Board Smart

APPROVE KEY DECISIONS

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> *"In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing."*
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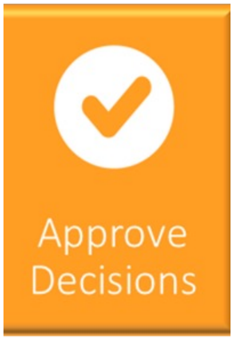
> **- THEODORE ROOSEVELT**, 26TH U.S. PRESIDENT

Effective governance is essential to organizational adaptation, survival, and success. This is the fourth in a series of six articles about how to improve governance and board effectiveness through the exercise of powers reserved exclusively for the board of a public retirement system. In this article, we describe six leading practices to improve the exercise of the board's power to approve key decisions.



1. Identify key decisions requiring board approval

2. Ensure stakeholders are effectively engaged

3. Calendar recurring approvals

4. Ensure prudent due diligence

5. Ensure adequate documentation and accurate records are maintained

6. Conduct post-implementation reviews

Effective governance requires that decisions are made by qualified individuals who are knowledgeable about the subject. They should have adequate skills, time, and resources to conduct effective due diligence in reaching their decision or before making a recommendation for board approval. The individuals must also act in good faith.

Recall that in exercising the power to set direction and policy (the subject of the third article in this series), the board is involved throughout the decision-making process. However, in exercising its power to "approve key decisions," the board is typically involved at the end of the decision-making process. Boards approve many decisions by executive management. To reasonably rely on management (or others') recommendations for board approval, the board should understand the process of due diligence (proper care) used to arrive at the recommendation.

Due diligence preceding a request for board approval should include an analysis of the facts and circumstances that led to the recommendation for approval. While the board may modify or reject the recommendation, the hallmark of "approval" is that the steps leading up to board consideration have been performed by others.

Of course, there are decisions wholly delegated to the executive by the board and are guided by the law, the organization's bylaws, charters, board's policies, and the purpose of the organization. Such delegations do not require further board approval but do require effective oversight (the subject of the next article in this series).

> Engage at the end of the due diligence process.

An effective approval process requires the board to decide what decisions to delegate entirely to executive management (or others), and what must come back to the board for approval. Frequently occurring delegations to executives are usually described in the organization's bylaws, charters, and governance policies as part of the board's power to set direction and policy. Other delegations are ad hoc. For instance, many board resolutions include blanket statements saying that the delegee is given all necessary authority and resources to carry out a board's policy decision.

By contrast, other resolutions explicitly ask the delegee to propose a course of action which the board must approve at some future date before that action is implemented. This can include the nature of the delegation, to whom, and a time frame for the issue to return to the board for approval (if so required) to help to avoid misunderstandings and controversies later.

Certain decisions are delegated to named corporate officers. As a simple example, the board must, in most jurisdictions, approve who can expend money, open bank accounts, or enter into contracts. These are often called authorized signatories.

All organizations should consider creating and documenting a clearly defined list of signing authorities. Together with what and how much they are allowed to commit to, the list identifies those decisions that must be escalated either to a more senior officer, a management committee, or ultimately to the board.

While certain approvals occur only once, many are annual. For all decisions, there should be a disciplined process for due diligence and related continuing education such that the board receives appropriate education related to a decision prior to being required to make that decision.

> Prudence is defined by the rigor of the process.

Recurring decisions can be calendared so that continuing education prior to a required decision is timely. The advantage is twofold. First, decisions will likely be better because the board members will know more. Second, education will likely burnish the board's ability to fulfill the prudency obligation of fiduciary duty.

1. Identify key decisions requiring board approval

The board should clearly articulate those decisions which require its approval and those which have been delegated to management. There is no definitive all-inclusive list to determine the decisions which require board approval. The principle of "one size fits one" applies as the requirements will vary by the facts and circumstances facing each organization, though some decisions may be mandated to be made by the board by various jurisdictions and regulators.

Determining which decisions are delegable will depend, to some extent, on the particular circumstances of the organization and its stage of maturity. Boards may want to consult with legal counsel when in doubt about whether a particular issue requires board approval.[1] Generally speaking, the level of materiality to the organization determines whether or not a board needs to formally approve a course of action.[2]

The level of materiality may need to be balanced with the frequency and number of times the same type of decision arises. Other considerations include the time frame within which the decision must be made, ease of establishing comprehensive decision criteria for delegation of the decision, and location in the organization of any expertise required to understand underlying aspects of complex matters.

Decisions that typically require board approval include:

- Election of officers
- Final selection of board advisors
- Hiring, terminating, compensating, or amending contracts of senior management
- Establishing or amending employee incentives and insurance plans
- Issuance of board reports
- Finances and budgets such as adopting an annual budget, borrowing, or lending money
- Changing the location of the principal office

- Entering into agreements of material importance to the system such as new retirement plan computer systems, legislative change requests, policy changes, or staff reorganizations
- Instituting or settling major litigation
- Establishing or changing dates of regular meetings of trustees

Additionally, many boards set specific limits on decisions which must come to the board for approval such as dollar limits on a transaction or the decision to invest materially in a new asset class or to change how benefit payments are processed. In other words, the board sets both qualitative and quantitative materiality thresholds for decisions it wants to see before they are finalized. Given that the level of materiality is judged against the specific retirement system's situation, it makes sense that there is not a standard list of either what has to go to a board for approval. This decision must be made by each board itself.

2. Ensure key stakeholders are effectively engaged

Ensuring there is an effective way for stakeholders' views to be considered is key when a board makes a major decision. A stakeholder is anyone who is affected by or who can affect the organization.

We read daily about how retirement systems are blindsided by unforeseen reactions by members, employees, legislatures, etc. In hindsight, however, these were often "preventable surprises." It was just that management did not consider a particular stakeholder group prior to recommending a course of action, and the board did not use its constructive challenge to ask about all the groups affected.

Public retirement systems are center stage in an emotionally charged debate about their future. They are under increased public scrutiny and find themselves challenged to inform and maintain confidence with multiple external constituencies The Covid-19 pandemic powerfully underscored the need for retirement systems to be forward looking to find the most effective methods to interact with their constituents, especially during times of crisis.

Each system needs to understand and find ways to effectively engage with their key stakeholders. This includes clearly identifying those stakeholders and identifying the issues that most concern them.

The system needs to develop proactive relationships with each stakeholder group. The system should also develop mechanisms to understand how each stakeholder group perceives them and develop plans to close any gaps between how they are perceived and how the system wants to be perceived. Success demands that the messages are reinforced in actual practice.

Be proactive, engage broadly, and document.

3. Calendar recurring approvals

Calendaring recurring approvals is a way to effectively deal with such issues as the election of officers, employee and/or board evaluations, setting the compensation of principal employees, or adopting an annual budget. Advance calendaring can also be used for multi-year events that require approval such as setting the asset allocation.

Setting a forward calendar of required decisions and the related due diligence processes executive management has used in making the final recommendation helps to ensure a "no surprises" approach for both the board and management. It also can help identify issues for board education, well in advance of the time such education is needed.

4. Ensure prudent due diligence

A prudent due diligence process means that before an item is brought to the board for approval, the process for making the recommendation for board approval should have been clearly documented. Management should have a record of the diligence undertaken in making the recommendation, and a rationale for the recommendation. That record, either as is or in summary, should be available to board members who want more detail on that particular item.

If a board member has a question about an item calendared for approval, they should use constructive challenge. Such dialogue makes sure that various agreed-upon factors were appropriately considered.

Constructive challenge serves to validate that management has done adequate due diligence prior to bringing a recommendation for approval to the board. Or, in some cases, suggest that the item be sent back for further study or an alternative recommendation.

What were the outcomes?
Lessons learned?

5. Ensure adequate documentation and accurate records are maintained

The process for making the recommendation for board approval should be clearly documented, i.e., describe the diligence or care that was taken. Sometimes the recommendation itself is enough, but, if not, it helps if the rationale for the recommendations is presented in consistent format. The entire rationale need not be presented in a board book but should be available to any board member who wants to know more or "drill down."

Maintaining a written record of approvals helps prevent misunderstandings, captures any caveats to approvals, and provides a record for the board in the event of legal challenge.

Minutes should be approved by the board at a subsequent meeting and then signed or otherwise certified by the secretary and filed appropriately. If allowed, written consents should be processed according to the system's bylaws and appropriate regulations.

6. Require post-implementation reviews

Finally, a leading practice is to conduct post-implementation reviews of material decisions. At the time of approval, a board should consider whether it wants a report at a future date on how the actions authorized by a particular approval have worked out.

Though many typical approvals (e.g., authorized signatories, minutes, routine yearly approvals, etc.) do not lend themselves to post-implementation review, approvals that change policy and/or commit resources are prime candidates for a report on implementation. Such reports help the board understand what works and why. Post-implementation reviews can provide invaluable context when strategic items (such as the budget) come up in the future.

Summary

In this article, we described six leading practices to improve the board's exercise of its power to approve key decisions. The next article in this series "Oversee Execution" describes some common oversight challenges and four leading practices to improve the board's exercise of the responsibility and power to oversee.

How can the board know if the direction is being properly executed? How can they stay situationally aware? How can they stay on top of large volumes of complex, rapidly changing data? How will they be promptly notified when exceptions occur?

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[1] https://www.cairncross.com/blog/ch-news/the-board-of-directors-role-and-the-importance-of-obtaining-board-approvals/

[2] https://www.activefilings.com/information/guides/corporate-actions/