

# California Public Employees Retirement System

## Enterprise Risk Management – Top Residual Risk Report as of May 7, 2013

### *Summary of Top Residual Risks for this Reporting Period*

Risk Category	Risk Domain	Residual Risk Factors		
		Dec. 2012	May 2013	Trend
Strategic	Health Care Costs	▲	▲	➡
Strategic	Pension Funding		■	➡
Strategic	Municipal Bankruptcy		⬢	➡
Strategic	Human Resources Management	▲	▲	↓
Strategic	Stakeholder Perception	▲	▲	➡
Operational	Information Security	▲	▲	↓
Financial	Financial Controls and Systems	▲	▲	↓
Financial	Investment Risk Management	■	■	↑
Financial	Investment Controls and Systems	⬢	■	↓

### *Legend*

Residual Risk Ranking		Residual Risk Trend	
●	Minimum	↓	Decrease
▲	Moderate	➡	Remain constant
■	Elevated	↑	Increase
⬢	High		

*Residual risk reports on each category highlighted above are provided in detail in the following pages.*

## Health Care Costs

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
		Dec.	May	
Strategic				
Health Care Costs	High			

**Risk Statement**

This domain identifies risks in the health care environment that may impact increases in health care benefit costs and may erode CalPERS ability to provide its members with high quality, low cost health care services and adversely impact CalPERS as the preferred health care choice for employers and employees.

**Management's Mitigation Strategies**

1. Implement the Board approved Health Benefit Purchasing Review Initiatives (3-5 year strategic plan). Initially focus on the following:
  - Evidence-based medicine
  - Value-based purchasing
  - Bundled payments
  - Integrated Healthcare
  - Uniform Metrics
  - Shared Decision-Making
  - Transparency
  - Intensive Case Management
  - Reduce Unwarranted Care
  - HMO Procurement
  - Kaiser Contract
  - PPO Procurement
  - Risk Adjustment.
2. Focus on the top 3 cost drivers (inpatient hospital, outpatient hospital and specialty drugs) and work with the health plans to develop targeted strategies to address these drivers (Ongoing).
3. Manage new PPO & HMO contracts.
4. Implement Dependent Eligibility Verification project (2015).
5. Improve transparency of provider costs and distribute better information to stakeholders.
6. Continue purchaser collaboration efforts (i.e., PBGH, Covered California).

**Comments**

The mitigation strategies are a long term plan for 3-5 years. Mitigation strategies are monitored with minimum change in residual risk ranking expected this year. Residual risk ranking is expected to stay constant at the moderate level for this period and in the near future.

## **Pension Funding**

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
		Dec.	May	
Strategic				
Pension Funding	Extremely High			

**Risk Statement**

This domain identifies risks that may impact CalPERS pension plan sustainability including ability to provide retirement security for members which is affordable and attractive to employers, and maintain low volatility in contributions and sufficient funding levels.

- Management's Mitigation Strategies**
1. Deliver investment performance that exceeds benchmark results within acceptable risk targets.
  2. Regularly review actuarial policies and update as appropriate.
  3. Review actuarial assumptions regularly (economic and demographic).
  4. Board has adopted actuarial smoothing and an amortization method that strive for a balance between contribution stability and improved funded status over 30 years. Review asset smoothing policy in March 2013 and update as appropriate.
  5. Monitor employer accounts receivable and file payroll reports.
  6. Develop a risk model for the asset/liability framework to identify risk levels.
  7. Pension Reform Implementation will put downward pressure on contribution rates.

**Comments**

Assessment of risks has changed. While residual risks has decreased over the past year, better tools have allowed for reassessment of risks where inherent risks is now greater than first understood. Nevertheless, the residual risk ranking is expected to stay elevated for this period and in the near future.

## *Municipal Bankruptcy*

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
		Dec.	May	
Strategic				
Municipal Bankruptcy	Extremely High			

#### Risk Statement

This domain identifies risks related to and arising out of municipal bankruptcy that may impact employers and members pension or health plan terms (including benefits), contributions or premiums, or other actions that threaten the integrity and soundness of the system.

#### Management's Mitigation Strategies

1. Actively defend the integrity and soundness of the system in bankruptcy court; sponsor legislation to strengthen system protection.
2. Policy analysis to determine under what circumstances CalPERS might want to initiate termination proceedings.
3. Ensure actuarial policies minimize the probability that large single year rate increases will be necessary.
4. Establish a centralized collection process that monitors outstanding contribution payments, provides notification for past due amounts and applies interest/penalties for delinquent accounts.

#### Comments

Municipal bankruptcy is expected to remain at the residual risk high level until the economy improves. Once the economy improves the residual risk ranking is expected to change from red (high) to yellow (moderate). Legal bankruptcy ruling in CalPERS favor will also reduce the residual risk ranking from red (high) to orange (elevated). Nevertheless, the residual risk ranking is expected to stay at the high level for this period and in the near future.

## Human Resources Management

Residual Risk Status Overview				
Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
Strategic		Dec.	May	
Human Resources Management	Extremely High			
Risk Statement				
This domain identifies risks that may impact the availability of an adequate knowledgeable workforce with sufficient training and skills to meet organizational goals and objectives. This includes recruitment, hiring, succession planning, and labor relations.				
Management's Mitigation Strategies				
1. Initiate an enterprise-wide, five-year strategic workforce development and implementation plan that would include; succession planning, an automated Human Resources system, staff training and mentoring, and other talent management initiatives. 2. Some tactical examples of Talent Management strategies throughout the enterprise are listed below: Recruit: Implement a new online applicant tracking system; Investment Manager Class Study; Financial Office Restructure; Actuarial Classification Study; Retain: Executive Succession Planning; Career Services Unit & Job Rotation Program; Actuarial & Auditor Study Programs; Wellness Works and Fitness Center Programs; Develop: Learning Management System (LMS)/Skills Based Training; Customer Services & Support (CSS) Training Plan; Investment Office (INVO) Smart training program; Empower: Informal Mentoring; Code of Service & Compliance Training; 3 Dimensional Recognition Program;				
Comments				
Mitigation strategies are a long term workforce development plan for 5 years. This is the first year of integration for the Strategic Workforce Development Program. Mitigation strategies are monitored with minimum change in residual risk ranking expected this year. Residual risk ranking is expected to stay constant at the moderate level for this period and in the near future.				

## Stakeholder Perception

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
Strategic		Dec.	May	
Stakeholder Perception	High	▲	▲	■

#### Risk Statement

This domain identifies risks that may impact effective communications and relationships with key stakeholders that maintain a high level of confidence in CalPERS and ensure greater success at achieving CalPERS mission and vision.

#### Management's Mitigation Strategies

1. Stakeholder Relations will conduct a Stakeholder Relations Risk Assessment. (The Baseline was completed June 2011; the follow-up assessment plan is currently being developed for the next three years 2012-2015). The next survey assessments are scheduled in May 2013. After approval, the Reputational Risk Assessment Survey will be sent out to CalPERS Employees, Employers, Members every six months for three years.
2. We are currently implementing the brand voice and visuals throughout CalPERS communications.
3. We have created a Sales Coordination Group consisting of staff from across CalPERS sales and outreach areas that meets regularly to reduce risks related to stakeholder perceptions.
4. Our Strategic Marketing Council, consisting of the Deputy Executive Officers responsible for External Affairs, Benefit Programs Policy & Planning, and Customer Services & Support provides staff direction to address marketing efforts across the organization. The council will be looking at our current efforts in the area of marketing for Long-Term Care, Open Enrollment, and Supplemental Income Plans.
5. We will proactively inform Legislative leaders, key committee chairs and vice chairs, and consultants about issues that could impact CalPERS reputation. (This is an ongoing initiative, being conducted by the Office of Government Affairs on a regular basis).
6. We will Develop and implement a communications strategy to increase visibility and public presence of CalPERS leadership, in the media and among stakeholders. STRL staff is researching, enhancing calendars and recommending to leadership opportunities for expanded outreach.
7. Implementing a social media strategy that targets growth, engagement, education, and awareness of CalPERS online community. We started on July 1, 2011, with 1,657 Likes on Facebook and as of 5/17/2013, we have expanded to 7,087 Likes on Facebook and increased the number of twitter followers to 6473.
8. We will continue to enhance the social media strategy by raising our voice in the electronic conversation through monitoring and engaging with our stakeholder groups via their social media channels. The Office of Stakeholder Relations is leading this effort with consultation from PAOF Web and the Brand Management Team.
9. We've built a database of publicly available pension data and have plans to make it available on CalPERS On-Line. We currently provide the data to the media and public via their Public Records Act (PRA) requests. By launching our own database we can control the integrity of the data and better manage the messaging around the numbers. We plan to launch the database in the Summer of 2013.
10. We are expanding our ability to be more transparent and keeping our members and stakeholders informed through various webinars and webcasts, including live Board meetings on the Web.
11. We are proactively involved with the media, stakeholders, and the legislature on important topics, such as pension reform, municipal bankruptcies, and Long-Term Care.

#### Comments

Stakeholder perception is expected to remain at the residual risk moderate level with most risk events being external and uncontrolled by CalPERS. Mitigation strategies are monitored for execution and delivery of services with minimum change in residual risk ranking expected this year. Residual risk ranking is expected to stay at the moderate level for this period and in the near future.

## Information Security

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		
		Dec.	May	Projected Trend
Operational				
Information Security	Extremely High			

**Risk Statement**

This domain identifies risks that may impact information security that protects access to employer and member personal health and financial data, and prevents loss of information assets. This includes compliance with CalPERS information security policies and state requirements.

**Management's Mitigation Strategies**

1. Reduce security risks and vulnerabilities through improving protection from malicious internet threats, enhancement of data loss prevention technologies, security for mobile devices, and proactive security assessment processes.
2. Phase 1 of Security Roadmap Program will address six areas of improvement, which when implemented, will significantly reduce risks and improve information security throughout CalPERS. The six initiatives are outlined below:
  - Non signature-based protection against Malicious Mobile Code (MMC)
  - United States Government Configuration Baseline (USGCB) Compliance
  - Mobile Device Management
  - Develop Procedures for Periodic Security Assessments
  - Update EPPO Security Practices
  - Data Loss Prevention.

**Comments**

Mitigation strategy is a long term information security plan for 2-3 years. This is the first year of integration for the Security Roadmap Program. Mitigation strategy is monitored with minimum change in residual risk ranking expected this year. The residual risk ranking is expected to stay at the moderate level for this period and in the near future.

## Financial Controls and Systems

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
		Dec.	May	
Financial				
Financial Controls & Systems	Extremely High			

**Risk Statement**

This domain identifies risks that may impact the effectiveness of CalPERS financial controls to ensure accurate accounting for plan assets and liabilities. This includes policies and processes, implementation and management of controls for decision making, and use of assets, including appropriate authorizations, segregation of duties and delegation of authority.

**Management's Mitigation Strategies**

Develop and implement the following 10 key activities:

1. Cross-divisional efforts between ACTO and Fiscal to ensure assets in risk pools are reconciled to general ledger.
2. Produce summaries of financial information monthly verses annually to increase analysis, to educate decision makers and promote transparency.
3. Develop cash forecasting process and improve controls for cash flow (operational) generated by the trusts.
4. Ongoing development of financial reports in myCalPERS System to identify process problems, quality assurance issues and ensure the transfer of all generated financial activity into PeopleSoft.
5. Perform quality assurance testing in myCalPERS enhancements/changes to safeguard financial information.
6. Work collaboratively cross-divisionally to implement new/changes to programs to ensure accurate recording and reporting of financial activity.
7. Continue development of financial and cash management reports for PERF to improve financial forecasting and more accurate estimates.
8. Ongoing refinement of monthly investment expense report incorporating proposed account mapping changes by INVO.
9. Improve investment reconciliation process to identify investment and Fund Accounting Books of Record for public market assets.
10. Develop more effective budgeting process and present One Budget information to Board.

**Comments**

Mitigation strategies are monitored with minimum change in residual risk ranking expected this year. Residual risk ranking is expected to stay constant at the moderate level for this period and in the near future.

## *Investment Risk Management*

### Residual Risk Status Overview

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
		Dec.	May	
Financial				
Investment Risk Management	Extremely High			

**Risk Statement**

This domain identifies risks that may impact the management, measurement, monitoring and reporting of investment risk. This includes adequacy of resources, tools and governance structure to measure and manage risk.

- Management's Mitigation Strategies**
1. Implement new investment risk management system and risk budgeting framework - Barra II implementation completed; new reporting function being rolled out.
  2. Inventory all risk management functions both at the Total Fund and Asset Class level.
  3. Develop an investment risk budgeting framework.
  4. Recruit key senior management positions in Risk Group.
  5. Appointment of Interim Risk Group Senior Investment Officer (SIO).

**Comments**

Mitigation strategies are monitored with a change in residual risk ranking from orange (elevated) to yellow (moderate) expected when mitigation strategy number 1 is implemented, and a change in the residual risk upward trend to a downward trend when mitigation strategies 2 to 5 are implemented. For this reporting period, the residual risk ranking is expected to stay constant at the elevated level - orange.

### **Investment Controls and Systems**

#### **Residual Risk Status Overview**

Risk Category/Risk Domain	Inherent Risk	Residual Risk		
		FY2012-13		Projected Trend
		Dec.	May	
Financial				
Investment Controls and Systems	Extremely High			

#### **Risk Statement**

This domain identifies risks that may impact CalPERS investment control framework to effectively manage the portfolio, minimize fund expenses, provide for safekeeping of assets, and operate fund within context of all relevant legal requirements. This includes investment technology systems that are reliable and provide accurate, relevant data in a secure manner that supports the operations and accounting for investment funds.

#### **Management's Mitigation Strategies**

1. Completion of the PM2 Project.
2. Implementation of the Private Equity Portfolio Management System and Private Equity Accounting and Data Collection Services.
3. Full implementation of INVO expense tracking and reporting system.
4. Establish investment compliance monitoring program.
5. Develop more robust performance analysis and attribution capabilities. Estimated completion of tasks end by FY 2013/14.
6. Materially complete all initiatives identified in the refreshed Target Operating Model, optimistic completion date FY 2014/15.
7. Began contract negotiations and implementation planning with selected service providers for private equity IBOR and accounting.
8. Complete Disaster Recovery/Business Continuity Plan testing of Charles River and Aladdin at the Emergency Operations Center.
9. Complete substantial aspects of the policy and process changes for loading real estate appraisal data from Altus into AREIS.
10. Complete substantial aspects of the work needed to establish contractual agreements and policy/procedure changes needed to fully support OTC trading.

#### **Comments**

Mitigation strategies are monitored with a change in residual risk ranking from orange (elevated) to green (minimal) expected when mitigation strategy number 2 is implemented, and from orange (elevated) to yellow (moderate) when mitigation strategies 1 and 3 to 11 are implemented. For this reporting period, the residual risk ranking has changed to elevated level - orange.