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Date: February 5, 2013

**AGENDA ITEM 3c – Consent Calendar: ACTION REQUIRED**

**TO: MEMBERS, GOVERNANCE COMMITTEE**

- I. SUBJECT:** Board and Committee Effectiveness
- II. PROGRAM:** EXECUTIVE
- III. RECOMMENDATION:** Action Required – To proceed with the engagement of Mercer to conduct Board Evaluation.
- IV. ANALYSIS:**

Boards and individual directors have come under increasing pressure to improve their overall performance and governance. Boards today are expected to be more engaged, more knowledgeable and more effective than in the past. One tool that many boards use to examine and improve effectiveness is the board evaluation. Board evaluations give the board an opportunity to identify and remove obstacles to better performance and highlight best practices. Under Sarbanes-Oxley, boards must conduct regular evaluations of their Board of Directors and this is also a requirement for non-profit organizations. State Fund is subject to Model Audit Rule (MAR). While MAR does not have this specific requirement, it is a best practice to conduct regular board evaluations.

The State Fund Board of Directors conducted a Board Evaluation in 2Q 2010. Since the 2010 survey was taken, 60% of the Executive Committee has been replaced (CEO, CFO, COO, CRO, Claims Executive and Chief Actuary).

At the August 16, 2012 Governance Committee meeting, the Committee instructed the staff to engage in a competitive bid process with vendors that provide Board evaluations and take all actions necessary in order to present a recommendation to the Governance Committee.

**V. RESULTS/COSTS:**

- Statement of Work (SOW) was sent to potential vendors on October 29, 2012
- Only one responded to the RFP - National Association of Corporate Directors (NACD)
- The staff was directed to source other options and General Counsel contacted Michael Franklin at Mercer (previously known as Delta Consulting, part of Oliver Wyman) since he was the lead consultant used by Claims and Legal to work on their team effectiveness and optimization plans.
- Michael Franklin's discussions with Board Chair, General Counsel and Board Liaison developed the recommended approach (see attached)
- Cost is \$80,00 plus expenses

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HILDA PADUA, Asst. Corporate Secretary &  
Board Liaison

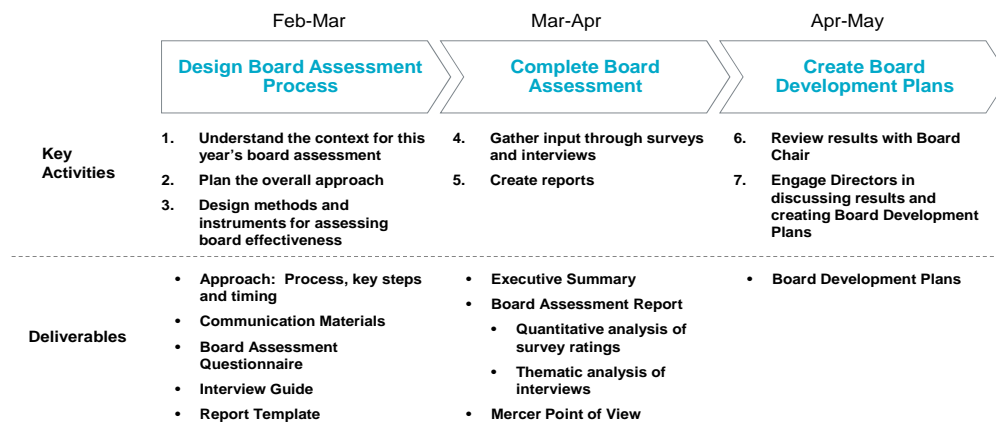
## Executive Summary: Proposal for State Fund Board Effectiveness Assessment February 4, 2013

The objectives of our work together are to:

- Develop a board evaluation process that assesses the board’s current effectiveness and provides a baseline for measuring progress over time
- Complete the board assessment to deepen the board’s understanding of what helps and hinders its effectiveness and to identify a few key areas on which to focus improvement
- Engage the board in creating an action plan to continue improving its effectiveness

In accomplishing those objectives, we will work with you through the steps and activities described below.

Figure 1  
**Overview of Approach**



- 1. Understand the context for this year’s board assessment.** While we are familiar with State Fund through work we have done with company executives over the past few years, we will conduct additional due diligence to ensure that we understand the context for designing and completing this year’s board assessment. In doing so, we will review relevant organizational and board information such as the strategic plans, the last board self-assessment, biographic profiles of the board members and relevant board minutes. We would also like to talk with members of the Governance Committee to understand their perspectives about what will make this year’s board assessment most helpful.
- 2. Plan the overall approach.** We will then work with the Governance Committee and CEO to review and refine the overall approach to enhancing board effectiveness. In doing so, we will review the output and discuss the benefits and problems with the last board assessment and determine if and how that evaluation should serve as a “baseline” against which to compare this year’s board assessment. Whether we leverage the previous evaluation or create a new approach, our experience is that using tailored surveys and individual interviews with directors to gather input provides objective, robust and

actionable data. Using those data, the full board can then be engaged to make informed decisions about the “vital few” areas on which to focus improvement and to identify specific actions it can take to strengthen the board's effectiveness.

3. **Design methods and instruments for assessing board effectiveness.** With that approach in mind, we will leverage the last board evaluation and/or adapt Mercer's existing board assessment instruments to create a board assessment questionnaire (BAQ), an interview guide, and a report template that are tailored specifically for State Fund's board.
  4. **Gather input through surveys and interviews.** Once the design of the BAQ is complete, we will make arrangements for directors to complete the survey online and will collect and analyze the data. We will also conduct individual interviews with each director to better understand the rationale for their ratings and to gather more in-depth observations and perspectives about the board's effectiveness. The input that is provided by directors will remain anonymous, in that we won't identify the sources of ratings or comments that we capture from interviews.
  5. **Create reports.** We will then produce a report that will include an executive summary of the findings from the survey and interviews, a detailed analysis and description of the quantitative results and a thematic analysis of the interviews that shows the key themes that emerged, with each theme supported by verbatim comments.
  6. **Review results with the board chair.** We will deliver the report and then meet with the Chair individually to review the results and to make plans for engaging the Governance Committee and the full board in discussing the results and creating development plans for the board. During our meeting we will discuss the Chair's perspectives on the key issues to address; provide our point of view; and design the objectives and agenda for a session(s) with the Governance Committee and full board.
  7. **Engage directors in discussing results and creating board development plans.** We will then deliver the appropriate materials to the full board and work with the Chair to facilitate a session (likely during the May board meeting), the objectives of which will be to discuss the results of the assessment, identify the “vital few” issues on which to focus improvement activities and create specific plans for continuing to enhance the board's effectiveness.
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Figure 2  
**Board Assessment Questionnaire – Sample Format and Questions**

**Board Roles**

**Please read each statement carefully and indicate the number that best describes your opinion.**

*To what extent...*

	To a very small extent	To a small extent	To some extent	To a great extent	To a very great extent
1. ...do board members demonstrate a clear understanding of their roles and responsibilities?	1	2	3	4	5
2. ...is the board effectively engaged in defining corporate strategy?	1	2	3	4	5
3. ...does the board effectively oversee the financial management of the company?	1	2	3	4	5
4. ...is the board regularly and effectively involved in long-term planning for CEO and executive succession and development?	1	2	3	4	5
5. ...does the board effectively evaluate and hold the CEO accountable for achieving goals?	1	2	3	4	5
6. ...does the board effectively assess and manage enterprise risk?	1	2	3	4	5
7. ...does the board oversee and ensure that the company is acting ethically and in compliance with relevant laws and regulations?	1	2	3	4	5

**Staffing and Pricing**

Michael Franklin, a Partner in Mercer’s San Francisco’s office, will lead the engagement, conduct all interviews with the directors and oversee the development of deliverables. Michael has been working with boards and executives on leadership of organizational change for over twenty-five years and brings expertise in CEO and board effectiveness. He will collaborate with Wendy Lu, a Principal in Mercer’s San Francisco office, who will help plan and coordinate the assessment process, assist in completing interviews, complete the data analyses and produce the assessment reports.

Mercer’s practice is to commit to a fixed fee for the engagement and then to allocate fees evenly across the engagement period. Total consulting fees for the scope of work outlined in this letter are \$80,000. Thus, for a four-month engagement, the fees will be \$20,000 per month. We bill expenses separately and at cost.