



Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 9a

October 20, 2015

ITEM NAME: Enterprise Risk Reports – Finance and Administration Committee

PROGRAM: Administration

ITEM TYPE: Information

EXECUTIVE SUMMARY

Enterprise-wide risk assessments are periodically performed to identify, analyze, monitor, and mitigate risks. Results of these assessments are presented to the Board of Administration through an Enterprise Risk Management Dashboard (Dashboard) and Top Risk Reports. This month, each Board Committee that oversees a Dashboard risk is receiving an update from staff. The purpose of the agenda item is to obtain the Committee's input and perspective on staff's assessment of each risk and associated mitigation activities. Additionally, this information will enrich the collaborative enterprise assessment and management of risks and inform the recalibration of the Dashboard, scheduled to be presented to the Risk and Audit Committee in November 2015.

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, management across the enterprise continues to contribute to a risk management framework that includes consideration of risk in decision-making, planning, and prioritization of business activities to achieve strategic and operational objectives.

BACKGROUND

Enterprise risk management facilitates risk identification and risk monitoring activities that inform and support decision-making and resource allocation priorities at both the strategic and operational levels across the enterprise.

Integrated Assurance is a structured approach to aligning and coordinating assurance processes within in an enterprise to optimize risk and governance oversight. In the Integrated Assurance model, management is referred to as the "first line of defense" which ensures risks are assessed and managed properly within day-to-day operations. The Risk and Audit Committee directly oversees integrated assurance functions, including Enterprise Risk, Enterprise

Compliance, and Audit services, referred to as the second and third lines of defense in the Integrated Assurance model. In addition, the Risk and Audit Committee, as set forth in its Delegation Resolution, provides oversight and approval of the enterprise risk management framework, including the assessment and management of the entire landscape of risks as an interconnected and interrelated risk portfolio.

The role of each Board committee is to ensure their respective functions are carried out in accordance with their Delegation Resolutions and include oversight and management of risks related to the delegated duties. A Benefit/Risk section is in each agenda item presented to Board committees to ensure risk consideration in committee actions and information. Also, to further enhance the assessment and management of enterprise risk, the respective Committees' risks are being presented in a series of agenda items for discussion and input.

Please refer to Attachment 1 for a graphical depiction of committee roles, responsibilities, and relationships as they relate to risk management.

ANALYSIS

Risks Overseen by the Finance and Administration Committee

The Finance and Administration Committee's (Committee) responsibilities encompass a broad array of business functions and related risks. The Committee ensures financial soundness through oversight of financial statements and reporting, all budget matters, and treasury management. It also oversees CalPERS' strategic and business plans, contracting, and business continuity. More specifically, Section (B) (20) of the Delegation Resolution for the Finance and Administration Committee, Delegation No: FA-15-01, states the Committee "Oversees management of risks related to the duties delegated to this Committee".

In support of these stated authorities, the Committee is the oversight body for 15, or 50 percent, of the 30 risk domains listed on the Dashboard.

- Attachment 2 displays the risk domains, sub-risks, status, and trends for the risk domains under the authority of this Committee.
- Attachment 3 provides a graphical depiction of recent trend data for risks overseen by the Committee.
- Attachment 4 depicts a heat map of all Dashboard risks, including the top ten.

More than half of the highest-ranked enterprise risks fall under the primary oversight of the Committee, including six of the top ten risks. Table 1 further depicts the proportion of risks overseen by the Committee.

Table 1

Enterprise Dashboard Risks	Finance & Administration Committee	Other Committees	Total	Finance & Administration Percentage
Top Ten Risks	6	4	10	60 %
Risks Below Top Ten	9	11	20	45 %
Total	15	15	30	50 %

Risks Overview and Recommended Rank

To provide the Committee with the assurance that these risks are being considered and addressed through daily activities, brief overviews of the risk domains and associated mitigation strategies are listed below.

Participating Employer Financial Hardship/Insolvency is one of the top ten risks and overall rank has remained at the Elevated-level since May 2014. To date, possible municipal bankruptcies and potential adverse court decisions have not come to pass, and mitigation strategies that include improved monitoring and reporting processes for collection of employers' contributions have contributed to the constant risk ranking.

Key initiatives within the CalPERS 2014-16 and 2015-17 Business Plans strategically focus on further mitigating associated risks. Accomplishments, as well as planned initiatives related to this risk domain are outlined.

2014-16 Business Plan Accomplishments

- Staff from Actuarial (ACTO), Financial (FINO), and Investment (INVO) offices partnered to clarify, systematize, and communicate the process for voluntary and involuntary termination of participation in the System by contracting agencies.
- CalPERS Staff finalized decision regarding legislative amendments to strengthen CalPERS' rights and remedies upon employer default, determined what form such legislation will take, and drafted proposed statutory amendments.

Planned 2015-17 Business Plan Initiatives

- Assess the impacts of participating employer bankruptcy cases and evaluate legislative and/or regulatory action to protect the System and mitigate risks

Concerns surrounding CalPERS' rights and remedies upon employer default, and other risks associated with employers' potential financial hardship remain. Municipalities continue to experience budgetary strain, due in large part to pension obligations. For this reason, the risk domain is proposed to remain at Elevated-level of risk with a revised projected trend of Constant.

Pension Funding (Asset Liability Management) is one of the top ten risks and overall rank has remained at Elevated-level since October 2013. The consistent ranking reflects that identified mitigation strategies are a long-term effort. This risk incorporates the sustainability of CalPERS pension plans' affordability and attractiveness to employers, the goal of low volatility in contributions, and appropriate funding levels through the management of assets and liabilities. While the Committee has the authority to oversee the financial soundness of the overall CalPERS system, financial controls, and actuarial policies and methods, the management of this risk also is affected by investment administration and pension system administration, which report under those functions' respective committees.

Throughout the last year, the Asset Liability Management team, which consists of staff from the ACTO, FINO, and INVO, has engaged the Board of Administration in a series of conversations focused on identifying and understanding the pension funding risks, evolution of the risks, and possible mitigation strategies and associated impacts. Most recently, a Board Workshop was presented in August 2015, where two risk mitigation strategies, a Flexible glide path and a Blended glide path, were discussed along with considerations, cost impacts, and information on stakeholder outreach where risk mitigation was a topic of discussion. Staff will be presenting a Risk Mitigation Policy for initial review by the Board at the October 2015 session.

Challenges do remain, such as a rapidly maturing public employee workforce and the associated cash flow requirements. The trend of a higher number of retirements is expected to continue as the baby boomer generation leaves the workforce to enter into its retirement years.

Today's investment market and associated volatility provide an additional challenge of expected increase in employer contribution rate volatility. In fiscal year 2014-15, CalPERS experienced lower returns and a resultant lower funded status. Poor returns, or even market failure as experienced during the financial crisis from 2008-2010, can lead to very high contribution levels and possible resultant employer insolvency or even municipal bankruptcy. For these reasons, the risk domain is proposed to remain at Elevated-level of risk with a revised projected trend of Upward.

Business Continuity Management is one of the top ten risks, and overall rank has remained at Moderate-level since October 2013. Mitigation strategies include enterprise-wide integration and coordination of plans for business continuity, disaster recovery, and emergency response. Business Continuity Plans (BCPs) are developed and updated periodically to facilitate clear roles and responsibilities during times of an emergency, as well as identify interdependencies of key business processes and associated risks from disruptions by natural, technological, or human created hazards. State Policy, pursuant to Executive Order S-04-06, requires each agency to annually update their BCPs and file a Continuity Plan Evaluation Checklist with the California Office of Emergency Services by January 15th of each year.

In September 2015, CalPERS Executive staff and select Division Chiefs participated in training at the Emergency Operations Center (EOC) to ensure familiarity of EOC functions/facilities, understand how response is managed in the Lincoln Plaza campus, and discuss management and operational issues and crisis management techniques. Further exercises are planned, as well as clarified roles, responsibilities, and Delegations of Authority for areas of key responsibilities. Updates on these efforts will be reported to the Committee in future quarterly status reports from Enterprise Risk Management.

The risk has challenges associated with the potential for an unpredictable high-velocity event such as a cyber-threat or unpredictable major disruption to business operations. With an increased trend in data breaches, as well as environmental changes and natural disasters, or national security issues, staff have gained an increased awareness of the risks associated with today's environment. As a result, the risk domain is proposed to increase to an Elevated-level of risk with a projected trend of Constant.

Information Security is one of the top ten risks, and overall rank has remained at Moderate-level since October 2013, in recognition of CalPERS highly sensitive financial, health, and investment data and the every- evolving threat of cybersecurity. CalPERS' information security program is a collaborative and integrated effort that ensures CalPERS technology and information remains secure against the constantly changing landscape of threats.

Through a variety of Disaster Recovery Exercises, staff are able to evaluate and improve technical recovery readiness; over the last year, ITSB and INVO have participated in multiple exercises and are using the information to identify mission-critical capabilities and how to respond to the accordingly, depending on the scenario- such as a cyber-attack.

Additionally, ITSB staff began a multi-year effort, entitled the Security Roadmap Program, which includes priorities, yearly initiatives, and deliverables focused on

implementing the latest preventative measures. Progress will be reported to the Committee through the CalPERS 2015-17 Business Plan.

Challenges associated with an expansion of sophisticated computer systems and software used to transact business activities is present with this risk. Constant evolution of the internet, applications, and systems expose critical information to possible misuse or theft; as a result, privacy and security rise to a high level of concern. As with business continuity, the increased trend in data breaches has provided staff with an increased awareness of the risks associated with today's environment. As a result, the risk domain is proposed to increase to an Elevated-level of risk with a projected trend of Constant.

Physical Security Controls is one of the top ten risks and overall rank has remained at Moderate-level since May 2014, in recognition that high profile institutions, such as CalPERS, are inherently subject to greater risks such as vandalism, natural and manmade disasters, and accidental damage. Staff have worked with building management and third-party vendors to perform physical risk assessments, as well as enhance security controls at regional offices and Board offsite meetings. These enhancements include:

- Enhanced surveillance equipment
- Increased public access control protocols
- Strengthened policies and procedures which prevent unauthorized access to a facility and business assets
- Conducted staff training on emergency evacuation procedures

Challenges associated with this risk can include mitigation costs related to building safety, such as security personnel and more elaborate security systems, as well as structural improvements. This risk domain is proposed to remain at the Moderate-level with a projected trend remaining at Constant; No Change.

Financial Controls and Systems is one of the top ten risks, and the risk level lowered from the Elevated to Moderate-level in May 2015. This reflected progress made in the analysis and reconciliation of the financial system with underlying records, successful implementation of new pension accounting standards, such as the Governmental Accounting Standards Board (GASB) Statement No. 68, and the establishment of a Treasury Management Program. Additional accomplishments related to mitigating this risk include:

- FINO staff improved the analysis of the monthly vacancy and pipeline position report for a more accurate reflection of available vacancies throughout the organization.
- FINO staff actively participated in the Cost Effectiveness Measures (CEM) cost analysis for the organization, which resulted in an improved financial review process and more accurate data.

- Staff implemented the PeopleSoft Allocation functionality for assets under management as it relates to the investment expense allocation to CalPERS trust funds and completed enhanced automation of manual reconciliation and summary reports currently utilized by Cash Accounting & Controls and Retirement Program Accounting.
- Staff developed and proposed the Treasury Management Reserve Policy, which governs the practices related to the establishment and oversight of cash reserves for programs that serve as an option for payment of CalPERS' obligations if a market or external environment event results in the depletion of cash. Final Committee approval will be sought in October 2015.

Challenges associated with this risk include the large volume of data/ transactions, with accuracy dependent upon the systems used to collect and report the data. Additional challenges include ensuring the appropriate staffing levels and skillsets necessary to ensure accounting and reporting is performed properly. For these reasons, the risk domain is proposed to remain at Moderate-level of risk with a projected trend remaining at Constant; No Change

Organization has remained at the Moderate-level since May 2014. Although it is not one of the top ten risks, there is a change in the projected trend due to improved clarity of employee roles and decision-making authority through the development of a Policy management framework and repository for policies, procedures, delegations and guidelines, as outlined in the Enterprise Compliance Division 2015-17 Business Plan.

Also contributing to the projected decrease of risk, is the increase in knowledge sharing and innovation through increased use of The Spark (an internal social media platform) and the development of the Enterprise Internal Innovation Program. The program aims to inspire staff to share innovative ideas and solutions that effectively improves performance and service, and is set to fully launch in June 2016. With these improvements, the risk domain is proposed to remain at Moderate-level of risk, with a revised projected trend of Downward.

Conclusion

Through the prior stated actions and initiatives, CalPERS executives and program management strive to provide confidence that risks are recognized, raised and managed throughout day-to-day operations, while informing strategic and operational initiatives. As the risk landscape continues to evolve, staff will continue to seek the Committee's input on identified risks, ranking, and corresponding mitigation strategies in order to ensure the Committee is able to appropriately administer its delegated authorities.

BUDGET AND FISCAL IMPACTS

Funding for risk management activities is provided through the approved enterprise operating budget.

BENEFITS / RISKS

Each committee's focus on its respective risks will assist the Board to more effectively oversee enterprise risk and ensure it is being appropriately managed. The committee overseeing individual risks will have the opportunity to bring different considerations and input to the assessment of risks to further ensure management has appropriate and robust risk response strategies to achieve business objectives and reduce unwanted 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 - Committee Roles and Responsibilities
- Attachment 2 – Dashboard for the Finance and Administration Committee
- Attachment 3 – Risk Management Heat Map Trends – Finance and Administration Committee
- Attachment 4 – Risk Management Enterprise Heat Map

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