

September 20, 2016

Item Name: 2015-16 Annual Compliance Report**Program:** Enterprise Compliance**Item Type:** Information Consent**Executive Summary**

This agenda item presents the FY 2015-16 Annual Compliance Report, which will be included as a section within CalPERS Comprehensive Annual Financial Report (CAFR).

Strategic Plan

This item supports CalPERS Strategic Plan Goal B: *Cultivate a high-performing, risk-intelligent, and innovative organization* and the 2015 – 17 Business Plan initiative:

Enhance Internal Controls – Develop and implement enhanced internal controls that improve compliance and reduce operational risks.

By providing effective compliance monitoring and oversight, Enterprise Compliance assists in mitigating compliance risks throughout the organization.

Background

The Annual Compliance Report summarizes CalPERS' enterprise-wide compliance activities for each year. The FY 2015-16 Annual Compliance Report reflects the period of July 1, 2015 to June 30, 2016.

Analysis

The Annual Compliance Report documents CalPERS' most significant compliance-related improvements and accomplishments, supporting effective Board oversight and enhancing transparency and public confidence.

The Board of Administration and executive management team are responsible for providing direction and overseeing the effectiveness of the organization's compliance. In 2015, the Board approved, and 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. This year's Annual Compliance Report highlights activities and accomplishments during "Year One" of the Compliance Plan.

Compliance awareness and risk management are integral to cultivating a high-performing, risk-intelligent, and innovative organization. CalPERS has embraced an Integrated Assurance model that incorporates governance, risk and compliance practices as a multi-faceted approach to promoting compliance awareness and accountability. This approach encourages collaboration and an increased understanding of roles and responsibilities in ensuring compliance and detecting and preventing improper conduct. The Integrated Assurance model centers on "The Three Lines of Defense" framework, which distributes compliance activities within the organization as follows:

- **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 audit are the Third Line of Defense, offering independent challenge to the levels of assurance provided by program areas and oversight functions.

First Line of Defense

Program areas throughout CalPERS continued to strengthen existing safeguards, establish new controls and implement new legislative and regulatory changes. This year these activities included:

- CalPERS completed a multi-year Dependent Eligibility Verification process, conducted to ensure that only eligible dependents are enrolled in CalPERS health plans.
- As of September 1, 2015, a total of 18,282 ineligible dependents, 2.6 percent of the entire project's dependent population, were removed from coverage. Savings and claims cost avoidance are estimated to be almost \$122 million, a return on investment of 31:1 for the complete project.
- CalPERS restructured its Complementary Annuitant Premium Program to ensure compliance with statutes and regulations. CalPERS also completed User Access Review assessments to maintain member data integrity and privacy, and restrict access to designated staff.
- During Fiscal Year 2015-16, CalPERS produced 3,627 annual government-mandated actuarial valuations that set employer contribution rates and reported plan assets and liabilities for State and Public Agencies, Schools, Legislators' Retirement System, Judges' Retirement Systems I and II, and the 1959 Survivor Benefit Program.
- Board approval was received for the CalPERS Budget Policy to ensure that CalPERS budgeting practices align with the allocation and utilization of resources to meet the organization's mission and strategic objectives. Establishing the policy ensures the organization maintains a fiscally sustainable balanced budget that translates the intentions of the CalPERS Strategic Plan and objectives.

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.

CalPERS Enterprise Compliance program is responsible for monitoring and oversight activities. This year, those activities included:

- Developed new Enterprise Compliance Activity reports for management and Executive which focused on improving the level of disclosure effectiveness. Continual review and attention ensures that compliance reporting and disclosures remain timely and relevant.
- Rolled out an Operating Event management process to embedded compliance and risk liaisons in the Customer Service and Support and Operations and Technology branches. The system is modeled on the existing Operating Event processes used by Investment Office embedded compliance and risk personnel.



- Amended the CalPERS Conflict of Interest Code effective October 8, 2015. The revisions to the Code: (1) ensure that designated positions are reflected by state classification instead of working titles meaning greater alignment to statutory requirements; (2) organize disclosure categories at the agency-level rather than at the division-level which provides consistent levels of disclosure across the organization; and (3) promote further transparency.
- Achieved 100% compliance from staff required to file 2015 Annual Form 700 Statements by April 1, 2016 pursuant to the Conflict of Interest Code and the Political Reform Act.
- Achieved 100% compliance from “Covered Persons” responsible for completing Personal Trading Attestations certifying they (1) have disclosed all Covered Accounts and (2) have read and understand the Regulations annually by June 30, 2016.
- Established enterprise-wide standards for delegations of authority and policy management consistent with professional best practice. These standards include templates, guidelines, definitions, process flows, and establishment of clear oversight and policy management roles and responsibilities. The new policy changes will continue to promote and improve accountability, standardization, and good policy management practices.
- Hosted workshops on Internal Controls, Financial Reporting, and Audits to the CalPERS Board of Administration and risk and compliance management. These workshops served to strengthen the Board’s understanding of the concepts and enable them to successfully fulfill their roles and responsibilities.
- Hosted the first “Compliance Town Hall,” which included customized compliance scenarios.

The Enterprise Risk Management Division facilitates the creation and maintenance of 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 the identification of, monitoring, and response to organizational risks.

This year, Enterprise Risk Management collaborated with the Enterprise Compliance Division and the Office of Audit Services to develop a joint assessment tool. They also collaborated to conduct the annual integrated assurance risk assessment interviews with each CalPERS Division and Senior Executive. Upon completing the integrated assurance risk assessments, the three program areas convened to analyze findings. This analysis confirmed top enterprise risks and revealed common themes to consider when contemplating the most effective mitigation measures to determine if present mitigation plans are appropriate.

Third Line of Defense

CalPERS maintains an effective audit program comprised of internal audits and contracting public agency reviews.

In Fiscal Year 2015-16, the Office of Audit Services achieved the following:

- Completed 35 internal audits. These audits included reviews of health premium receipts and disbursements, Administration of Old Age and Survivors Insurance program, Judges’ Retirement System, my|CalPERS Users Access Rights, PeopleSoft Human Capital Management, Information Technology Asset Management, health plan contract compliance, and external real estate manager contract compliance.



- CalPERS completed 125 public agency reviews. These reviews assist CalPERS in ensuring agencies are paying the correct contributions and members are receiving accurate retirement benefits.

Budget and Fiscal Impacts

The inclusion of the report in the CAFR results in minor cost savings, attributable to the production and publication of a single unified report instead of two separate reports that were previously produced.

Benefits/Risks

The establishment of an effective ethics and compliance program provides significant benefits to the organization:

- Monitoring and testing provide assurance regarding program area compliance.
- Reporting and disclosures provide assurance related to conflicts of interest.

Implementing the activities outlined in this agenda reduces CalPERS exposure to legal, financial, reputational and operational risks from:

- Failure to comply with laws or regulations, and/or
- The appearance of misconduct or noncompliance.

Attachments

Attachment 1 - Annual Compliance Report – Fiscal Year Ended June 30, 2016

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