

This report details CalPERS achievements in the 2011-12 fiscal year. Highlights include the launch of my|CalPERS, enhancements to our core pension, investment, and health functions, and improvements to our decision-making processes that will enable our organization to continue to succeed in the future.

2011-12 CalPERS Business Plan

Final Report
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Enterprise Strategy and Performance

Table of Contents

2011-12 Plan Development.....	3
Customer Focus: Today & Tomorrow.....	4
Leadership and Soundness.....	5
Building Internal Strength.....	8
Conclusion.....	11

2011-12 Plan Development

At the close of the 2010-11 fiscal year, CalPERS had made progress on many fronts in the face of challenges and change. The foundation of our work was centered on three primary business goals: customer service, sustainability of our programs and services, and building internal strength.

We implemented a number of reforms to strengthen accountability, transparency and ethics to help restore confidence and integrity in the organization. As of June 30, 2011, our funded status had risen to 70 percent, and we earned back more than \$70 billion in the investment portfolio from its recessionary low.

In the area of health care, we negotiated an overall average premium increase of 4.1 percent, well below the projected national trend of 8.5 percent. We continued to provide technical advice to decision makers on pension issues and serve as an honest broker of information.

Internally, we reorganized our functions to prepare for the launch of my|CalPERS and to ensure excellent customer service delivery of retirement and health benefits to our members and employers. We also began to shift our focus to greater risk management and financial integrity.

While the year was marked with achievements and success, CalPERS leadership team recognized that there would be no shortage of challenges in the 2011-12 fiscal year.

As part of the planning process for 2011-12 Business Plan, our leadership team identified the challenges and opportunities CalPERS would face. The Business Plan (Attachment 1) was intended to build upon the achievements of the previous year and further CalPERS leadership by again focusing on three primary objectives including customer service, stability and soundness of our pension and health programs, and continued alignment of our culture, strategy and structure. The Board of Administration approved the Business Plan in April 2011.

The Plan included three overarching enterprise priority areas that are intrinsically tied to the existing CalPERS vision and mission.

- The **Customer Focus: Today & Tomorrow** initiatives focused on transforming customer service to meet the changing needs of members and employers. These efforts included delivering enhanced customer capabilities with the launch of my|CalPERS, ensuring a successful transition of staff and customers to the new system, and developing an enterprise strategy for transforming core service delivery.
- At the core of **Leadership and Soundness** was delivering strong investment results, adapting to changing conditions, and exercising leadership in pension, health, and financial market policy. The objectives and initiatives in this area included influencing State and federal retirement policy discussions, improving the cost effectiveness of the health program, implementing strategic investment priorities, and enhancing financial, actuarial and program reporting to stakeholders.

- The ***Building Internal Strength*** initiatives included completing the planned efforts of the organizational structure and cultural alignment initiatives, diversity and inclusion efforts, integrating a risk management culture into the organization, and reducing reliance on consulting services.

Together, these three priority areas ensured continued focus on customer service through the transition to the new my|CalPERS environment, improvements to the stability and soundness of our pension, investment and health programs, and building a strong foundation for our future. Each priority was supported by several initiatives detailing the work to be completed. Over the year, 43 of those 46 initiatives, each a major undertaking, were successfully completed. All of these initiatives represent fundamental changes in the way we do business; they increased our efficiency and effectiveness; improved accountability and transparency; and laid the groundwork to tackle the challenges that lie ahead.

The following is a summary of significant achievements for 2011-12.

Customer Focus: Today & Tomorrow

Focus on improved customer service, while implementing my|CalPERS and transforming our core service delivery to meet the changing needs of members and employers.

my|CalPERS

For 2011-12, the organization was keenly focused on maintaining customer service through the transition of staff, members and employers to the new my|CalPERS system. While the new system offered many new capabilities, merging 49 separate legacy systems proved to be a complicated process. Over the past several years, many teams have worked diligently to prepare for the my|CalPERS launch – training staff to use the new system; developing new policies and procedures; preparing data for transfer to new formats; and working with employers to be able to receive accurate enrollment and payroll information.

As a result of this work, the initial my|CalPERS system launched on September 19, 2011, with additional functionality for Judges and Legislators Systems being released March 25, 2012. While the launch was successful, we did encounter issues along the way, and stabilization of the system has taken longer than expected. However, staff worked together to identify and resolve issues quickly, and many areas were back to pre-launch levels or better by the end of the fiscal year. For the remaining areas, teams will continue to focus on what can be done to improve our systems and processes to deliver a better customer experience.

My|CalPERS will serve as the platform for future customer service delivery, with self-service functionality for members launching in 2012. In the new system, CalPERS will be better able to handle inquiries from both members and employers, getting the right answer at the right time. In addition, the new system enabled us to begin building business intelligence capabilities that give a holistic view of our data. Being able to analyze trends across health and pension systems and better understand the diversity of our membership will help us remain nimble in a changing environment and tailor our services to meet specific needs.

Service Delivery Transformation

Over the next several years, we will be adapting to the new capabilities offered by my|CalPERS. A wealth of new information and increased automation will allow for a more analytical approach to our work, and we will be looking to leverage new opportunities to communicate with our members through a variety of channels, constituting a wrap-around approach to customer care.

A major accomplishment in 2011-12 was the development of business intelligence pilot programs that drew upon the data from my|CalPERS to analyze such diverse topics as changes in retirement age over time and potential indicators of retirement fraud. Continued development of these capabilities in the 2012-14 CalPERS Business Plan will allow for a more fully developed solution, allowing the organization to better position delivery of services to meet customer needs.

CalPERS has also made equally significant improvements in the delivery of health care services. As chronically ill patients and potentially avoidable conditions represented a major portion of health care costs, several studies were undertaken to determine underlying causes and potential solutions to these issues. Through research and collaboration with insurers and providers, we gathered the information needed to bring about strategic improvements in health care delivery. These improvements are reflected in the 21 initiatives of our new health benefits procurement strategy.

Leadership and Soundness

Ensure the stability and soundness of CalPERS pension and health programs by delivering sound investment results, adapting to changing conditions, and exercising leadership in pension, health and financial market policy.

Pension Program

In an era of increased scrutiny of public spending, with a particular focus on pensions, CalPERS has made great strides in improving accessibility and transparency of our information. In 2011-12, staff in the Actuarial Office and Public Affairs worked to provide greater detail regarding termination liabilities and sensitivity to market returns in annual valuation reports to employers. These reports will help employers understand the full costs of various pension plan structures, and how employer contributions can vary in different market scenarios. Employers can use this information to make informed decisions on plan formulas for new hires, and to understand how pensions factor into the total compensation package. As part of a movement toward greater transparency in government, these reports are now publicly available on the Internet.

In addition to helping public employers understand the effects of changes to their pension plans, CalPERS has strengthened its ability to analyze issues affecting the retirement system as a whole. Establishing the Retirement Research and Planning Division expanded our capability to pursue important research topics in retirement security. To date, we have published two retirement security white papers (*Retirement Security in Modern Times* and *Business Intelligence*), and distributed toolkits to local and federal elected representatives to provide them with accurate information as they form retirement policy.

Our legal office published a paper (*Vested Rights of CalPERS Members*) analyzing CalPERS member vested rights under the law. The paper is intended to educate stakeholders on vested rights issues and can be found on our website.

Also of significant importance in 2011-12, CalPERS conducted a review of actuarial assumptions, allowing for adjustments to new economic forecasts. This review resulted in an update to the inflation assumption and the lowering of the discount rate by 0.25 percent. In addition, as directed by the Board, we have worked to phase in the impact over time so as to minimize the impact on employer budgets.

Finally, staff has undertaken reviews of specific programs to address current issues. Specifically, the methods used to share risks across small employers have been reviewed to ensure that risks are shared in the simplest manner possible, without creating moral hazard or adverse selection. In addition, as municipal governments face significant challenges, we have reviewed the policies regarding termination of pension contracts. This has resulted in a more conservative asset allocation and greater termination liabilities, ensuring that members whose agencies are no longer participating will still see their full payment – even in the event of further market weaknesses.

Health Program

To ensure the long-term success of our health program in this changing and uncertain environment, the CalPERS Board of Administration approved the Health Benefits Purchasing Review strategies and initiatives on January 24, 2012. These strategies are designed to gain efficiencies, contain costs and improve outcomes, while transforming health products and offerings to meet the needs of members and employers. For the 2014 health plan procurement, strategies will focus on the following 12 initiatives:

- incentives for disease management;
- intensive care management;
- overuse, underuse, and misuse;
- integrated healthcare;
- uniform metrics;
- self-funding;
- transparency;
- shared decision-making;
- evidence-based medicine;
- value-based purchasing;
- regional competition; and
- risk adjustment.

We will also look at four health strategies and initiatives: dependent eligibility verification; wellness platform; Medicare A/B; and tiered structure.

We have also undertaken workplace wellness initiatives to supplement the procurement strategies. CalPERS, in partnership with Santa Cruz County, Abbott, the California Association of Physician Groups, and the Institute for Health and Productivity Management, formed a partnership to develop a worksite wellness program that increased employee health, morale and productivity, and resulted in lower overall costs. More than 500 County employees participated, with 37 percent (twice the national average) completing the program and follow-up testing. One hundred fifty-two participants lost more than 950 pounds and 21 participants reduced certain risk factors

resulting in a significant reduction in the predicted onset of chronic diseases like Type 2 diabetes, heart disease and stroke. We believe workplace wellness strategies are the foundation for a healthier, happier and more productive workplace and workforce, and look forward to expanding pilot efforts like this in the future.

Finally, CalPERS has begun pursuing statutory and regulatory changes necessary to ensure a sustainable health program for the future. These changes will allow the Board to implement risk adjustment across plans and to adjust premiums as part of health promotion and disease management programs. Other changes have also benefited CalPERS members and stakeholders, such as implementing payment reforms, improving health outcomes, and encouraging different health plans to compete on quality.

Investment Program

CalPERS has continued to work to ensure the highest possible risk-adjusted returns. While returns in any one year may have significant fluctuations due to market conditions, CalPERS continued to improve upon its infrastructure to deliver world class results for years to come. In addition, steps to improve governance and clarify asset class goals, and made progress in promoting financial market reform to ensure investor interests are represented.

Since the financial downturn, the Investment Office has been intensely focused on asset allocation and risk management. The financial crisis challenged existing models, and institutional investors looked for new approaches to allocating investments. At CalPERS, this resulted in a new risk-based asset allocation and a greater understanding of the integration needed between investment asset and pension liability decisions. To address these concerns, we developed an integrated asset and liability decision-making framework for the Board, and shifted to a new risk-based asset allocation.

In addition to better managing risk and returns, the Investment Office implemented several measures to improve internal controls and move toward the target operating model. Project teams worked to improve processes and transparency for expense management, placement agents, incentive compensation, compliance, and travel approvals. New accounting systems and an investment risk management system have been brought online to provide enhanced analysis and transparency of the fund's position and risk profile.

In response to Legislative mandate, the Investment Office developed a draft five-year plan for emerging manager participation, which will be presented to the Board in August 2012. The work streams outlined in the plan are intended to: improve program design, oversight and investment performance; improve investment decision making and program management of emerging manager strategies; and increase CalPERS communication with emerging managers and stakeholder groups. This plan will improve alignment between our culture of valuing diversity and our business strategies related to investment performance with emerging managers.

Other major Investment Office initiatives last year included:

- shifting \$7 billion in assets to internal management and providing in-house monitoring capabilities for 340 investments in order to reduce costs;
- migrating funds to new asset allocation policies;

- promoting environmental, social, and governance (ESG) issues in investing, consistent with our fiduciary duty;
- publishing CalPERS first total fund report on ESG, *Towards Sustainable Investment – Taking Responsibility*; and
- implementing the Global Equity Capital Allocation and Governance Model.

CalPERS Investment Office also began engaging the California business community to better understand how CalPERS can help invest in California infrastructure. We held four roundtable discussions throughout California to explore opportunities for infrastructure investments in energy, water and transportation, as well as the obstacles and challenges to investing in the infrastructure sector.

Building Internal Strength

Deliver world-class customer service to our members and employers by improving the alignment between our culture, business strategy, and organization structure. Create a risk-intelligent environment that ensures accountability, integrity, transparency, nimbleness, and innovation. Further develop our staff to create a high-performing employee team with a broad and diverse range of skills, ideas, and perspectives.

Organization and Culture Alignment

With the implementation of the new my|CalPERS system and a renewed focus on issues such as risk management, pension reform and customer service, CalPERS continued realigning the organization. In 2011-12, key parts of the reorganization included formalizing the Office of Enterprise Risk Management and establishing the Retirement Research and Planning Division and the Center for Innovation. These new functions will allow for greater coordination, communication and governance of risk issues, and will help CalPERS establish and communicate policy positions. Last year we also created the Customer Account Services Division, bringing together the account servicing elements from both the health and pension sides of our organization to provide a more user-focused and holistic approach to customer service.

Diversity & Inclusion

At CalPERS, diversity and inclusion are part of our culture. Creating an environment where diverse thoughts and opinions can be brought to the table fosters the development of high-performing teams. We seek to develop an appreciation for diversity and inclusion not only within our own staff, but also in our business partners.

In 2011-12, efforts focused on cultivating a diverse culture among CalPERS leaders, with training sessions for Executive Staff and all levels of management on diversity and generational issues, and web-based toolkits and training for managers and staff. Staff facilitated two sessions with Executive Staff as part of the Diversity and Inclusion Development Journey. The goal of each session was to enhance leadership's understanding of diversity and inclusion and emphasize the leader's role in increasing diversity and fostering an inclusive work environment. Staff also hosted a workshop on the multi-generational workforce for CalPERS leaders in April 2012. The workshop demonstrated the importance for managers and supervisors to understand what events shape each generation, why generations behave the way they do, and how to leverage generational dimensions of diversity for business success.

Staff also launched an employee web-based diversity and inclusion training series aimed to provide staff with knowledge and tools to communicate more effectively, understand and respect differing viewpoints, and interact successfully in a team environment. An additional online toolkit for managers and supervisors was launched in June 2012 that will enable managers and supervisors to learn about diversity and inclusion in the workplace. The toolkit features easy-to-use resources for improving communications skills, building team relationships, and suggestions for practicing diversity and inclusion behaviors and core values within our diverse workplace.

Our Legal Office added ten minority or woman owned law firms to our pool of outside counsel, greatly increasing the diversity within the pool with which CalPERS contracts for legal services. The pool now better reflects California's diverse population, provides a broad spectrum of experience, talent, viewpoints and strategies, and elevates the professional expertise available to the CalPERS system through contracting opportunities. We also revised our survey of law firms under contract to seek information about each firm's diversity and inclusion initiatives and programs.

We also commissioned the Diverse Director DataSource (3D) in partnership with CalSTRS, as a new resource for finding talent to serve on corporate boards. In August 2011, 3D was opened to applicants with the relevant skills and experience to be considered as a director candidate and a pool of over 400 candidates has been established with 700 total profiles created. 3D calls for greater accountability, integrity, transparency and risk oversight on boards by offering diverse talent to nominate to corporate boards who add a diversity of thought, perspective, background, skill-set and experience.

As mentioned previously, the Investment Office developed a draft five-year plan for emerging manager participation with the goals of improving program performance, investment decision making, and communication with emerging managers and stakeholders. Diverse managers are likely to be emerging managers, and as a result an ancillary benefit of our emerging manager strategies may be to align emerging manager investment programs with CalPERS culture of valuing diversity and inclusion.

Our diversity and inclusion efforts, together with our core values, will enable us to build a pipeline to a more diverse talent pool; retain high-performing staff; and create a more inclusive environment that helps us minimize risk and take full advantage of the opportunities before us.

Risk Management

We made progress in maturing our risk management program by integrating risk management practices into governance structures and our culture to effectively evaluate, monitor and manage risk across the organization.

One major accomplishment was incorporating risk management into key strategic processes such as business planning, budgeting, workload management, and Board agenda items. To enhance the CalPERS risk-intelligent environment, we developed an inventory of approximately 150 well defined enterprise-wide strategic, operational, financial, and compliance risks. The portfolio of risk and controls were evaluated and reported on an enterprise-wide risk dashboard and the top risks of the organization were identified, evaluated, and mitigation strategies were developed as appropriate. We also

developed tools to help management identify, track, and manage risk, and clearly articulate the level of risk they are willing to accept in pursuing organizational goals.

All managers and supervisors received training on risk management and information security to further develop their risk intelligent capabilities. At the very foundation of a risk and compliance program are the laws, regulations and policies that govern the organization. A policy library was made available to all staff to increase awareness and promote compliance with existing policies. Finally, the OERM introduced a framework for integrating CalPERS governance, risk and compliance functions.

CalPERS is becoming a risk-intelligent organization aware of the risk that must be managed and mitigated to achieve our overall business strategies and deliver services to our members, employers, and stakeholders.

Staff Competencies | Consultant Reduction

In addition to a focus on diversity and inclusion, part of building a strong workforce is focusing on building staff competencies and reducing reliance on consultants. In 2011-12, CalPERS worked to add knowledge transfer language to multi-year consulting services contracts. We identified contracts where knowledge transfer to State staff would be beneficial, and required future contracts to include knowledge transfer language. Investing in our staff and their abilities will gradually result in a reduction in contract expenditures, and provide increased efficiencies for our organization.

In response to the 2010 Organizational Health Survey, we implemented a Career Services Program in April 2012. Under the new program, Career Services Analysts provide employees with consultative services regarding upward mobility, potential career paths, and personal and professional development. This program recognizes that our employees are our greatest asset and builds internal strength by developing staff to ensure a broad range of diverse skills, ideas, and perspectives. We also launched a Job Rotation Program pilot in June 2012 with participation from across the enterprise. The program supports both succession planning and employee career planning, and will help managers build bench strength and foster employee development.

In addition to building staff competencies through knowledge transfer and development opportunities, we also set a goal to reduce our spending on consulting services by five percent in the 2011-12 budget. Staff developed a framework and tracking program to monitor the planned reduction in consultant contract expenditures and implementation. The effort was a success with consultant expenditures 6.25 percent below the allocated budget amount. Through this initiative we have achieved significant cost reductions, increased staff capabilities and improved efficiencies.

Strategy & Board Governance

Building a strong organization starts at the top. Leadership must be able to set clear vision, structure itself to focus on the right issues, and gain a clear view into the most critical issues facing the organization. In recognition of that fact, CalPERS undertook several initiatives in 2011-12 to ensure that strong controls were in place for the Board and Executive Staff, and that decision makers were not only getting things done right, but getting the right things done.

In February 2012 CalPERS provided new templates and additional training on preparing effective agenda items. We also launched new Board Committee structures that reduced

gaps and overlaps in Committee responsibilities, and established new agenda item templates and consent agendas to allow the Board to spend more time on policy and strategic concerns. In addition, last year the Board adopted several new policies governing its own behavior, including governance, gift and travel policies. These policies were designed to increase accountability and transparency.

The new Board Committee structure, agenda materials and consent calendar enabled the Board to operate at a more strategic level and improved its accountability, decision making, and oversight. This was an important step in laying the foundation for the new 2012-17 Strategic Plan. Development of this plan began in January 2012 through dialogue with both the Board and Executive Staff about key issues facing CalPERS. Between January and July, staff engaged a variety of stakeholders, seeking input from labor, employees, retiree and member groups, employers, and State and federal government. These stakeholders have been actively participating, and as the plan is finalized in August 2012, their views will help shape the direction for CalPERS in the years to come.

CalPERS also began webcasting its Board and Committee meetings over the internet. The webcasts were yet another step toward our commitment to transparency and accountability to our members, employers, stakeholders and the general public. CalPERS live meeting coverage is closed-captioned. Recordings and transcripts are also archived and available on our website for one year.

Conclusion

In the 2011-12 fiscal year, CalPERS made significant progress toward each of the three priorities. We maintained and improved our customer service through the implementation of the my|CalPERS system. Our investment portfolio is being restructured to focus on a risk-based asset allocation model and risk aware culture. We also strengthened internal controls and developed a new framework to better understand and manage the tradeoffs between funded status, employer rates and rate volatility. Our health program initiated a three- to five-year strategy to ensure cost-effective, quality and sustainable health benefits for our members and employers. We strengthened our infrastructure by restructuring our organization, enhancing our risk-intelligent culture, putting in place new programs for our staff, and developing a new five-year Strategic Plan.

Taken together, these accomplishments position us for even greater success in the years to come. In the 2012-14 CalPERS Business Plan and the 2012-17 CalPERS Strategic Plan, we will continue our work to ensure secure retirements for California's public employees as we focus on improving the strength of the System, strengthening our organization and culture, and shaping public policy.