



Agenda Item 8a

June 17, 2014

ITEM NAME: Semi-Annual Enterprise Risk Reports

PROGRAM: Enterprise Risk Management

ITEM TYPE: Information

EXECUTIVE SUMMARY

The Enterprise Risk Management Dashboard and Top Risk reports provide an overview of CalPERS risk environment. Since our last report in October 2013, the CalPERS Executive Team and management continued to actively assess, monitor, and manage risk across the organization. Significant measures were taken by the Board of Administration, acting upon management's recommendations, to effectively reduce risk within specific risk domains as noted on the enterprise risk dashboard.

Overall, the level of risk intelligence continues to advance across the organization with an increased level of participation by the Division Chief Council and completion of the risk registers supporting the enterprise risk dashboard. Continuing to cultivate a risk intelligent organization involves the integration of people, processes and systems to methodically manage performance and risk. As management increases their risk awareness and risk assessment capabilities, we are also identifying areas of segmentation that require integration to effectively manage risk. As a result, some risk domains ratings are elevated over the last reporting period.

The Enterprise Risk Management Dashboard (Attachment 1) represents CalPERS current risk profile. The risk domains shown on the Dashboard include specific related sub risks that are individually assessed and monitored. The aggregate ratings of the underlying risks in each domain are illustrated on the Enterprise Risk Management Dashboard.

Based upon the Risk Dashboard Recalibration result, we identified ten top risk domains which display the most significant impact and likelihood that may affect the completion of strategic goals and objectives. The enterprise risk reports are designed to promote governance, transparency, increase risk awareness, and improve enterprise risk management at CalPERS.

STRATEGIC PLAN

Enterprise risk management reporting supports CalPERS 2012-2017 Strategic Plan Goal B: Cultivate a high-performing, risk-intelligent and innovative organization. The Enterprise Risk Management Dashboard and Top Risk Report will assist the Board to more effectively oversee enterprise risk management at CalPERS.

BACKGROUND

The Enterprise Risk Management Division periodically recalibrates the Enterprise Risk Dashboard ratings. The Dashboard provides an overview of the CalPERS risk landscape that CalPERS is managing to better serve our members, employers, and other stakeholders.

The assessment of risk is a systematic process for identifying and evaluating events (i.e., possible risks and opportunities) that could affect the achievement of business objectives. Such events can be identified in the external environment (e.g., economic and political trends, regulatory landscape, news and industry trends) and within CalPERS internal environment (e.g., strategic plans, business plan objectives, people, processes, and technology). When these events intersect with CalPERS strategic or business plan objectives, or can be predicted to do so, they become risks. Risk is therefore defined as “the possibility that an event will occur and adversely affect the achievement of objectives.”¹

For this reporting period, the CalPERS Division Chief Council (DCC) members were more actively involved with the risk assessment process, participating in the development of detailed risk registers, which includes risk identification, risk response strategies and risk evaluation to determine the risk domain rating on the Enterprise Risk Management Dashboard. To ensure an appropriate level of risk governance, the overall results are reviewed by the DCC, the Executive Risk Management Committee (ERMC), as well as presented at the Deputies meeting. Based upon feedback from DCC, ERMC and Deputies meeting, the risk assessment results are further recalibrated then reported to the Risk and Audit Committee on the Enterprise Risk Management Dashboard as provided.

The ERMC identifies the most significant risk domains that may impact achievement of CalPERS goals and objectives. The Top Risk Report outlines the key risks ratings for three recent reporting periods and a summary of risk mitigation accomplishments, on-going risk responses, and planned mitigation strategies designed to reduce the level of risk over time. The Top Risk Report is appended to this agenda item as Attachment 2.

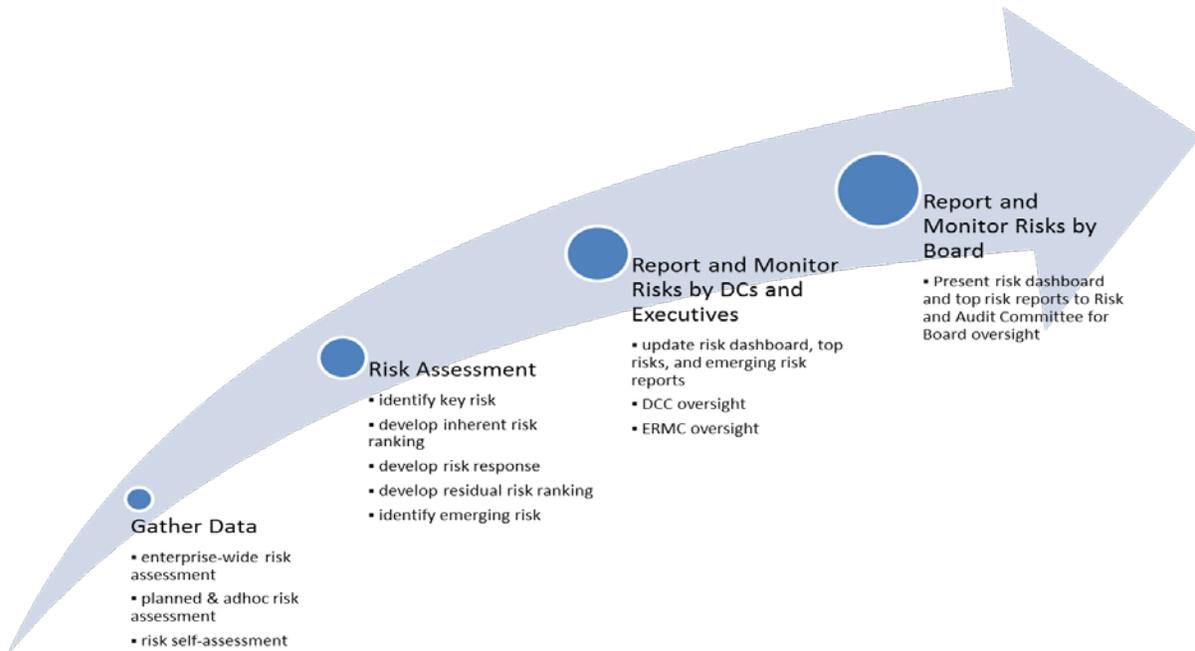
ANALYSIS

The Enterprise Risk Dashboard recalibration process includes (1) collection of internal and external data through environmental scan, enterprise-wide risk assessment, and risk self-assessment survey (2) risk assessment in terms of inherent risk, risk response strategies, and residual risk (3) report and monitor risks by Division Chief Council (DCC) and Executive Risk Management Committee

¹ Committee of Sponsoring Organizations, Enterprise Risk Management—Integrated Framework.

(ERMC) (4) report and monitor risks by the Board of Administration. Please refer to the Illustration 1: Risk Report Flow below.

Illustration 1: Risk Report Flow



The DCC identified, assessed, and prepared a response to the key risks within each domain, with all 32 risk domains now supported with detailed risk registers. The risk assessment process, applied consistently throughout the organization, empowers management to better identify, evaluate, and manage the right risks, all while maintaining the appropriate controls to ensure effective and efficient operations and compliance with applicable laws, rules, and policies. The risks are assessed using consistent criteria to determine the impact and likelihood of an event from a strategic, operational, financial, reputational, and legal/compliance perspective.

The Enterprise Risk Management Dashboard represents CalPERS current risk profile broken down into strategic, operational, financial, and compliance/ethics categories. A member of the Executive Leadership team is assigned ownership of a risk domain and provides a response to manage the most significant risks. Management provides assurance as to whether the strategies are on track, within budget, and having the desired effect on treating the risk.

In the May 2014 reporting period, we noted several changes in the risk domain ratings. The Enterprise Risk Management Dashboard includes 32 risk domains that were reviewed and updated to better illustrate the current view of CalPERS risk environment. The following highlights are noted in the Dashboard:

Strategic Planning and Implementation – As the new strategic measures for monitoring progress on the strategic plan are being implemented; management recognized two new risks for implementing the strategic measures, including availability of appropriate data to measure and the ability to measure performance. With these new risks, the domain rating increased.

Asset Allocation – A new risk domain was created on the Dashboard to assess the risks related to asset allocation that may impact achieving the targeted rate of return. CalPERS conducted a comprehensive asset liability study. As a result, the Board approved a new asset allocation strategy with lower risk on asset liability management. The chosen asset allocation requires interaction with the capital markets. This domain allows the Board to monitor implementation of the new asset allocation. The new domain rating is moderate.

Participating Employer Financial Hardship/Insolvency - While the State economy has improved, many participating employer budgets are already stressed and pension contribution rates increased. CalPERS remains actively engaged in current participating employer bankruptcy proceedings to defend the integrity and soundness of the system. Management has also implemented steps to monitor and improve collection of contributions from participating employers. Because of these factors, the risk domain rating decreased.

Organization – The Organizational Health Index survey identified a lack of clarity for employee roles and decision-making authority within day-to-day practices. With the new risk identification, the risk domain rating increased.

Procurement and Contract Management – With the initial creation of the risk register, management identified elevated risks associated with the contracting process and contract management with third parties. This risk domain rating increased along with management improved risk awareness.

Customer Service - One of the most notable areas of improvement is Customer Service. The Customer Service and Support (CSS) Performance Dashboard shows that CSS Operations meet or exceed the established performance targets. An independent survey conducted by Stakeholder Relations reports a 31% increase in customer service satisfaction to employers. As a result, the risk domain rating decreased.

Data Integrity and Management - A new risk domain was created on the Dashboard to assess the risks related data governance or controls. Effective data quality governance is essential and management is implementing mitigation strategies to increase data integrity. Management formed a working group to assess and mitigate data quality issues that may impact providing services to our members.

Financial Controls and Systems - Critical to effective management of this risk is the reduction of segmentation and the integration of people, processes and systems. Based upon the CFO and Controller's identification of two new sub risks focused on strengthening controls over treasury management, financial reporting, and implementation GASB 67 and 68, management has increased awareness of the risks impacting this domain. As such, the risk domain rating increased.

Investment Risk Management – The Investment Office recruited the Senior Portfolio Manager and continues to staff risk management group. The Investment Office has developed process to measure, monitor and report total and active risks for the fund and within each asset class. As a result, the risk domain rating decreased.

Actuarial Policies/Practices - The Board adopted the recommended mortality projections based upon an experience study and revised a few relevant demographic assumptions. These changes align the actual experience of the system to the actuarial assumptions used to project pension liabilities. This risk domain now has a low rating.

Laws, Rules, and Regulations – Management focus on compliance with laws, rules and regulations has identified a new risk associated with lack of clarity around roles and responsibilities, insufficient separation of duties, and immature compliance framework to provide appropriate level of assurance. The risk ranking increased.

Policy and Procedures – Policies serve as a formal statement that establishes the governing principles, responsibilities and standards for operation. Management identified the need to establish an enterprise policy framework that supports operational integration and effectively manages the policy lifecycle. While staff has made progress by establishing an enterprise policy oversight function, implementing a centralized repository, and developing a policy management framework, work remains to fully implement the policy management framework across the enterprise, including the continued build of the compliance monitoring program, process and systems. The risk domain rating increased.

BUDGET AND FISCAL IMPACTS

Funding for the proposed risk assessment activities will be provided through the Enterprise Risk Management Division budget.

ATTACHMENTS

Attachment 1 – Enterprise Risk Management Dashboard

- Displays the current risk environment and changes since the last reporting period as well as the expected future trend for 32 risk domains.

Attachment 2 – Top Risk Report

- Describes the most significant risks and provides an overview of the management risk responses.

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