



## **Agenda Item 6**

October 20, 2015

**ITEM NAME:** Enterprise Risk Reports – Pension & Health Benefits Committee

**PROGRAM:** Administration

**ITEM TYPE:** Information

### **EXECUTIVE SUMMARY**

Committee executives are presenting their individual committee-specific risk dashboards to their respective Board of Administration (Board) committees responsible for the risks identified on the Enterprise Risk Dashboard. The objectives of the presentations are to obtain the input and perspectives of the committees that oversee the programs responsible for the first line of defense on those risks. Additionally, this information will enrich the collaborative enterprise assessment and management of risks and inform the annual recalibration and update of the enterprise dashboard. The culmination of the committee presentations is scheduled to be presented to the Risk and Audit Committee in November 2015.

### **STRATEGIC PLAN**

Enterprise risk management supports the California Public Employees' Retirement System (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 robust 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 is a vital function in facilitating 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 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**

The Pension & Health Benefits Committee (PHBC) oversees all matters related to strategy, policy, structure, and actuarial studies as well as rate setting for pension, health, and CalPERS Long-Term Care (LTC) Program administration.

The PHBC is the oversight body for four of the 30 risk domains listed on the Enterprise Risk Dashboard, none of which are on the top ten risks. These risk domains include: Health Care Cost, LTC, Health Plan Management, and Customer Service.

### **Risks and Trends**

Please refer to the heat map in Attachment 3 for the recent trend data of risks overseen by the PHBC. The heat map highlights all risks on the Enterprise Risk Dashboard. Of the four risk domains overseen by the PHBC, only one risk is of Moderate risk impact. The other three risk domains overseen by the PHBC fall within Minimal risk impact.

**Health Care Cost** currently reflects a Moderate risk level as this area has experienced recent volatility. Mitigation strategies have been developed and/or implemented. As reported to the Board during Fiscal Year (FY) 2014-2015, some of the strategies include:

- Continued Reference Pricing for single knee and hip joint replacement hospital stays. Reference Pricing addresses wide variations in prices for similar services and supports CalPERS goal to increase value through improving quality and lowering costs.
- Contracted for a single Health Maintenance Organization Medicare Advantage plan with the UnitedHealthcare Group to address concerns around the cost of retiree health benefits while providing members with more extensive coverage.
- Completed the Dependent Eligibility Verification, a multi-year project to verify that only eligible dependents are enrolled on active and retired state, public agency, and school employee's health plans. The project ensures program integrity and sustainability, and reduces unnecessary spending.
- Developed Parent-Child Relationship regulatory language to provide clear guidance on eligibility for this specialized dependent type. Clear regulation will ensure proper and consistent enrollment of eligible child dependents in the CalPERS health benefits program.

As discussed in previous committee meetings, challenges are presented with The Excise Tax on High Cost Employer-Sponsored Health Coverage (Excise Tax), slated to take effect in 2018. The Excise Tax is a 40 percent tax on the aggregate cost of certain employer-sponsored health benefits above annual dollar thresholds indexed to the Consumer Price Index for Urban Consumers (CPI-U). The 2018 annual thresholds are \$10,200 for individual coverage and \$27,500 for all other coverage. Aggregate cost includes both the employer and the employee share of health plan premiums, and all pre-tax contributions to certain health accounts (i.e. flexible spending accounts or health savings accounts) regardless of which party contributes.

The Excise Tax will be calculated and reported by CalPERS contracting employers and the liability is shared among all of the coverage providers. Coverage providers include the health plan, the employer, and any third-party vendor used to administer benefits. Liability is shared on a pro-rata basis so that each coverage provider pays the excise tax based on their proportionate share of the total aggregate benefits provided to the employee. Employers need to know which of the benefits they offer their employees will be included in the aggregate cost of health benefits to ensure they calculate the tax correctly and they are not inadvertently triggering the tax. If the Excise Tax is passed on to members and employers through premiums, CalPERS members and employers will likely be faced with large premium increases due to the Excise Tax. It is this reason that the risk domain is proposed to remain at Moderate with a projected trend upward.

**LTC and Health Plan Management** reflects a Minimal risk level for both risk domains, due to the progress made on mitigation strategy development or implementation. As shared with this committee during FY 2014-2015, highlights of those mitigation strategies are as follows:

- Launch of LTC4 Open Application (continuous) combined with deployment of marketing strategy to bring in new participants.
- Increased sales and marketing outreach at employer benefit fairs, CalPERS Benefit Education Events and other stakeholder functions.
- Distributed employer kits that explore the new LTC product and helps assist with employee questions. Includes materials to be shared with employees to make them aware of the LTC coverage options available through CalPERS.
- Implemented 2015 rate increase with actuarial office completing FY 2014-2015 annual valuation for presentation in November.
- Conducted first and second reconciliations in coordination with the Financial Reporting & Accounting Services Office.
- Continued review and development of internal policies & procedures to standardize processes.

**Customer Service** risk continues to reflect a Minimal risk level, and is expected to remain so for the foreseeable future. This trend is due to the implementation of several programs within Customer Service. As reported to the PHBC during FY 2014-15, strategies include:

- The implementation of program and business planning initiatives within Customer Service areas enabled us to mitigate risk. These efforts include collaboration with Information Technology to enhance system functionality, monitor proposed legislation and implement necessary changes when chaptered, measure customer satisfaction, work with Data Governance Committee to identify possible issues, and utilize human resource workforce management tools.
- Performance metrics are monitored and measured regularly to mitigate risk. Additionally, Customer Service continues to manage periodization of functional optimization initiatives, provide program performance metrics and dashboards to the Board for evaluation, and maintain a high standard of data integrity.

- The development of a Customer Service compliance representative and team is a mitigation strategy designed to prevent compliance risks. In coordination with the Enterprise Compliance area we have positioned ourselves to better identify and monitor compliance issues while focusing on the implementation of necessary changes to operations. Given the complexities of our system, these efforts are very important and will enable us to quickly identify compliance issues and reduce our exposure to ongoing compliance risks.

As discussed during the FY 2014-2015, Data Integrity continues to be a focus and challenge for Customer Services and Support and the organization as a whole. Proactively assisting our business partners with their data and payroll reporting requirements, while effectively prioritizing internal data clean-up tasks, enables us to manage this ongoing challenge. We rely heavily on data submitted by employers which is used to calculate retirement benefits and employer rates. Enhancing our internal controls while partnering with our contracting employers allows us to comply with all applicable pension and health rules and provide accurate benefits. For this reason, the risk domain is proposed to remain at Minimal-level with the projected trend as Constant.

### **CONCLUSION**

The program areas overseen by the PHBC consider risk to be a top priority and strive to make improvements proactively. Staff continues to manage and report identified risk to the PHBC as problems arise. With the ever changing nature of risk, staff will continue to seek input from the PHBC for prioritization of mitigation strategies and risk management.

### **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 – Risk Management- Risk Summary Report
- Attachment 3 – Risk Management- Heat Map Trends October 2014 to May 2015
- Attachment 4 – Risk Management- Heat Map

---

CHERYL EASON  
Chief Financial Officer

---

DOUG P. McKEEVER  
Deputy Executive Officer  
Benefit Programs Policy and Planning