Information

Agenda Item 8a

June 16, 2015

ITEM NAME: Semi-Annual Enterprise Risk Reports (Dashboard)

PROGRAM: Risk Management

ITEM TYPE: Information

EXECUTIVE SUMMARY

The purpose of this item is to provide an overview of the top strategic risks facing CalPERS along with a status update to the risk mitigation efforts underway. This report includes input from management and staff throughout the organization. Staff has provided four attachments which visually culminate the risk trends and analysis for the period of October 2014 through May 2015.

- **Risk Management Dashboard – Top Risk Summary** – Attachment 1 – summarizes the top risk domains considered to have the highest potential impact if not properly mitigated.
- **Risk Management Heat Map** – Attachment 2 – displays the 30 identified risk domains facing the organization along with their respective impact and likelihood.
- **Risk Management Heat Map Trends** – Attachment 3 – reflects the changes in the rating of the 30 identified risk domains since the last report.
- **Risk Management Dashboard –** Attachment 4 – provides an overview of the 30 risk domains facing the organization, including description, risk level and trends.

STRATEGIC PLAN

Enterprise risk management supports CalPERS 2012-2017 Strategic Plan Goal B: Cultivate a high-performing, risk-intelligent and innovative organization. To achieve this goal, Enterprise Risk Management Division (ERMD) works with management to implement a robust risk framework that includes consideration of risk in decision-making, planning, and prioritization of business activities.

BACKGROUND

A key role of ERMD is to facilitate risk identification and risk monitoring activities that inform and support decision making and resource allocation priorities. To this end, ERMD collaborates with management to complete a periodic risk assessment that

provide senior management and the Board with a recalibrated view of risks that could have a significant impact on the organization's achievement of goals and objectives.

The results of the recalibration are reflected in the attached four reports. To ensure an appropriate level of risk governance, the overall results are reviewed by senior management and executive staff, and are then reported to the Risk and Audit Committee.

ANALYSIS

Risk Management Dashboard - Top Risk Summary (Attachment 1)
The Risk Management Dashboard - Top Risk Summary (Top Risk Summary) provides an overview of the top risks identified for the organization, including the risk rankings and projected trends. The Top Risk Summary reflects the top 20 percent of the risks on the dashboard. This includes the top six risks rather than the top ten risks that were provided in previous reports. This concentration reflects a desire to focus senior management and the Board on the most critical risks facing CalPERS. The assessment of top risks recognizes a combination of current perspectives of senior staff about the ranking of risks, and recent/current mitigation activities related to those risks which were removed from the top risk report.

Staff determined that major focus should be maintained on the following six risk domains:

- **Pension Funding (Asset Liability Management)** remains a top risk. Many factors that affect pension funding risk are not within CalPERS control; in addition, this risk has a long-term horizon, so this risk will likely remain in the top risks for the foreseeable future. The Asset Liability Management team is working on mitigations for pension funding risk to be discussed with the CalPERS Board of Administration.

- **Asset Allocation** was elevated to a top risk due primarily to global investment outlooks. Experts anticipate a less favorable investment return environment in the next several years, so the risk in achieving the target investment returns will be a top challenge. The interrelationship between this risk and pension funding make this a top risk as well. An increase in projected trend from October 2014 to May 2015 is due to the lower anticipated investment returns as mentioned.

- **Participating Employer Financial Hardship/Insolvency** remains a top risk. Although the previous prospect of many municipal bankruptcies and potential adverse court decisions has not come to pass, leading to an anticipated trend of reduced risk, concerns with employers' potential financial hardship keep this risk at the forefront.

- **Business Continuity Management** risk moved into the top risks due to the increasing potential for an unpredictable high-velocity event such as a cyber-threat or unpredictable major disruption to business operations. In addition, due to the unpredictability of a business interruption and increasing potential velocity, management believes business continuity belongs in the top risk category. The trend from October 2014 to May 2015 was increased due to the reasons listed above and gaps between business continuity and disaster recovery.

- **Information Security** and cybersecurity remain in the top risks to monitor, and by the nature of this risk, management anticipates that despite ongoing mitigations evolving to counter the threat, cybersecurity threats will continue to need ongoing top attention; therefore, the anticipated trend remains level.

- **Human Resources Management** risk moved into the top risk area to recognize the challenge of ensuring that a talent pool is being developed to sustain the complex operations of CalPERS, and effect viable succession and knowledge transfer plans in light of changing demographics and talent needs. The trend from October 2014 to May 2015 was increased due to an increase in likelihood and impact in the subrisks of succession planning and turnover.

Risk Management Heat Map (Attachment 2)
The Risk Management Heat Map (Heat Map) displays the 30 identified risk domains facing the organization. The two factors used to determine the risk ranking levels, as displayed in the matrix, are the likelihood of the risk to occur and impact of the occurrence for each risk domain. The Heat Map provides a relative ranking of each risk domain against other identified risks, along with an indication of where they fall within the red, yellow and green categorization spectrum. The higher the level of risk, the closer the domain is plotted to the red area of the heat map.

Risk Management Heat Map Trends (Attachment 3)
The Risk Management Heat Map Trends (Heat Map Trends) reflects the changes in the risk rating for the 30 identified risk domains since the last report in October 2014. The Heat Map Trends is organized by the change in risk level (increase, decrease or stable) since the last reporting period. Since October 2014, four risk domains experienced an increase in the risk level, 14 of the domains experienced a decrease in the risk level and the remaining domains saw no change in the level of risk.

Each domain was categorized into one of four risk rankings: low, medium, elevated or high. While some of the domain's risk level might have increased or decreased, it is possible the actual risk ranking did not change due to each risk ranking having a range of possible scores that allows a domain to fall into that risk ranking. For instance, increases in Human Resources Management subrisks of talent acquisition, and succession planning and turnover caused the residual risk to increase. Although the risk level for the Human Resources Management domain increased, the score remained within the moderate level risk range.

The following represents the most notable changes in the report:

<u>Increase in Trends</u>
- **Human Resources Management**, which includes talent acquisition, succession planning and turnover, saw the greatest increase of all risk domains since the last reporting period. This is due to an increase in likelihood and impact in the subrisks of succession planning and turnover.

<u>Decrease in Trends</u>
- **Strategic Planning and Implementation**, which includes monitoring and reporting on strategic plan implementation, staff capability and skillsets, and internal/external environmental impact on strategy decreased since the last reporting period due to hiring of staff specifically in strategic planning and the program maturity.

- **Procurement and Contract Management**, which includes third-party and partnership contract management decreased since the last reporting period due to increase in automation, increase in level of review and shift of mitigation strategies from planned to in progress.

- **Laws, Rules and Regulations**, which includes regulatory compliance failure, inconsistencies in policies and underground regulations has decreased since the last reporting period due to the activity in building out the enterprise compliance plan and policy management framework.

- **Policy and Procedures**, which includes policy administration, policy measures and monitoring, and policy standards has decreased since the last reporting period due to the activity in developing an enterprise policy management repository and policy framework. Additionally, management felt the ranking was high relative to other risks within the risk domain.

The Risk Management Dashboard (Attachment 4)
The Risk Management Dashboard describes the 30 risk domains identified by staff and management that are tracked and reported upon. Overall, the assessed risk levels are generally stable to somewhat reduced since the last reporting period. A few areas scored slightly higher or have less favorable anticipated trends, primarily those captured in the top risks. For the risks that decreased, a number of these were due to implementation of mitigation activities identified in earlier reports as well as the general maturing and development of risk assessments and mitigation efforts. For example, Strategic Planning risk is assessed as reduced due primarily to implementation of strategic risk measures and better alignment of the business plan and budget. Financial Controls assessed risk level benefited from successful implementation of new pension accounting standards.

<u>Innovative Enhanced Risk Assessment Approach Planned</u>
In August 2015 and September 2015, ERMD will launch an innovative approach to further enrich the collaborative enterprise assessment and management of risks. In this new approach, each committee executive will present an individual mini-dashboard to their respective board committees. The purpose of this approach will be to obtain the input and perspectives from the committee members that "oversee" those risks. Additionally, this information will be used to inform the annual recalibration and update of the entire enterprise dashboard. The recalibrated dashboard will then be brought back to the Risk and Audit Committee in November 2015, coinciding with the year-end financial and audit report.

BUDGET AND FISCAL IMPACTS
Funding for Dashboard and Top Risk updates is provided through the approved Enterprise Risk Management Division budget.

BENEFITS / RISKS
The Dashboard and Top Risk Report assist the Board to more effectively oversee enterprise risk management. The risk identification and recalibration process brings awareness to management to ensure that risk response strategies are in place to achieve business objectives and reduce risk.

Failure to monitor risks, trends, and mitigations may reduce the likelihood of attaining the benefits of effective enterprise risk management. Without regular reassessment and updates, risk information may fail to guide effective deployment of resources and significant risks may not be managed appropriately.

ATTACHMENTS
Attachment 1 – Risk Management Dashboard – Top Risk Summary
Attachment 2 – Risk Management Heat Map
Attachment 3 – Risk Management Heat Map Trends
Attachment 4 –Risk Management Dashboard

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