
Compliance Section

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Summary

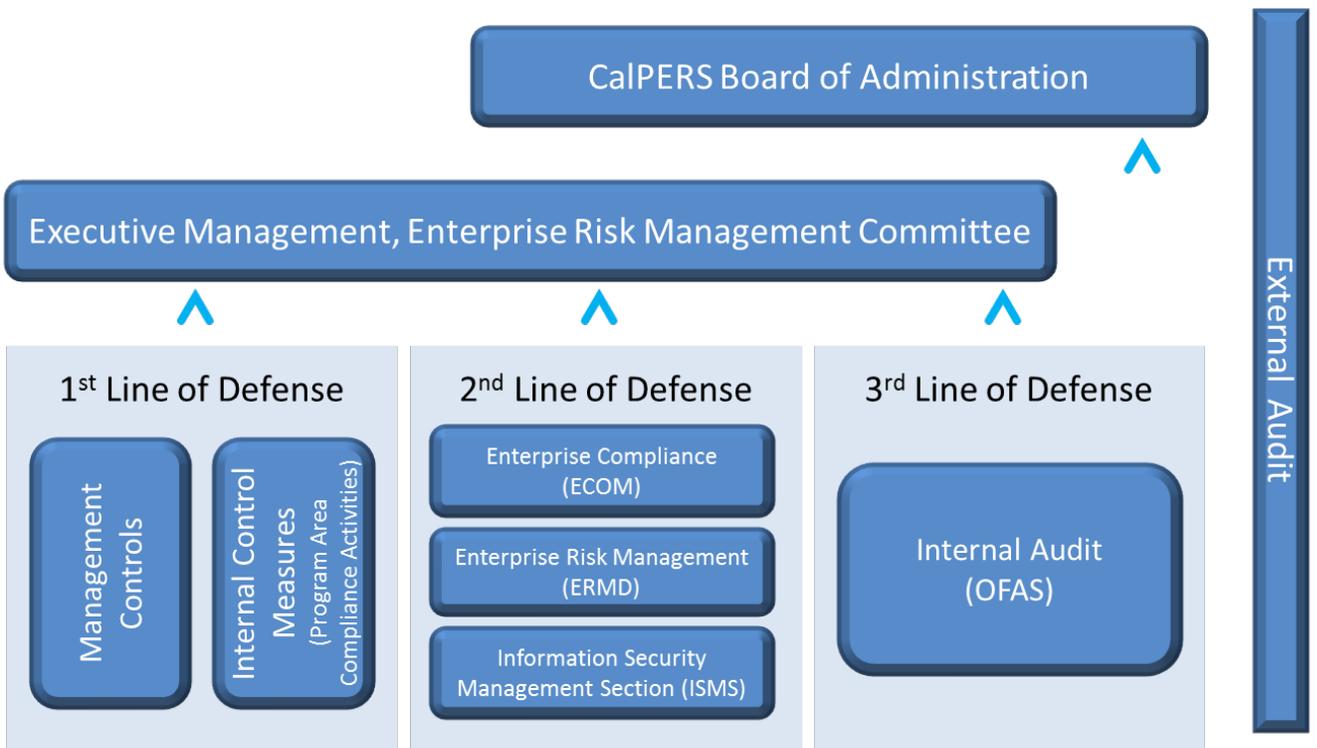
The California Public Employees' Retirement System (CalPERS) first developed the Annual Compliance Report to communicate our compliance initiatives and accomplishments. Enterprise compliance at CalPERS helps achieve Strategic Plan Goal B: to cultivate a high-performing, risk-intelligent and innovative organization. This report highlights the compliance accomplishments of CalPERS for the period from July 1, 2013 through June 30, 2014.

CalPERS is committed to practicing strong ethics, compliance, risk management and good governance at all levels, grounded in the following principles:

- Documentation and a clear understanding of standards, policies and procedures.
- Oversight of compliance by the Board of Administration (Board) and executive officers.
- Proper delegation of authority and responsibilities.
- Effective compliance-related communication and training.
- Monitoring, auditing and reporting of internal control processes.
- Consistent and appropriate methods of response to noncompliance.
- Continuous review and assessment of our business practices.

Through CalPERS implementation of the integrated assurance model, we bring together the people, processes and systems to manage performance and risk to achieve our strategic goals and objectives. The model and its three lines of defense promote better collaboration and results in the more efficient use of limited resources.

The Three Lines of Defense Model



Each line of defense operates in the following complementary, but different ways:

- First Line of Defense – The program areas comply with laws, rules, regulations and policies by establishing and administering controls to prevent and detect noncompliance.
- Second Line of Defense – The Office of Enterprise Risk Management consists of two divisions, focusing on Risk Management and Compliance:
 - The Enterprise Risk Management Division identifies and monitors risks of all types throughout CalPERS.
 - The Enterprise Compliance Division's purpose is to monitor and oversee program area compliance with laws, regulations and policies, and work with program areas to identify and manage compliance risks.
- Third Line of Defense – The Office of Audit Services conducts independent assurance activities to determine the effectiveness of internal controls enterprise-wide, including adherence to laws and policies for effective risk management.

Highlights

During Fiscal Year 2013-14, CalPERS continued to build and enhance compliance practices and controls throughout the organization, in support of our commitment to strong ethics, compliance, risk management and governance. CalPERS further developed our integrated assurance structure to ensure we accomplish our Strategic Goal of cultivating a high-performing, risk-intelligent and innovative organization.

During this reporting period, CalPERS business areas placed a significant focus on developing and maintaining automated technology solutions that support operational controls, streamline processes and improve consistency. These activities help improve data quality and accuracy used for decision-making, program administration, and service to members. Through a combination of enhancing existing systems and implementing new applications, CalPERS was able to ensure recording of key information, improve knowledge sharing and transparency, and establish ongoing management controls to reduce error and detect potentially inappropriate activity.

Enhanced educational programs were another major focus throughout the organization. Education and outreach improve our ability to ensure compliance internally for our employees as well as externally for employers, members and retirees, by providing up-to-date information on laws, rules and policies. New training programs were established internally to provide staff with the information they need to comply with applicable laws, rules and regulations. CalPERS provided retirement planning and health benefit education to more than 53,000 members and over 2,940 employer representatives to provide information necessary for employers to accurately administer benefits and ensure members have the information necessary to make informed retirement and health decisions. By providing consistent information to all parties and improving understanding and awareness, CalPERS reduces the risk of noncompliance.

The CalPERS Board worked closely with the Actuarial, Financial and Investment Offices throughout the fiscal year to improve pension benefit and asset liability management policies in order to ensure transparency, proper funding and sustainability of the System, in compliance with applicable laws and regulations.

Assurance activities also included significant automation of compliance oversight, improving storage and retention of key information and enhancing staff's ability to detect incidents of noncompliance. During Fiscal Year 2013-14, CalPERS began the implementation of an automated Governance Risk and Compliance solution to centralize and coordinate governance, risk and compliance related incidents and activity and completed the first full year of CalPERS Personal Trading Regulation monitoring, strengthening CalPERS compliance oversight capabilities. CalPERS also significantly strengthened its information security infrastructure, by implementing a new information asset management system and implementing improvements to identity and access management to ensure that sensitive information is appropriately restricted and secured.

Business Operations (First Line of Defense)

CalPERS business areas undertook a wide range of activities to ensure compliance with the CalPERS legal and regulatory landscape. Business areas developed policies, procedures and processes to guide staff to effectively carry out business operations while promoting a culture of sound governance and controls. CalPERS also worked to bring employers and members into compliance with existing requirements.

Benefit Administration

Health

Health Benefit Administration

CalPERS conducted activities designed to improve compliance, accuracy and timeliness of health benefit administration, including:

- Conducted the ongoing Dependent Eligibility Verification project to validate that only eligible dependents are enrolled in CalPERS health plans. Staff estimates that over \$41 million has already been saved, as a result of voluntary disenrollment during the amnesty period from March through June 2013.
- Implemented a new full file enrollment reconciliation process with health plans, resulting in more timely enrollment. Implementation of the new process ensures each health plan is in compliance with its contract with CalPERS by identifying and correcting enrollment data discrepancies between CalPERS and health plan records.
- Implemented system modifications to automatically generate Complementary Annuitant Premium Program notifications to affected members.
- Automated notification and future cancellation of members who fail to complete their enrollment with the new Medicare Advantage Plans.

Health Plan Contract Management

CalPERS standardized health plan contracting, resulting in the following benefits:

- Consistent rules apply to members enrolled in different health plans.
- Increased transparency and better aligned incentives with health outcomes.
- Health plan payment changes that allow for more transparency and control of certain types of payments made to providers.
- Implementation of risk-adjusted health plan premiums.
- Standardized Business Associate Agreements to provide protections regarding disclosure of CalPERS members' Protected Health Information, in accordance with the Health Insurance Portability and Accountability Act (HIPAA).

Patient Protection and Affordable Care Act (ACA)

CalPERS continued to implement the ACA, including:

- Administering internal tracking processes to ensure appropriate implementation of ACA rules.

- Partnering with the California Department of Human Resources and the State Controller's Office to identify impacts and to implement changes related to the Employer Shared Responsibility regulations under the ACA.

Health Insurance Portability and Accountability Act (HIPAA)

The CalPERS HIPAA program is responsible for oversight and administration of the organizations HIPAA compliance efforts. The program focuses on three main areas:

- Ensuring all new projects, Requests for Proposals, and contracts are vetted for HIPAA compliance.
- Reviewing and assessing all health plan partner incident notifications to determine if a breach has occurred and reporting breach incidents.
- Monitoring the annual HIPAA web-based training requirement for all staff and contractors.

CalPERS implemented an independent assurance process to verify that all database administrator access to member information is monitored and recorded, in compliance with HIPAA and information security best practice.

HIPAA regulations require all CalPERS business partners that are provided access to CalPERS Protected Health Information to sign a Business Associate Agreement. CalPERS significantly revised its standard Business Associate Agreement to comply with new legal requirements. CalPERS also successfully negotiated Business Associate Agreements with two new major business partners.

Pension

CalPERS established several new safeguards to help accurately administer pension benefits in compliance with laws and regulations, including:

- Implemented a new internal quality assurance process over member-submitted service and disability retirement applications, assisting staff with applying procedures accurately and mitigating the risk of errors impacting member benefits.
- Worked with employers to reduce outstanding payroll reports by 68 percent, resulting in more accurate and timely updates to member accounts.
- Improved reporting to provide oversight of key transactions, in order to ensure appropriate checks and balances are being applied.

CalPERS applied forfeiture of benefits actions, in compliance with the Public Employees' Pension Reform Act of 2013 (PEPRA), which revokes benefit eligibility for public employees convicted of any state or federal felony arising out of or in the performance of his or her official duties.

CalPERS also implemented legislation that took effect during FY 2013-14:

- Assembly Bills 1144 and 1346, which established alternative health vesting schedules for specified employees of the City of Carson and Sacramento Metropolitan Fire District.
- Assembly Bill 1222, which exempted specified transit employees from PEPRA.

CalPERS updated and implemented policies, procedures and job aids to provide staff with clear, accurate directions regarding compliance with laws, regulations and rules in the performance of their duties:

- Implemented policy and procedure changes related to determining the validity of federal tax withholding elections for retirement payments to ensure compliance with Internal Revenue Service regulations. Staff worked with over 89,000 impacted members to correct invalid tax withholding elections.
- Improved training and information on procedures for administering retirement applications and calculations to achieve more consistent documentation and improved oversight of workload overrides.
- Improved Service Credit Purchase procedures to help staff accurately and consistently administer service credit purchase transactions and provide effective oversight.

Actuarial

CalPERS adopted significant changes with actuarial standards of practice to ensure proper funding and sustainability of the system, in compliance with actuarial standards.

- At the March 19, 2014 meeting, the Board approved the adoption of new actuarial assumptions that included mortality improvements.
- At the May 21, 2014 meeting, the Board approved significant changes to the existing risk pool structure by combining all existing risk pools into two: one for safety plans and one for miscellaneous plans.

CalPERS took several steps to improve transparency and provide information employers can use to accurately project future financial obligations. These changes are reflected in the annual valuation reports and include projected rates for two additional years for a total of five years, and show the impact of the Board-adopted smoothing changes.

Pursuant to Government Code Section 20133, CalPERS completed an actuarial study into the mortality, service and compensation experience of members and persons receiving benefits from the system. An independent review was conducted to evaluate the completed Experience Study and assumption changes approved by the Board.

Customer Service

Customer contact center representatives achieved an average quality assurance evaluation score of 93 percent for member and employer phone teams, reflecting a high rate of compliance with proper security and verification procedures.

CalPERS developed and finalized a process for managing customer contacts that fall outside of the scope of normal business processes, in order to improve consistency and accuracy of information provided to members. Materials were also developed to promote uniform handling of calls on common scenarios in order to improve response accuracy.

To ensure members make informed retirement and health decisions, CalPERS staff provided retirement planning and health program education to more than 53,000 members through various methods, including instructor-led classes, webinar offerings, computer based trainings, and at CalPERS Retirement Planning Fairs and Benefits Education Events.

Employer Education

To provide employers with the information they need to accurately administer their employee benefits in compliance with relevant laws, rules and regulations, CalPERS:

- Conducted over 255 training classes to employers.
- Provided an employer teleconference regarding Public Employees' Pension Reform Act (PEPRA) changes.
- Conducted 35 Disability Retirement and Industrial Disability Retirement Employer Disability Workshops throughout the state.
- Published 15 updates to the Employer Reference Guides and 22 new computer based education modules.
- Issued a wide range of circular letters and periodic bulletins to improve employer knowledge about compliance requirements.
- Created new my|CalPERS reports to provide employers with accurate, up to date financial and billing information.

As California's State Social Security Administrator, CalPERS provided public employers with information and advice about Social Security and Medicare coverage for state and local government employees. To this end, CalPERS maintained educational webpages and issued Circular Letters and Periodic Bulletins to California employers.

Investments

During Fiscal Year 2013-14, CalPERS completed initiatives across our core investment compliance functions and responsibilities, including operational risk assessment, internal and independent investment policy testing, development and modification of investment policies, procedures and controls, ongoing program surveillance and staff compliance training.

These initiatives included:

- Developed enhanced standards and practices for compliance monitoring and oversight.
- Tested investment policies using a risk-based methodology for compliance with stated requirements.
- Created new policies and procedures that reflect asset management industry best practices related to records retention and trading practices.
- Formalized the process to identify, report and remediate investment policy violations across the Investment Office to the Investment Committee.
- Completed the integration of the investment policy inventory with associated compliance testing methodology.

- Performed pre- and post-travel reviews for compliance with the Investment Office Travel Policy and Fair Political Practices Commission regulations for 100 percent of business-related travel.
- Facilitated comprehensive investment compliance training for all Investment Office staff.

Administration

CalPERS implemented sustainable building practices and energy and water efficiency improvements, pursuant to Governor's Executive Orders B-18-12 and B-16-12, including water efficiency measures to reduce water consumption by 20 percent and installing additional Electric Vehicle infrastructure and charging stations.

To ensure compliance with the Public Records Act or PRA (Government Code Section 6250 et seq.), CalPERS maintained its on-line form for submission of PRA requests as well as guidelines and procedures to provide consistent, accurate information to members of the public about submitting a PRA request. The Board received a monthly summary report of PRAs processed and received; the reports were posted to CalPERS On-Line to support accountability and Board oversight.

CalPERS supported "Sunshine Week 2014," a week dedicated to promoting transparent and open government. CalPERS used established social media channels to share the goals of Sunshine Week and to remind the public about steps CalPERS has taken to become more transparent.

Financial Controls

Financial transparency and accurate financial reporting establish a basis for Board oversight of CalPERS operations and are a critical component of CalPERS compliance with national and state accounting and reporting requirements and standards.

CalPERS implemented changes under Government Code Section 20537, related to charging interest on delinquent employer contribution receivables. Employer compliance with requirements governing timely payment of retirement contributions has improved, with delinquent employer accounts declining from a peak of 659 in August 2013 to 91 in June 2014.

Staff also enhanced investment accounting practices, as follows:

- Redesigned Real Assets and Private Equity general ledger reconciliations to enhance the unit's ability to perform the reconciliations more efficiently and accurately.
- Automated several real assets year-end reporting requirements via the Automated Real Estate Investment System, improving efficiency and accuracy by eliminating several manually-updated spreadsheets.

In February 2014, both PeopleSoft Contracts 9.1 and PeopleSoft Financials 9.1 modules successfully merged with the benefit of preserving all existing data and

capitalizing on one integrated application known as PeopleSoft Financial and Supply Chain Management system. The unified system streamlines procurement processes, enforces expense policy and eliminates duplicate records, improving accuracy, completeness and availability of related contract and financial information.

CalPERS has been preparing for the implementation of GASB Statement No. 67, Financial Reporting for Pension Plans, which is effective Fiscal Year 2013-14. This includes the determination of the number of plans to separately present in the basic financial statements as well as the classification of each plan as single-employer, agent multiple-employer, or cost-sharing multiple employer. We have developed the necessary notes to the financial statements and the supplementary schedules required by these changes and have worked with our External Auditors to ensure compliance of these standards.

Equal Employment Opportunity

CalPERS is strongly committed to fair and equitable treatment and diversity of our employees and officers. CalPERS is required to establish an effective Equal Employment Opportunity (EEO) Program and provide EEO to all individuals in all its activities. By doing so, CalPERS fulfills our legal obligations and builds a workplace that evaluates and rewards staff based on merit and accomplishment, resulting in improved outcomes throughout our operations. In Fiscal Year 2013-14, CalPERS submitted its Annual Workforce Analysis Report to the California Department of Human Resources and updated the Harassment Prevention Policy to include several new and revised protected categories.

Human Resources

CalPERS implemented the State Personnel Board's Transfer Rule 250, which defines the conditions under which employees may transfer between different State employment classifications. Staff clarified allowable transfers based on the new rule and communicated the new requirements to CalPERS management and employees.

CalPERS implemented automated systems to improve management of employment-related information and reduce frequency of errors, by establishing an automated timesheet system to process and approve timesheets electronically, improving accuracy and efficiency.

CalPERS developed and revised internal training programs to ensure staff are fully knowledgeable about compliance requirements affecting them. Topics implemented during this reporting period include contract management, procurement, Public Records Act requests, Section 508 of the Rehabilitation Act of 1973 document accessibility requirements and compliance review documentation.

CalPERS also established a new Leadership Essentials and Direction for Your Emerging Role (LEADER) program training policy which outlines the statutory requirements for all designated CalPERS supervisors in compliance with Government Code Section 19995.4.

Assurance (Second Line of Defense)

The CalPERS Compliance and Enterprise Risk Management programs provide a second line of defense. Compliance activities at CalPERS are related to preventing and detecting potential conflicts of interest and to ensure compliance with laws, rules and regulations. By centrally reporting on the full range of policies, laws and regulations that affect CalPERS operations, the compliance function helps identify requirements that may affect business operations.

Compliance Monitoring and Oversight

Compliance Reviews

CalPERS staff completed several compliance reviews and validations, providing additional assurance that CalPERS is complying with relevant requirements in the following areas:

- CalPERS Diversity Outreach Program's annual reporting requirements to the California Department of Human Resources.
- California State Auditor's Whistleblower Hotline notification requirements.
- Contract-Related Disclosure Policy requirements related to identifying potential conflicts of interest.

Electronic Governance, Risk and Compliance (eGRC)

To enhance and coordinate CalPERS Governance, Risk and Compliance (GRC) activities, CalPERS has developed and currently has the following systems in production:

- Risk Dashboard Recalibration System.
- Enterprise Wide Risk Assessment System.

Form 700 Statement of Economic Interests

In accordance with the Political Reform Act (Government Code Section 81000 et seq.), the Board and designated staff and consultants are required to file disclosures of their financial interests, using the Form 700 Statement of Economic Interests, overseen by the Fair Political Practices Commission (FPPC). Consistent with FPPC requirements, CalPERS filing officer provided the oversight and monitoring of all filings.

As of June 30, 2014, Form 700s have been submitted by all Board members and staff required to submit Form 700s.

Personal Trading

This year marked CalPERS first full year of CalPERS Personal Trading Regulation monitoring and compliance, where all covered persons pre-cleared their security transactions before executing trades, safeguarding against trading with material non-public information. CalPERS administered the Personal Trading Regulations via the automated platform (Compliance11), providing additional safeguards and reducing the risk of restricted trading.

As of June 30, 2014, the Annual Attestation for all covered persons had been completed.

Policy Management Framework

An enterprise-wide Policy Management Framework and Policy Library were established. This included a policy oversight approach and compliance function, which monitors policies across their entire life-cycle, using a centralized process and location to assure that CalPERS policies remain current and consistent over time.

Regulatory Compliance Library

CalPERS maintains the Regulatory Compliance Library, which centralizes the laws, regulations and rules governing each program. The library is available as a reference for all CalPERS staff and provides compliance staff with a basis for compliance reviews.

Ethics

CalPERS maintains and monitors an externally-hosted Ethics Helpline, allowing individuals internal or external to CalPERS to anonymously and securely report concerns about potential misconduct or inappropriate activities. Complaints can also be submitted to the Whistleblower Hotline administered by the California State Auditor. By establishing systems and processes that support compliance and encourage reporting of unethical or inappropriate activities, CalPERS promotes a strong ethical culture.

During FY 2013-14, 96 ethics-related complaints were submitted to the CalPERS Ethics Helpline, of which 83 (86 percent) had been closed as of June 30, 2014.

Information Security

CalPERS operates an information security program in compliance with Government Code Section 11549.3 and State Administrative Manual Section 5300.5. The program includes planning, oversight, and coordination of CalPERS information security program activities to effectively manage risk, provide for the protection of information assets, and prevent illegal activity, fraud, waste, and abuse in the use of information assets.

The existing privacy program was successfully expanded to support compliance with new requirements in State Administrative Manual Chapter 5310 - Privacy. Staff also implemented a new Information Asset Management System, automating maintenance of the inventory and classification of CalPERS information assets. This new system streamlines processes for complying with the Information Security Program Management Standard (SIMM 5305-A), California Public Records Act, Information Practices Act of 1977, and the Standards for Security Categorization of Federal Information and Information Systems (FIPS, Publication 199).

Controls over users' access to my|CalPERS application were strengthened, and staff revised my|CalPERS procedures and required documentation to reflect these changes.

CalPERS also established new controls over management of information security events and incidents.

Information Security Policy Refresh

Information Security Policies and Control Standards were updated to maintain compliance with revisions to State Administrative Manual Chapter 5300 - Information Security. This update resulted in mapping the new and revised State Administrative Manual Chapter 5300 requirements to individual CalPERS Information Security Policies and Control Standards.

CalPERS Identity and Access Management (CallAM) Project

The CallAM Project upgraded and enhanced CalPERS identity and access management security infrastructure to strengthen compliance with information security control standards. Of the 86 internal control standards identified for traceability to the CallAM business and technical requirements, 80 (93 percent) were satisfied with the remaining 6 (7 percent) deferred to future identity and access management efforts when internal-facing applications will be integrated with the enterprise solution.

Implementation of the CallAM Project and integration of my|CalPERS provide important information security controls and position CalPERS to rapidly comply, in a standardized and security hardened manner, with future security control standards, as further onsite and cloud-based CalPERS business systems are integrated with the new identity and access management security infrastructure.

United States Government Configuration Baseline

The United States Government Configuration Baseline project implemented computer security controls for Microsoft Windows based personal computers. CalPERS reviewed the recommended settings and adopted approximately 88 percent of Windows 7 settings and almost 100 percent of Internet explorer settings. These settings were used to establish the CalPERS configuration baseline, which strengthens and enhances PC security. The settings are now part of CalPERS standard PC build.

Audit Program (Third Line of Defense)

CalPERS maintains an effective audit program comprised of internal audits and contracting public agency reviews. CalPERS internal auditors perform assurance and consulting work consistent with the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.

CalPERS audit program provides assurance over the following activities:

- Internal audits covering retirement, health, investments, information technology, fiscal, operations support, and other internal areas. In Fiscal Year 2013-14, audits included private equity manager contract compliance, self-funded health plan administration compliance, health plan compliance and external real estate manager contract compliance reviews.
- The Public Agency Review Program, which reviews CalPERS contracting public agency compliance pertaining to their contracts with CalPERS and the accuracy of reported CalPERS membership and employee compensation information. In Fiscal Year 2013-14, changes arising from the implementation of Public Employees' Pension Reform Act (PEPRA) were added to the scope of the reviews.
- Financial Integrity and State Manager's Accountability Act of 1983 (FISMA) biennial review requirement, to assess internal accounting systems, administrative control and monitoring practices. In Fiscal Year 2013-14, CalPERS audited controls over revolving funds, human resources, and payroll.

As of June 30, 2014, CalPERS is in compliance with the Board Audit Resolution Policy prohibiting unresolved internal audit findings more than one year old.

Legislation and Regulations

CalPERS governance framework is comprised of a wide range of laws, regulations, policies and external guidance. CalPERS seeks amendments and regulations where necessary to support our business goals and monitors changes to our governance framework to help ensure that amendments and new requirements are appropriately implemented.

Legislation

In Fiscal Year 2013-14, CalPERS advocated for the successful passage and enactment of three Board sponsored state legislative proposals:

- Assembly Bill 373, the CalPERS Long-Term Care Bill, expands eligibility for participation in the CalPERS Long-Term Care Program.
- Senate Bill 215, the CalPERS 2013 Omnibus Bill, standardizes CalPERS health and pension contracting services and establishes technical changes and clarifications improving benefit administration.
- Senate Bill 220, the CalPERS Pension Reform Conformity Bill, amended the Public Employees' Retirement Law to conform with the Public Employees' Pension Reform Act of 2013 (PEPRA).

At the close of each legislative session, CalPERS compiles a list of all newly enacted legislation and monitors implementation progress for its successful completion.

Regulations

CalPERS made the following regulatory changes:

- Amended Title 2 California Code of Regulations (CCR) Sections 599.500 and 599.508, which permit the Board to implement and apply a risk adjustment methodology in health plan rate negotiations, in conformity with the Patient Protection and Affordable Care Act.
- Amended Title 2 CCR Section 579.2 and added Title 2 CCR Section 579.3, 579.21, 579.22, and 579.25 to align CalPERS regulations with PEPRA, including:
 - Defining what constitutes a qualifying retirement plan.
 - Defining systems subject to reciprocity.
 - Clarifying final compensation determination factors.
 - Criteria for application of the pensionable compensation cap established by PEPRA.
 - Clarifying the Public Safety Officer exception to the 180-day wait period.