



Risk and Audit Committee

Agenda Item 4d

June 14, 2022

Item Name: Status Report – Enterprise Risk Management

Program: Enterprise Risk Management Division

Item Type: Information Consent

Executive Summary

This is an update of activities included in the Enterprise Risk Management Plan (Plan) and Strategic Risk Measures (SRMs) through April 30, 2022. Prior Plan updates were presented at the April 18, 2022 committee meeting that included the January 1, 2022 through March 31, 2022 reporting period and only minor changes are reflected in the Plan update. There are no changes to the SRM quarterly update.

Additionally, this item provides updates to the Enterprise Risk Management Framework including proposed changes to the 2022-27 SRMs now retitled to Strategic Risk Indicators (SRIs) Dashboard beginning in fiscal year 2022-23 and updates to the 2021-22 Developing Risks Report first reported in September 2021. This item highlights the inclusion of the SRIs into CalPERS Enterprise Performance Management (EPM) framework integrating risk management with strategic planning. This is an important step in maturing the Enterprise Risk Management Framework by creating a platform to consider risk return tradeoffs concurrently during strategic plan goal discussions to aid in making better risk-informed decisions.

Strategic Plan

This agenda item supports the 2017-22 CalPERS Strategic Plan Goal - Risk Management: Cultivate a risk-intelligent organization and the upcoming 2022-27 CalPERS Strategic Plan Goal – Organizational Excellence: Cultivate a risk-intelligent and innovative culture through our team and processes. The Enterprise Risk Management Division (ERMD) provides assurance to the CalPERS Board of Administration through the implementation of an effective enterprise-wide risk management program.

Background

ERMD developed the 2021-22 Plan to communicate priorities in support of CalPERS' Strategic and Business Plans, vision, and mission. In April 2021, ERMD received Committee approval for the Plan, which aligns program initiatives to the strategic plan goals of Fund Sustainability and

Risk Management. Progress on the Plan activities for the period are reported on the Plan Dashboard. (Attachment 1)

Strategic Risk Indicators

Enterprise risk management is a vital function in facilitating risk identification and monitoring activities that promote risk-informed decision-making at both the strategic and operational levels across the enterprise. The monitoring and reporting of SRIs play an important role in understanding the relationship between risk and performance by providing the board and management with advanced warnings of events that may compromise the achievement of strategic and operational goals. ERMD began working with the Enterprise Strategy and Performance Division (ESPD) during the current fiscal year to include risk management concepts into strategic planning with the culmination of this work resulting in the proposed integration of the SRIs into the EPM reporting. The benefit of integrated reporting is the board can simultaneously review performance and risk information to contemplate whether any additional actions or decisions are warranted and if the current course is still within the board's risk appetite and tolerances as discussed below.

In making strategic decisions regarding risk, boards communicate to the organization their philosophy of risk-taking by establishing risk appetite and tolerances. Risk appetite is the amount of risk an organization is willing to undertake on the basis of risk-return trade-offs in pursuit of objectives and is usually reflected by broad qualitative statements developed and approved by a board. Risk tolerance on the other hand, is the amount of uncertainty the organization is prepared to accept set in quantitative minimum and maximum tolerances to identify variance from the board's desired target. The risk tolerances are categorized into three levels: no attention/monitoring needed (green), monitoring required (yellow), and attention required (red).

Analysis

ERMD significant Plan activities and accomplishments for this period include:

Risk Management Goal Activities:

ERMD continued to collaborate with the enterprise to advance the Enterprise Risk Management Framework by:

- reporting quarterly updates to the Strategic Risk Measures dashboard to the Committee.

ERMD continued advancing cultivation of a risk-intelligent organization by:

- showcasing both compliance and risk functions by administering the fifth annual Compliance and Risk Employee Survey to help develop risk outreach, education, and communication plan.
- continuing to partner with ESPD in the development of the 2022–27 Strategic Plan to integrate risk considerations into the strategic planning process to support risk-informed decision making.

ERMD continued enhancing the Enterprise Internal Control Framework by:

- providing risk management training to new team members at New Employee Orientation sessions and conducting a new Your Role in Keeping CalPERS Safe webinar for team members to emphasize the importance of the first line of defense (FLOD).

ERMD continued enhancing compliance and risk functions throughout the enterprise by:

- publishing the approved 2021 State Leadership Accountability Act Report to the CalPERS internet site certifying that CalPERS' internal control systems and monitoring systems are adequate to address current risks. The report is available in the Forms & Publication section of the CalPERS internet site.
- communicating the importance of considering risks to CalPERS when making decisions with all team members through bulletins, spotlight ads, team member memos, and Microsoft Yammer posts.
- finalizing and implementing the Information Assets Data Retention policy.

Enterprise Risk Measures:

The Enterprise Risk Measures Dashboard summarizes the status of the CalPERS Strategic Risk Measures (SRMs) originally approved by the Committee in June 2018. Exception reports are attached detailing the risk performance, root cause analysis, and mitigations identified as next steps to reduce the risk for those SRMs that are performing outside of the board's risk tolerance. (Attachment 2)

A review of the data reported for the third quarter of fiscal year 2021-22 found three SRMs not meeting their respective risk tolerance as set by the Committee that "Require Attention" for High-Quality Affordable Health Care and Reduce Complexity strategic goals. An analysis and root cause of the risk can be found in the SRM detail provided in Attachment 2.

High-Quality Affordable Health Care:

- Legislation that negatively impacts CalPERS - Senate Bill 510 provides that COVID-19 testing and treatment will be without cost-sharing including employer ongoing/surveillance testing. The employer testing portion of costs being shifted to health plans could impact affordability. CalPERS is working with the Department of Managed Health Care to ensure that costs are reasonable.

Reduce Complexity:

- Proposed legislation that would reduce plan designs - As of April 2022, proposed legislation does not exist.
- Externally proposed bills that have the potential to increase the complexity of the plan design - The Board was most recently provided information of Senate Bills 457, 1173, and 1328 during the April 2022 state and federal legislation update.

Beginning in fiscal year 2022-23 the Enterprise Risk Measures Dashboard and the SRMs will be retitled to Strategic Risk Indicators (SRIs) Dashboard to better distinguish them from the performance strategic measures once integrated into the EPM reporting structure. One advantage of including SRIs within EPM reporting is that they are a leading indicator providing the board with advance warning that something is occurring that may compromise the achievement of a strategic goal. Performance measures are typically lagging indicators that

inform on prior periods. The SRIs provide a framework and metrics to ensure that the organization operates and manages risk in alignment with the board's risk appetite. ERMD collaborated with subject matter experts (SMEs) most familiar with the topics and processes associated with the risk indicator. The SMEs reviewed and determined which risk indicators are the most suitable as leading risk indicators. ERMD worked together with the SMEs to review and determine the appropriate risk tolerance levels for each continuing and new SRI. The suggested risk tolerance levels were developed to monitor the degree of uncertainty CalPERS is prepared to accept based on the board's risk appetite. Outcomes from the SMEs were vetted by the Division Chiefs and Executive owners for each underlying risk indicator.

The SRIs Dashboard and following table summarize the current 2017-22 risk indicators recommended to continue into the 2022-27 strategic plan cycle along with new proposed SRIs, which align to new strategic goals. (Attachment 3) Summary sheets were created to align with the EPM reporting structure and will continue to provide exception reporting by detailing the risk indicator description, intent, status, tolerances, root cause analysis, and mitigations identified as action items for those SRIs performing outside of the board's risk tolerance.

2022-27 Strategic Goal	Strategic Risk Indicator
Member Experience	Continuing: <ul style="list-style-type: none"> • Externally proposed bills potentially increasing the complexity of the plan design New: <ul style="list-style-type: none"> • myCalPERS unauthorized account access attempts (Closed session-Under development)
Pension Sustainability	Continuing: <ul style="list-style-type: none"> • Investment return: Funded status impact • Employer contribution rate impact
Exceptional Health Care	Continuing: <ul style="list-style-type: none"> • Legislation that negatively impacts CalPERS • Maintain health care fund actuarial reserve
Stakeholder Engagement	Continuing: <ul style="list-style-type: none"> • Investment return: Funded status impact
Organizational Excellence	Continuing: <ul style="list-style-type: none"> • Externally proposed bills potentially increasing the complexity of the plan design New: <ul style="list-style-type: none"> • Organizational continuous improvement – annual engagement survey

ERMD also recommends removing the following current SRIs at the end of the 2021-22 fiscal year as the majority of these SRIs are already captured in ESPD's EPM framework as a strategic measure/key performance indicator or no longer aligns to the 2022-27 strategic goals.

- Probability of PERF funding levels below 50%
- Percent of contracting agencies retained
- Increase in Total Covered Lives
- Proposed legislation that would reduce plan designs
- Continuous process improvement adoption
- Enterprise Risk Training Index (Under development)
- Employee Engagement Survey – Diversity and Inclusion (D&I)

Pending affirmative Committee direction, ERMD will incorporate all recommended changes into the SRIs Dashboard and align reporting with ESPD's quarterly schedule beginning in fiscal year 2022-23 through the board's Insight tool. The use of Insight provides board members on-demand access to the SRI information and furthers the goal of providing comprehensive performance and risk information through a central information system.

Developing Risks:

The 2021-22 Developing Risk Report Update provides a summary of the top four developing risks we are monitoring that are not yet well understood. (Attachment 4) The inflationary pressures developing risk was added to the original September 2021 report to reflect changes identified in the emerging risk environment. The long-term effects of potential prolonged inflation on CalPERS' strategic goals and objectives have yet to be determined.

Budget and Fiscal Impacts

Not Applicable

Attachments

Attachment 1 – ERMD 2021-22 Q3 Work Plan Update

Attachment 2 – Enterprise Risk Measures Dashboard

Attachment 3 – Strategic Risk Indicators Dashboard

Attachment 4 – 2021-22 Developing Risks Report Update

Forrest Grimes
Chief Risk Officer

Kevin Fein
Chief Compliance Officer