

## CONDUCT THE BUSINESS OF THE BOARD

By Rick Funston, CEO, Funston Advisory Services LLC, and Board Smart LLC and Jon Lukomnik, Managing Partner, Sinclair Capital

*“If your actions inspire others to dream more, learn more, do more, and become more, you are a leader.”*

- JOHN QUINCY ADAMS, 6TH PRESIDENT OF THE UNITED STATES

Effective governance is essential to organizational adaptation, survival, and success. This is the second in a series of six articles about how to improve board effectiveness through the exercise

of the powers reserved exclusively for the board of a public retirement system. In this article, we discuss nine leading practices to help the board improve the way it conducts its business.



1. Set the ethical tone and instill a strong culture
2. Set the policy agenda
3. Effectively engage the board
4. Leverage committees for research, oversight, and verification
5. Communicate effectively
6. Self-evaluate and continuously develop
7. Provide individualized onboarding and continuing education
8. Establish and maintain clear lines of relationships with the board
9. Select, evaluate, compensate, and plan for executive succession

## Conducting the business of the board and its committees

One of the fundamental powers reserved for a board is to conduct its business and that of its committees. This covers a wide range of matters, such as governance policies, agenda-setting, rules of order, self-evaluation and development, committees (structures, charters, composition, selection/election of chairs and vice-chairs), evaluation, compensation, and succession of the executive director (ED) and the chief audit

executive (CAE), and board member dynamics and engagement.

Retirement system trustees bring an essential diversity of backgrounds, experiences, and perspectives. They can also bring very different understandings of what constitutes good governance. How can they quickly find common ground for how they will conduct themselves?

### 1. Set the ethical tone and instill a strong culture

Setting the proper ethical tone is essential. Effective performance management is characterized by an effective system of internal control (i.e., checks and balances). The system of internal control begins with a comprehensive set of board governance policies that set the tone ranging from board operations and investments to conflicts of interest to diversity, equity, and inclusion to record retention.

Such policies have to be reflected in actual practice. How the board conducts itself sets the tone for the entire organization. There is nothing that will destroy an organization more quickly than the perception that there is one set of rules for employees, and another for board members and senior executives.

Also, there needs to be a commitment to ensuring “bad news” travels fast and messengers aren’t shot. This requires constructive, not destructive, challenge. This requires respectful but effective challenge amongst board members and between board members and management. Constructive challenge is designed to elicit information and understand the level of diligence performed by management before making a recommendation.

The board sets the tone.

## 2. Set the policy agenda

What does the board need to accomplish over the next few years? Recognizing there will always be unforeseeable issues, what are the foreseeable policy priorities and recurring decisions? How does the board set its agenda and stay focused on what's vitally important?

Effective boards use an annual or even multi-year decision calendar. Generally, the chair oversees the development of the calendar, amalgamating the work plans from each committee and management. The policy calendar guides the content of agendas throughout the year and enables the scheduling of relevant educational or informational sessions in advance of key policy decisions. It is also leading practice for the chair to gather additional suggested agenda items from board members and executive management before each meeting.

Many boards organize their agendas to address the easy things first and leave the tough discussions until later. Unfortunately, that's when people are often tired, their patience is wearing thin, and their eyes are on the clock.

Instead, consider putting the easy issues last, rather than first. Discuss the harder issues earlier in the meeting when people are fresher. When dealing with complex policy issues, it can also be helpful for the executive and the board's advisors to provide a list of options with related pros and cons. This enables the board to make informed choices rather than just consider a single recommendation. It may take longer, but better engagement and understanding usually lead to better decisions and a shared commitment to the resulting direction.

The board also sets the style of the organization by the way board members conduct themselves toward one another, executives and staff, and the board's advisors. Are they respectful and constructive in the way they challenge the information and recommendations presented to them? (See also constructive challenge.) Are they professionally skeptical without being antagonistic or asking "gotcha" type questions?

## 3. Effectively engage the board

The chair of the board plays a critical role in determining board productivity and effectiveness.

First, the chair presides at board meetings and makes sure the business of the board is conducted effectively and efficiently; discussions are on-topic and constructive; ensures that every trustee has

an opportunity to be heard; all agenda items are fully reviewed, and meetings are called and held in accordance with the governing legislation and the board's bylaws and agreed-upon rules of order. This includes ensuring the board receives board materials in a timely fashion.

Second, the chair works with other board members and the executive director to develop meaningful agendas.

Third, the chair ensures the implementation of the board's policy for evaluating the performance of the ED and CAE and communicates the results. In some systems, the chief investment officer (CIO) is also a direct report to the board. The effective chair, however, avoids substituting his/her opinions for those of the board and remembers that the ED and the CAE work for the entire board. While often sharing responsibility with committee chairs to coordinate the implementation of delegated duties and reporting, the chair should avoid micromanaging day-to-day operations. Any dissatisfaction with the ED's or CAE's performance should be addressed as part of the regular performance appraisal process.

Fourth, the chair monitors and assesses board performance and the process for improvement. (See also "Self-Evaluate" below.) The chair's role is to communicate the results of the self-evaluation; consult with board members on their roles and help them assess their performance; ensure committees and members are complying with their responsibilities; ensure that the board's reporting requirements are met; be open to input; and take advantage of the training available on how to be an effective chair.

Finally, the chair serves as a spokesperson for the board on agreed-upon matters. When speaking for the board, personal opinions should not be substituted for the board's view. When speaking for the board or the organization, particularly on sensitive or complex issues, the chair collaborates with the ED and public relations, so messages are unified, clear, and consistent.

## 4. Leverage committees for research, oversight, and verification

Committees enable a board to gain insight into strategy, performance, and risk by delegating its research and oversight work. Most public retirement systems have at least three standing committees: audit (sometimes including non-investment risk), governance, and investment. Within their respective mandates, committees research important policy areas and make recommendations to the full board for its consideration and approval.

Committees are also the board's primary mechanism for oversight of performance and risk and the verification of the reliability of the information they depend on. Committees can devote more time to overseeing the execution of the board's approved directions and policies and compare actual to expected performance. Significant performance exceptions should be quickly escalated by the executive director to the appropriate

committee for assessing and recommending potential responses. Generally, each board member should participate on at least one committee.

Ad hoc committees are created by boards to address specific, time-limited issues. Committee membership, whether standing or ad hoc, is often appointed or nominated (subject to a vote of the board) by the chair of the board. There are a variety of ways to select/elect a committee chair, including

appointment by the chair of the board, election by the committee members, etc. In general, the board chair should not chair any committee.

Committees enable the board to improve insight and oversight.

## 5. Communicate effectively

The main public source of information about an organization is the executive director (ED). EDs are public figures, and part of their job is dealing with stakeholders and the public. However, there is a growing expectation that trustees will also be able to communicate effectively, both inside and outside the boardroom. This means that trustees must be aware of confidentiality and material non-public information rules.

When speaking publicly, trustees should clearly identify whether they are speaking as a member of the board or as an individual. The board should speak with one voice and provide clear, unified direction to staff and stakeholders. The board's credibility depends on it.

How effective is the board?

## 6. Self-evaluate and continuously develop

The board should evaluate its efficacy and identify opportunities for improvement regularly; most boards evaluate themselves annually. The evaluations should consider whether the committee, leadership structure, and the board's processes and operations are effective for the current and foreseeable future.

Evaluations, whether formal or informal, should begin with assessing if the board, its committees, and its members have satisfactorily performed their fiduciary duties and responsibilities. Is the board exercising its powers prudently and effectively?

Evaluation of individual board members is a leading practice though it can be politically fraught, requiring emotional intelligence in both designing and communicating the evaluation. One key to an effective evaluation is to avoid blame and focus on intended outcomes and improvement opportunities. Of course, to be effective, there must be follow-through on the self-evaluation findings and recommendations. Many boards also use third-party

facilitators in the self-evaluations. Boards should consult with their legal counsel to determine how best to treat the results of self-evaluations given public records and public meetings laws.

In addition to self-evaluations, effective boards and trustees embrace continuing education as an essential way to improve and fulfill the fiduciary duty to stay informed. In a rapidly changing environment, keeping pace with change, learning from the experiences of others, and applying lessons learned is essential to improving the efficacy of the board and thus the resilience and agility of the system.

Continuing education must also be customized to the enterprise and the specific needs of individual trustees because "one size fits one."<sup>1,2</sup> Just think about some of the current issues of importance in board rooms today: workplace/workforce, cybersecurity, ESG, and cryptocurrency, inflation, and supply chain disruption – not one of which was a widespread issue even five years ago.

## 7. Provide individualized onboarding and continuing education

The onboarding of new board members is often intense. Traditional onboarding often is compared to "drinking from a fire hose." There is a lot to learn and there is no forgiveness period; trustees become fully responsible immediately upon assumption of their role. They can get drowned in information that is rarely customized

to the new trustee's individual experience, understanding, or needs.

There are several options to accelerate the learning curve. These range from one-on-one meetings with other trustees and executives to mentoring assignments to thoughtful onboarding

tailored to the needs of the individual. Technology can also help. Today, customized onboarding and continuing education are offered online. Understanding the experience and expertise of each trustee can also inform the chair's committee assignments.

For the first year of service, the board should consider assigning both a board and staff mentor to new board members from day one. This helps ensure new trustees are welcomed and provided quick and individualized responses to questions to accelerate individual learning and contributions.

## 8. Establish and maintain clear lines of relationship with the board

Lines of relationship define who is accountable to whom. There are typically four sets of relationships with boards of trustees, and they all have different roles. Keeping them clear and separate helps boards govern more effectively.

The first line of relationship is with the senior executive officers and staff who are responsible for pension-specific operations such as investments, member services, and health care. This first line of management has the primary responsibility for operational performance and risk, as well as the effectiveness of controls to prevent, detect, and correct performance problems.

The second line is responsible for enterprise-wide functions, including, for example, financial management, legal, compliance, information technology, cybersecurity, and human resources.

The third line is internal audit (IA), which reports directly to the board on the reliability of management's reports and the effectiveness

of controls. To be effective, IA must be independent of management. For this reason, the head of IA is typically a direct report to the board, along with the ED (and sometimes the Chief Investment Officer).

The fourth line of relationship is comprised of independent advisors and auditors. While they need to work cooperatively with management on a day-to-day basis, they are independent of the executive and accountable to the board. To ensure that accountability, they should be hired and evaluated by the board, not management.

Are lines of relationship with the board clear?

## 9. Select, evaluate, compensate, and plan for executive succession

A critical responsibility of the board is to select, incentivize, evaluate, and establish a succession plan for its direct reports, typically the ED, the CAE sometimes the CIO. The board and the direct report should mutually determine goals at the start of each executive's tenure and at least annually thereafter. Objectives should link to the enterprise's strategic plan (for the ED), the investment strategy (for the CIO), and the audit plan (for the CAE).

Succession plans come in two types: emergency and planned. Emergency succession plans are designed for the "what if the ED gets hit by a

bus" situation. There should be at least one but preferably multiple internal candidates who might be considered for either emergency or planned succession, and the board should seek opportunities to better know those individuals. Often the ED confidentially recommends to the chair who should be named, but the final decision is, of course, up to the board. As part of the strategic plan, the ED should also have a plan to address succession needs throughout the retirement system. The board also needs to ensure similar plans are in place for the CAE and CIO.

### Summary

Public pension plan trusteeship is not an easy job, and few come to the task with the ideal background, experience, and expertise. Yet, having a clear understanding from the outset of how to conduct the business of the board and its committees is imperative. This article outlined nine leading practices to help a board improve its exercise of the power to conduct the business of the board and that of its committees.

The next article in this series discusses leading practices in the board's power to "Set direction and policy and then prudently delegate execution". How can the board be effectively engaged in setting direction? What are the key steps in strategic thinking and planning? How can the board prudently delegate execution?

For further information, contact Rick Funston, CEO Board Smart LLC [rfunston@boardsmart.com](mailto:rfunston@boardsmart.com)

<sup>1</sup> <https://www.boardeffect.com/blog/importance-board-governance-training/>

<sup>2</sup> <https://insights.diligent.com/board-education/the-best-practices-for-board-education/>