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## Overview

The California Public Employees' Retirement System (CalPERS) compiles an Annual Compliance Report for inclusion in the Comprehensive Annual Financial Report (CAFR). This year's report highlights activities and accomplishments for the fiscal year ending June 30, 2015 and outlines the organization's upcoming compliance initiatives. Compliance is embedded into CalPERS strategy, culture, and day-to-day business operations and many of our activities and accomplishments directly support the organization's business plan.

CalPERS 2015-17 Business Plan: *Actively managing business risks with an enterprise view.*

CalPERS Board of Administration and executive management launched CalPERS Compliance program in 2004 and continue their commitment to support strong ethics, compliance, and risk management practices. As the regulatory and compliance landscape has evolved over the past decade, CalPERS developed a new multi-year Compliance Plan, building upon the already effective compliance practices in place. This new Compliance Plan takes into account current industry trends along with management input in establishing compliance focused priorities. As part of implementing the new Compliance Plan, CalPERS is developing frameworks and tools aimed at enhancing its control environment, addressing operating events, and improving the management of policies and delegations of authority. Additionally, the plan will focus on fostering a compliance-aware culture through communication, education, and training.

Compliance awareness and risk management are integral to cultivating a high-performing, risk-intelligent, and innovative organization. In order to implement our governance, risk, and compliance practices, CalPERS has embraced an integrated assurance model to promote a multi-faceted approach to compliance awareness and accountability. This three lines of defense approach promotes collaboration and an increased understanding of roles and responsibilities in ensuring compliance and detecting and preventing improper conduct.

The Board of Administration and executive management team provide direction and oversee the effectiveness of the organization’s compliance practices using the Three Lines of Defense model.

- **First Line of Defense** – The first level of the control environment are the program areas which perform day-to-day risk management activity.
- **Second Line of Defense** – Oversight functions, such as Enterprise Compliance and Enterprise Risk Management, set direction, define policy, and provide assurance.
- **Third Line of Defense** – Internal and external audits are the third line of defense, offering an independent challenge to the levels of assurance provided by program areas and oversight functions.

**Integrated Assurance Model: Three Lines of Defense**

**The Three Lines of Defense**



## **2014-15 Highlights**

During Fiscal Year 2014-15, CalPERS focused on strengthening the organization's control environment, monitoring compliance with laws and policies, and improving governance practices and ethics programs. A focus was placed on maturing the integrated assurance model, where the compliance, risk and audit functions collaborated to assess and prioritize the organization's top risks. This approach allowed each program to enhance their understanding of the control environment and further the development of each of their annual business plans.

### **First Line of Defense**

CalPERS Pension and Health programs undertook a number of initiatives that help to ensure compliance within the legal and regulatory landscape. Program areas continued to develop and enhance policies, procedures, and processes to guide staff in effectively carrying out business operations while promoting a culture of effective internal controls and compliance.

### **Pension Administration**

In response to changes in the legal and regulatory environments, CalPERS implemented processes and controls to ensure compliance in the following areas:

- Developed external communications, updated member accounts, internal processes and system changes to comply with *State of California v. United States Department of Labor*, the court decision ending the transit workers' exemption from the Public Employees' Pension Reform Act (PEPRA).
- Implemented policy and procedural changes regarding charter school eligibility to participate in a governmental retirement plan based on recent Internal Revenue Service (IRS) and Treasury Department guidance.

- Established new agency merger procedures to accurately and efficiently administer pension benefits and provide CalPERS business partners with merger guidelines to support compliance.
- Implemented CalPERS 2014 Omnibus Bill, AB 2472, which:
  - Clarified that state member eligibility for retirement at age 50 for service under both state First and Second Tier benefit formulas only applies to members who are not subject to the PEPR of 2013 benefit formulas
  - Allowed the use of the employer contribution rate in effect at the time the compensation is earned when making prior period adjustments
  - Allowed members, including members of Judges' Retirement System I and Judges' Retirement System II, to make a change to their election of a survivor benefit option if CalPERS receives their request within 30 days of the issuance of their first retirement payment.

CalPERS Regional Offices developed and implemented document processing procedures and controls to ensure that no confidential member information is subject to unauthorized view, access, use, modification, disposal, loss, or theft.

### [Health Administration](#)

CalPERS continued the Dependent Eligibility Verification process, which validates that only eligible dependents are enrolled in CalPERS health plans. As of October 1, 2014, nearly 9,000 ineligible dependents were removed from coverage with a total estimated savings of \$106 million.

CalPERS provided oversight and monitoring of health plan contract requirements and processes for business partners, including receiving independent validation that over \$2.5 billion capitation and fee for service payments made in 2014 met flex-funded health plans' contract requirements.

CalPERS implemented a pilot expansion of its Quality Assurance Program to include employer and member electronic inquiries in addition to phone inquiries. This program supports compliance with information security and HIPAA regulations through monitoring appropriate disclosure or non-disclosure of member account-specific information to ensure it is in alignment with security rules. It also ensures accuracy and uniformity of responses.

CalPERS ensured the implementation of Title 2 of the California Code of Regulations 599.518, Coverage: Member Health Appeals Process, which:

- Provided guidelines and clarity to ensure that members are given a full and fair review
- Protected CalPERS' authority in rendering final health appeal decisions

CalPERS continued to implement Affordable Care Act (ACA) compliance processes, including:

- Issued Circular Letter 600-020-14 to inform members of changes in health plans, health insurance, and ACA laws and regulations.
- Ongoing partnership with California Department of Human Resources and State Controller's Office to identify impacts and implement changes related to Employer Shared Responsibility regulations pursuant to the ACA.

Additionally, to ensure Health Insurance Portability and Accountability Act (HIPAA) compliance, CalPERS focused on three main areas:

- Monitored all new projects, requests for proposals, and contracts are vetted for HIPAA compliance
- Reviewed and assessed all health plan partner incident notifications to determine if a breach has occurred and reporting breach incidents were appropriately addressed

- Tracked the annual HIPAA Web-based training requirement for all staff and contractors

## Internal Operations

### *Financial Controls & Reporting*

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

In FY 2014-15, CalPERS produced over 3,000 annual government-mandated actuarial valuations that set employer contribution rates for State and Public Agencies, Schools, Legislators' Retirement System, Judges' Retirement System I and II, and the 1959 Survivor Benefit Program.

CalPERS implemented changes under Government Code 22899, which streamlines the collection process for Public Agency Health Premium Billing. The changes include the standardization of collection letters and the method of assessing interest on delinquent accounts. This is part of an ongoing effort to standardize the collection process across all receivable types.

CalPERS implemented Governmental Accounting Standards Board (GASB) Statement No. 67, Financial Reporting for Pension Plans, which included 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. GASB 67 developed the necessary notes to the financial statements and the supplementary schedules required by these changes, too. CalPERS also implemented GASB Statement No. 68, Accounting and Financial Reporting for Pensions and worked with our external auditors to ensure compliance of these standards. CalPERS has conducted Employer Response Dialogue

sessions across the state at all eight Regional Offices and produced two webinars to assist public employers in fulfilling their GASB 68 reporting requirements. These requirements improve transparency by placing the net pension liability of both the Fund and the employer's pension obligations in their financial statements.

CalPERS Special Programs Division continued to monitor GASB accounting standards and reviewed all 450 plus employers under contract with the California Employers' Retiree Benefit Trust (CERBT) to ensure that the CERBT provided compliant GASB 43 reporting.

Board approval was received for the Treasury Management Policy to ensure the payment of member benefits and organizational expenses without interruption. The policy sets forth the responsibilities, structure, and approach to ensure the payment of member benefits and organizational obligations are provided without interruption, provide an integrated oversight structure, maintain appropriate coverage and reserve levels for programs and the enterprise, and manage enterprise liquidity risk.

### ***Investment Office***

Investment Compliance and Operational Risk serves as an embedded compliance function and assists the Investment Office staff by ensuring compliance with key policies, laws, and regulations that impact the Investment Office. In Fiscal Year 2014-15, CalPERS Investment Compliance and Operational Risk:

- Constructed the policy development strategic framework, recommended revision to total fund investment policy statements, and consolidated CalPERS-specific investments terms into a central glossary.
- Led the process to adopt CalPERS External Investment Resource Conflict of Interest Regulation.
- Collaborated with CalPERS' Legal Office to obtain additional guidance from the Fair Political Practices Commission regarding travel payments.



### *Human Resources*

CalPERS is 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, we fulfill our legal obligations and build a workplace that evaluates and rewards staff based on merit and accomplishment, resulting in improved outcomes throughout our operations.

CalPERS developed policy, processes, and procedures for monitoring the composition of oral panels in departmental examinations by the equal employment opportunity officer pursuant to Government Code section 19795, subdivision (a).

CalPERS conducted an Annual Workforce Analysis as required by Executive Order, Government Code, and California Code of Regulations, and submitted the report to the California Department of Human Resources. The purpose of the annual workforce analysis is to establish an effective EEO program and to provide EEO to all individuals in all our activities.

CalPERS implemented a new criminal history background check through LiveScan for all prospective CalPERS employees. This new pre-employment screening requirement is an industry best practice in financial, pension, and health organizations as well as in other state departments. It also reflects CalPERS commitment to protect the interests of the state, members, constituents, employers, and employees. This enhanced pre-employment screening process seeks to achieve the following goals:

- Support increased security of CalPERS employees, information, and assets
- Support consistent hiring and screening practices
- Proactively reduce the risk of employee-related loss
- Mitigate the likelihood of an adverse incident(s) occurring within CalPERS that could jeopardize member, employer, and/or public confidence

CalPERS developed a Direct Deposit and Accounts Receivable policy and procedure, including roles and responsibilities for employees participating in Direct Deposit as well the HRSD Personnel Specialists, to ensure all CalPERS staff are knowledgeable about the eligibility requirements for participation in the Direct Deposit Program and the legal requirements related to recouping compensation of overpayments, should they occur.

### ***Education & Training***

CalPERS successfully implemented AB 1163, Retirement System Board Member Education and Training, which requires that:

- The CalPERS Board of Administration adopt an education policy for Board members that identifies appropriate topics and training opportunities related to pension fund administration and investments
- Each Board member receive at least 24 hours of education in each two-year period
- The Board posts its education policy and an annual report on Board member compliance on the CalPERS website.

To ensure members make informed retirement and health decisions, CalPERS staff provided retirement planning and health program education to more than 87,000 members through various methods, including instructor-led classes, webinars, computer-based trainings, and at our CalPERS Benefits Education Events.

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 300 training classes for employers
- Published 15 updates to the Employer Reference Guides

- Maintained educational Web pages and issued a wide range of Circular Letters and periodic bulletins to improve employer knowledge about compliance requirements; and
- Developed and implemented 14 new Health Business Rule computer-based training modules, and piloted an instructor-led training module to 21 public agencies to assist business partners in complying with Public Employees' Medical and Hospital Care Act rules and regulations.

CalPERS provided educational workshops to employees about CalPERS policies regarding discrimination and harassment, as well as topics relating to protected classes and other diversity and inclusion subjects such as generational differences, gender identity, disability, and unconscious bias.

CalPERS conducted staff training sessions to support and enhance understanding and compliance with the Public Records Act (PRA) and introduce staff to the new Web submission PRA tool.

Additionally, CalPERS Investment Office staff completed 90 minutes of mandatory in-person compliance training in 2014 regarding applicable laws and policies.

### ***Administration***

CalPERS supported Sunshine Week 2015, 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 we have taken to become more transparent.

Pursuant to the Governor's Executive Order B-18-12 and the January 2014 drought State of Emergency Declaration, CalPERS implemented sustainable building practices and energy and water efficiency improvements. The water saving measures alone resulted in a 30 percent

reduction from January through December 2014 (saving more than 9 million gallons) compared to water usage in 2013.

CalPERS successfully implemented the new requisition system, eProcurement, which replaced WeBuy in order to strengthen controls around purchasing. In addition, enhancements were made to the PeopleSoft system to assist with capturing Small Business and Disabled Veteran Business Enterprise (DVBE) participation information for annual reporting to Department of General Services. This contributed to CalPERS being recognized as the Small Business and DVBE Advocate of the Year by the Department of General Services.

In compliance with Government Code Section 7299.4, CalPERS conducted a statewide language survey to determine the number of annual public contacts by native language, number of bilingual employees in public contact positions, and available options to serve language needs.

### **Second Line of Defense**

CalPERS Enterprise Compliance Division and Enterprise Risk Management Division partner and collaborate as the second line of defense in order to provide oversight, guidance, and monitoring of governance, risk, and compliance activities. Through these efforts, they are able to support the organization in mitigating strategic and operational risks along with strengthening the organization's control environment and promoting strong ethical business practices. To demonstrate this alignment, both divisions worked closely together to develop and implement their annual plans. Internal Audits, while independent and considered the third line of defense, provided input in an effort to strengthen their understanding of risks and mitigation strategies underway, ultimately maximizing resources and enhancing governance practices.

## Compliance

CalPERS Enterprise Compliance program is responsible for providing compliance monitoring and oversight of our operations in order to ensure the organization complies with all applicable laws, regulations, and policies. This approach supports a culture that prevents, detects, and corrects ethical and compliance related risks throughout the organization. This year, CalPERS reassessed the compliance program's mission and functions due to changes and complexities in laws, regulations, and standards, along with an evolving role for compliance within organizations.

*The purpose of Enterprise Compliance is to ensure that CalPERS maintains compliance with the letter and spirit of all applicable laws, regulations and policies in partnership with program areas.*

Enterprise Compliance mission is to define and oversee CalPERS Compliance Program to:

- Promote a positive control environment
- Prevent, detect, and respond to issues of non-compliance
- Serve as a resource for guidance about compliance and ethical issues
- Ensure program and policies reinforce ethical decision making
- Ensure that CalPERS meets its fiduciary, regulatory, and contractual obligations
- Create and maintain a culture of honesty and integrity
- Encourage a commitment to doing the right thing

To implement the mission, CalPERS established a new Compliance Plan aimed at building and enhancing compliance capabilities in order to mature the program, consistent with changes in the broader compliance landscape. The Compliance Plan identifies core elements for establishing an effective compliance and ethics program, which includes clarifying leadership roles and

responsibilities, developing and implementing management tools and frameworks, and enhancing compliance awareness. This plan is focused on the following areas:

- Leadership and Governance – Establish program area compliance liaisons to strengthen compliance awareness and effectiveness throughout the organization.
- Standards and Codes – Improve the policy and delegation of authority framework, review lifecycle, and management practices.
- Risk Assessment and Priorities – Identify compliance priorities through the ongoing assessment of incidents and risks.
- Operating Events and Incident Management – Develop a standardized incident management resolution process.
- Monitoring and Testing – Align integrated assurance practices among risk, audit, legal and compliance functions.
- Reporting and Disclosures – Enhance the compliance reporting to the Board of Administration and Executive leadership.
- Education and Communication – Expand compliance awareness education and training in order to strengthen the culture of compliance controls.

### ***Policy and Delegation Management***

During FY 2014-15, Enterprise Compliance assumed responsibility for CalPERS enterprise-wide Policy and Delegation Management Framework and Library. This included:

- Development of an enterprise policy framework intended to promote clarity and improve policy management
- Socialization with key stakeholders
- Piloting and implementing the improved framework throughout the organization

Policies revised under the new framework include:

- CalPERS Board Governance Policy and Board Member Education Policy
- Staff Ethical Decision-Making Policy

### ***Monitoring and Control***

CalPERS maintained ongoing compliance with regulatory and investment policy requirements and continued activities to mitigate investment compliance risks. Including:

- Performed daily portfolio compliance monitoring of public market asset classes as well as forensic testing of public market asset class investment activities.
- Performed a risk assessment of process, policies, and procedures to identify areas of improvement and established additional compliance processes and defined protocols that follow industry practices.

### ***Reporting and Disclosures***

As part of the Enterprise Compliance Program's monitoring, reporting, and disclosure responsibilities, it regularly produces several internal and external reports including:

- Conflict of Interest Code - Form 700 Statement of Economic Interests
- Ethics Helpline and Citizen Complaint Act of 1997

#### **Conflict of Interest Code – Form 700 Statement of Economic Interests**

The Political Reform Act (Government Code Section 81000 et seq.) requires CalPERS to adopt, and periodically update, a Conflict of Interest Code (Code) in order to designate positions required to file a Statement of Economic Interests - Form 700. In 2015, CalPERS revised the Code to: (1) update the list of designated positions to remove working titles and only reflect state classifications; (2) organize disclosure categories at the agency-level rather than at the division-

level; and (3) promote further transparency. This revised approach will simplify and streamline the administration and oversight process for the code.

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

The 2014 annual Form 700 filings were due March 1, 2015 for elected Board Members and April 1, 2015 for all other filers. ECOM began notifying affected individuals in January 2015 and partnered with the Investment and Legal offices to provide communications, training, and office hours. Additionally, staff made a significant effort to encourage electronic filing, which ensures a more complete and accurate filing. As of April 1, 2015, 100 percent of CalPERS filers had completed their annual statements in a timely manner.

CalPERS Personal Trading policy is intended to safeguard against trading with material non-public information. CalPERS Enterprise Compliance administers the Personal Trading policy via an automated platform, providing additional safeguards and reducing the risk of restricted trading. As of June 30, 2015, all CalPERS covered persons had completed their Annual Attestations requirements.

#### Ethics Helpline and Citizen Complaint Act of 1997

CalPERS maintains and monitors a third-party hosted Ethics Helpline, allowing individuals internal or external to CalPERS to anonymously and securely report concerns about potential misconduct or inappropriate activities. By establishing processes and controls that support compliance and encourage reporting of unethical or inappropriate activities, CalPERS promotes



a strong ethical culture. During FY 2014-15, 103 ethics-related complaints were submitted to the CalPERS Ethics Helpline, of which 88 (85 percent) had been closed as of June 30, 2015.

### Risk Management

The Enterprise Risk Management Division (ERMD) facilitates creating and maintaining a risk-intelligent culture at CalPERS by providing risk management training, conducting risk assessments, performing risk dashboard recalibration, and developing tools to assist staff in identifying, monitoring, and responding to organizational risks.

CalPERS periodically performs risk assessments to update our risk environment. A risk assessment is intended to provide management with a view of events that could impact the achievement of goals and objectives, and enhance decision-making. As one component of the risk management framework, risk assessments are performed to identify, analyze, evaluate, treat, communicate, and monitor risks on an on-going basis. The process is a collaborative effort involving staff, management, and executive leadership.

The organization considers the internal and external environment, enterprise risk dashboard, recalibration results, observations from various risk assessment projects and audit findings as a foundation for its efforts. In Fiscal Year 2014-15, the level of risk intelligence continues to advance across the organization with an increased level of participation by management in updating risk registers supporting the enterprise risk dashboard. Management continues to increase their risk awareness and risk assessment capabilities.

The level of risk intelligence has increased across the organization as demonstrated by the increased level of participation of the Senior Leadership Council and completion of the risk registers supporting the enterprise risk dashboard. The Enterprise Risk Management process continues to mature with increased involvement of the division chiefs and oversight by the Enterprise Risk Management Committee.

The CalPERS Business Continuity General Plan has been updated in an effort to ensure the health and safety of all employees, minimize damage to facilities, equipment, and vital records and minimize business disruption and financial loss. Main efforts of the Business Continuity General Plan are to restore critical business functions within a defined time frame, maintain CalPERS positive public image, and assure members, clients, and stakeholders that their interests are protected. Planning for business continuity allows crucial decisions to be made in a non-crisis environment. All of the various divisions within CalPERS reviewed and updated their Business Continuity Plans.

### **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.

### **Audit Services**

CalPERS audit program provides assurance over the following activities:

- Internal audits cover retirement, health, investments, information technology, fiscal, operations support, and other internal areas. In Fiscal Year 2014-15, audits included global equity manager contract compliance, self-funded health plan administration compliance, health plan compliance, and external real estate manager contract compliance reviews.
- Public agency reviews assess contracting public agency compliance pertaining to their contracts with CalPERS and the accuracy of reported CalPERS membership and employee compensation information. In Fiscal Year 2014-15, CalPERS issued 85 public

agency final reports and completed 40 limited scope reviews (38 of the reviews were related to validating member census data) for a total of 125 reviews. These reviews assist CalPERS in ensuring agencies are paying the correct contributions and members receive accurate retirement benefits.

- 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 2014-15, CalPERS completed corrective action plans as required by the Department of Finance.

As of June 30, 2015, CalPERS is in compliance with the Board Audit Resolution Policy prohibiting unresolved internal audit findings more than one year old.