November 14, 2017

Item Name: Enterprise Risk Management Framework Review

Program: Enterprise Risk Management Division

Item Type: Information

Executive Summary
The purpose of this item is to provide the Risk and Audit Committee (Committee) with an update of the current state of enterprise risk management efforts. Senior leaders and the Executive Team worked collectively with the Enterprise Risk Management Division (ERMD) to review and update all enterprise risk profiles. In addition, senior leaders and executives participated in a risk scoring exercise to evaluate and prioritize enterprise risk. The updated FY 2017-18 Enterprise Risk Management Dashboard (Dashboard, Attachment 1) is the culmination of an enterprise-wide effort to review and assess current risks to the enterprise and revise the corresponding reporting documents.

Strategic Plan
This agenda item supports CalPERS Strategic Plan Goal: Cultivate a Risk-Intelligent Organization. Enterprise Risk Management provides assurance to the Board through the implementation of an effective enterprise-wide risk management program and the continued cultivation of a risk-intelligent organization.

Background
Enterprise Risk Management is a vital function in facilitating risk identification and monitoring activities that inform and support decision-making and resource allocation priorities at the strategic and operational levels across the enterprise.

The Annual Enterprise Risk Assessment process commenced in August when cross-functional teams and senior leaders across the organization collaboratively reviewed and updated the Enterprise Risk Profiles (Attachment 2). A major difference from last year's risk assessment exercise was the introduction of materiality, the level of impact at which a risk occurrence will threaten the achievement of a strategic or business objective. Many of the risks discussed showed a decline in probability and an increase in impact. Completed risk profiles were reviewed by both senior leaders and executives in September and October; and was immediately followed by the Enterprise Risk Scoring exercise.

ERMD led senior leaders and the Executive Team in separate exercises to score the Enterprise Risks. Risks were scored in the areas of probability, impact, and velocity on a five-point scale. Risk probability is defined as the likelihood that a given risk event will occur, risk impact is the extent to which a risk event might affect the enterprise, and risk velocity is the speed of onset in which an organization feels the impact if a risk event occurs. In addition to these three scoring parameters, examples of materiality were used in the scoring exercise.

ERMD averaged the scores of senior leaders and the Executive Team. Variances in scores from the prior year were discussed with the Executive Team. The scoring results is reflected in the Heatmap for Committee review (Attachment 3).

Analysis
The following are key changes to the risk profiles and scoring results when compared year over year for all enterprise risks.

Risk Profiles:
All risk profiles underwent a series of edits facilitated by ERMD working collaboratively with the Integrated Assurance second line of defense teams (Compliance, Risk Management, Audits, Information Security, Legal, and the Controller) to review the risk statement, analysis, drivers, and mitigations. Many were revised to read more clearly by using more concise language targeted toward a broader audience. Completed risk profiles were reviewed by senior leaders and the Executive Team.

Benefit Administration:
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- Scoring results remain the same year over year.

Business Continuity:
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- Scoring results remain the same year over year with expectations that Business Continuity Project - Phase II efforts will reduce the impact of this risk moving forward.

Internal Governance and Control Environment:
- The title of the Enterprise Risk, formerly known as, Compliance was changed to Internal Governance and Control Environment to clarify that each CalPERS team member is accountable for mitigating this risk rather than solely our Enterprise Compliance team.
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- A slight decrease in the level of impact from 2016-17 to 2017-18 due to materiality.

Health Care Administration:
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- Impact increased from 2016-17 to 2017-18 due to materiality and the rise of inherent risk concerning political uncertainty within the health insurance markets. While the Health Policy and Benefits Branch believes CalPERS is well positioned to navigate potential changes the undercurrent of uncertainty is responsible for increased concern.

Information Security:
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- Scoring results remain the same year over year.

Pension Funding:
- For clarification, the Finance and Administration Committee (FAC) oversees financial soundness of the overall CalPERS system, approves asset liability management and funding risk methodologies, and actuarial methods while the Investment Committee sets investment risk appetite and tolerances.

- Risk appetite and trade-offs will be discussed during the Asset Liability Management (ALM) workshop in November.
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- A slight decrease in the level of impact from 2016-17 to 2017-18 primarily due to methodologies used to determine the strategic measure, percentage likelihood of falling below 50% funded status, and increased cash flow into the system.

Stakeholder Confidence:
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- Scoring results remain the same year over year.

Talent Management:
- The revised risk statement focuses on efforts to fill critical positions, as well as reviewing the overall workforce skillset throughout the Enterprise.
- Risk drivers, mitigations, and controls were revised to be clearer and more concise.
- A slight increase in the level of impact from 2016-17 to 2017-18 due to materiality.
- This risk will be reviewed by the Performance, Compensation, & Talent Management Committee in February 2018.

Senior leaders and the Executive Team determined that Data Management and Operational Efficiency should be removed as enterprise risks, since both are incorporated and mitigated within the other risks. Embedding these elements as risk drivers within the remaining risk profiles focuses attention on how both data management inaccuracies and complexity could compromise achieving multiple organizational goals. Various measures can be custom tailored to mitigate differing potential negative outcomes.

In November 2017, Committee Executives will present most of the updated profiles to their respective Board Committees for their review and input. Pension Funding (Investment Committee) and Talent Management will be presented to their respective committees in February 2018.

Risk Reporting
The updated enterprise risk reports are as follows:
- **Enterprise Risk Dashboard** (Attachment 1) – provides the current rating of the top risks, risk categories, and risk statements identifying Board Committee and Executive owners. Trendline analysis will be available in FY 2018-19, once a baseline is established from annual implementation of the Enterprise Risk Management Framework beginning in FY 2016-17 and the introduction of materiality in FY 2017-18.
- **Enterprise Risk Management Profiles** (Attachment 2) – provides the Committee with detailed information on each enterprise risk. The profiles are aligned to the CalPERS Strategic Plan for 2017-22 and include the functional objective, risk statement and analysis, risk drivers and associated mitigation measures in place, current residual risk rating, and future mitigation measures, where applicable.
- **Risk Heat Map** (Attachment 3) – illustrates the prioritization of the Enterprise Risks and appropriate urgency of response.

Next Steps Will Include:
- Incorporate Committee feedback.

- Initiate development of key risk indicators (KRIs)
- Review Pension Funding and Talent Management with respective committees.
- Establish risk appetite for Pension Funding.

Attachments
Attachment 1 – Enterprise Risk Management Dashboard
Attachment 2 – Enterprise Risk Profiles
Attachment 3 – Enterprise Risk Management Heatmap

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CalPERS