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CHIEF COMPLIANCE OFFICER LETTER

The Annual Compliance Report outlines key accomplishments on ethics and compliance activities covering fiscal year (FY) 2017-18. This report is included as a complement to the Comprehensive Annual Financial Report (CAFR). The Enterprise Compliance Branch (Enterprise Compliance) of the California Public Employees' Retirement System (CalPERS) is responsible for coordinating, supporting, and promoting an effective enterprise-wide ethics and compliance program. Enterprise Compliance is at the forefront of compliance and ethics at CalPERS, working to protect the enterprise by ensuring we are following all the laws and regulations that govern our business.

Consistent with the CalPERS core values of Integrity, Openness, and Accountability, Enterprise Compliance is keenly aware of our responsibility to exemplify ethical behavior and practices for nearly 3,000 fellow team members. To leverage our effectiveness, our staff of 26 team members embraces partnerships with other program areas to maximize our impact. These partnerships across the enterprise enable us to raise awareness about compliance and ethics. They also help us reinforce our belief that compliance is the personal responsibility of every CalPERS team member.

Enterprise Compliance also recognizes that effective compliance programs grow organically; our job is to make sure everyone knows how they can positively impact our organization. For instance, we have embedded compliance liaisons in some of our largest program areas who serve as first line compliance experts. We are grateful for their participation and partnership throughout the CalPERS organization.

Marlene Timberlake D'Adamo

Marlene Timberlake D'Adamo
Chief Compliance Officer

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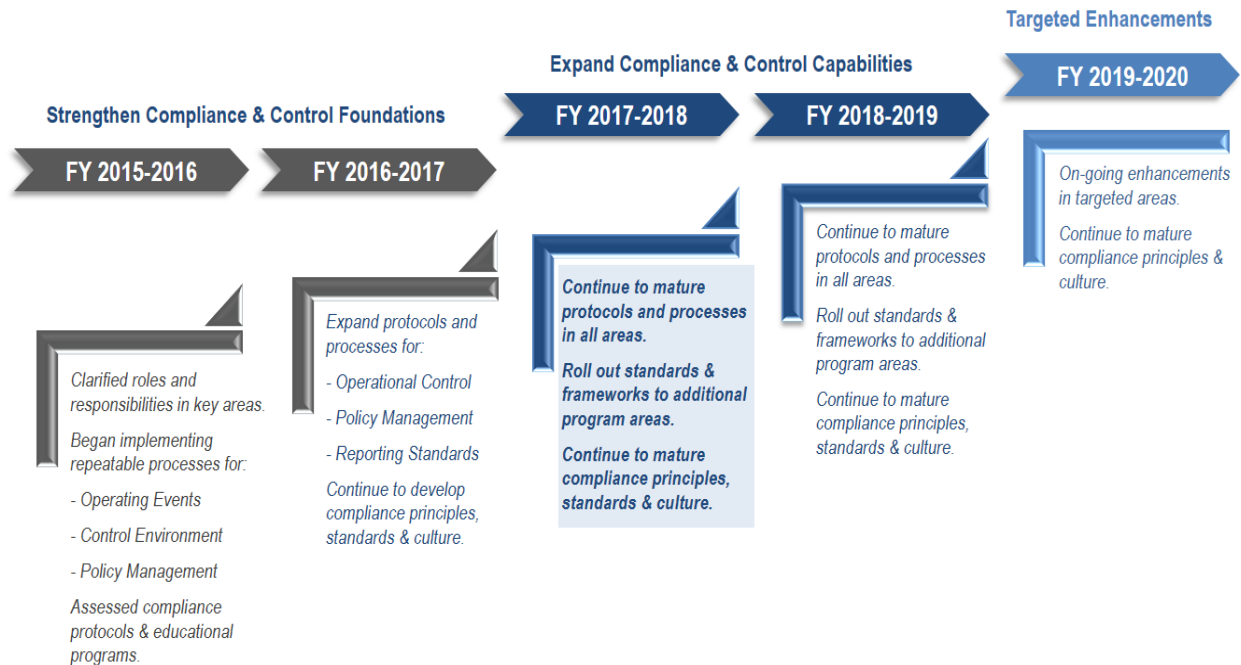September 25, 2018
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CULTURE OF COMPLIANCE

We strive to make compliance embedded into the CalPERS strategy, culture, and day-to-day business operations. All of Enterprise Compliance's activities and accomplishments directly support our organization's strategic plan and core values.

In 2015, Enterprise Compliance developed a new multi-year compliance plan, building upon the already effective compliance practices in place. The five-year compliance plan is aimed at building and enhancing compliance capabilities to mature the program and is consistent with changes in the broader compliance landscape (see Figure 1). The compliance plan focuses on strengthening our compliance and ethics program by fostering a culture of compliance, clarifying the compliance governance structure, and providing our CalPERS Board and management with compliance tools and information to fulfill their oversight responsibilities. We believe that compliance is everyone's responsibility throughout the organization.

Our compliance plan moves us towards implementing activities designed to strengthen our culture of compliance. A strong compliance culture is fundamental to a risk intelligent organization and supports our strategic goal.

Figure 1: Five- Year Compliance Plan

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INTERGRATED ASSURANCE MODEL: THREE LINES OF DEFENSE

To implement our governance, risk, and compliance practices, we have embraced an Integrated Assurance Model to promote a multi-faceted approach to compliance awareness and accountability. The model centers on a Three Lines of Defense framework (see Figure 2), which promotes collaboration and an increased understanding of roles and responsibilities to detect, prevent, and correct instances of non-compliance.

Figure 2: Integrated Assurance Model
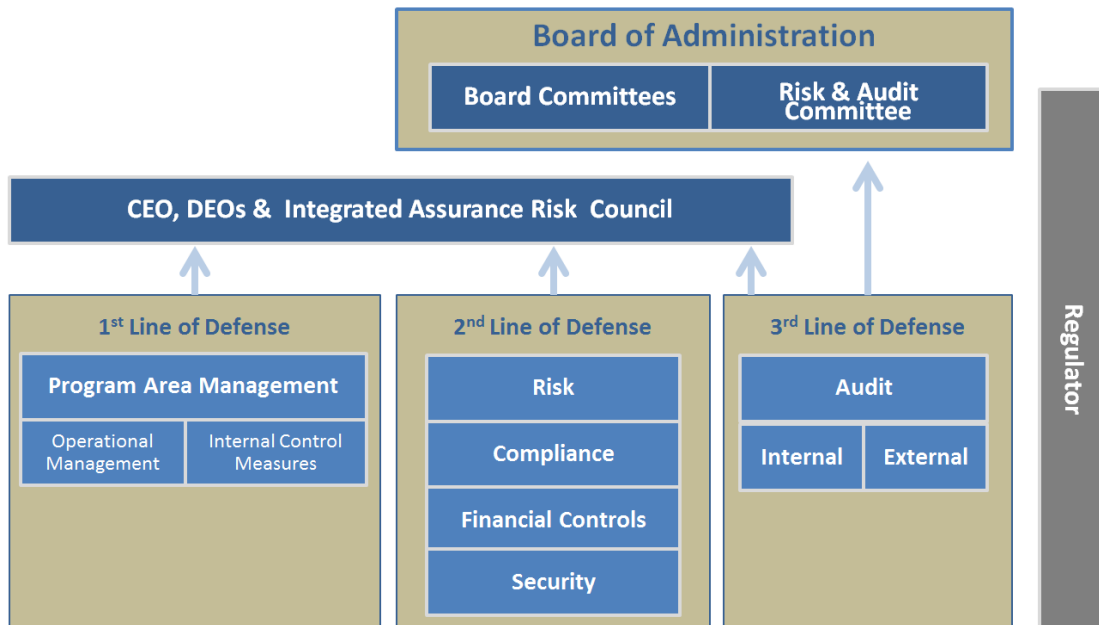
(Figure 2)

- **First Line of Defense** – The first level of the control environment are the program areas, which perform day-to-day risk management activities. In addition to performing day-to-day operations, the functional areas are responsible for compliance and risk mitigation.
- **Second Line of Defense** – The Enterprise Compliance Branch and Enterprise Risk Management Division partner collaborate to provide oversight, guidance, monitoring of governance, risk, and compliance activities. As a result of this partnership, we are able to support the organization in mitigating strategic and operational risks along with strengthening the organization's control environment and promoting strong ethical

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business practices. To demonstrate this alignment, both work closely together to develop and implement their annual plans.

- **Third Line of Defense** – Internal audits provides independent assurance on the effectiveness of governance, risk management, and internal controls. The Office of Audit Services participates in a joint organization wide-risk assessment with the Risk and Compliance offices. This coordination assists with the development of a common view of risk across the organization.

The Integrated Assurance Model helps clarify roles and responsibilities and promote ownership of compliance throughout the organization. Through the Three Lines of Defense, CalPERS encourages a culture of doing the right thing. By fostering a work environment based on our core values of quality, respect, integrity, openness, accountability and balance, CalPERS also recognizes that compliance is everyone's responsibility. The partners within the Integrated Assurance Model hold monthly working sessions to collaboratively discuss, plan, and receive feedback on each party's inter-related efforts. These monthly meetings help ensure cooperation and improve timing of reviews by reducing over-lapping efforts and encourage collaboration with the program areas.

FISCAL YEAR 2017-18 ETHICS AND COMPLIANCE PROGRAM INITIATIVES HIGHLIGHTS

Enterprise Compliance is guided by compliance standards set out in a variety of federal and state guidelines. Federal Sentencing Guidelines identify consistent, continuous promotion and enforcement of compliance and ethics standards as essential components of an effective compliance program. The California State Leadership Accountability Act also sets compliance industry best practices, benchmarks, and organizational needs for the state agencies of California.

Through our internal partnerships, Enterprise Compliance identified program areas and topics where additional time and attention are necessary to continue to meet compliance requirements, support ethical behaviors and ensure overall organizational integrity.

ENTERPRISE COMPLIANCE BRANCH
The Enterprise Compliance Branch is committed to ensuring CalPERS maintains compliance with the letter and spirt of all applicable laws, regulation, and policies in partnership with program areas. This Branch is comprised of four units:
- o Enterprise Compliance Monitoring and Oversight,
- o Enterprise Ethical Standards and Investigations,
- o Enterprise Policy and Delegation Management, and

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o Enterprise Compliance Operations, Communications, and Reporting.

Enterprise Compliance Monitoring and Oversight Unit

This unit is responsible for developing consistency in program area compliance activities and ongoing monitoring and reporting of the enterprise.

Compliance Monitoring and Oversight

- Implemented regular monitoring of Investment decision-making materials and incorporated reporting of Investment Policy violations to the Risk and Audit Committee
- Conducted targeted compliance reviews and compliance monitoring of program areas
- Developed framework to track legislative change implementation

Embedded Compliance Program

- Partnered with embedded compliance liaisons to strengthen compliance controls, oversight, and awareness
- Collaborated with Customer Services and Support and Operations and Technology liaisons to create and adopt Branch compliance plans
- Clarified roles and responsibilities for new Financial Office and Health Policy and Benefits Branch compliance liaisons

Enterprise Ethical Standards and Investigations Unit

This unit oversees all ethics policies and conflict of interest disclosures. The unit is involved in many business areas of CalPERS where decision makers are required to file the Statement of Economic Interests From 700 to stay in compliance with the California Fair Political Practices Commission regulations. This unit also oversees the Ethics Helpline, which is a reporting tool for anonymous complaints that are then researched and investigated by appropriate program areas.

Conflicts of Interest

- Aligned Conflict of Interest Rules with vendor management process
- Created contract review tools to improve consultant Form 700 filing processes
- Developed new training and improved communications process to better outline vendor Form 700 roles and responsibilities for contract mangers and compliance liaisons
- Enhanced reporting and outreach to all Form 700 filers

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Ethics Laws & Policies Oversight

- Evaluated, revised, and consolidated CalPERS ethics-related laws and policies
- Reviewed and prepared revisions to CalPERS Statement of Incompatible Activities
- Conducted review of CalPERS Conflict of Interest Code, including assessments of new classification for potential Form 700 filer requirements
- Created a roadmap of all ethics-related policies to be combined into a single manual for clarity and ease of understanding
- Enhanced program administration to ensure consistency across intake channels
- Standardized the tracking and reporting of Ethics Helpline cases in the ethics case management system
- Completed the transition to online tracking/reporting through our ethics case management system

Enterprise Policy and Delegation Management Unit

This unit has the responsibility for maintaining a policy and authoritative source governance program. The purpose of this program is to maintain current comprehensive policies, delegations and charters conveying CalPERS expectations. CalPERS has established enterprise-wide standards for policy management and delegations of authority consistent with professional best practice.

Policy Management

- Expanded frameworks to include guidance on committee governance and guidelines
- Developed governance framework, including standardized templates for committee charters and bylaws
- Developed on-demand policy training materials, to support CalPERS team members in navigating each step of the Enterprise policy lifecycle

Delegation Management

- Aligned Board-approved policies and reporting with Board delegations of authority
- Developed a framework to ensure Board Committee reporting complies with Committee delegations of authority
- Conducted preliminary historical assessment of Board Agenda Items for future alignment with Board Delegations of Authority in support of enterprise efforts to streamline and improve Board Reporting

Compliance Operations, Communications and Reporting Unit

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The Compliance Education, Communications, and Reporting unit is responsible for external mandated reporting, communications, education, and training.

Communications

- Continued to enhance compliance education and communication
- Developed and rolled out the Compliance Discussion Guides to align Core Values with compliance principles to help initiate conversations on building a strong ethical culture
- Hosted Second Annual National Compliance and Ethics Week in November 2017, including an Executive Panel Discussion on Ethical Leadership for managers and an Enterprise Compliance open-house
- Sponsored onsite training on Compliance Metrics Development
- Published InCalPERS articles and the Spark (an internal social media platform) weekly posts highlighting compliance related priorities, team members and topics
- Presented CalPERS Compliance Program at the 2017 Education Forum
- Participated in outreach events to create awareness of the compliance program during CalPERS Career Fair and Take Our Daughters and Sons to Work Day
- Set baselines for Employee Awareness Survey, Stakeholder Assessment, and Maturity Program Assessment that support the CalPERS Five-Year Strategic Goal

Compliance Reporting

- Continued to expand compliance reporting to include program operations
- Updated the Enterprise Compliance Activity Report with additional metrics, including trend information
- Incorporated Investment Office, Operations and Technology Branch, and Customer Services and Support into the Enterprise Compliance Fiscal Year 2017-18 Mid-Year Plan Update

EMBEDDED COMPLIANCE PROGRAM

An important strategy Enterprise Compliance uses to help meet compliance efforts is partnering with embedded compliance liaisons in key program areas to provide reporting mechanisms and help solidify the enterprise-wide culture of compliance. Embedded liaisons are individuals or team members that have a portion of their job function to help their program areas promote, coordinate, and facilitate compliance efforts. Sometimes referred to as Compliance Champions, the embedded

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compliance liaisons often help bridge compliance concerns between Enterprise Compliance and program team members.

Health Policy and Benefits Branch

The Health Policy and Benefits Branch (HPBB) administers and oversees the CalPERS Health Benefits Program and Long-Term Care Program. HPBB is composed of the following divisions:
- o Health Account Management Division
- o Health Benefits Administrative Support
- o Health Plan Administration Division
- o Health Policy Research Division

Policy Management

- Implemented health benefit delivery policies and procedures in compliance with the administration of the Public Employees' Medical and Hospital Care Act (PEMHCA) and Affordable Care Act (ACA)

Compliance Monitoring and Oversight

- Conducted semi-annual my|CalPERS user access reviews to comply with information security standards

Compliance Reporting

- Developed and submitted annual report on health premium increases and decreases pursuant to the Budget Act of 2015 (Stats. 2015, Ch 10, Sec. 2.00, Item 7900-015-0822 (2))

Health Benefits Program
- Developed and submitted an annual report on Health Benefits Program pursuant to California Government Code Section 22866(a)

Customer Services and Support Branch

The Customer Services and Support (CSS) branch administers health and pension benefits as well as related services to our members and business partners, delivering end-to-end customer service that is adaptive to our customers' needs. Within CSS, the Embedded Compliance program supports a coordinated effort in ensuring compliance with applicable laws, regulations and polices which govern our business.

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Communication

- Led efforts to address significant changes in the audit compliance and resolution process through the Audit Resolution Project
- The team developed a six-month process that incorporated communications, education, escalation, and enforcement phases
  - Provides structure and uniformity to increase efficiencies within CalPERS and with our business partners
  - Increased interactions and reduced response times resulted in 100 percent of surveyed agencies reporting they were "very satisfied" with the audit resolution process.

Compliance Monitoring and Oversight

Service Credit Purchase Elections Compliance
- Successfully resolved over 170 survivor benefit cases that did not receive a Service Credit purchase payment
- Collected over $1.1 million in outstanding accounts receivables contributing to the overall sustainability of the fund

Compliance Reporting

- Worked with business partners to reconcile retirement appointments in my|CalPERS and reduced the number of outstanding unreconciled appointments by 126,000, a reduction of over 50 percent
- Reduced the number of participant retirement enrollment appointments with missing payroll over 12-months by 94 percent

Investment Office
The Investment Compliance and Operational Risk office serves as an embedded compliance function and assists our Investment Office staff by ensuring compliance with key policies, laws, and regulations that impact the Investment Office.

Compliance Monitoring and Oversight

- Partnered with Investment Office's asset classes to produce and present the Assembly Bill (AB) 2833 (Alternative Investment Fee Transparency) report to the Investment Committee as part of the disclosure for Public Investment Funds

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Controls Enhancements
- Worked with the Global Fixed Income team to design and implement additional controls to enhance pre-trade compliance reviews

Compliance Reporting

- Continued to lead the Investment roadmap initiative relating to broker selection and evaluation practices; and associated reporting and governance activities

Operations and Technology Branch
The Operations and Technology (OPT) Branch encompasses a wide range of Enterprise-wide operational support functions, including Enterprise Solutions Development Division, Enterprise Strategy and Performance Division, Human Resources Division, Information Security Office, Information Technology Services Branch, Operations Support Services Division, Retirement Research & Planning Davison, Technology Business Management Division, and Technology Infrastructure Services Division. The OPT Embedded Compliance Team acts as branch liaisons between OPT divisions and Enterprise Compliance, the Enterprise Risk Management Division and the Office of Audit Services, to help ensure compliance with mandatory training and disclosures, assist with policy creation and updates, and ensure compliance with contracting delegations of authority, as well as coordinating resolution of audit findings within OPT.

Information Technology Services
The Information Technology Services Branch (ITSB) partners with CalPERS business stakeholders to design and implement technology solutions that add business value and deliver customer focused results. These services include system analysis, design, programming, testing, implementation, and maintenance for major computer systems and databases. ITSB also provides technical support and training for personal computers, local area networks, and office automation facilities.

Compliance Monitoring and Oversight

- Coordinated and led the completion of the Identity Access Management Policy and Program which provides governance, oversight and management of enterprise identity and access management processes. The Identity Access Management Program's goal is to ensure that the right people have the right access, at the right time

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- Facilitated the appropriate, timely management of user identities, and associated system access throughout the enterprise and by automating on-boarding, allowing for a streamlined user-provisioning and account set-up process

Human Resource Services Division

The Human Resources Division leads the enterprise strategies in talent management practices to acquire, develop, motivate and retain a diverse, high-performing workforce, in compliance with applicable laws, rules and regulations.

Policy Management

- Partnered with Enterprise Compliance to develop and begin work on a formal policy management plan, to ensure all human resource policies are up to date and working as intended, in compliance with enterprise standards

Conflicts of Interest

- Enhanced Conflicts of Interest process
- Refined Form 700 notification process by using PeopleSoft
- Human Resources and Enterprise Compliance developed a process to streamline identification of new staff or staff moving into positions required to file Form 700

Communications

- Improved Human Resources Process Documentation
- Worked with program staff to develop and improve process maps and desk manuals to provide consistency and ensure compliant processes.

- Enhanced Human Resources Leadership Development
- Offered CalPERS leaders multiple opportunities for leadership training that counted toward the 20-hour requirement of ongoing biennial/leadership development training as stated in California Government Code 19995.4 (a total of 157 possible Continuing Education Credits (CECs) can be earned by one leader through these offerings):
  - o 15 seven-hour Leadership Development classes (7 CECs each/105 CECs possible)
  - o One two-day workshop of Executive Presentation Skills (14 CECs)

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- One two-day coaching clinic for 25 Emerging Leader Program mentors (20 CECs for each participant)
- Two Leadership Forums (3 CECs for each leader in attendance)
- One Executive Presentation Skills Panel Member Opportunity (2 CECs)
- Five Supervisory Skills Enhancement classes (2 CECs each/10 CECs possible)

Compliance Reporting

Improved Mandatory Training Reporting
- Operations and Technology Branch's embedded compliance team facilitated their branch's approximate 100% completion rate of mandatory trainings, Form 700 filings, and Personal Trading attestations.

Operations Support Services Division
The Operations Support Services Division (OSSD) provides a variety of essential support services to the CalPERS Board, management, and staff. These include contracts management, copy and printing services, facilities and building management, mailroom and receiving services, parking and rideshare, purchasing, records and asset management and CalPERS Board Elections.

Embedded Compliance Program

- Collaborated with Enterprise Compliance Branch's Targeted Compliance Review of contracting practices
- Conducted a targeted compliance review of contracting practices resulting in strengthened internal controls
- Operations Support Services Division and Enterprise Compliance and presented to the Integrated Assurance Risk Council in March 2018
- Created a new Spring-Fed Pool/Letter of Engagement unit to support effective administration and oversight of Spring-Fed Pools
- Developed an enterprise-wide training/education plan regarding proper Spring-Fed Pool/Letter of Engagement use and is currently drafting procedures to standardize the letter of engagement process across the enterprise

SUMMARY
The compliance efforts at CalPERS continues to mature and make progress. The efforts of dedicated compliance resources and our internal partners is an investment in the long-term foundation of CalPERS culture of ethical behavior and the processes that strengthen internal controls. Elements of compliance can be found interwoven in all six of CalPERS Core Values of

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Quality, Respect, Accountability, Integrity, Openness, and Balance. Enterprise Compliance takes pride in helping with these efforts and will continue to give guidance and direction to help CalPERS continue to build a sustainable future based on a strong foundation of integrity and compliance.