



Finance and Administration Committee Agenda Item 5a

April 19, 2016

Item Name: 2016-17 Annual Budget Proposal (Second Reading)

Program: Financial Office

Item Type: Action

Recommendation

Approve the Fiscal Year (FY) 2016-17 Annual Budget Proposal as a Second Reading in the amount of \$1,788,000,000 and 2,872 positions and approve the transmittal of this agenda item to the Joint Legislative Budget Committee, fiscal committees of the Legislature, State Controller, and Department of Finance, in accordance with the Budget Act of 2015, and to the Legislative Analyst's Office, Government Operations Agency, and the Office of the Legislative Counsel.

Executive Summary

Due to first reading recommendations from the Board, the following changes have been included in the second reading:

- Fiscal Year 2016-17 Annual CalPERS Total Budget chart (page 2 of agenda below) updated to include the FY 2015-16 Forecast,
- One-time and discretionary costs (Attachment 1, page 18),
- Updated explanation for the Federal Legislative Representative cost increase (Attachment 1, page 26, item 2.13), and,
- Investment External Management Fees chart footnote update (Attachment 1, page 28).

The FY 2016-17 Annual Budget Proposal in the amount of \$1,788,000,000 and 2,872 positions is broken down as follows:

- (1) Operating Costs which include \$455,771,000 in Administrative Operating Costs, \$90,538,000 in Investment Operating Costs, and \$896,705,000 in Investment External Management Fees
- (2) Enterprise Project Costs of \$40,882,000
- (3) Headquarters Building Costs of \$31,295,000
- (4) Third Party Administrator Fees of \$272,809,000

The FY 2016-17 Annual Budget Proposal is focused on core business needs critical to CalPERS long-term strategy and on furthering our mission of building retirement and health security for those who serve California. The FY 2016-17 Annual Budget specifies the anticipated resources required to achieve efficiencies, identify and implement cost-saving measures, manage risks, deliver quality customer service, and provide strong affordable health care programs to effectively deliver retirement and health security for the public workers of California.

The FY 2016-17 CalPERS Total Budget of \$1,788.0 million represents an overall net decrease of \$19.6 million, or 1.1 percent, from the FY 2015-16 CalPERS Total Budget. The decrease of

\$42.6 million in Investment External Management Fees and Third Party Administrator Fees is offset by an increase of \$23.0 million in Administrative and Investment Operating Costs, Enterprise Project Costs and Headquarter Building Costs.

Strategic Plan

This agenda item supports Goal B of the CalPERS 2012-17 Strategic Plan, which is to cultivate a high-performing, risk-intelligent and innovative organization. Through the annual budget process, CalPERS staff can address and mitigate certain risks throughout the enterprise. The end result of this process allows for the enhancement of business process, ultimately heightening the quality and efficiency of service to our members and employers.

Fiscal Year 2016-17 Annual CalPERS Total Budget

(in thousands)	FY 2015-16		FY 2016-17 Proposed Budget	Budget to Budget		FY 2015-16 Budget to Forecast	
	Approved Budget ¹	FY 2015-16 Forecast		\$	%	\$	%
				Incr / (Decr)	Incr / (Decr)	Incr / (Decr)	Incr / (Decr)
Administrative Operating Costs	\$ 444,697	\$ 431,094	\$ 455,771	\$ 11,075	2.5%	(\$13,602)	(3.2%)
Investment Operating Costs ²	82,959	82,959	90,538	7,579	9.1%	-	0.0%
Subtotal	\$ 527,656	\$ 514,053	\$ 546,309	\$ 18,653	3.5%	(\$13,602)	(2.6%)
Investment External Management Fees	930,726	930,726	896,705	(34,021)	(3.7%)	-	0.0%
Total: Operating Costs	\$ 1,458,382	\$ 1,444,779	\$ 1,443,014	(\$15,368)	(1.1%)	(\$13,602)	(0.9%)
Enterprise Project Costs	37,508	35,610	40,882	3,374	9.0%	(1,898)	(5.3%)
Headquarters Building Costs	30,350	28,350	31,295	946	3.1%	(2,000)	(7.1%)
Third Party Administrator Fees	281,360	278,415	272,809	(8,551)	(3.0%)	(2,945)	(1.1%)
CalPERS Total Budget	\$ 1,807,600	\$ 1,787,155	\$ 1,788,000	(\$19,600)	(1.1%)	(\$20,445)	(1.1%)
Total Positions	2,765.0		2,872.0	107.0	3.9%		

¹ FY 2015-16 Mid-Year Budget approved by CalPERS Board of Administration on December 15, 2015.

² Investment operating expenses are not part of CalPERS Administrative Operating Costs and therefore should not be included in CalPERS pro-rata assessment.

The Financial Office works collaboratively with divisions through this process to analyze the operational needs of the organization while ensuring alignment with CalPERS strategic goals and business plan. Program areas submit formal budget requests to identify the funding and staffing required to achieve the goals set forth in the CalPERS strategic plan and business plan as well as to address new services, initiatives, and projects consistent with the priorities of the organization. The proposed budget is reviewed by the Finance and Administration Committee of the Board of Administration in March and April, as a first and second reading. Upon approval of the annual budget by the Board of Administration, the approved budget becomes effective July 1st of the new fiscal year.

Background

The annual budget process is designed to review the organization's existing operational resource needs to maintain current service levels, as well as prioritize resource requests for new services, initiatives, and projects required to meet CalPERS mission, strategic goals, and business plan priorities. The budget process begins in October of each year with the release of the Financial Office's annual budget memo communicated to enterprise management that provides a universal message detailing instructions, budget policy direction, and expectations and objectives.

The CalPERS Total Budget is composed of five main cost areas: Administrative and Investment Operating Costs, Investment External Management Fees, Enterprise Project Costs, Headquarters Building Costs, and Third Party Administrator Fees.

Analysis

The Financial Office Budget staff conduct a thorough analysis of the formal budget requests as part of the technical preparation of the budget. All program areas participate in the budget preparation process, including the development of programs and services consistent with the CalPERS strategic and business plans, development of budget requests specifying resources anticipated to carry out those programs and services while considering strategic planning goals and objectives, cost efficiencies, risks, business planning initiatives, board or legislative mandates, and workload capacity.

In discussions and collaboration with divisional senior management, all submissions are reviewed and discussed with budget staff, Senior Management and Executive leadership prior to the final proposed budget being submitted to the Finance and Administration Committee of the Board of Administration for review and approval.

The proposed budget provides the annual financial plan for FY 2016-17 with projections for FY 2017-18. CalPERS is committed to maintaining efficient and effective administration that is accountable and transparent to its stakeholders. The document compiles the financial data needed to support CalPERS goals, is aligned with the proposed initiatives outlined in the CalPERS FY 2016-17 Business Plan, and is based on the departmental review of operations.

This budget was built upon five key areas:

- Innovative approaches to improving benefit services and continued customer focus
- Effective information technology solutions and strong data governance
- Cost efficiencies and workload capacity
- Effective risk management and compliance
- Sound management practices and leadership development

Major highlights of the CalPERS Total Budget include:

- myCalPERS System Optimization improvements to realize increased operational efficiencies (\$23.5 million)
- Redesign of the Actuarial Valuation System (AVS) to provide information that meets actuarial practices and supports new Governmental Accounting Standards Board (GASB) reporting requirements (\$4.8 million)
- Continued building of a sound Compliance Program for CalPERS (\$1.2 million)
- Ongoing Security Roadmap efforts to protect and secure CalPERS member and employer data (\$5.2 million)



- Increased workload in the Customer Services and Support area specific to addressing increased death benefits processing, GASB reporting and audit responses (\$1.5 million)
- Implementation of an in-house Opportunistic Investment Program (\$1.3 million)

Staff from CalPERS and the Department of Finance (DOF) have discussed the status of the Health Care Fund and agreed that it should be considered a part of the annual State budgeting process, ensuring that funding for it and the Contingency Reserve Fund are treated in similar fashion. The DOF also supports a \$6.6 million increase to the Health Care Fund, which includes one additional position.

Budget and Fiscal Impacts

The FY 2016-17 CalPERS Total Budget of \$1,788.0 million represents an overall net decrease of \$19.6 million, or 1.1 percent, from the FY 2015-16 CalPERS Total Budget. The request for 2,872 permanent positions (PYs) is an increase of 107 PYs (3.9 percent) over the current approved positions of 2,765 PYs.¹

Benefits and Risks

The benefits of the Committee recommending approval of the proposed budget, and the Board of Administration subsequently approving the recommendation, will allow CalPERS to meet resource needs, fulfill the objectives set in the CalPERS 2016-17 Business Plan, and align the organization with our long-term strategies.

The risks of not approving the proposed budget include potential resource shortfalls which may inhibit the enterprise's ability to achieve our organizational goals, deliver on customer service, reduce reliance on outside consultants, and proactively monitor public agencies for compliance.

Attachments

Attachment 1 – FY 2016-17 Annual Budget Proposal

Attachment 2 – Transmittal Letter

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Chief Financial Officer

¹ 68 PYs of the 107 PYs being requested are conversions from temporary and do not involve increased funding from the previous approved budget.