

# **California Public Employees' Retirement System**

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## **Fiscal Year 2017-18 Annual Budget Proposal**

Second Reading  
May 16, 2017





GOVERNMENT FINANCE OFFICERS ASSOCIATION

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**California Public Employees' Retirement System  
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For the Fiscal Year Beginning

**July 1, 2016**

Executive Director

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### **Strategic Planning and Enterprise Priorities**

The Fiscal Year (FY) 2017-18 Total Budget is focused on core business needs necessary to the California Public Employees' Retirement System's (CalPERS) long-term strategy and on furthering our mission of delivering retirement and health care benefits to members and their beneficiaries. The initiatives comprised in the budget will be implemented to achieve efficiencies, identify and implement cost-saving measures, manage risks, and deliver quality customer service and affordable health care programs. The budget focuses on the organization's five strategic goals:

- Fund Sustainability
- Health Care Affordability
- Reduce Complexity
- Risk Management
- Talent Management

The proposed budget provides the annual financial plan for FY 2017-18 and supports the CalPERS 2017-22 Strategic Plan. The CalPERS team has taken steps to consider the impacts of enterprise risks that may threaten achieving Strategic Plan Goals throughout the annual budget process. The Strategic Plan and associated enterprise risks have been aligned and current mitigation measures have been identified and evaluated for effectiveness.

This document compiles the financial data needed to support CalPERS goals, is aligned with the initiatives outlined in the CalPERS 2017-18 Business Plan, and is based on the departmental review of operations. In alignment with the CalPERS strategic goals and business planning, five key areas of focus were identified for the FY 2017-18 Budget:

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

### **Risk Mitigation – Cultivate a Risk-Intelligent Organization**

Since the cultivation of a risk-intelligent organization is an iterative process, the organization is presently establishing the Board's risk appetite and tolerances as a next step in maturing the Risk Management Framework. This will aid in more effectively analyzing how resources should be allocated within the organization in order to improve efficiencies by promoting more informed budgeting decisions in alignment with Board direction. Budgeting discipline will continue to be further advanced through the development of performance metrics in order to monitor progress. Key Performance Indicators (KPIs) and Key Risk Indicators (KRIs) will further refine our processes and leverage the use of data that will continue to drive the advancement of a risk-intelligent organization.

# A. Strategic Planning & Enterprise Priorities

The continued enhancement of business processes is intended to ultimately heighten the quality and efficiency of service to our members, employers, and stakeholders while encouraging employee engagement.

Below is the CalPERS Enterprise Risk Management Dashboard presented to the Board in November 2016. This provided the current rating of the top risks, risk categories, and risk statements identified by Board Committee and Executive owners.





## ENTERPRISE RISK MANAGEMENT DASHBOARD

RISK RATING	RISK CATEGORY / RISK STATEMENT	TYPE
High Impact   High Probability	<b>INFORMATION SECURITY</b> Failure to protect and secure information assets from cyber-attack or unauthorized access.	Operational
	<b>BUSINESS CONTINUITY</b> Inability to recover timely and resume critical business functions following a major business interruption event.	Operational
	<b>PENSION FUNDING</b> Failure to meet benefit obligations to current and future members and beneficiaries.	Strategic
	<b>COMPLIANCE</b> Failure to comply with laws, regulations, and policies.	Strategic
	<b>STAKEHOLDER CONFIDENCE</b> Inability to maintain stakeholder confidence in CalPERS as a trusted fiduciary.	Strategic
High Impact   Low Probability	<b>DATA MANAGEMENT</b> Inaccuracy of data and reporting used to make business decisions.	Operational
	<b>TALENT MANAGEMENT</b> Inability to effectively recruit and retain a highly-skilled workforce to support the achievement of CalPERS business objectives.	Strategic
	<b>BENEFIT ADMINISTRATION</b> CalPERS members, retirees, and beneficiaries may not receive timely and/or accurate benefits.	Operational
Low Impact   Low Probability	<b>OPERATIONAL EFFICIENCY</b> Inability to meet CalPERS strategic and business objectives in a cost-effective and efficient manner.	Operational
	<b>HEALTH CARE ADMINISTRATION</b> Inability to offer high quality, accessible, and affordable health care at a competitive price.	Strategic

The following is the CalPERS 2017-22 Strategic Plan as approved by the Board in February 2017.

## 2017-22 Strategic Goals and Strategies

STRATEGIC GOAL	OBJECTIVES	INITIATIVES
 <p><b>Strengthen the long-term sustainability of the pension fund</b></p>	Fund the System through an integrated view of pension assets and liabilities	<p>Alignment of Asset Liability Management - Incorporates elements of funding risk from both an asset and liability perspective to ensure the sustainability of the fund</p> <p>Employer Contracting and Collection Reporting – Develop and implement a report for identifying agency collection issues and contract terminations</p> <p>*Redesign and Enhance the Actuarial Valuation System – Redesign and enhance the Actuarial Valuation System to increase capabilities, streamline processes, and create more robust valuation systems</p>
	Mitigate the risk of significant investment loss	*Investment Risk Management and Performance Attribution – Build effective investment risk and performance attribution review and decision processes within and across asset classes to ensure risks are fully understood, intended, and compensated
	Deliver target risk-adjusted investment returns	<p>*Enhance Capital Allocation Framework – Enhance the Capital Allocation framework through improved risk factor modeling and greater understanding and ownership of trust-level investment risk and performance</p> <p>*Enhance Investment Platform and Controls – Enhance the investment platform and internal controls environment to achieve optimum efficiency</p>
	Educate employers, members, and stakeholders on system risks and mitigation strategies	Stakeholder Education on System Risks & Mitigation – Identify, develop, and implement training, education, and outreach opportunities to educate employers, members, and stakeholders on system risks, mitigation strategies, and compliance enhancements
	Integrate environmental, social, and governance (ESG) considerations into investment decision making	*Investment Beliefs and ESG Risk Integration – Develop a framework for the integration of CalPERS Investment Beliefs and ESG risk considerations into the investment decision-making process
 <p><b>Transform health care purchasing and delivery to achieve affordability</b></p>	Restructure benefit design to promote high-value health care	<p>Value-Based Insurance Design: Feasibility – Research and develop health benefit design strategies to improve member health, and value of care, while decreasing costs in PPO plans</p> <p>Site of Care Management – Leverage current Integrated Health Care and Population Health delivery models to contain health care costs in PPO plans for possible expansion to HMOs</p> <p>Pharmacy Benefit Manager Pilot – Develop and implement strategies to align our pharmacy benefit manager with our reference pricing model</p> <p>Reference Pricing Expansion – Leverage existing efforts to reduce health care costs by expanding the use of reference pricing for routine non-emergency procedures with price variation in the PPOs</p>
	Improve the health status of our employees, members and their families, and the communities where they live	<p>Population Health Alignment with Let's Get Healthy California Taskforce Report Dashboard – Provide employers with aggregate health care data to identify major health care costs and enhance Population Health Management (PHM)</p> <p>Partner with Health Plans to Engage in Community Activities – Collaborate with health plans to positively impact the health of our members by engaging in community activities which create a culture of good health</p>
	Reduce the overuse of ineffective or unnecessary medical care	<p>Statewide Collaboration Through Smart Care California – Partner with Covered California and Department of Health Care Services through Smart Care California coalition promote safe, affordable care in the area of opioid use, Caesarean-sections and spinal/back disorders</p> <p>Review and Update Shared Savings Accountable Care Organizations Cost and Quality Targets – Research, analyze, and update shared savings cost and quality targets and expand the use of evidence-based medicine in improving outcomes while decreasing costs</p> <p>Research and Expand Evidence-Based Medicine – Apply outcome-based medical strategies to provide affordable and high value care</p>

# A. Strategic Planning & Enterprise Priorities

 <b>Reduce complexity across the enterprise</b>	<p>Simplify programs to improve service and/or reduce cost</p>	<p>CEM Complexity Score Reduction – Assess current complexity score and identify target areas of complexity reduction</p> <p>Customer Satisfaction – Actionable Feedback – Identify actionable feedback from customer satisfaction surveys and implement reasonable improvements that will result in enhanced customer service</p> <p>Improve Pension Benefit Payments Timeliness – Identify current issues impacting benefit payment timeliness and mitigate constraints to increase service levels more consistently towards the goal or accept the current level of service</p> <p>* Implement Digital Communication Strategy – Enhance digital communications capabilities to support outreach and communication to members, employers, and other stakeholders</p> <p>* External Manager Monitoring, Expectations, and Reduction Strategy – Develop enhanced governance and protocols to improve efficiencies and controls in assessing and engaging external managers and migrating additional asset types in house</p>
	<p>Streamline operations to gain efficiencies, improve productivity, and reduce costs</p>	<p>Develop Lean Business Process Improvement Culture – Develop and implement a training program on the Lean methodology of business process improvement to reduce complexity throughout the enterprise</p> <p>Reduce System Costs and Improve Efficiencies – Identify cost drivers and assess enterprise-wide cost savings for proposed areas of improvement to reduce costs and improve efficiencies to the System</p> <p>* Enhance Business Effectiveness, Resource Allocation, and Efficiency of Investment Programs – Enhance cost effectiveness, resource allocation, and efficiency of the investment program to increase net returns on assets</p> <p>* Investment Program Long-Term Planning – Explore long-term planning considerations including private assets business model, talent management, and office locations</p>
 <b>Cultivate a risk-intelligent organization</b>	<p>Enhance compliance and risk functions throughout the enterprise</p>	<p>Data Governance Policies and Procedures – Create/enhance policies and processes to strengthen data-driven decisions through accurate and appropriate data, ensure data is appropriately defined and intent of information is understood, and improve the consistency of data use across the enterprise</p> <p>Increase Enterprise-Wide Risk Awareness – Develop enterprise-wide risk communication and training plans to increase risk awareness, and strengthen and expand risk capabilities</p> <p>Increase Enterprise-Wide Compliance Awareness – Develop compliance communication and training plans to increase awareness throughout the enterprise</p>
	<p>Enhance cyber security programs</p>	<p>Enterprise Business Continuity Plan, Phase II – Design comprehensive and functional business continuity plan that identifies resources and systems, and creates procedures needed for the resumption of all normal critical and non-critical business operations after 30 days post disaster</p> <p>Information Security Roadmap – Advance the cyber security strategy and roadmap to mitigate cyber security risks</p>
	<p>Recruit and empower a broad range of talents to meet organization priorities</p>	<p>Develop and Implement an Expanded Recruitment Strategy – Develop and implement a plan to increase the number of channels used to broadcast open positions</p> <p>Develop and Administer Team Member Engagement Surveys – Develop a plan and implement a new engagement survey(s) to continually improve our culture and preserve our reputation as a destination employer</p> <p>* Expand Diversity Program – Develop and begin implementing a plan to expand the Diversity and Inclusion Program to recruit and empower a broad range of talents to meet organizational priorities</p> <p>* Emerging Leader Pilot Program – Implement and evaluate a journey-level training program to prepare non-supervisory employees for future leadership roles</p>
 <b>Promote a high-performing and diverse workforce</b>	<p>Cultivate robust leadership competencies and develop succession plans across the enterprise</p>	<p>Develop 2017-22 Workforce Plan – Develop a plan to implement a phased approach to address workforce planning that includes: recruitment, retention, development, empowerment, and succession planning</p> <p>Enterprise Competencies – Refresh and adopt competencies for leadership and team members that align with expected behaviors to promote a high performing work culture</p>

\* Multi-year initiative(s) continuing from prior business plan

### 2017-18 Budget Message

The proposed CalPERS Total Budget for FY 2017-18 represents continued process improvements and reductions in costs. With continued fiscal prudence, this is the fourth annual budget to deliver budget requirements lower than the previous year.

Reductions in costs were a collaborative effort with all CalPERS leaders working to identify efficiencies in the organization and improve business process workflows. The CalPERS Total Budget represents the financial resources needed to help us achieve our strategic priorities and initiatives and to better serve our members, employer agencies, and stakeholders.

The proposed FY 2017-18 CalPERS Total Budget of \$1,676.4 million, represents a decrease of \$110.5 million or 6.2 percent from the FY 2016-17 Approved Budget of \$1,786.9 million. The request also includes a decrease of 5.0 authorized positions from 2,880 to 2,875.

The FY 2017-18 Proposed Budget highlights include:

- Reduction of 5.0 limited-term authorized positions approved by the Board in FY 2015-16 for two years.
- No new positions are proposed as the organization will continue to address resource needs through the realignment of existing positions and the implementation of an enterprise position pooling concept.
- Resources for the final year of the myCalPERS Business Optimization improvements to complete targeted initiatives and increase operational efficiencies (\$8.8 million).
- Continuation of the redesign of the Actuarial Valuation System (AVS) to provide information that meets actuarial practices and supports new Governmental Accounting Standards Board (GASB) reporting requirements (\$3.9 million).
- Ongoing Security Roadmap maintenance and operational efforts to protect and secure CalPERS member and employer data (\$4.2 million).
- Funding to procure a vendor to provide expanded data backup, restoration, and disaster recovery services (\$7.0 million).
- Combining all health program administrative costs into one fund, the Contingency Reserve Fund (CRF); previously, administrative costs were assigned to two funds, the CRF and the Health Care Fund (HCF). This change was agreed to in collaboration with the Department of Finance.

The focus of the FY 2017-18 CalPERS Total Budget continues to demonstrate the mission of CalPERS and the priorities of the enterprise and our stakeholders in a transparent manner while delivering value-based, managed-risk perspective fiscal management.



### **Recent Accomplishments (2016-17)**

The 2016-17 Business Plan Update presented to the Board in February 2017 provided the status of current business initiatives and upcoming activities. Recent accomplishments were also highlighted and include the following:

- Completion of Pilot to Improve Long-Term Care Hospital Transition Care for Senior Members – Assess the specialized hospital transition care management program to improve quality and reduce hospital readmissions from Preferred Provider Organization Health Plan members with Long-Term Care policies.
- Provide Health Costs Education and Outreach – Provide employees with aggregate views of health data to identify major health care costs and assess impacts.
- Master Enterprise Business Continuity Plan – Update master Business Continuity Program that accounts for enterprise priorities and can be executed post a major disruption.

### **Future Years Outlook (2018 and Beyond)**

In February 2017, the Board approved the new five-year CalPERS 2017-22 Strategic Plan. This plan represents the culmination of a comprehensive process including Board and Executive workshops, environmental scan analysis, external stakeholder engagement, and outreach to CalPERS staff. In the next five years, CalPERS is committed to building effective investment processes to ensure efficiencies, mitigate risk, and set controls to increase net returns on assets. In the area of health care, efforts to contain health care costs and identify cost savings, and to create a culture of good health for our members will be a priority. Process reviews will transpire to create efficiencies and reduce complexity across the enterprise, and efforts will take place to advance the cyber security strategy and roadmap to mitigate cyber security risks.

CalPERS continues to explore cost efficiencies and identify cost savings throughout the organization. The continued success of the my|CalPERS Optimization efforts will improve technological infrastructure and workload processing times. The organization will also continue to build upon its internal investment team and become less reliant on more costly external investment managers. Finally, the CalPERS team will continue working together to reduce complexities, monitor expenses, and maximize existing resources to ensure additional cost savings are realized.

## 2016-17 Budget Forecast

The current FY 2016-17 Forecast of \$1,770.0 million is (a) \$139.1 million or 8.5 percent higher than the FY 2015-16 actual expenditures of \$1,631.0 million, and (b) \$16.9 million or 0.9 percent lower than the FY 2016-17 Approved Budget of \$1,786.9 million.

### FY 2015-16 vs. FY 2016-17

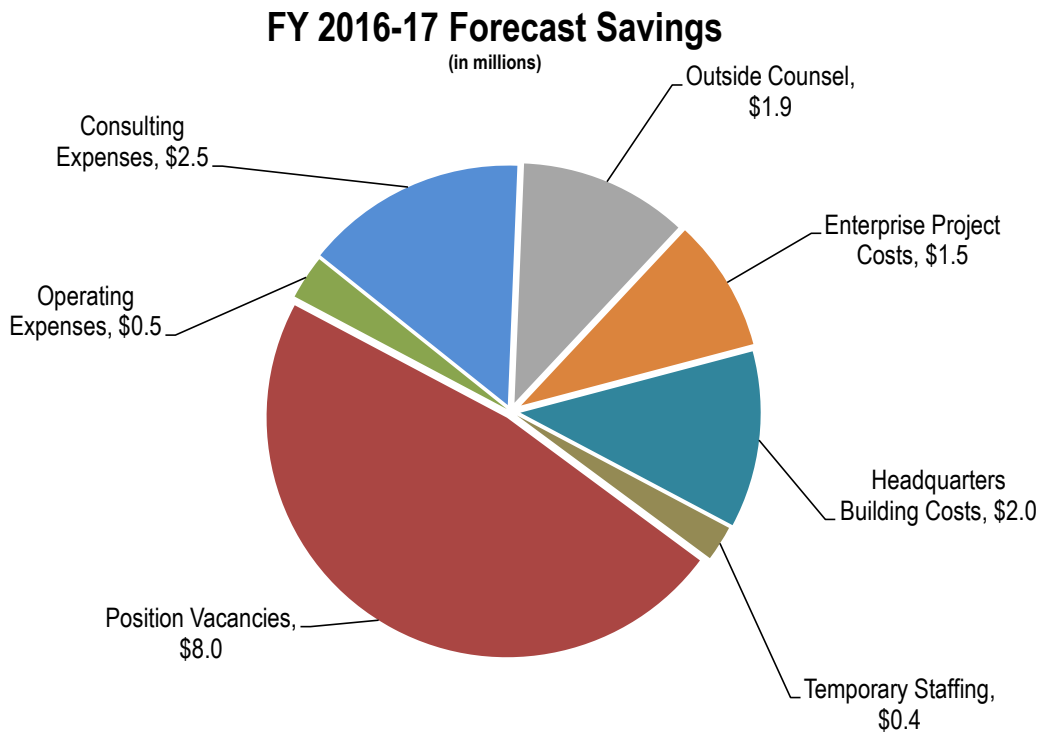
(in millions)	FY 2015-16 Actual	FY 2016-17 Approved Budget	FY 2016-17 Forecast	Actual to Forecast		Budget to Forecast	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)	\$ Change Incr / (Decr)	% Change Incr / (Decr)
Administrative Operating Costs	\$421.5	\$458.8	\$445.5	\$23.9	5.7%	(\$13.3)	(2.9%)
Investment Operating Costs	72.6	89.5	89.5	16.9	23.3%	-	0.0%
Investment External Management Fees	794.5	896.7	896.7	102.2	12.9%	-	0.0%
Third Party Administrator Fees	282.6	272.8	272.8	(9.8)	(3.5%)	-	0.0%
<b>Total: Operating Costs</b>	<b>\$1,571.2</b>	<b>\$1,717.8</b>	<b>\$1,704.5</b>	<b>\$133.3</b>	<b>8.5%</b>	<b>(\$13.3)</b>	<b>(0.8%)</b>
Enterprise Project Costs	32.1	37.7	36.2	4.1	12.8%	(1.5)	(4.1%)
Headquarters Building Costs	27.7	31.3	29.3	1.6	5.8%	(2.0)	(6.4%)
<b>CalPERS Total Budget</b>	<b>\$1,631.0</b>	<b>\$1,786.9</b>	<b>\$1,770.0</b>	<b>\$139.1</b>	<b>8.5%</b>	<b>(\$16.9)</b>	<b>(0.9%)</b>

### Comparison of FY 2016-17 Forecast to FY 2015-16 Actual Expenses

The current FY 2016-17 Forecast of \$1,770.0 million is \$139.1 million or 8.5 percent higher than the previous year 2015-16 actual expenditures of \$1,631.0 million. This is a result of (a) higher estimated investment management fees (\$102.2 million) due to an anticipated increase in assets under management and market analysis, (b) lower third party administrator fees (\$9.8 million) due to health program enrollment shifts in the 2016 plan year, (c) higher headquarters building costs (\$1.6 million) primarily due to salary increases and building improvements, (d) higher administrative and investment operating costs (\$40.9 million) due to employee compensation increases, continued insourcing of investment functions, increase in the frequency of real estate appraisals, and the addition of 39.0 new positions in FY 2016-17; and (e) higher enterprise project costs (\$4.1 million) primarily due to increases in the Security Roadmap Project (\$0.9 million), the Actuarial Valuation System Redesign Project (\$2.1 million), and the addition of the Infrastructure Modernization Project (\$3.4 million) in FY 2016-17, offset by reductions due to projects that were concluded in FY 2015-16.

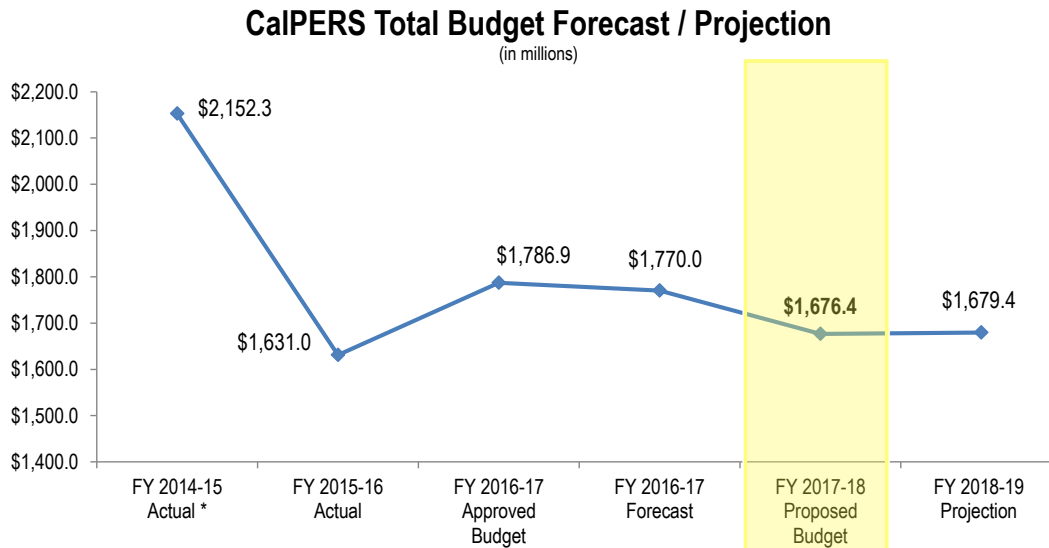
## Comparison of FY 2016-17 Forecast to FY 2016-17 Approved Budget

The current FY 2016-17 Forecast is estimated to be \$1,770.0 million, a decrease of \$16.9 million or 0.9 percent from the FY 2016-17 Approved Budget of \$1,786.9 million. The \$16.9 million decrease is mainly attributed to (a) higher vacancies and temporary staff savings (\$8.4 million), (b) lower than anticipated outside counsel costs (\$1.9 million), (c) reduced operating and consulting expenses (\$3.0 million), (d) reduced headquarters building costs (\$2.0 million) due to year-to-date spending trends, and (e) enterprise project cost savings (\$1.5 million) primarily due to savings in the Infrastructure Modernization Project.



## Total Proposed Budget Summary

The following chart displays actual expenditures for prior FYs 2014-15 and 2015-16, the FY 2016-17 Approved Budget and Forecast, the FY 2017-18 Proposed Budget, and the FY 2018-19 Projection.



\* In FY 2014-15, the actual Investment External Management fees exceeded the budget due to higher than anticipated investment performance.

The proposed FY 2017-18 CalPERS Total Budget is \$1,676.4 million, which represents an overall decrease of approximately \$110.5 million (6.2 percent) from the FY 2016-17 Approved Budget of \$1,786.9 million. Specifically, this is an increase of \$17.3 million (3.2 percent) in administrative and investment operating costs and an increase of \$10.1 million (3.7 percent) in third party administrator fees offset by a decrease of \$119.2 million (-13.3 percent) in investment external management fees, a decrease of \$14.4 million (-38.2 percent) in enterprise project costs, and a decrease of \$4.2 million (-13.6 percent) in headquarters building costs.

## D. Total Proposed Budget Summary

### Fiscal Year 2017-18 Annual CalPERS Total Budget

(in thousands)	FY 2016-17 Approved Budget <sup>1</sup>	FY 2016-17 Forecast	FY 2017-18 Proposed Budget	FY 2018-19 Projection	Budget to Budget	
					\$ Change Incr / (Decr)	% Change Incr / (Decr)
Administrative Operating Costs	\$ 458,790	\$ 445,476	\$ 474,441	\$ 495,600	\$ 15,650	3.4%
Investment Operating Costs <sup>2</sup>	89,538	89,538	91,236	91,236	1,699	1.9%
Investment External Management Fees	896,705	896,705	777,518	777,518	(119,187)	(13.3%)
Third Party Administrator Fees	272,809	272,809	282,860	282,860	10,051	3.7%
<b>Total: Operating Costs</b>	<b>\$ 1,717,842</b>	<b>\$ 1,704,528</b>	<b>\$ 1,626,055</b>	<b>\$ 1,647,214</b>	<b>(\$91,787)</b>	<b>(5.3%)</b>
Enterprise Project Costs	37,736	36,189	23,302	5,140	(14,434)	(38.2%)
Headquarters Building Costs	31,295	29,295	27,046	27,046	(4,249)	(13.6%)
<b>CalPERS Total Budget</b>	<b>\$ 1,786,873</b>	<b>\$ 1,770,012</b>	<b>\$ 1,676,403</b>	<b>\$ 1,679,401</b>	<b>(\$110,470)</b>	<b>(6.2%)</b>
<b>Total Positions</b>	<b>2,880.0</b>		<b>(5.0)</b>		<b>2,875.0</b>	<b>(0.2%)</b>

<sup>1</sup> FY 2016-17 Mid-Year Budget approved by CalPERS Board of Administration on December 20, 2016.

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

Key changes in the FY 2017-18 CalPERS Total Budget include an overall net decrease of \$110.5 million (decrease of \$137.8 million offset by an increase of \$27.4 million) from the FY 2016-17 Approved Budget.

Cost decreases of \$137.8 million are associated with:

- Investment external management fees (\$119.2 million)
- Enterprise project costs (\$14.4 million)
- Headquarters building costs (\$4.2 million)

These cost decreases were offset by increases of \$27.4 million associated with:

- Administrative operating costs (\$15.6 million)
- Investment operating costs (\$1.7 million)
- Third party administrator fees (\$10.1 million)

Each budget area will be covered separately and detailed to provide analysis of the historical trending and current proposal of the costs.

Incorporated into the FY 2017-18 CalPERS Total Budget are the following assumptions and factors that guided the development of the budget to meet the needs of the organization:

- Includes resources to support FY 2017-18 business plan initiatives
- Reductions in temporary staffing costs by \$1.6 million
- Includes targeted vacancy factor of 5.0 percent
- Reduction in State of California central administrative services (Pro-Rata) costs due to a reduced allocation assessed to the CalPERS organization (\$0.3 million)
- Includes increases for State employees' salary and benefit adjustments per bargaining unit agreements and estimated adjustments

### **2018-19 and 2019-20 Budget Projections**

The FY 2018-19 Projection will represent the second year of the five-year 2017-22 Strategic Plan. The FY 2018-19 Projection estimates an increase of \$3.0 million or 0.2 percent from the FY 2017-18 Proposed Budget.

The administrative operating costs are anticipated to increase by \$21.2 million (4.5 percent) and include estimated collective bargaining, benefit, and merit salary increases in personnel services for CalPERS staff. No increase is included for operating expenses as any inflationary increases are anticipated to be offset by operational efficiencies and an overall reduction in operating costs.

This increase is offset by an anticipated decrease in enterprise project costs of \$18.2 million (77.9 percent). A proposed budget of \$5.1 million in the FY 2018-19 projection includes multi-year projects currently undertaken by the organization.

The FY 2019-20 Projection will represent the third year of the five-year 2017-22 Strategic Plan. The FY 2019-20 Projection estimates an increase of \$20.4 million or 1.2 percent from the FY 2018-19 Projection. This increase is due to estimated collective bargaining, benefit, and merit salary increases in personnel services for CalPERS staff. No increase is included for operating expenses as any inflationary increases are anticipated to be offset by operational efficiencies and an overall reduction in operating costs.

No additional positions are included in the FY 2018-19 and FY 2019-20 Projections. The organization is committed to continuing to manage vacancies and redirect positions when appropriate through the enterprise position pooling process.

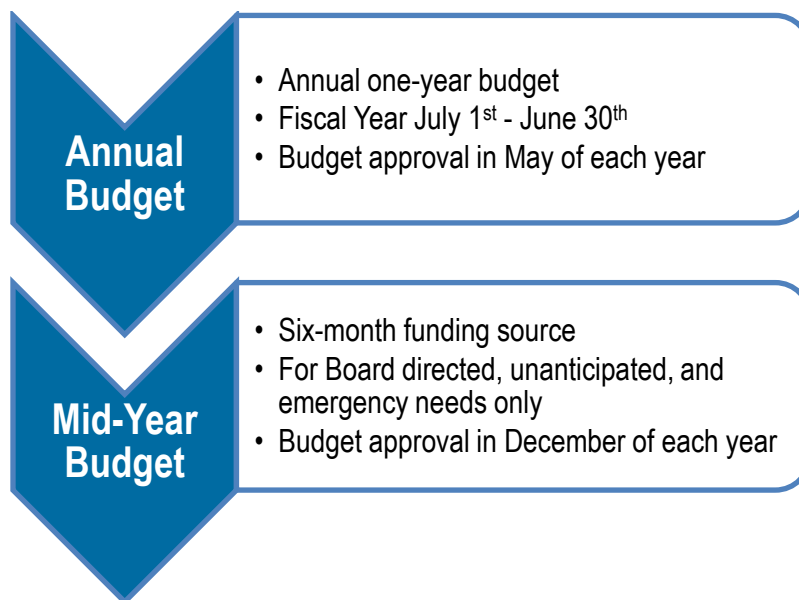
Projections for the Investment External Management Fees are unchanged for the FY 2018-19 and FY 2019-20 as are the Investment Operating Costs. These are likely to change, but projections are unavailable. There are no anticipated changes to the Headquarters Building Costs. The Third Party Administrator fees will most likely change based on increases in membership and strong rate negotiations

## CalPERS Budget Process

For more than eight decades, CalPERS has built retirement and health security for those who serve California. As stewards of the System, we are committed to retirement security and wellness to ensure that their benefits and earned retirements are protected. CalPERS enterprise priorities are determined through a business planning process. The 2017-22 Strategic Plan and the 2017-18 Business Plan were approved by the CalPERS Board of Administration in February 2017. The annual budget process is the period for reviewing the organization's existing resources and requests needed to meet CalPERS mission, strategic plan, and business plan priorities. The strategic goals of the enterprise, the mission of CalPERS, and the priorities of our stakeholders are incorporated into the budget process.

Pursuant to the CalPERS Budget Policy, the CalPERS budget is a financial plan for the spending and allocation of resources needed to meet the organization's mission, vision and values necessary to build and maintain retirement and health security for members that serve the state of California. The rigorous budget process is an ongoing budget planning activity that considers the priorities of the enterprise as well as CalPERS values and mission as the basis for determining how and where to use resources.

CalPERS has two formal budget processes during the fiscal year -- the annual and mid-year budget processes.





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 enterprise budget process begins in October of each year with the release of the Financial Office's annual budget memo to enterprise management that provides a universal message detailing instructions, budget policy direction, and communication of expectations and objectives.

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. Programs requesting resources related to new services, initiatives, and projects submit detailed formal budget request documents. 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 (FAC) of the Board for review. The annual budget is submitted to the FAC in April (first reading) and May (second reading) with an annual budget effective date of July 1<sup>st</sup> of the new fiscal year.

The purpose of the mid-year budget process is to amend the approved annual budget for additional funds if Board-directed, critical, emergency, or unforeseen circumstances arise after the start of the new fiscal year requiring funding in the current year. The Board reviews for approval the mid-year budget in November and December with a revised annual budget effective date of January 1<sup>st</sup>. Occasionally it may be necessary to present to the Board a budgetary technical adjustment or true-up outside of the annual and mid-year cycle. This may be necessary to reflect statewide budget adjustments (i.e., salary negotiations) occurring late in the fiscal year.

### **State Budget Process**

In addition to the CalPERS Budget Process, CalPERS is required to go through the state budget process for resource needs related to the Health Benefits Program. Resource requests for programs funded from the Contingency Reserve require approval through the annual state budget process.

- The State budget cycle begins in June with the development of Budget Change Proposal (BCP) Concepts. Concepts are submitted to the Financial Office for consideration in May.
- All submissions are reviewed and discussed with budget staff, senior management, and executive leadership prior to submitting to the Government Operations Agency (GOA) for review and approval.

- Concepts approved by GOA in June can be developed into BCPs and submitted to the GOA for signature in August, and to the Department of Finance (DOF) for review and approval in September.
- BCPs approved by DOF are included in the Governor's proposed annual budget along with the budget bill.
- Once the Governor's proposed annual budget is released in January, Legislative budget hearings are held to discuss and consider BCPs.
- BCPs approved by the Legislature are included in the budget bill, then signed by the Governor and become effective July 1<sup>st</sup> of the new fiscal year.

As part of provisional budget language included in the 2016 Budget Act, CalPERS in conjunction with DOF was required to conduct a zero-based budget exercise as part of the 2017-18 Governor's Budget development. This exercise, conducted in the summer and fall of 2016, examined the administrative expenses of the CalPERS' Health Benefits Program as it relates specifically to the administrative expenses. DOF led the examination and reviewed direct and indirect expenses, program objectives, workload metrics, cost allocation methodologies, reserve levels, personnel services, and operating expense and equipment. DOF did not review health benefit plans or health premiums.

As a result of the examination, DOF recommends the following:

- Streamline the Health Benefits Program cost recovery model by consolidating the administrative revenues and expenditures into a single fund to improve transparency.
- Continue working with CalPERS to refine workload metrics for assigning indirect costs to the health program.
- Continue working with CalPERS regarding IT project processes.
- Continue working with CalPERS to identify administrative efficiencies.
- Reduce the reserve for administrative expenses from three months to one month.

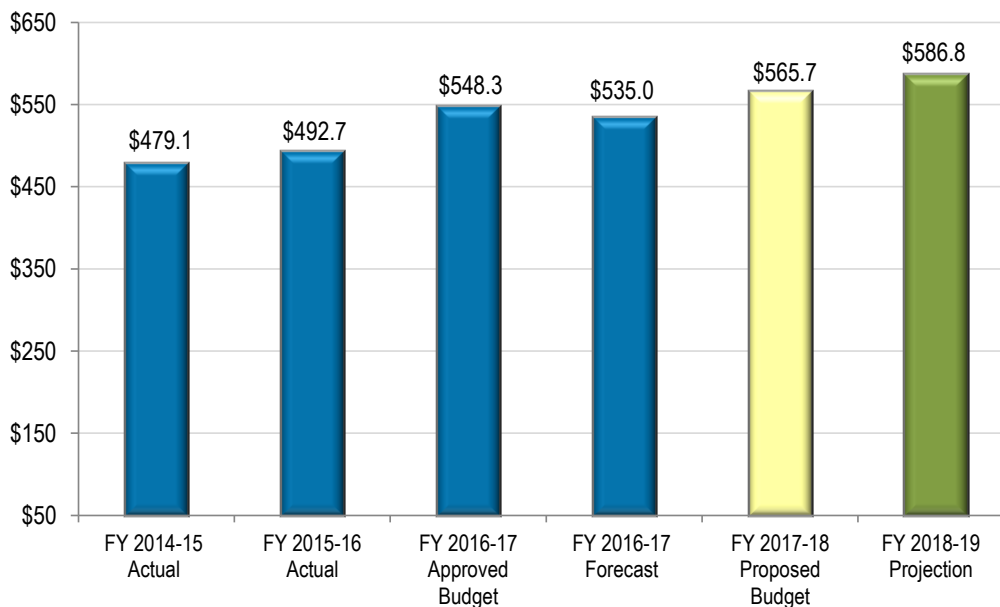
## FY 2017-18 CalPERS Total Budget by Area

The CalPERS Total Budget is comprised of five main areas which are presented on a consolidated basis to increase transparency and provide a comprehensive budget perspective. The budget areas are as follows:

- Total Administrative and Investment Operating Costs
- Investment External Management Fees
- Third Party Administrator Fees
- Enterprise Project Costs
- Headquarters Building Costs

### Administrative and Investment Operating Costs Trend

(in millions)



Note: excludes Investment External Management Fees

Total Operating Costs (includes administrative and investments) for the FY 2017-18 Proposed Budget are \$565.7 million compared to \$548.3 million in the FY 2016-17 Approved Budget, an increase of \$17.3 million (3.2 percent), mainly due to increases in personnel services of \$22.2 million, offset by a decrease in operating expenses of \$4.9 million.

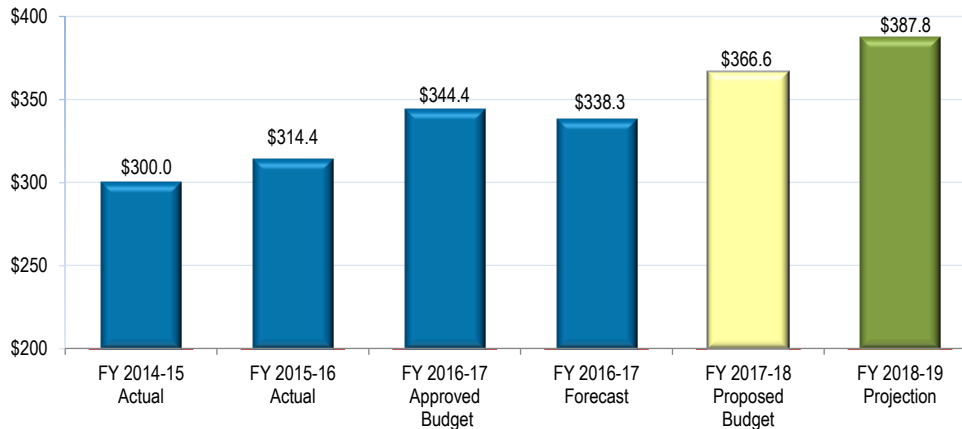
Operating costs are detailed in the following pages, explaining major changes in operating line items.

# G. Operating Costs

(in thousands)	FY 2015-16 Actual	FY 2016-17 Approved Budget	FY 2017-18 Proposed Budget	Budget to Budget	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
<b>Administrative and Investment Operating Costs</b>					
<b>[1] PERSONNEL SERVICES</b>					
Salaries & Wages	\$ 203,845	\$ 236,186	\$ 246,962	\$ 10,776	4.6%
Temporary Help	12,768	10,619	9,009	(1,609)	(15.2%)
Overtime	2,155	2,395	2,370	(25)	(1.1%)
Benefits	95,645	120,408	127,374	6,966	5.8%
<b>Total Personnel Services</b>	<b>\$ 314,412</b>	<b>\$ 369,608</b>	<b>\$ 385,715</b>	<b>\$ 16,107</b>	<b>4.4%</b>
Vacancy Savings		(25,226)	(19,127)	6,099	
<b>Revised Total Personnel Services</b>	<b>\$ 314,412</b>	<b>\$ 344,382</b>	<b>\$ 366,588</b>	<b>\$ 22,206</b>	<b>6.4%</b>
<b>[2] OPERATING EXPENSES &amp; EQUIPMENT</b>					
General Expense [2.1]	\$ 7,766	\$ 9,857	\$ 8,808	\$ (1,049)	(10.6%)
Fund Admin Services/Subscriptions [2.2]	4,005	3,630	3,126	(504)	(13.9%)
Software [2.3]	1,384	2,724	2,046	(678)	(24.9%)
Printing [2.4]	1,623	1,728	1,951	223	12.9%
Postage [2.5]	3,224	1,433	3,667	2,234	155.9%
Communications [2.6]	1,877	2,332	1,907	(425)	(18.2%)
Data Processing Services	16,087	17,094	17,128	34	0.2%
Travel [2.7]	2,247	3,134	3,393	259	8.3%
Training	952	1,750	1,660	(89)	(5.1%)
Medical Exam/Disability Travel [2.8]	1,764	1,703	1,908	206	12.1%
Facilities Operations	3,668	5,481	5,665	184	3.4%
Central Administrative Services	25,154	24,710	24,411	(299)	(1.2%)
External Legal Counsel	10,151	13,489	13,189	(300)	(2.2%)
Professional Services [2.9]	7,886	6,896	5,126	(1,769)	(25.7%)
Consultants [2.10]	16,784	21,349	18,261	(3,087)	(14.5%)
Consultants - Investments [2.11]	13,649	20,204	19,501	(703)	(3.5%)
Audit Services [2.12]	1,129	1,799	1,305	(494)	(27.5%)
Master Custodian Fees [2.13]	4,592	6,800	4,490	(2,310)	(34.0%)
Appraisal Fees/Tax Advisory Services [2.14]	9,450	9,453	10,781	1,328	14.0%
Federal Legislative Rep	882	900	900	-	0.0%
Admin Hearings [2.15]	1,149	760	1,300	540	71.1%
Other Investment Expenses [2.16]	849	1,546	1,164	(382)	(24.7%)
Consolidated Data Centers	66	90	90	-	0.0%
Trading & Portfolio Mgmt Systems [2.17]	19,320	22,101	24,847	2,746	12.4%
Data/Analytics [2.18]	14,746	16,477	17,015	538	3.3%
Business Operations Tool/Other Technology [2.19]	1,121	1,060	2,608	1,548	146.0%
Equipment (Includes EDP) [2.20]	6,726	5,447	2,841	(2,606)	(47.8%)
<b>Total Operating Expenses &amp; Equipment</b>	<b>\$ 178,251</b>	<b>\$ 203,946</b>	<b>\$ 199,089</b>	<b>\$ (4,857)</b>	<b>(2.4%)</b>
<b>Total Costs</b>	<b>\$ 492,663</b>	<b>\$ 548,328</b>	<b>\$ 565,677</b>	<b>\$ 17,349</b>	<b>3.2%</b>

## [1] PERSONNEL SERVICES

**Personnel Services Costs Trend**  
(in millions)



The \$366.6 million represents a \$22.2 million net increase (6.4 percent) over the FY 2016-17 Approved Budget of \$344.4 million. This is primarily due to (a) salary and benefit increases (\$18.1 million) negotiated during the statewide collective bargaining process as well as anticipated increases for non-represented employees, (b) the reduction of 5.0 positions (-\$0.4 million), and (c) a decrease in temporary staffing and overtime costs (-\$1.6 million). Further, during FY 2016-17, a one-time reduction of \$8.0 million for additional vacancy savings was approved at mid-year based on the vacancy trend at that time. For FY 2017-18, \$6.1 million is being restored. It is anticipated that our vacancies will decline as divisions continue to manage existing vacancies as part of their workforce planning efforts and the enterprise implements a position pooling concept.

To recognize the impact of vacancies on the cost of personnel services, an overall vacancy savings target of 5.0 percent has been applied in FY 2017-18, thus reducing costs by \$19.1 million, from \$385.7 million to a revised net cost of \$366.6 million. The current year-to-date vacancy rate is 8.3 percent.

### Reduction in Authorized Positions

The CalPERS authorized position count is decreasing by 5.0, from 2,880 in FY 2016-17 to 2,875 in FY 2017-18.

In FY 2015-16, 5.0 positions were approved for a two-year term within the Customer Services and Support branch. These positions were created to address backlogs in completing service retirement calculations and payroll adjustments (2.0 positions), Internal Revenue Code 415(b) determinations

which limit the total annual benefit amount that can be paid from a defined benefit plan (1.0 position), and membership and eligibility determinations and membership appeals (2.0 positions).

The backlogs within these program areas have been reduced to manageable levels. These positions expire at the end of FY 2016-17 and have been removed from the FY 2017-18 total position count.

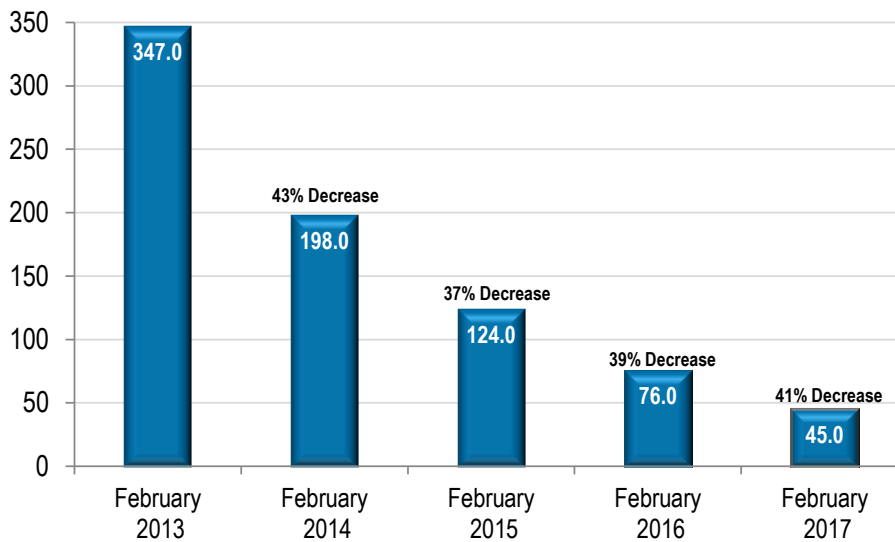
### Fiscal Year 2017-18 Positions by Branch

Branch	FY 2016-17 Authorized Positions (as of 02/28/17)	Position Reductions	FY 2017-18 Authorized Positions	% Change	Vacant Positions
Actuarial Office	58.0	-	58.0	-	6.0
Benefit Program, Policy and Planning	160.0	-	160.0	-	17.0
Communications & Stakeholder Relations	63.0	-	63.0	-	6.0
Customer Services and Support	964.5	(5.0)	959.5	(0.5%)	60.0
BNSD					
Retirement Calculation/Payroll Adjustment Backlog.....		(2.0)			
IRC 415(b) Replacement Benefit Plan Backlog.....		(1.0)			
EAMD					
Membership Eligibility Determinations and Appeals Backlog.....		(2.0)			
Executive Office	16.0	-	16.0	-	2.0
Financial Office	245.0	-	245.0	-	23.0
General Counsel	137.0	-	137.0	-	13.0
Investment Office	352.0	-	352.0	-	56.0
Operations and Technology	884.5	-	884.5	-	55.5
<b>Total</b>	<b>2,880.0</b>	<b>(5.0)</b>	<b>2,875.0</b>	<b>(0.2%)</b>	<b>238.5</b>
Vacancy Percentage to Total Authorized Positions					8.3%

## Reduction of Blanket Positions

With the implementation of the my|CalPERS system through the end of 2011, blanket positions were used to assist with the organizational transition to the new system. After this transitional period, the organization began an enterprise-wide effort to reduce reliance on blanket positions and formally implemented a blanket policy to assist the organization with this effort. The success of this effort is shown in the decline of blanket positions. In February 2013, 347.0 blanket positions existed and as of February 2017, this number decreased to 45.0, a decrease of 302.0 positions or 87 percent over a period of four years.

**Reduction of Blanket Positions**  
From February 2013 to February 2017 (4 years)

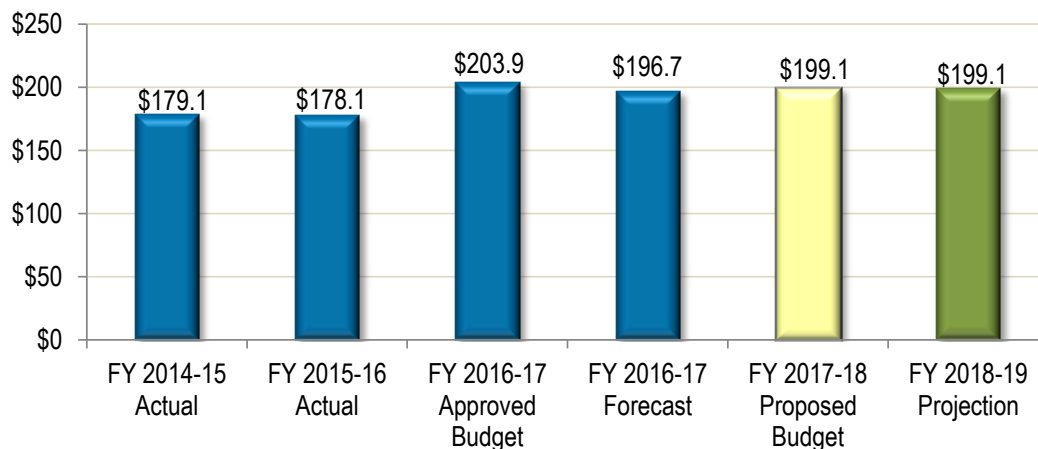


## [2] OPERATING EXPENSES & EQUIPMENT

Operating Expenses and Equipment costs of \$199.1 million represent a decrease of \$4.9 million (2.4 percent) from the FY 2016-17 Budget of \$203.9 million.

### Operating Expenses & Equipment Costs Trend

(in millions)



#### [2.1] General Expense

General Expense costs are estimated to decrease by \$1.0 million as the organization continues to reduce purchases of office supplies and consolidate subscriptions and membership purchases.

#### [2.2] Fund Admin Services/Subscriptions

Fund Administration Services fees are estimated to decrease by \$0.5 million due to the reduction of the Investment Book of Record (IBOR) annual fee and the elimination of Activist portfolio fund admin fees as this program is winding down.

#### [2.3] Software

Software costs are estimated to decrease by \$0.7 million due to one-time purchases in FY 2016-17 and a reduction in the number of virtual desktop license purchases.

#### [2.4] Printing

Printing costs are estimated to increase by \$0.2 million due to the higher cost for recycled paper and growth in enterprise printing requests.



### **[2.5] Postage**

Postage costs are increasing by \$2.2 million when comparing FY 2016-17 to FY 2017-18. However, FY 2016-17 was lower because the postage meter was funded at the end of FY 2015-16, thereby reducing the expenditures in FY 2016-17. Further, an increase of \$0.5 million is proposed for the second half of the 2017 member at large election which includes mailing 1.45 million ballot booklets and return ballots to members. While the 2017 member at large election will include internet and phone voting options, the mail-outs will continue through the next election cycle. Postage savings are expected to substantially materialize by 2021 and the savings amount will depend upon the success of voters using the internet/phone voting options.

### **[2.6] Communications**

Communication costs are estimated to decrease by \$0.4 million to align with FY 2015-16 actual expenditures.

### **[2.7] Travel**

Travel costs are estimated to increase by \$0.3 million due to additional administrative hearings, public agency audits, and information technology training needs that requires staff to travel.

### **[2.8] Medical Exams/Disability Travel**

Medical exams/disability travel is anticipated to increase by \$0.2 million which is in alignment with the FY 2016-17 forecasted expenditures.

### **[2.9] Professional Services**

Professional Services are estimated to decrease by \$1.8 million primarily due to a reduction in the State Controller's Office billings for issuing retirement warrants; a review of recent billings identified overcharges that are now being offset.

### **[2.10] Consultants**

Consultant costs are estimated to decrease by \$3.1 million due to a reduction for various contracts including consulting actuaries (\$1.4 million), streamlining the Comprehensive Annual Financial Report (\$0.3 million), information technology service consultants (\$0.4 million), video/graphic design services (\$0.2 million), strategic plan development (\$0.1 million), and other miscellaneous services. This continues the organization's efforts to reduce reliance on consultants and provide knowledge transfer to State staff.

### **[2.11] Consultants - Investments**

Investment Consultants costs are estimated to decrease by \$0.7 million based on current projections.

### **[2.12] Audit Services**

Audit services are estimated to decrease by \$0.5 million primarily due to the renewal of the Financial Statement audit and Governmental Accounting Standards Board (GASB) 67 service contracts which will be awarded through a competitive bidding process.

### **[2.13] Master Custodian Fees**

Master Custodian Fees are projected to decrease by \$2.3 million due to available settlement credits that can be applied to FY 2017-18 services.

### **[2.14] Appraisal fees/Tax Advisory Services**

Appraisal Fees are estimated to increase by \$1.3 million due to a projection of assets to be appraised provided by the Investment Office.

### **[2.15] Administrative Hearings**

Administrative Hearings are estimated to increase by \$0.5 million to align with actual expenditures resulting from an increase in the number of hearings for disability and compensation review cases.

### **[2.16] Other Investment Expenses**

Other Investment Expenses are estimated to decrease by \$0.4 million based on prior year expenditure trends. These expenses include payments to emerging manager advisors for a portion of legal, tax, and audit fees the advisors pay and CalPERS has agreed to reimburse.

### **[2.17] Trading & Portfolio Management Systems**

Trading and Portfolio Management Systems costs are estimated to increase by \$2.7 million due to increased assumptions in assets under management, potential resource needs for the development of the new Opportunistic Credit Strategies program, and exploring the potential migration of the Real Assets accounting and support model to the same model used for Private Equity, which provides scale, efficiencies, and an improved control environment.

### **[2.18] Data/Analytics**

Data analytics costs are estimated to increase by \$0.5 million compared to FY 2016-17 due to the implementation of the Investment Office's Roadmap Initiatives.

### **[2.19] Business Operations Tool/Other Technology**

Business Operations Tool/Other technology costs are estimated to increase by \$1.5 million due to the implementation of the Investment Office's Roadmap Initiatives.

### **[2.20] Equipment (includes EDP)**

Equipment costs are estimated to decrease by \$2.6 million due to a reduction in hardware refresh funding (from \$4.2 million in FY 2016-17 to \$1.5 million in FY 2017-18). This reduction is a result of the efforts undertaken by the Information Technology Services Branch and the Financial Office in the latter part of 2016 to provide a comprehensive and updated hardware inventory and an updated hardware refresh policy.

## [3] INVESTMENT EXTERNAL MANAGEMENT FEES

The FY 2017-18 Proposed Budget of \$777.5 million is made up of \$557.3 million for External Management Base Fees and \$220.2 million for External Management Performance Fees and is an overall decrease of \$119.2 million or 13.3 percent from the FY 2016-17 Approved Budget. Total External Management Base Fees are decreasing by \$120.1 million or 17.7 percent and total External Management Performance Fees are increasing by \$0.9 million or 0.4 percent from the FY 2016-17 Approved Budget.

(in thousands)	FY 2015-16 Actual	FY 2016-17 Approved Budget	FY 2017-18 Proposed Budget	Budget to Budget	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
Global Equity	\$70,054	\$92,750	<b>\$87,974</b>	(\$4,776)	(5.1%)
Fixed Income	10,206	8,797	<b>10,003</b>	1,206	13.7%
Real Assets <sup>1</sup> [3.0]	178,583	165,378	<b>184,742</b>	19,365	11.7%
Absolute Return Strategy [3.1]	6,229	4,000	<b>800</b>	(3,200)	(80.0%)
Private Equity [3.2]	353,338	391,000	<b>260,000</b>	(131,000)	(33.5%)
Activist Funds	19,803	6,185	<b>5,362</b>	(823)	(13.3%)
Multi Asset Class	8,115	9,358	<b>8,467</b>	(891)	(9.5%)
<b>External Mgmt - Base Fees</b>	<b>\$646,328</b>	<b>\$677,468</b>	<b>\$557,349</b>	<b>(\$120,119)</b>	<b>(17.7%)</b>
Global Equity	\$50,250	\$72,258	<b>\$71,071</b>	(\$1,186)	(1.6%)
Fixed Income	3,363	4,114	<b>3,336</b>	(778)	(18.9%)
Real Assets <sup>1</sup>	82,875	142,865	<b>142,865</b>	-	0.0%
Absolute Return Strategy	(781)	-	<b>-</b>	-	0.0%
Activist Funds	12,451	-	<b>-</b>	-	0.0%
Multi Asset Class [3.3]	-	-	<b>2,896</b>	2,896	100.0%
<b>External Mgmt - Performance Fees<sup>2</sup></b>	<b>\$148,158</b>	<b>\$219,237</b>	<b>\$220,169</b>	<b>\$932</b>	<b>0.4%</b>
<b>Total External Mgmt Fees</b>	<b>\$794,486</b>	<b>\$896,705</b>	<b>\$777,518</b>	<b>(\$119,187)</b>	<b>(13.3%)</b>

<sup>1</sup> Real Assets include Forestland/Infrastructure.

<sup>2</sup> Performance Fees for Private Equity are deducted from the net returns earned in that asset class.

Major variances from the FY 2016-17 budget are described below:

**[3.0] Real Assets** base fees are estimated to increase by \$19.4 million based on projections, increased estimations in the average net asset value, and market analysis from the external managers.

**[3.1] Absolute Return Strategy (ARS)** base fees are estimated to decrease by \$3.2 million due to market assumptions and the continued wind down of this portfolio.

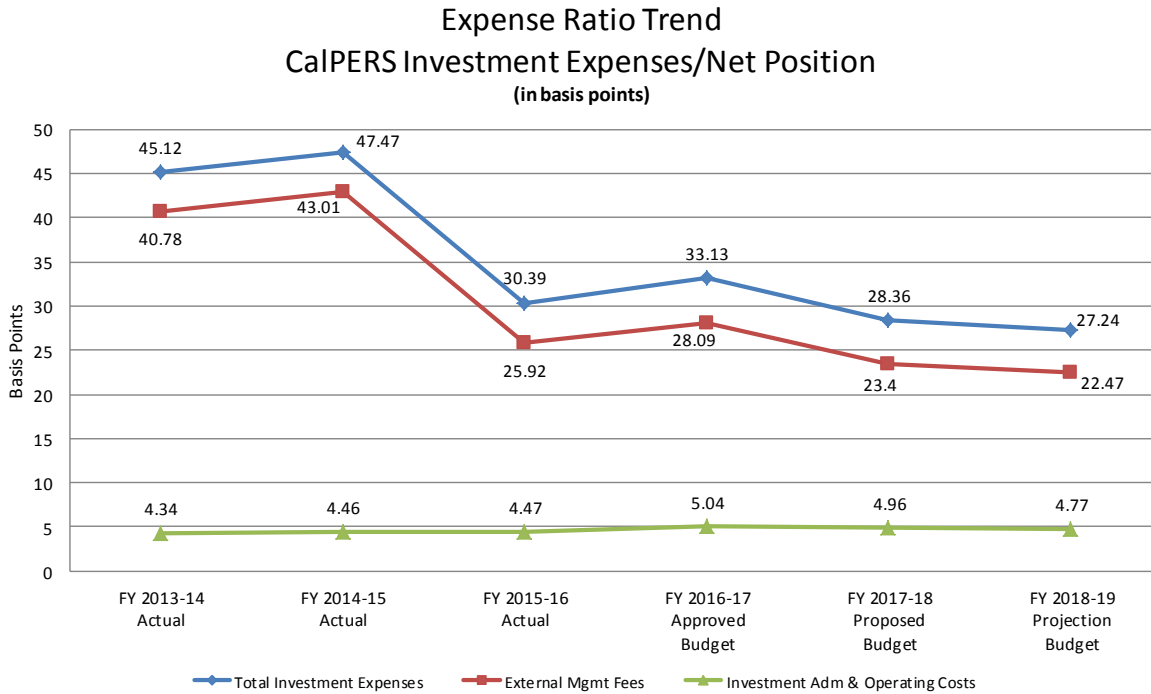
**[3.2] Private Equity** base fees are estimated to decrease by \$131.0 million due to market assumptions and the effectiveness of the Private Equity Accounting and Reporting System (PEARS) which allows for more accurate capturing and reporting of fees.

**[3.3] Multi Asset Class** performance fees are estimated to increase by \$2.9 million compared to zero projection from previous year. This increase is based on the asset class assumption of having a slight increase in these funds and the assumption that they will perform moderately well in FY 2017-18.

The following table shows the net decrease in investment costs, comparing the decrease in external management fees offset by the increase in the investment administrative and operating costs.

(in millions)	FY 2015-16 Actual	FY 2016-17 Budget	FY 2017-18 Proposed Budget	Budget to Budget	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
Administrative	\$64.5	\$71.2	\$73.7	\$2.5	3.5%
Investment Operating Costs	72.6	89.5	91.2	1.7	1.9%
External Management Fees (Base and Performance)	794.5	896.7	777.5	(119.2)	(13.3%)
<b>Total</b>	<b>\$931.6</b>	<b>\$1,057.5</b>	<b>\$942.5</b>	<b>(\$115.0)</b>	<b>(10.9%)</b>

## Expense Ratio / Basis Points Trend



Note: For FY 2016-17, FY 2017-18 and FY 2018-19, the forecasted net positions are based on the average assets under management from the past five years.

### Basis Points Trend

The expense ratio reflects investment expenses in relation to the value of the portfolio also known as net position. The above chart displays External Management Fees and Investment Administrative and Operating Costs in relation to the net position of the assets under management. In summary, there is a downward trend in expenses relative to the net position in each year displayed.

The decrease in basis points from FY 2014-15 Actual Total Investment Expenses to FY 2015-16 is due to the decrease in External Management Fees in comparison to the net position. This is due to lower payout in performance fees.

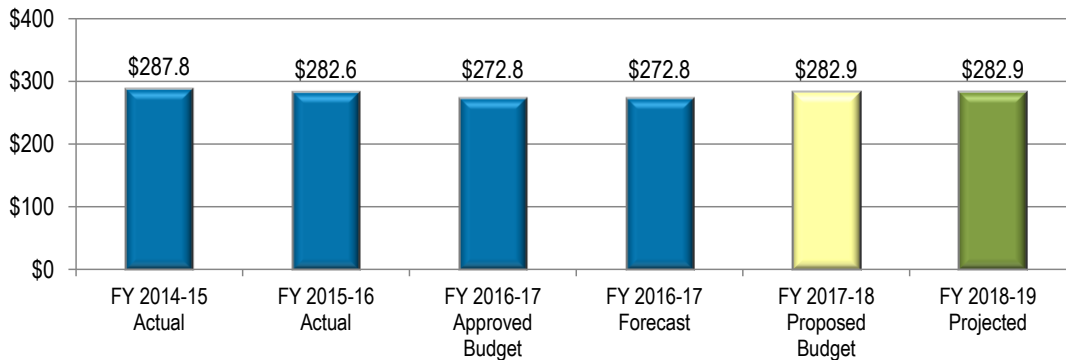
The expense ratio of the FY 2017-18 Proposed Budget is anticipated to be 28.36 basis points. This assumes a downward trend in the ratio as staff continues to negotiate more favorable portfolio management terms, and the Investment Office continues to bring assets to be managed internally.

## Third Party Administrator Fees

Third Party Administrator Fees cover administration, recordkeeping, and participant communication services for the CalPERS Health Program, Long-Term Care Program, the Supplemental Income Plan Program, and the California Employers' Retiree Benefit Trust Fund Program. Establishing strong partnerships to support delivery of health and pension services continues to strengthen our focus on improving long-term health and pension benefit sustainability for our members.

### Third Party Administrator Fees Trend

(in millions)



Total Third Party Administrator Fees for the FY 2017-18 Proposed Budget are \$282.9 million, an increase of \$10.1 million or 3.7 percent from the FY 2016-17 Approved Budget of \$272.8 million. The \$10.1 million increase is mainly driven by increased fees in the Health Program and the Pharmacy Benefit Manager. The following details each of the program areas:

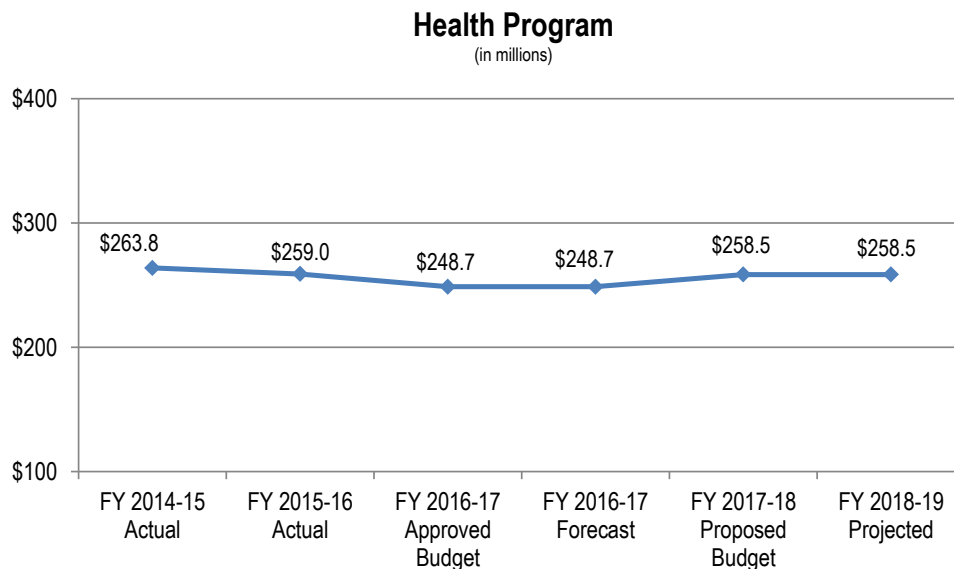
(in thousands)	FY 2015-16 Actual	FY 2016-17 Approved Budget	FY 2017-18 Proposed Budget	Budget to Budget	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
Health Program	\$ 244,818	\$ 229,310	\$ 236,830	\$ 7,520	3.3%
Health Program - State Controllers' Office	-	900	900	-	0.0%
<b>Subtotal, Health</b>	<b>244,818</b>	<b>230,210</b>	<b>237,730</b>	<b>7,520</b>	<b>3.3%</b>
Pharmacy Benefit Manager					
CVS Caremark	14,197	7,513	-	(7,513)	(100.0%)
OptumRx - PPO/HMO <sup>1</sup>	-	10,978	20,805	9,826	89.5%
<b>Subtotal, Pharmacy Benefit Manager</b>	<b>\$ 14,197</b>	<b>\$ 18,491</b>	<b>\$ 20,805</b>	<b>\$ 2,313</b>	<b>12.5%</b>
Long-Term Care Program - LTCG	19,886	20,210	20,903	693	3.4%
Supplemental Income Plan - Voya	3,683	3,899	3,326	(573)	(14.7%)
California Employers' Retiree Benefit Trust - (CERBT)	-	-	97	97	100.0%
Northeast Retirement Services (NRS) <sup>2</sup>					
<b>TOTAL</b>	<b>\$ 282,584</b>	<b>\$ 272,809</b>	<b>\$ 282,860</b>	<b>\$ 10,051</b>	<b>3.7%</b>

<sup>1</sup> Effective January 1, 2017, the CalPERS pharmacy benefit manager changed from CVS/Caremark to OptumRx.

<sup>2</sup> Third party administrative fees for the CERBT program are now being captured separately and displayed in the budget.

## Health Program

The Health Program provides health coverage to more than 1.4 million members and their families enrolled in CalPERS health plans which include all active and retired California State employees, as well as active and retired employees of local agencies and school districts in California. Health coverage providers whose third party administration fees are calculated separate from premiums include Anthem Blue Cross, Blue Shield of California, Health Net, Sharp, and United Healthcare.



The FY 2017-18 Proposed Budget of \$258.5 million for the CalPERS Health Program represents a net increase of \$9.8 million or 3.9 percent from the FY 2016-17 Approved Budget mainly driven by:

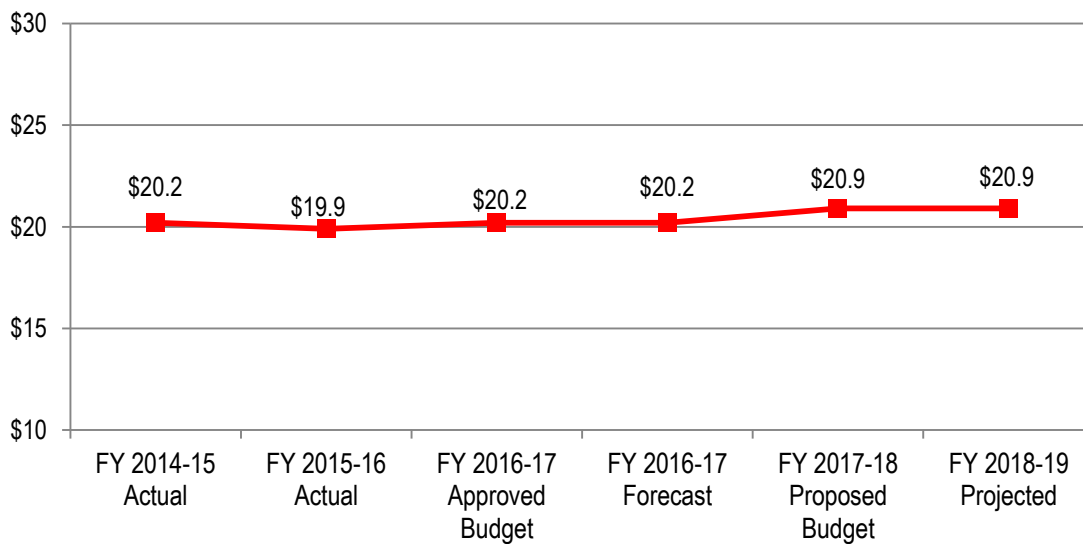
- A \$7.5 million increase to self-funded and flex-funded health plan administration due to 2018 third-party administration (TPA) fees and the elimination of the Blue Shield NetValue plan which caused mandatory plan migration for over 78,000 lives; nearly half of those lives migrated to the Blue Shield Access+ plan and more expensive TPA fees.
- A \$2.3 million increase is related to the new Pharmacy Benefit Manager, OptumRx, effective January 2017. The new contract includes customer service enhancements and increased coordination between OptumRx and the Centers for Medicare and Medicaid Services due to increased participation in a federal prescription drug plan that provides cost savings to employers (Employer Group Waiver Plan). Administrative service fees on a per-member, per-month basis will remain static over the five-year contract term.

The FY 2018-19 Projection is estimated to be the same as the FY 2017-18 Proposed Budget due to continued efficiencies identified in the 2017-22 Health Initiatives presented to the Board in March 2017 which could offset any increases in fees and membership.

## Long-Term Care

The Long-Term Care Program, as administered by Long Term Care Group, provides comprehensive personal non-medical assistance, including care at home, adult care centers, assisted living facilities, and nursing homes to its members. Administrator fees include underwriting costs, billing/banking, care advisory services, claims administration, reports, and customer service.

**Long-Term Care**  
(in millions)

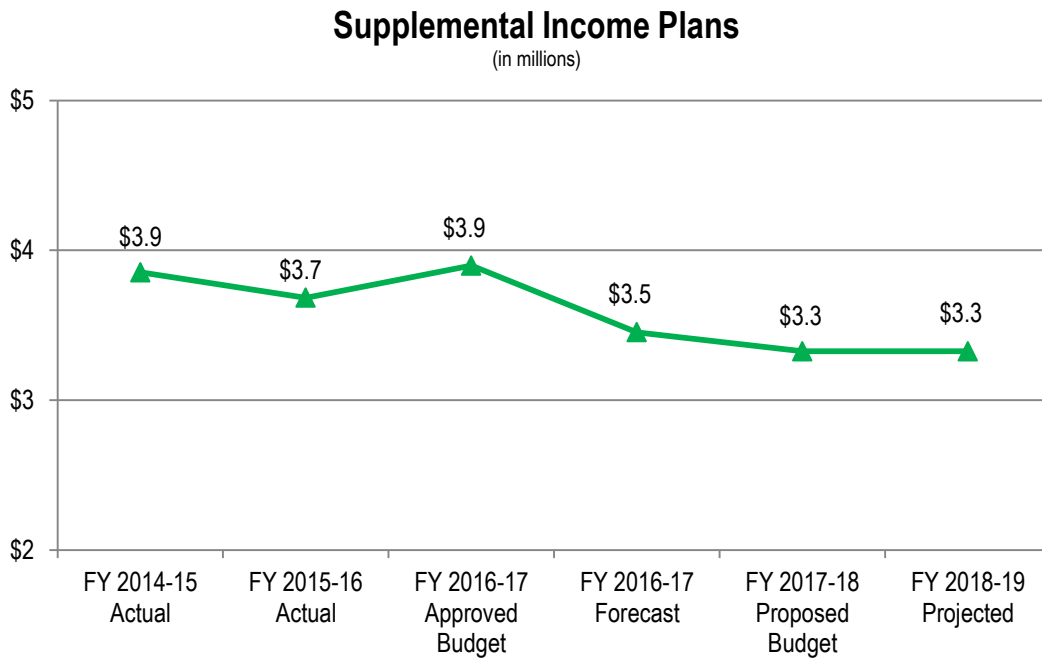


The Proposed Budget of \$20.9 million for FY 2017-18 represents an increase of \$0.7 million or 3.4 percent from the FY 2016-17 Approved Budget. This increase is attributed to system modifications related to the expansion of applicants eligible to apply for the program, and program enhancements such as expanded access to each participant's own evidence of coverage (EOC) information online. The FY 2016-17 Forecast is estimated to be the same as the FY 2016-17 Approved Budget. The FY 2018-19 Projection is estimated to be the same as the FY 2017-18 Proposed Budget.



## Supplemental Income Plans

The Supplemental Income Plans (SIP) program provides deferred compensation and defined contribution plans for employees of participating public agencies, schools, and the State of California. The Voya Group is the third party administrator responsible for providing recordkeeping and administrative services for the SIP Program.



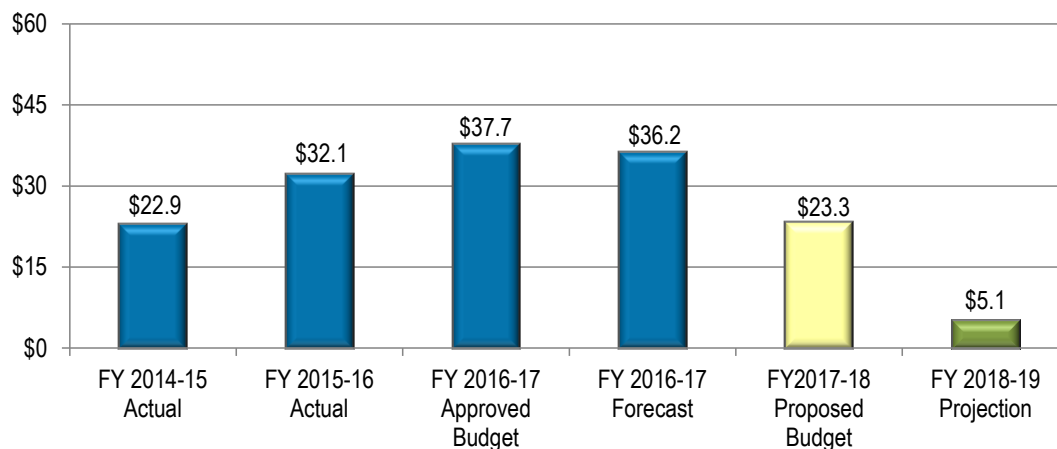
The FY 2017-18 Proposed Budget of \$3.3 million represents a decrease of \$0.6 million from the FY 2016-17 Approved Budget due to the renegotiation of the VOYA group contract and the incorporation of one field rep into the assumed 20.25 bps fees which resulted in a net savings.

## H. Enterprise Projects

The FY 2017-18 Enterprise Project Costs of \$23.3 million represent a decrease of \$14.4 million or 38.2 percent from the FY 2016-17 Approved Budget of \$37.7 million. Compared to the FY 2016-17 Forecast of \$36.2 million, the FY 2017-18 Proposed Budget represents a decrease of \$12.9 million or 35.6 percent.

### Enterprise Project Costs Trend

(in millions)



Enterprise Projects (in thousands)	FY 2016-17 Approved Budget	FY 2016-17 Forecast	FY 2017-18 Proposed Budget	FY 2018-19 Projection	Budget to Budget	
					\$ Change Incr / (Decr)	% Change Incr / (Decr)
[1] myCalPERS Business Optimization	\$23,470	\$23,470	\$8,775	-	(\$14,695)	(62.6%)
[2] Actuarial Valuation System Redesign	2,797	2,686	3,931	4,128	1,134	40.5%
[3] Business Intelligence	1,000	992	585	-	(415)	(41.5%)
[4] Data Backup, Restoration, and Disaster Recovery	-	-	7,000	-	7,000	100.0%
[5] Long Term Care Third Party Administrator	-	-	1,424	627	1,424	100.0%
[6] Business Continuity	-	-	250	385	250	100.0%
[7] CalPERS Education Center Replacement	-	-	1,337	-	1,337	100.0%
[8] Security Roadmap	4,243	4,041	-	-	(4,243)	(100.0%)
PeopleSoft HCM 9.2 Upgrade	365	326	-	-	(365)	(100.0%)
Infrastructure Modernization	4,200	3,363	-	-	(4,200)	(100.0%)
Compliance Program Infrastructure, Framework, & eGR	550	550	-	-	(550)	(100.0%)
Treasury Management	100	89	-	-	(100)	(100.0%)
Windows 10 Planning and Migration	300	300	-	-	(300)	(100.0%)
Succession Planning	260	171	-	-	(260)	(100.0%)
Executive Compensation Project	200	200	-	-	(200)	(100.0%)
Tobacco Divestment	250	-	-	-	(250)	(100.0%)
<b>Total of Enterprise Projects</b>	<b>\$37,736</b>	<b>\$36,189</b>	<b>\$23,302</b>	<b>\$5,140</b>	<b>(\$14,434)</b>	<b>(38.2%)</b>

The concentration of projects for FY 2017-18 is centered around the final year of the my|CalPERS optimization effort, continuing the redesign of the Actuarial Valuation System, continuing Business Intelligence activities, completing the redesign and modernization of the CalPERS Education Center, and undertaking an effort to procure a vendor to continue and expand the data backup, restoration, and disaster recovery functions for the organization.

### **[1] my|CalPERS Business Optimization**

In January 2015, a joint effort between the program areas and the Information Technology Services Branch (ITSB) was launched to leverage the my|CalPERS system to achieve increased operational efficiencies across the CalPERS organization. The effort outlined initiatives to increase performance and functionality in four major areas: improved customer service, reduced financial and business risk, increased operational performance, and streamlined business processes.

Since its inception, there have been approximately fifty-three optimization initiatives implemented. Some of the most significant for FY 2014-15 and FY 2015-16 include:

- The simplification of Medicare service payers and disability retirement package automation
- Comprehensive system reconciliation for financial and actuarial activities
- Internal staff workflows redesigned and streamlined to better serve our members and partners
- Online Health Statements and enhanced online calculators
- Optimization of final compensation reviews
- Faster resolution of warrant returns and Business Partner payment gaps

Current FY 2016-17 funding continues to maintain planned levels for completing high-priority functional and technical initiatives needed to optimize the my|CalPERS application and CalPERS operations.

These initiatives include:

- Process improvements in the service credit purchase program
- Enhanced State enrollments
- Interest payment functionality
- Modifications to Online Life Option Beneficiary Self Services
- Contribution and Planning tools for Business Partners
- Efficiencies in technical areas related to system and database performance improvements, application testing and production reporting
- Data integrity enhancements
- Streamlined Online Retirement Benefits Estimates and Options Simplification

FY 2017-18 is the final year of the my|CalPERS Business Optimization project. Consultant funding will be used to complete targeted initiatives to increase operational efficiencies, performance, and functionality. These initiatives include:

- Internal simplification of member applications and retirement elections workflow (\$2.6 million)
- Service credit purchase maintenance reductions (\$1.5 million)
- Contract provisioning and Agency Social Security compliance streamlining (per section 218 of the Social Security Act) (\$1.9 million)

- System data maintainability (\$1.8 million)
- Public Employees' Pension Reform Act (PEPRA) program simplification (\$0.5 million)
- Project management (\$0.5 million)

The optimization project is on target to complete by June 2018, as reported in the FY 2016-17 Annual Budget review.

Project Life Cycle Costs - my CaIPERS Business Optimization			
Fiscal Year	Project Budget	Operational Budget	Total
2014-15 Actuals	\$ 17,399,603	\$ -	\$ 17,399,603
2015-16 Actuals	24,159,800	-	24,159,800
2016-17 Forecast	23,470,000	-	23,470,000
2017-18 Proposed Budget	8,775,000	-	8,775,000
2018-19 Projection	-	-	-
<b>Total</b>	<b>\$ 73,804,403</b>	<b>\$ -</b>	<b>\$ 73,804,403</b>

## [2] Actuarial Valuation System Redesign

The current Actuarial Valuation System (AVS) has been in existence for over 20 years and no longer meets evolving actuarial practices, including changes required for employers to comply with new standards implemented by the Governmental Accounting Standards Board (GASB). The investment to redesign the AVS system will provide the capabilities needed to keep current with evolving practices and comply with GASB. This is a multi-year project with an estimated total project cost of \$13.0 million. (This is \$10 million less than what had been projected last year; now that the project has moved from the conceptual phase to the design and implementation phases, a more precise cost estimate is available.)

Phase 1 is completed and identified business process requirements to develop a concept for the new database model. Phase II began in FY 2016-17 and includes configuring the new database model, integrating data from the existing AVS system, and validating data integrity. In FY 2017-18, Phase II activities will continue. In addition, application hardware and software will be procured, system configuration and data integration will continue, user acceptance testing and training will be performed, and primary support functions will begin transitioning from project consultants to State staff. This project is expected to be completed in FY 2020-21.

Funding proposed in FY 2017-18 totals \$3.9 million and includes:

- |                              |                      |
|------------------------------|----------------------|
| • Project Consultants        | \$2.5 million        |
| • Backfill Resources*        | 0.9 million          |
| • Hardware/Software/Training | <u>0.5 million</u>   |
| <b>Total</b>                 | <b>\$3.9 million</b> |

\* Temporary backfill resources perform core workload while existing State resources are assigned to the project to provide expertise in designing the new system as well as to learn the new system functionality.

Project Life Cycle Costs - Actuarial Valuation System			
Fiscal Year	Project Budget	Operational Budget	Total
2014-15 Actuals	\$ 132,230	\$ -	\$ 132,230
2015-16 Actuals	588,823	-	588,823
2016-17 Forecast	2,686,032	-	2,686,032
2017-18 Proposed Budget	3,931,000	-	3,931,000
2018-19 Projection	4,128,000	-	4,128,000
2019-20 Projection	1,000,000	-	1,000,000
2020-21 Projection	500,000	-	500,000
<b>Total</b>	<b>\$ 12,966,085</b>	<b>\$ -</b>	<b>\$ 12,966,085</b>

### [3] Business Intelligence

The Business Intelligence (BI) project is an ongoing multi-year effort that ensures CalPERS technology and information supports an environment where the business can make fact-based decisions using accurate and timely data and information. Since its inception in FY 2013-14, accomplishments include the development of communication and project management action plans, completed deliverables for the Human Resources and Public Affairs Divisions, the Financial Office, and Audit Services, and the development of the CalPERS 2014 Retirement Trend Report and the CalPERS Economic Impacts in California Report.

In FY 2016-17 funding is being used to maintain the current BI data environments, create a BI product depository, develop a self-service environment that will allow for better access to the data, provide a better understanding of the retirement data warehouse, and continued system development.

The BI program has gradually reduced reliance on consulting resources and continues knowledge transfer to State staff. Funding in FY 2017-18 totals \$585,000 and will fund consulting resources to assist staff with enhancements of the BI environment related to data extraction, report and dashboard development, and expansion of the self-service environment including:

- Expansion of pension data in the BI data warehouse for the Financial Office to utilize for the Comprehensive Annual Financial Report (CAFR) statistical section.
- Establishment of Human Resources Division's Workforce Planning dashboards by extracting data from the PeopleSoft Human Capital Management (HCM) System to integrate it with the my|CalPERS data.
- Development of a self-service solution that provides data for the Office of Audit Services to support a new risk assessment program.
- Expansion of the data warehouse to support health enrollment data initiatives for the Health Planning and Research Division.
- Training needed to replace BI database administrator consultants with State staff.

### Project Life Cycle Costs - Business Intelligence

Fiscal Year	Project Budget	Operational Budget	Total
2013-14 Actuals	\$ 2,456,795	\$ -	\$ 2,456,795
2014-15 Actuals	1,240,223	-	1,240,223
2015-16 Actuals	991,714	-	991,714
2016-17 Forecast	992,305	-	992,305
2017-18 Proposed Budget <sup>1</sup>	585,300	1,546,000	2,131,300
2018-19 Projection	385,300	1,546,000	385,300
<b>Total</b>	<b>\$ 6,651,637</b>	<b>\$ 3,092,000</b>	<b>\$ 8,197,637</b>

<sup>1</sup> In addition to the project budget costs, the operational budget includes 9.0 staff (\$1.3 million) and \$246,000 for consulting services.

#### [4] Data Backup, Restoration, and Disaster Recovery Services

CalPERS' current contract to provide data backup, restoration, and disaster recovery services expires in June 2017. A service provider will be procured to design, develop, and implement a new and expanded disaster recovery data backup system to support CalPERS Business Continuity Plans (BCP) and Technical Recovery Plan (TRP).

The expanded system will allow CalPERS to mitigate risk of data loss and service disruption associated with an unanticipated local or regional disaster as required by the California State Administration Manual for business continuity. The 2016 Business Impact Analysis and BCP now require data applications to be available and include recovery objectives up to 30 days for disaster recovery; CalPERS' traditional timeframe has been 96 hours. The system will also be designed to correct operational deficiencies discovered in data recovery testing and improve other expanded recovery capabilities for all CalPERS mission critical applications. The expansion of business resumption service items and length of time required for data recovery backup will impact the cost of service.

Funding proposed in FY 2017-18 totals \$7.0 million and includes the following components:

- \$4.5 million one-time funding for infrastructure hardware, software, telecommunication circuits, and professional services for implementing a new solution at CalPERS and at a remote site.
- \$2.5 million for the first year of service for backup, restoration, and disaster recovery solutions. This includes the continuation of existing disaster recovery services while transitioning to a new managed service solution contract that meets CalPERS needs.

### Project Life Cycle Costs - Data Backup, Restoration, and Disaster Recovery Services

Fiscal Year	Project Budget	Operational Budget	Total
2017-18 Proposed Budget	\$ 7,000,000	\$ -	\$ 7,000,000
2018-19 Projection		2,500,000	2,500,000
2019-20 Projection		2,500,000	2,500,000
2020-21 Projection		2,500,000	2,500,000
2021-22 Projection		2,500,000	2,500,000
<b>Total</b>	<b>\$ 7,000,000</b>	<b>\$ 10,000,000</b>	<b>\$ 17,000,000</b>

Note: The current operational budget includes \$1.2 million for the existing data backup, restoration, and disaster recovery vendor. This amount will offset the \$2.5 million annual ongoing support cost of the new system so the net increase to the operational budget will be \$1.3 million.

## [5] Long-Term Care Third-Party Administrator Transition

The current contract to provide Third Party Administrator (TPA) services for CalPERS' Long-Term Care (LTC) Program expires in December 2017. One-time funding is proposed to provide project management and administration services for the potential transition to a new LTC Third Party Administrator. This funding is needed if a new vendor is selected and approved by the Board of Administration. The LTC program has never undertaken the transition of the LTC Third Party Administrator. Due to the complexity and magnitude of this effort there would be the need for a specialized LTC transition vendor to assist with the administrative services necessary to provide a transition plan, which include:

- Project communication, change management, and project execution (\$0.4 million)
- Business process overview, configuration strategy, integration plan, and data migration/testing plan (\$1.0 million)

The potential transition would require data conversion and system interface between the two vendors for the transfer of historical information related to policy holders, membership policies, evidence of coverage, premium payment and banking records, open claims, and in process applications. In addition, benefit review audits would need to be performed.

<b>Project Life Cycle Costs - Long-Term Care Third-Party Administrator Transition</b>			
<b>Fiscal Year</b>	<b>Project Budget</b>	<b>Operational Budget</b>	<b>Total</b>
2017-18 Proposed Budget	\$ 1,423,500	\$ -	\$ 1,423,500
2018-19 Projection	627,050		627,050
<b>Total</b>	\$ 2,050,550	\$ -	\$ <b>2,050,550</b>

## [6] CalPERS Business Continuity Project

One-time funding is needed to update the Master Enterprise Business Continuity Program to minimize risk to CalPERS critical business functions for recovery in case of a cyber-disaster.

During FY 2016-17, an enterprise-wide business impact analysis was conducted to identify and prioritize critical business functions and determine the recovery time objectives for up to 30 days post disaster. In addition, an information technology analysis was conducted, business continuity plans for thirty divisions were updated, and a Master Enterprise Business Continuity Plan was submitted to the California Office of Emergency Services and the California Information Security Office.

Consultant funding of \$250,000 is proposed in FY 2017-18 to execute the Master Enterprise Business Continuity Plan scheduled to begin in July 2017. This phase of the project is to identify the essential software systems and business functions that need to be restored after the 30 days post disaster period for 31, 60 and 90 days through to full business resumption. Consultant funding will provide the necessary business continuity expertise to assist key division personnel in identifying essential business functions that need to be restored, and allow CalPERS to remain in compliance with the California Office of Emergency Services and the California Information Security Office requirements.

<b>Project Life Cycle Costs - CalPERS Business Continuity Project</b>			
<b>Fiscal Year</b>	<b>Project Budget</b>	<b>Operational Budget</b>	<b>Total</b>
2017-18 Proposed Budget	\$ 250,000	\$ -	\$ 250,000
<b>Total</b>	\$ 250,000	\$ -	\$ 250,000

## [7] CalPERS Education Center Replacement

The Customer Service and Outreach Division (CSOD) is the main point of contact for employer and member services. The CalPERS Education Center (CEC) software platform was originally developed in-house ten years ago to be a self-service education tool to provide better customer service by reaching more of our members. Due to my|CalPERS priorities, many fixes related to appointments and calendars as well as enhancements to increase system efficiency were deferred. This resulted in configurability and functionality limitations, causing potential security issues and lack of integration with my|CalPERS.

This project addresses these issues by redesigning and modernizing the current CEC system. In FY 2015-16 the Customer Service and Outreach Division partnered with the Information Technology Services Division to gather business requirements and develop a proof of concept for the new system. In FY 2017-18, the technical solution will be implemented to improve education delivery efficiencies for the regional offices, streamline the scheduling and appointment process for customers, improve data integrity with my|CalPERS, improve the quality of reporting and provide improvements to the CalPERS Benefit Education Event registration process.

Funding proposed in FY 2017-18 totals \$1.3 million and includes:

- Design and testing consultants (\$1.2 million)
- Scanning solution to replace manual process (\$0.1 million)

<b>Project Life Cycle Costs - CalPERS Education Center Replacement</b>			
<b>Fiscal Year</b>	<b>Project Budget</b>	<b>Operational Budget</b>	<b>Total</b>
2015-16 Actuals	\$ 940,392	\$ -	\$ 940,392
2016-17 Forecast	-	-	-
2017-18 Proposed Budget	1,337,000	-	1,337,000
2018-19 Projection	-	25,000	25,000
<b>Total</b>	\$ 2,277,392	\$ 25,000	\$ 2,302,392

## [8] Security Roadmap

The Security Roadmap Project (SRP) is to ensure CalPERS technology and member data remains secure against continuously changing threats in the environment.

Beginning in FY 2017-18, funding for security activities is transitioned to the operational budget and includes costs for the purchase and maintenance of various security software products (\$1.7 million) and 21.0 team members (\$2.5 million). Efforts will be directed towards further improvements to ensure CalPERS' technology and member data remain secure against the constantly changing threat environment, including the following activities:

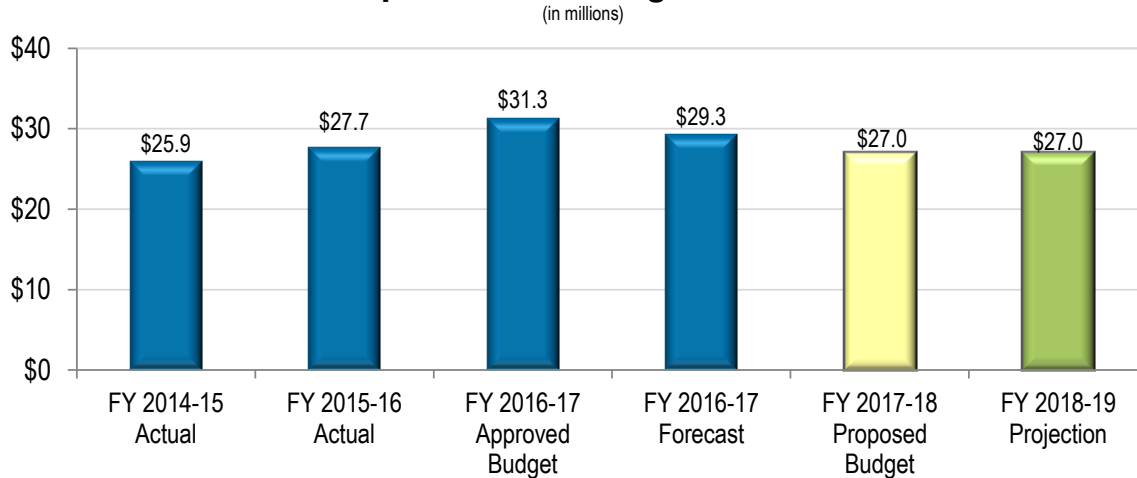


- Develop and implement an identity lifecycle methodology with the identity access management program.
- Deploy multi-factor authentication to remaining privileged account users.
- Migrate the IronPoint anti-spam system to the cloud and shutdown the physical hardware appliances located in the data center.
- Identify cloud and non-cloud applications and systems that require additional security and implement the existing CalPERS advanced multi-factor authentication solution.
- Continue to mature the incident response process to complete strong and repeatable incident response plans for IT and the business to bring together a unified plan/process.
- Design and create additional my|CalPERS reports and associated dashboards using the enterprise logging system.
- Procure an enterprise threat intelligence solution to strengthen IT security and provide additional security monitoring processes to detect warning of potential risks through cloud based automation.
- Explore the value and application for a behavior analysis solution for detecting anomalies in the environment indicative of malicious activity detectable by traditional security solutions.
- Implement additional capabilities to increase the protection of the my|CalPERS database, i.e., discovery and classification of sensitive data and vulnerability assessments.

**Project Life Cycle Costs - Security Roadmap**

<b>Fiscal Year</b>	<b>Project Budget</b>	<b>Operational Budget</b>	<b>Total</b>
2013-14 Actuals	\$ 4,903,326	\$ -	\$ 4,903,326
2014-15 Actuals	2,019,330	-	2,019,330
2015-16 Actuals	3,082,613	-	3,082,613
2016-17 Forecast	4,041,416		4,041,416
2017-18 Proposed Budget	-	4,200,000	4,200,000
<b>Total</b>	<b>\$ 14,046,685</b>	<b>\$ 4,200,000</b>	<b>\$ 18,246,685</b>

## Headquarters Building Costs Trend



The FY 2017-18 Headquarters Building Costs are \$30.1 million, reduced by \$3.1 million in rent revenues, creating a net cost of \$27.0 million. Costs include operating expenses of \$19.4 million (utilities, engineering services, janitorial, security, etc.) and non-operating expenses of \$10.7 million (structural improvements, staff moves, insurance, etc.).

Operating expenses in the FY 2017-18 Proposed Budget are \$19.4 million, an increase of \$0.5 million from the FY 2016-17 Approved Budget of \$18.9 million. Non-operating expenses in the FY 2017-18 Proposed Budget are \$10.7 million, a reduction of \$4.7 million from the FY 2016-17 Approved Budget of \$15.4 million. The net reduction in total costs of \$4.2 million is broken down as follows:

Description	\$ in Millions
Janitorial - reduction due to new contract rates	\$(0.2)
General Maintenance - reduction for one-time Data Center enhancements	(0.6)
Security - increase for card readers, camera install, computer aided dispatch system (911 and panic buttons)	0.3
Operating Other – increase for sewage pump repairs, HVAC, and building energy recommissioning/audits	0.6
Owner Improvements - reduction in tenant improvements	(2.7)
Building Improvements - reduction in building improvement projects	(2.1)
Net impact of other changes	0.5
<b>Total</b>	<b>\$(4.2)</b>

In an effort to reduce costs in FY 2017-18, the timeline for regularly scheduled maintenance has been extended, including carpet and wall covering replacement (\$1.5 million).

# I. Headquarters Building Costs

## Headquarters Building Costs

(in thousands)	FY 2015-16 Actual Expenses	FY 2016-17 Approved Budget	FY 2017-18 Proposed Budget	Budget to Budget	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
<b>Operating:</b>					
Utilities	\$2,390	\$2,455	\$2,534	\$78	3.2%
Engineering Services	2,761	3,085	3,110	25	0.8%
Janitorial	2,719	3,202	3,030	(172)	(5.4%)
Landscaping	806	840	858	18	2.1%
General Maintenance	2,269	2,218	1,620	(598)	(27.0%)
Security	2,417	2,454	2,756	302	12.3%
Property Mgmt & Administrative Fees	1,095	1,227	1,354	127	10.3%
Café Plaza	353	376	382	6	1.6%
Front St Parking/Warehouse	615	660	726	66	10.0%
EOC (Sun Center) <sup>1</sup>	564	414	512	98	23.6%
Operating Other <sup>2</sup>	1,794	1,979	2,575	596	30.1%
<b>Total Operating Costs</b>	<b>17,782</b>	<b>18,911</b>	<b>19,456</b>	<b>544</b>	<b>2.9%</b>
<b>Non-Operating:</b>					
Owner Improvements <sup>3</sup>	5,210	7,158	4,472	(2,686)	(37.5%)
Building Improvements <sup>4</sup>	5,205	5,170	3,028	(2,142)	(41.4%)
Furniture & Fixtures	2,348	2,511	2,598	87	3.4%
Building Insurance	468	610	610	-	0.0%
<b>Total Non-Operating Costs</b>	<b>13,231</b>	<b>15,449</b>	<b>10,707</b>	<b>(4,742)</b>	<b>(30.7%)</b>
<b>Total Costs</b>	<b>\$31,013</b>	<b>\$34,360</b>	<b>\$30,163</b>	<b>(\$4,197)</b>	<b>(12.2%)</b>
Rent Revenue Offset <sup>5</sup>	(3,331)	(3,065)	(3,117)	(52)	1.7%
<b>Total Headquarters Building Costs</b>	<b>\$27,682</b>	<b>\$31,295</b>	<b>\$27,046</b>	<b>(\$4,249)</b>	<b>(13.6%)</b>

<sup>1</sup>Emergency Operations Center (EOC) includes utilities, janitorial, security, landscaping, generator maintenance.

<sup>2</sup>Includes ongoing expense categories that each individually equals less than \$300K annually such as electrical, HVAC, plumbing, general maintenance, waste removal, property taxes, child care center, parking garage.

<sup>3</sup>Non-Operating Owner Improvements include CalPERS operational enhancements and support for the movement of divisions, units, and/or staff within CalPERS.

<sup>4</sup>Non-Operating Building Improvements are improvements made to the building structure or common areas.

<sup>5</sup>The Headquarters Building Account receives rent revenue that is used to offset the annual expenses of the Headquarters Building Account.

[1] Total CalPERS Budget by Branch

(in thousands)	FY 2016-17 Approved Budget	FY 2017-18 Proposed Budget	Budget to Budget	
			\$ Change Incr / (Decr)	% Change Incr / (Decr)
<b>Administrative and Investment Operating Costs</b>				
Actuarial Office	9,538	10,241	703	7.4%
Benefit Programs Policy and Planning	26,115	27,177	1,061	4.1%
Communications and Stakeholder Relations	10,498	12,220	1,723	16.4%
Customer Services and Support	109,049	109,298	248	0.2%
Executive Office	7,001	6,691	(310)	(4.4%)
Financial Office	30,391	34,209	3,818	12.6%
General Counsel	25,733	27,525	1,792	7.0%
Investment Office	160,772	164,969	4,197	2.6%
Operations and Technology	144,521	148,936	4,415	3.1%
Pro-Rata Assessment	24,710	24,411	(299)	(1.2%)
<b>Subtotal</b>	<b>\$ 548,328</b>	<b>\$ 565,677</b>	<b>\$ 17,349</b>	<b>3.2%</b>
<b>Investment External Management Fees</b>	<b>896,705</b>	<b>777,518</b>	<b>(119,187)</b>	<b>(13.3%)</b>
<b>Third Party Administrator Fees</b>	<b>272,809</b>	<b>282,860</b>	<b>10,051</b>	<b>3.7%</b>
<b>Enterprise Projects Budget</b>	<b>37,736</b>	<b>23,302</b>	<b>(14,434)</b>	<b>(38.2%)</b>
<b>Headquarters Building Costs</b>	<b>31,295</b>	<b>27,046</b>	<b>(4,249)</b>	<b>(13.6%)</b>
<b>CalPERS Total Budget</b>	<b>\$ 1,786,873</b>	<b>\$ 1,676,403</b>	<b>(\$110,470)</b>	<b>(6.2%)</b>

The following are the main variances for the CalPERS Program areas from the previous year:

**Actuarial Office (ACTO)** [+\$0.7 million] - Costs are increasing due to employee compensation adjustments (\$1.9 million), offset by a reduction in actuarial consulting services of \$1.2 million.

**Benefit Programs Policy and Planning (BPPP)** [+\$1.1 million] - Costs are increasing due to employee compensation adjustments (\$1.5 million), offset by reductions in one-time consultant funding for the Long-Term Care RFP process (\$0.3 million) and the HMO flex funding global reconciliation (\$0.1 million).

**Communications and Stakeholder Relations (CSR) [+ \$1.7 million]** - Costs are increasing due to employee compensation adjustments (\$0.2 million). In addition, (a) the \$1.0 million annual postage budget for the PERSpective newsletter is being restored (this had been deleted in the FY 2016-17 budget because prior year funding was available) and (b) the facility rental costs for the CalPERS Benefit Education Events (CBEE) have been shifted from the Customer Services and Support (CSS) budget to the CSR budget (\$0.4 million).

**Customer Services and Support (CSS) [+ \$0.2 million]** - Costs are increasing due to employee compensation adjustments (\$6.8 million) and an increase in disability medical exam costs (\$0.2 million). These increases are offset by the following reductions: (a) the transfer of staff to the Financial Office reducing the CSS budget by \$4.2 million, (b) savings of \$1.5 million in the State Controller's Office contract to issue retirement warrants (due to overcharges that are now being offset), (c) temporary help reductions (\$0.7 million), (d) the expiration of five limited-term positions (\$0.4 million), and (e) the transfer of CBEE facility rental costs to CSR (\$0.4 million).

**Financial Office (FINO) [+ \$3.8 million]** - Costs are increasing due to employee compensation adjustments (\$2.0 million) and position transfers from CSS (\$4.2 million). These increases are offset by the following reductions: (a) temporary help and overtime (\$0.2 million), (b) one-time consulting needs (\$1.9 million), and (c) operating expense efficiencies (\$0.3 million).

**General Counsel (GCO) [+ \$1.8 million]** - Costs are increasing due to employee compensation adjustments (\$2.1 million) and an increase in the number of administrative hearings (member appeals) and public agency audits (\$0.6 million). These increases are offset by a reduction in outside counsel costs (\$0.5 million) and savings from the renewal of the contract for Financial Statement audit & GASB 67 services (\$0.4 million).

**Investment Office (INVO) [+ \$4.2 million]** - Costs are increasing due to employee compensation adjustments (\$2.5 million) and an increase in investment operating expenses (\$1.7 million) due to continued efforts to insource investment managers and system enhancements.

**Operations and Technology (OPT) [+ \$4.4 million]** - Costs are increasing due to employee compensation adjustments (\$6.2 million) and an increase in costs for the member-at-large election (\$1.1 million). These increases are offset by reductions in consulting services (\$0.1 million) and equipment (\$2.8 million) due to the hardware refresh request being less in FY 2017-18 pursuant to a comprehensive update of the inventory and the refresh criteria.

**[2] Administrative Budget by Trust Fund**

The proposed FY 2017-18 Administrative Budget is allocated to the following trust funds:

**Administrative Operating Costs by Fund Source**

(in thousands)	FY 2015-16 Actual Expenditures	FY 2016-17 Approved Budget	FY 2017-18 Proposed Budget	Change from Annual	
				\$ Change Incr / (Decr)	% Change Incr / (Decr)
<b>Administrative Operating Costs</b>					
Public Employees' Retirement Fund (PERF)	\$ 349,390	\$ 372,454	\$ 384,656	\$ 12,201	3.3%
Public Employees' Contingency Reserve Fund (CRF) <sup>1</sup>	26,955	28,268	71,114	42,846	151.6%
Public Employees' Health Care Fund (HCF) <sup>1</sup>	32,792	41,002	-	(41,002)	(100.0%)
Long-Term Care Fund (LTCF)	3,564	5,791	6,324	533	9.2%
Annuitants' Health Care Coverage Fund (AHCCF)	2,541	3,763	3,902	139	3.7%
Deferred Compensation Fund (IRC 457)	1,492	1,576	1,630	54	3.4%
Supplemental Contributions Program Fund (SCP)	175	145	139	(6)	(3.8%)
Judges' Retirement Fund (JRF)	1,257	1,747	1,848	101	5.8%
Judges' Retirement Fund II (JRF II)	1,389	1,977	2,272	295	14.9%
Legislators' Retirement Fund (LRF)	473	602	606	4	0.7%
Replacement Benefit Custodial Fund (RBF)	7	15	450	435	2900.0%
Reimbursements <sup>2</sup>	1,500	1,450	1,500	50	3.4%
<b>Total Administrative Operating Costs</b>	<b>\$ 421,534</b>	<b>\$ 458,790</b>	<b>\$ 474,441</b>	<b>\$ 15,650</b>	<b>3.4%</b>
<i>Statewide Pro-Rata Assessment</i>	<i>\$ 25,463</i>	<i>\$ 24,710</i>	<i>\$ 24,411</i>	<i>\$ (299)</i>	<i>(1.2%)</i>
<i>CalPERS Administrative Costs</i>	<i>\$ 396,071</i>	<i>\$ 434,080</i>	<i>\$ 450,030</i>	<i>\$ 15,949</i>	<i>3.7%</i>

<sup>1</sup>These amounts include estimates for statewide salary increases pending Department of Finance approval.

<sup>2</sup>Amounts received by CalPERS for services rendered. These reimbursements are actuarial valuations prepared for public agencies that qualify for reimbursement, cost of photocopies/postage related to the Public Records Act requests, annual employer conferences, and administrative assessments for employers' delinquent payroll.

The variances in the trust fund amounts between FY 2016-17 and FY 2017-18 are mainly attributed to employee compensation increases as described earlier in this document. Also, workload statistics from the program areas have been updated, and system maintenance and operations costs reflect those updates and are allocated to the trust funds. Furthermore, as part of the provisional budget language included in the 2016 Budget Act, the health program administrative expenses previously charged to the Health Care Fund (HCF) appropriation have been consolidated into the Contingency Reserve Fund beginning in FY 2017-18. Other details include:

**Public Employees' Retirement Fund (PERF)** – The increase of \$12.2 million is primarily related to statewide employee compensation increases and offset by a reduction in the pro-rata assessment.

**Public Employees' Contingency Reserve Fund (CRF)** – The increase of \$42.8 million is primarily due to the consolidation of the HCF appropriation into the CRF in addition to the statewide employee compensation and pro-rata assessment adjustments.

**Public Employees' Health Care Fund (HCF)** – The decrease of \$41.0 million is due to the consolidation of the HCF appropriation into the CRF as noted above.

**Public Employees' Long-Term Care (LTCF)** – The increase of \$0.5 million is mainly attributed to potential costs associated with a long-term care third party administrator transition.

**Public Employees' Annuitants' Health Care Coverage (AHCCF)** – The increase of \$0.1 million is mainly due to the statewide employee compensation and pro-rata assessment adjustments.

**Judges' Retirement Fund II (JRF II)** – The increase of \$0.3 million is mainly due to an increase in outside counsel costs and the pro-rata assessment adjustment.

**Replacement Benefit Custodial Fund (RBF)** – The increase of \$0.4 million is attributed to budgeting for the full cost recovery of the expenses to perform this activity. Member fees are being assessed beginning in March 2017; total fees anticipated in FY 2016-17 total \$150,000, representing one third of the cost recovery. Full cost recovery is projected beginning in FY 2017-18.