

# New Mexico Board Composition & Good Governance



Presented  
by:



In Partnership  
with:



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# Board Effectiveness Has an Impact

**Good Boards don't create good companies, but a bad Board will kill a company every time.**

*– Old Silicon Valley Saying*

## Board Members Have a Role

**The Board's role is to pull management out of the trees to see the forest.**

*– Pearl Zhu, Digitizing Boardrooms*



# Why Pensions Worry?

- Based on 2017 fiscal returns, Moody's estimated Adjusted Net Pension Liabilities for 50 States:

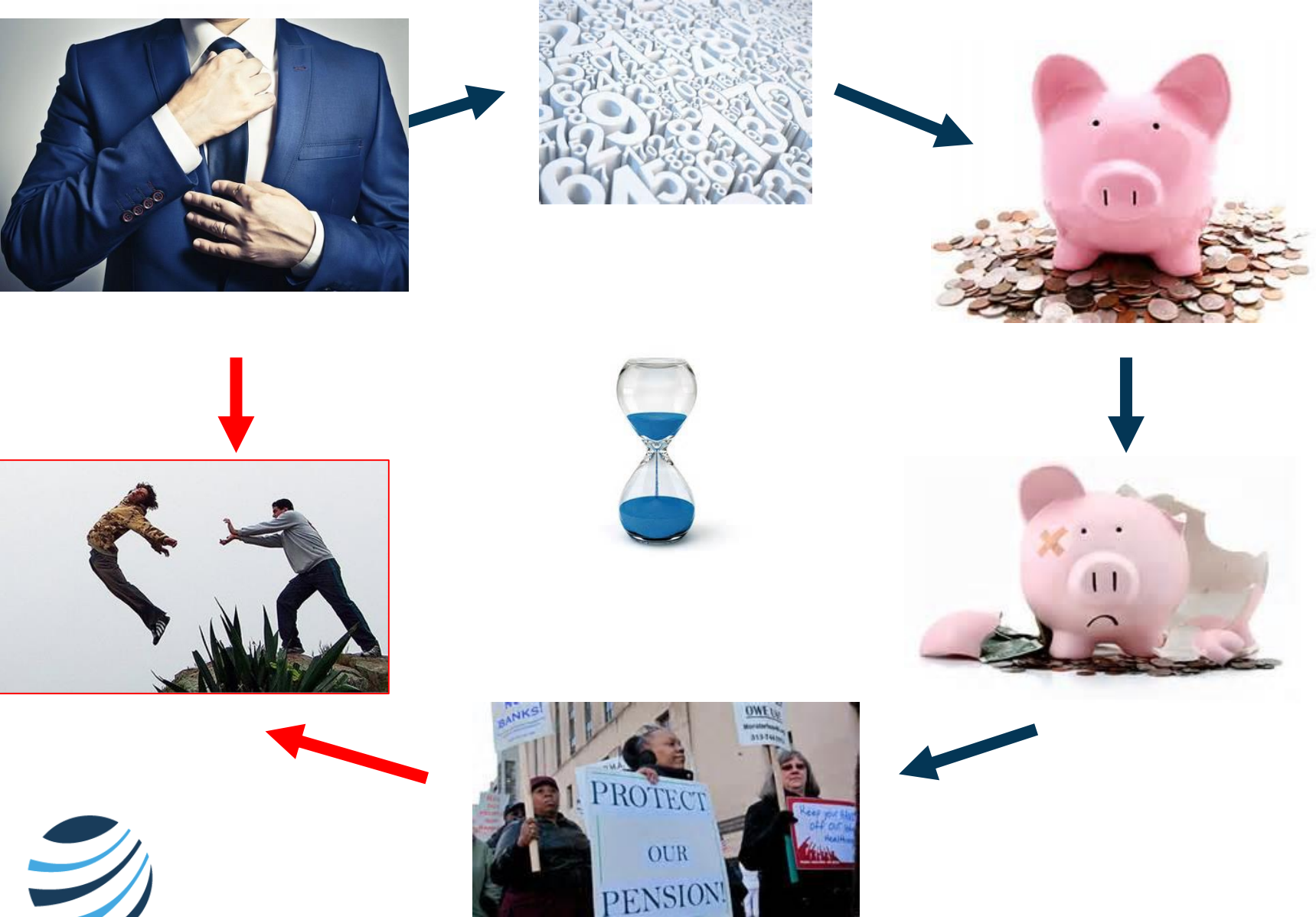
**Cumulative Total Reached \$1.6 Trillion  
147% of Total State Revenue**

- Illinois ~ 601% of state revenue (\$250.1B)
  - Considering borrowing \$107B in bonds
  - Chicago considering borrowing \$10B in bonds
- Connecticut ~ 360% of state revenue (\$71.2B)
- Kentucky ~ 332% of state revenue (\$48B)
- New Mexico ~ \$12.5 billion in unfunded pension liabilities**

Fixed costs of debt service, retiree health, & pensions exceed 30% of own-source revenue



# What Happens?



# Poor Governance Costs ... A Lot!

## (2007) The State Of Global Pension Fund Governance

☁ Poor Governance can cost pensions 1 to 2% annually

1. Financial oversight
2. Board composition and skills
3. Board evaluations
4. Clarity in board and management roles
5. High-performance cultures with competitive compensation



Ambachtsheer, Capelle, and Lum  
*The State Of Global Pension Fund Governance Today:  
Board Competency Still a Problem*



# Good Governance Helps Generate ... A Lot!

## (2019) Public Pension Board Composition & Returns

☁ Good Governance can gain pensions **24 bps in their 10-yr returns**

1. **Structure:** one fiduciary board for both investment and administrative oversight
2. **Size:** 6-10 members
3. **Stakeholder Representation:** at least one ex-officio member and only 20%-70% active and/or retired participants
4. **Financial Expertise:** at least two members with financial or actuarial experience
5. **Tenure:** 8-10 years of tenure, on average



Jean- Pierre Aubry, and Caroline Crawford  
*Does Public Pension Board Composition Impact Returns?*



A modern office interior with large windows and ergonomic chairs. The text is overlaid on this background.

***Given its Identified  
Impact***

***Pensions Need to Make  
Good Governance a  
Priority***

# Expected Duties of Board Members

## Basic Fiduciary Duties



**Loyalty**

(No Self-Dealing)

**Prudence**

(Detailed Process)

**Impartiality**

(Members' Benefit)





# Policy Board Governance Models

## Carver Model

- Places its focus on the “ends” of the organization’s purpose.
- The organization actively works towards what it needs to achieve or what it needs to do to realize its vision.
- The board gives the top executive the bulk of the responsibility for using the means to get to the “ends”.



**Noses In, Fingers Out**



# Policy Board Governance Models

## Cortex Model

- Focuses on the value that the organization brings to the community.
- The board defines the standards, expectations, and performance outcomes according to the aspiration of the organization.
- Clarifying and setting outcomes to achieve success become the primary duties of the board under this model.



**Noses In, Fingers on the Pulse**



# Possible Outcomes of Board Structure

	PROS	CONS
<b>Outside Appointees</b>	<ul style="list-style-type: none"><li>• Bring additional skills and knowledge</li><li>• Can provide “unbiased” views</li></ul>	<ul style="list-style-type: none"><li>• Do not have “skin in the game”</li><li>• Can provide “biased” views</li></ul>
<b>Member Trustees</b>	<ul style="list-style-type: none"><li>• Have “skin in the game”</li><li>• Understand member issues &amp; concerns</li></ul>	<ul style="list-style-type: none"><li>• May not be professional / have strong oversight skills</li></ul>

**Trustees can learn!!!**



A modern conference room with large windows and a long table. The room is empty, with several white office chairs arranged around a long white table. The windows are large and wrap around the room, providing a view of the outside. The ceiling is white with recessed lighting. The floor is a light-colored wood or laminate.

# ***Board Members Don't Know What They Don't Know***

# High Performing Boards

## Key Characteristics that aid in accomplishing tasks:

### 1. Clarity around role and focus

- Understanding role, scope of responsibilities and expected contribution to the long-term success of the fund

### 2. An effective chair

- Sets tone, direction and performance culture
- Creates an environment for engagement of Board members
- Open and honest relationships with CEO/Executive Director/CIO/Committee Chairs

### 3. A balanced Board team

- Strategic perspective plus specific technical experience and expertise
- Balance of temperament

### 4. A culture of trust and respect

- Chemistry, candid communication and mutual respect are critical



# Barriers to High Performing Boards

- No strategic plan
- Temptation to micro-manage
- Ineffective Nominating and/or Governance Committee
- Too small
  - Boards need enough members for committees to share in the other work of the Board
  - Sufficient numbers needed for diversity, and to solicit a range of viewpoints
- Lack of functioning committee structure
- Boards largely comprised of senior execs
- No plan for rotation/member development
- Failure to remove unproductive members
- No plan for orientation of new and old members





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***Boards Should Always  
Be Assessing Themselves  
and Increasing Their  
Skill Level***

# Easy Start to Strengthening Governance

## Governance Effectiveness Assessments

- Are necessary, impactful & a best practice
- Identify/uncover deficiencies
- Revisit/determine required board skills and expertise:
  - Finance
  - Investment
  - Risk management
  - Human capital management
  - Contract review and negotiation
- Strategically evolve and improve your Board capabilities
  - Education & training
  - Strategic recruitment



# Two Reasons Why Boards Evaluate Themselves

## **DIRECT**

### Evaluations help ensure that:

- The Board has the capacity and skills to provide proper oversight, risk management, and strategic guidance.
- The Board meets all its professional expectations and required compliance.

## **INDIRECT**

### Evaluations provide an opportunity to:

- Indirectly educate Board members.
- Identify problems (group, individual, etc.).
- Generate proactive improvement plans/strategies.



# A General Rule for Evaluations

## ❖ **Deep Dive** ➡ every 3 years

- Third party
- Interviews
- Action plan/improvement workplan
- Not done in the past (1<sup>st</sup> time)
- Serious issues exist

## ❖ **Shallow Dive** ➡ annually

- Minimum general survey
- Objective tracking (i.e. progress)
- Identification of sudden problems





- 
- Good assessments should clarify on:**
- Meeting of expectations/requirements
  - Performance
  - Ideas for improvement/way forward

# Skills Matrix Assessments

## Helps to Identify Gaps

- Strengthens governance practices.
- Helps to identify the skills, knowledge, experience and capabilities of current trustees.
- Helps to identify skill set gap for future challenges at your fund, which can be resolved by:
  - Trustee Education; and/or
  - Recruitment of additional trustee(s).





# Identifying Holes in your Skills Inventory

## Helps Identify Areas where:

- Boards are strong
- Improvements are required
- Targeted educational opportunities might help
- Strategic recruitment may be required

Skill/Attribute	Trustee # 1	Trustee # 2	Trustee # 3	Trustee # 4	Trustee # 5	Trustee # 6	Total
Investments	√	√			√		3
Pension Fund Knowledge	√	√	√	√	√	√	6
Compensation/HR		√					1
Governance Experience	√	√		√	√	√	5
Plan Member	√	√	√	√	√	√	6
Legal		√	√	√	√		4
Government Relations	√	√	√	√		√	5
Risk Management	√	√			√	√	4



Need for Individual skills development



Need for Board skills development



# Ways to Improve Trustee Skills

Leading funds utilize the following 6 strategies to improve upon the skills of trustees:

## 1. MAINTAINING MEMBERSHIPS

- Encourages trustees to uphold governance best practices at the Boards they sit on.

## 2. ATTENDING CONFERENCES OR SEMINARS

- Encourages trustees to provide information to other trustees relating to governance practices obtained from conferences or seminars.

## 3. BRINGING IN OUTSIDE EXPERTS

- Provides an update of new governance standards and trends from experts within the industry.

## 4. ALTERNATE MEETING LOCATION

- Strengthens governance practices throughout the organization and allows for better understanding of what the fund does.

## 5. ADDITIONAL MATERIALS FOR BOARD TRUSTEES

- Provides frequent updates on new governance standards and industry trends prior to Board meetings.

## 6. SUPPLEMENTAL MATERIAL FOR COMMITTEE MEMBERS

- Ensures Committee members are updated with changes that occur in investment, compensation and governance standards between Committee meetings.



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***Boards Will Never  
Get What They Don't  
Ask For!***

# Planned Succession is a Best Practice

## Articulate Business Strategy

- Management and board articulate a clear strategic vision for the future of the fund
- What “scenarios” will the next incumbent likely face?
- Understand the fund’s culture and values – will help assess “fit”

## Define Experience and Leadership Competencies Required to Implement Business Strategy

- What does the next leader look like?
- Build a future-oriented job profile based on future business needs

## Assess Potential Candidates

- Identify potential slate of successors
- Develop assessment process
- Evaluate candidates against criteria, and readiness to assume role within timeframe

## Development Planning

- Develop individual learning plans, including goals, resources, timeframe
- Most important development vehicle is work experience
- Variety of developmental activities should be explored
- Greater exposure to Board and activities

## Monitor, Measure and Evolve

- Develop and evaluate the plan and process
- Review progress against individual development plans, and refine as needed
- Revisit candidate ratings annually
- Identify key metrics
- Process and plan adjusted for lessons learned over previous year
- Communication strategy



# Have Pensions Given Up on Good Governance?

Given the return opportunity, how can pension trustees say yes?

But most public pensions are slow to:

- Assess their governance practices in recent years
- Review their foundational documents and guiding policies
- Introduce performance plans that incent the right behaviors
- Bring their boardrooms into the 1990s or early 2000s

**This is the way we have always done it!**

## Our Ongoing Challenge to our NAF Participants

- If they take our Accredited Fiduciary program and do not act:

**THEY HAVE GIVEN UP**



# Today's Presenters



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