and Management.” *Academy of Management Journal* 15 (4): 447–465.

5. Adapted from John Carver, *Boards That Make a Difference* (San Francisco, CA: Jossey-Bass, 2006).

6. Karl Sommers and Susan Radwan, *Effective Governance Using the Systems Thinking Approach* (Chula Vista, CA: Haines Centre for Strategic Management, 2011).

# Five Key Words for Effective Governance

by Ted Hull

*Policy Governance® consultant and practitioner Ted Hull applies his love of analogies (while recognizing that they can never be perfect) to help us understand the basics of good governance.*

**E**FFECTIVE GOVERNANCE includes learning five words. However, all five words need to be understood because missing one word will lead to trouble.

## Authority

Suppose you own a home in a modest area of town where you are raising your 2–3 children and your dog. Next door is an unoccupied, boarded-up house ... sort of. The back door is broken down, allowing access to potentially undesirable visitors. You are also aware that the smoke alarm system is not functional, which raises concerns that should a fire be “accidentally” set, your home and your family could be at risk. Furthermore, the property arguably would be worth more to the owner

if there were no house on the lot. You have brought this to the attention of the city, but nothing has been repaired or resolved. What are your options?

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The board is the only body within an organization that has the authority to govern.

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Let me suggest that if you feel strongly enough about the risk to your home and family, you should have the house demolished. I realize that you will have to pay for it, but that’s better than the potential of having the house catch fire and your home—and your family—becoming collateral damage. So, if you have the money to pay for demolition, you now have a plan that decreases the risk of fire and increases the value of the property next door.

The only thing you lack is authority. There is only one person who has the authority to demolish the house (permits and bylaws aside), and that is not you.

The board is the only body within an organization that has the authority to govern. If it doesn’t govern or govern well, no one else can assume that authority, (members and bylaws aside). This authority does not rest with the individuals on the board but with the board as a whole. This can

be understood better if the board is referred to as *it* rather than *they*. The board meets on Monday night, and it meets in Room 155. The implication of this is such that no one board member or director has the authority to govern. “*I am a board member*” carries no weight.

## Delegation

You have recently found out that your absent neighbor with the derelict house is an 86-year-old man who is incapacitated as a result of a stroke. He has become aware of the situation and decided to exercise his authority by having the house razed. Unable to do that himself, he has delegated his authority to someone while remaining ultimately responsible for the house.

No board can make sure that everything that should happen within an organization takes place. It is unreasonable to assume that a board can purchase office supplies or ensure that the towel dispenser works in the women’s washroom. So it delegates that authority.

## Clarity

Your octogenarian neighbor calls you to ask if you will take care of having the house demolished. Relieved, you agree to take care of it, which leads you to go to the city permit office and pull a demolition permit. Permit in hand, you head home, realizing that you need to call the owner about obtaining the funds to pay for the demolition. The owner casually comments that he has mailed a check to a demolition company in town. You and the company now have at least one thing in common—you are both confused. You will not pay to have the house destroyed until you get the money, and the demolition company can’t destroy it until it gets a permit. The net result is that the house will not be demolished.

This is a frequent trap into which boards can inadvertently fall. A board may delegate financial operations to

## FOOD FOR THOUGHT

“Just like any revolution eats its children, unchecked market fundamentalism can devour the social capital essential for the long-term dynamism of capitalism itself.”

Mark Carney in a speech at the Conference for Inclusive Capitalism, May 27, 2014; <http://www.youtube.com/watch?v=HCmAgT83iEg>

its CEO and then appoint a treasurer. So who does it hold accountable: the CEO or the treasurer? Or the CEO is responsible to oversee the staff, but an HR committee is somewhere in the mix. The CEO recognizes that an employee needs to be moved on, but the HR committee nixes the idea. The CEO is responsible for results while being told who will be employed to assist in producing those results. The board can't have it both ways; it cannot delegate the authority to its CEO to obtain certain results and then handcuff the CEO by dictating how the job must be done.

## Expectations

By now, you are convinced a controlled burn of the house next door would have been so simple and more straightforward. However, you have tracked down the person with the authority and he has delegated the authority to destroy the house solely to you. He expects the house will be knocked down, with the materials being recycled or dealt with in an environmentally friendly way. (He hasn't struck you as environmentally conscious, but work with me on this analogy). In addition, he needs it done within 90 days, after which time he will be fined by the city. Just one detail is missing: he hasn't stated all those expectations to you.

Boards have the right and responsibility to set expectations about the end results and the means that can't be used. Another heading for this section could be "No Surprises." The homeowner can't blame you if the expectation that the materials be recycled wasn't stated or if the deadline wasn't mentioned. In the same way, a CEO should not be blindsided by the disappointment of a board because of unmet but unspoken expectations.

## Checking

Let's assume now that all his expectations have been stated to you

in writing. But, by and by, the aged and disabled property owner receives a registered letter from the city indicating it has placed a lien on his property because the materials are still in a pile on the yard. (Let's skip the part where he is being sued because some kid stepped on a nail and got tetanus and his friend fell into the basement and broke his leg.)

Everything was apparently taken care of; the person with the authority delegated that authority to one person with clearly stated expectations. The only thing he didn't do was to check to see if the anticipated results were accomplished. And because we determined a long time ago that the

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The word *trust* should never be in a board's vocabulary, nor should the word *mistrust*.

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owner is the only one with the authority, he is the one responsible. "Oops" won't take care of his problems.

## Trust Is a Bad Word

The word *trust* should never be in a board's vocabulary, nor should the word *mistrust*. Checking is not an issue of trust or mistrust. A board must implicitly trust that its CEO will meet its expectations. If it starts out believing the CEO will not meet the stated expectations, the board should be ashamed of itself for hiring or keeping that individual. However, as much as your property owner friend might trust you, he has a responsibility that extends beyond him and you. He had a responsibility to the neighborhood, including the children who might wander onto his property.

In somewhat the same way, a board has responsibility that goes beyond its relationship with its CEO. It has a responsibility to those on

whose behalf it governs to make sure that what should happen has happened and what should not happen hasn't happened. Fulfilling this responsibility is not about trusting or not trusting; it is about checking in a manner that assures others about what is going on.

## Four out of Five Isn't Good Enough

*Authority, delegation, clarity, expectations, and checking.* Let's take out one word and see what we have.

A board cannot delegate *authority* it doesn't have.

If the word *delegation* comes out, then the board has some inane expectation that either it's going to do everything itself or that some unidentified person(s) will do some undisclosed task(s).

If the board has not provided *clarity* as to whom it has delegated its authority, then it will be frustrated with the constant "It's not my fault; I couldn't meet your expectations because someone else was responsible for something over which I had no control ..." or some iteration of that argument.

When *expectations* are not stated, then a board must not be surprised when its undeclared expectations are not met.

Without *checking* to monitor the accomplishment of the board's clearly stated expectations that it has delegated, it has no assurances that its values are being met. Furthermore, it has abdicated part of its responsibility in governing the organization on behalf of its members.

A board will be well on its way to effective governance when it sees its role as authoritative rather than advisory—it delegates but does not abdicate, its expectations are stated and not just implied, and it is checking instead of assuming. □

Ted Hull can be contacted at [thull@tedhullconsulting.com](mailto:thull@tedhullconsulting.com).

## Events

(continued from front page)

IPGA members and \$100 for nonmembers. For more information see [beyondconnectingthedots.com](http://beyondconnectingthedots.com) and [www.linkedin.com/groups/Systems-Thinking-World-2639211](http://www.linkedin.com/groups/Systems-Thinking-World-2639211)

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FEBRUARY 12, 2015

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### Making the Most of Your Policy Governance Consultant

— Webinar 11:30 a.m.–1:30 p.m. EST

For board members and staff who have been or are using the services of a Policy Governance® consultant and want to make the relationship as valuable as possible. This is an opportunity to learn from the experience of a variety of boards who will share the different relationships they have had and what has worked well and not so well in terms of:

- Structuring communications
- Balancing the need for ongoing support with overdependence
- Accountability and role clarity
- Mutual evaluation
- Making changes
- Any other questions you may have

For more information see <http://www.policygovernanceassociation.org/conferences/future-events.html>

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FEBRUARY 20–21, 2015

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### International Policy Governance Association Consultants' Forum

— Orlando, Florida

For more information contact [ceo@policygovernanceassociation.org](mailto:ceo@policygovernanceassociation.org)

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APRIL 8, 2015

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### Getting to Great Dialogue

— Webinar 11:30 a.m.–1:30 p.m. EST

For chairs, board members, and staff who are interested in how to gen-

erate productive dialogue at the board table and between boards and their owners and staff and their organizations' other stakeholders. This will be an expert presentation and Q&A session. For more information see <http://www.policygovernanceassociation.org/conferences/future-events.html>

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MAY 6, 2015

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### A Taste of Policy Governance

— Webinar 11:30 a.m.–1:30 p.m. EST

For staff and board members who want to explore the benefits and challenges of Policy Governance®. This is an opportunity to hear about from current practitioners about what using Policy Governance means for their boards. Come and meet chairs/CEOs/board members from three different organizations and get your questions answered. For more information see <http://www.policygovernanceassociation.org/conferences/future-events.html>

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JUNE 18–20, 2015

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### 12th International Policy Governance Association Conference: Leading Together

— Renaissance Harbour Hotel, Vancouver, Canada

Preconference sessions include a full-day Policy Governance® orientation. Two full days of other workshops on wide-ranging governance system topics. For more information see [www.policygovernanceassociation.org](http://www.policygovernanceassociation.org)

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JULY 14, 2015

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### Choosing a Policy Governance Consultant

— Webinar 11:30 a.m.–1:30 p.m. EST

For board members and staff who are considering whether to employ the services of a consultant to help them with considering/installing/maintaining

Policy Governance®. Our expert client panel will provide the benefit of their experience and discuss:

- Identifying your needs
- Getting the right level of expertise
- Getting the right "fit" with your board
- Affordability
- Structuring your relationship
- Any other questions you may have

For more information see <http://www.policygovernanceassociation.org/conferences/future-events.html>

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SEPTEMBER 9, 2015

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### Latest Approaches to Organizational Development

— Webinar 11:30 a.m.–1:30 p.m. EST

For board members, staff, consultants, researchers, and others who are interested in knowing about the latest thinking on organizational development and how it relates to board work in general and the Policy Governance® approach in particular.

This will be an expert presentation and Q&A session. □

## WRITING FOR BOARD LEADERSHIP

*Board Leadership* welcomes articles from governance practitioners, researchers, and consultants on topics related to the discovery, explanation, and discussion of innovative approaches to board governance. If you have something new to say or want to provide a new perspective on something already said, please get in touch to discuss your idea further and to get a copy of our publishing criteria. Email: [coliver@goodtogovern.com](mailto:coliver@goodtogovern.com). □

# Handling New Topics for the Board's Attention

by Caroline Oliver

*Our changing world keeps throwing up new subjects for boards' attention. Here, Board Leadership editor, Caroline Oliver, looks at how to avoid diluting the board's focus to the point that dealing effectively with the issues involved becomes impossible.*

REMEMBER when boards were first being told that they really should be looking at the impact of new technologies. Since then, the list of new things that boards are being urged to pay attention to seems to be growing exponentially. Suggestions abound that boards should be seeking to educate themselves on issues such as social media, cybersecurity, safeguarding, diversity, risk appetite, and reducing their organization's environmental footprint. All of these topics are important, and we know the number and range of those to come is likely to increase. We also know that board meeting time, and therefore board meeting agendas, cannot expand accordingly unless the board is to sit in permanent session.

In this article, I want to explore how boards can best take full account of new topics without spreading themselves so thin that they end up focused on "everything and nothing." The problem for boards, accountable as they are for everything about their organizations, is that the necessary breadth of their oversight comes at the expense of the depth needed to really understand and monitor individual issues.

New topics for possible board attention can arise from anywhere. A board member's casual conversation with a customer of the organization's services, a formal board-level annual environmental scan, a CEO's sense of something important that could impact current strategy, or a new bee

in a regulator's bonnet can lead to demands for board time. If everything is simply put straight onto the board's agenda, that agenda soon will become unmanageable. Filters are needed to ensure that what comes to the board table can be dealt with in a manner that enhances rather than dilutes the board's overall job. Unfortunately, developing such filters is easier said than done. What should they consist of, and why? How should they be applied?

Of course, today's board agendas do not go on forever, and so it follows that we must already be applying filters of some sort. Here are a few that I have observed:

- *CEO discretion*—the CEO decides what topics the board needs to address.
- *Chair discretion*—the chair decides what topics the board needs to address.
- *Strategic versus operational*—someone decides which is which.
- *Board member interest*—one or more passionate board members press the issue.
- *Stakeholder interest*—one or more passionate stakeholders press the issue.
- *Urgency*—someone decides that something should come to the board because time is too short for wider consultation.

The problem with all these filters is that they are being applied topic by topic in the absence of any clear

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## WHEN WE SAY ...

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

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

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

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

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

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

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

## New Topics

(continued from page 7)

criteria for what makes any topic one that can be addressed usefully at board level. A more systematic approach is surely needed to maintain board effectiveness in the face of increasing demands on its time. The governance system with which I am most familiar is Policy Governance®. *Board Leadership* readers may know of other systems that can help, and, in my editorial hat, I would very much welcome suggestions for others that we should feature in the future. For now, however, let me set out how the Policy Governance system provides criteria for board agenda setting so that you can see the sort of thing I am advocating.

In Policy Governance, the board's criteria for judging everything about the organization it governs is set out in its policies, or what we might call "board-level value statements." These policies are set out using a carefully designed architecture that requires:

- The separation of issues of purpose or "Ends" (defined as issues related to the organization's desired impacts on particular persons and the level of cost-efficiency with which they are produced) from all other issues.
- The separation of policies designed to instruct the board from policies designed to instruct the executive (CEO and staff).
- Delegation to the executive through the statement of issues of purpose as proscriptions and the statement of all other issues as prescriptions of "Limitations."
- The determination of all issues at the most overarching level before determination of more specific issues.
- Board policy making to cease at the level of specificity at which the board feels able to preauthorize all decisions and actions its delegates could take within "any reasonable interpretation" of that policy.

A list of resources for further understanding of the above can be

found on the website of the International Policy Governance Association (IPGA) at <http://www.policygovernanceassociation.org/resources/newsletters-a-books.html>, but for the purposes of this article, I simply want to illustrate how the above can work to create criteria for what topics should get onto the board's agenda and how.

Let us try applying the criteria suggested by the Policy Governance system to the ubiquitous topic of social media.

### Filter One: Is This Topic a Matter of Organizational Purpose/Ends?

Assuming social media is a tool your organization uses to provide benefits to its beneficiaries rather than being offered as a benefit in itself, social media is NOT a matter of your organization's purpose/Ends.

### Filter Two: Does This Topic Potentially Give Rise to Instructions to the Board or the Executive?

You probably will find that the topic of social media could give rise to both. For example, you might want to review your board member code of conduct to ensure that it deals adequately with board members' use of social media. And you might want to review your "Limitations" policies to ensure that your policy on, say, confidentiality of member/customer information is sufficiently robust.

Using its complete set of policies and the two filters above allows boards using the Policy Governance system to:

- Clearly establish whom they hold accountable for setting their agenda using their criteria and how they will monitor and evaluate this work.
- Ensure that no topic comes to the board that has already been discussed and delegated, unless it is a matter of concern as regards the monitoring and evaluation of that delegation.

- Ensure that all new topics on the board agenda (rather than matters of concern regarding the monitoring and evaluation of existing delegation) come framed as potential changes to existing board-level policy instructing the board and/or the executive as appropriate.

Painstaking and ponderous work?

Yes. Worth the effort in order to create a body of board values that can be continuously updated to take account of new topics without losing the overall plot? I leave you to be the judge. □

*Caroline Oliver is editor of Board Leadership, CEO of the International Policy Governance Association, and an international governance consultant. She can be contacted at [coliver@goodtogovern.com](mailto:coliver@goodtogovern.com)*

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