

September 19, 2017

Item Name: 2016 -17 Annual Compliance Report**Program:** Enterprise Compliance**Item Type:** Information**Executive Summary**

This agenda item presents the FY 2016-17 Annual Compliance Report, which will be included as a section within CalPERS Comprehensive Annual Financial Report (CAFR).

Strategic Plan

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

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

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

Background

The Annual Compliance Report summarizes CalPERS' enterprise-wide compliance activities for each year. The FY 2016-17 Annual Compliance Report reflects the period of July 1, 2016 to June 30, 2017.

Analysis

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

In 2015, the Board approved, and CalPERS developed a new multi-year Compliance Plan, building upon the already effective compliance practices in place. This new Compliance Plan takes into account current industry trends along with management input in establishing compliance focused priorities. This year's Annual Compliance Report highlights activities and accomplishments during "Year Two" of the Compliance Plan.

Compliance awareness and risk management are integral to cultivating a high-performing, risk-intelligent, and innovative organization. CalPERS has embraced an Integrated Assurance model that incorporates governance, risk and compliance practices as a multi-faceted approach to promoting compliance awareness and accountability.

The Integrated Assurance model centers on "The Three Lines of Defense" framework, which distributes compliance activities within the organization as follows:

- **First Line of Defense** – The first level of the control environment is the Program Areas which perform day to day risk management activity.

- **Second Line of Defense** – Oversight functions, such as Enterprise Compliance and Enterprise Risk Management, set direction, define policy and provide assurance.
- **Third Line of Defense** – Internal and external audit are the Third Line of Defense, offering independent challenge to the levels of assurance provided by program areas and oversight functions.

First Line of Defense

Program areas throughout CalPERS continued to strengthen existing safeguards, establish new controls and implement new legislative and regulatory changes. In Fiscal Year, 2016-17, the program areas achieved the following:

- Investment Compliance and Operational Risk organized and administered investment compliance training for Investment Office employees. The training addressed various ethics and conflicts of interest-related topics, including approval of outside employment and post-employment restrictions applicable to employees.
- Benefit Services Division securely cross-referenced over two million participant birthdates with Social Security data through a third-party vendor, identifying less than one percent of birthdates as discrepant and taking action to resolve. This effort ensured compliance with benefit administration rules and improved the accuracy of benefits paid. CalPERS attained an enterprise-wide annual mandatory training completion rate of 99.5 percent, as of July 1, 2017.

Second Line of Defense

CalPERS Enterprise Compliance Division and Enterprise Risk Management Division partner and collaborate as the second line of defense to provide oversight, guidance and monitoring of governance, risk and compliance activities.

CalPERS Enterprise Compliance program is responsible for monitoring and oversight activities. In Fiscal Year, 2016-17, the Enterprise Compliance Division achieved the following:

- CalPERS developed and finalized policy standards and education around policy governance and development. Enterprise Compliance collaborated with 18 program areas, performing a holistic review of Program's policies and offering guidance on organization and structure.
- Enterprise Compliance developed system enhancements to improve hotline allegation tracking and reporting. This resulted in improved Board reporting and enhanced transparency for the organization.

CalPERS Enterprise Risk Management Division facilitates the creation and maintenance of a risk-intelligent culture at CalPERS by providing risk management training, conducting risk assessments, performing risk dashboard recalibration, and developing tools to assist staff in the identification of, monitoring, and response to organizational risks. In Fiscal Year, 2016-17, the Enterprise Risk Management Division achieved the following:

- In June 2016, the Risk and Audit Committee approved the 2016-17 Enterprise Risk Management Plan to continue enhancing the Enterprise Risk Management Framework. In addition to establishing thresholds and Key Risk Indicators, there is an initiative to develop and implement an operational risk event reporting process to be carried over into the 2017-18 Enterprise Risk Management Division Plan.

- Biannual California State Leadership Accountability Act (SLAA) Corrective Action Plans were completed and timely filed with the Department of Finance on December 31, 2016 and June 30, 2017. The SLAA requires each state agency to maintain effective systems of internal control, evaluate and monitor the effectiveness of these controls on an ongoing basis and biannually report on the adequacy of the agency's systems of internal controls.

Third Line of Defense

CalPERS maintains an effective audit program comprised of internal audits and contracting public agency reviews. In Fiscal Year 2016-17, the Office of Audit Services achieved the following:

- Completed 27 internal audits. These assignments included reviews of administrative expense management, our global equity program, death benefits, Health Care Decision Support System, Health Insurance Portability and Accountability Act data assessment, health plan contract compliance, and external real estate manager contract compliance.
- Completed 161 public agency reviews with 451 compliance issues identified. These reviews assist CalPERS in ensuring agencies are paying the correct contributions and members are receiving accurate retirement benefits.

Budget and Fiscal Impacts

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

Benefits/Risks

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

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

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

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

Attachment

Attachment 1 - Annual Compliance Report – Fiscal Year Ended June 30, 2017

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