



Risk and Audit Committee

Agenda Item 6b

September 17, 2019

Item Name: Strategic Risk Measures

Program: Enterprise Risk Management

Item Type: Information

Executive Summary

The purpose of this item is to provide the Risk and Audit Committee (Committee) with status on the Strategic Risk Measures (SRMs) for the fourth quarter (April 1, 2019 through June 30, 2019) of fiscal year 2018-19 (Attachment 1). Also, in response to Committee direction to explore short and intermediate term metrics, three additional Fund Sustainability measures are included for consideration (Attachment 2).

Pending Committee direction, the new SRMs will be incorporated into the quarterly SRM Dashboard and reported in February 2020. The Enterprise Risk Management Division (ERMD) also recommends eliminating the current long-term employer contribution measures as we believe the proposed measures will add more value.

Strategic Plan

This agenda item supports the 2017-22 CalPERS Strategic Plan Goals of Fund Sustainability: Strengthen the long-term sustainability of the pension fund and Risk Management: Cultivate a risk-intelligent organization. ERMD provides assurance to the Board of Administration (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 promote risk informed decision-making at both the strategic and operational levels across the enterprise. The monitoring and reporting of SRMs play an important role in understanding the relationship between risk and performance by providing the Board and management with advanced warnings of events that may compromise the achievement of strategic and operational goals.

The SRMs and tolerances provided were reviewed by the Committee in June 2018 and are intended to provide management with clear direction on risk acceptance and trade-offs. The risk tolerances are categorized into three levels: managed appropriately (green), monitoring required (yellow), and attention required (red). SRMs are reviewed continually with the program areas

and leadership in an iterative process to ensure the current SRMs are providing accurate indications of risk.

Analysis

There are two SRM reports provided to the Committee in this agenda item that are included in Attachment 1. First, the SRM Dashboard summarizes the status of all the SRMs. Secondly, Enterprise Risk Measure Detail reports are included on an exception basis. They detail the risk performance, root cause analysis, and mitigations identified as next steps to reduce the risk for those SRMs that are performing outside of the Board's risk tolerance and require attention.

A review of data reported during the fourth quarter found three SRMs under the goals of Fund Sustainability and Reduce Complexity exceeded the risk tolerance set by the Committee and require attention. An analysis and root cause of the risks can be found in the SRM Detail.

Fund Sustainability

- The measures are updated annually in November and reporting results will not change in subsequent quarters until the data is refreshed.

Reduce Complexity

- Externally proposed bills that have the potential to increase the complexity of the plan design, accounted for quarterly as a point in time metric.
- The Board was most recently apprised of these bills during the August 2019 state and federal legislation update.

Proposed Fund Sustainability Measures

In response to Committee direction to explore short and intermediate term metrics, ERMD proposes three new risk measures that can be viewed in attachment 2. The measures graphically depict the impact of five investment return scenarios on the PERF funded status and employer contribution rates for typical safety and miscellaneous plans. These measures dovetail nicely with the new tool the actuarial office developed that will be presented to the Finance and Administration Committee (FAC) this week.

Investment return: Funded status impact

There are many points of information regarding the impact of investment returns on the PERF funded status at any point over the next ten years. The following are examples gleaned from the measure:

- If the seven percent target investment return is achieved over ten years, the estimated resulting PERF funded status would be 86 percent.
- A nine percent investment return over ten years would result in an estimated 99 percent PERF funded status.
- A five percent investment return over ten years would result in an estimated 74 percent PERF funded status.

Investment return: Employer contribution rate impact

There are many points of information regarding the impact of investment returns on employer contribution rates at any point over the next ten years. The following are examples gleaned from the measure:

- If the seven percent target investment return is achieved over ten years, the estimated resulting safety and miscellaneous contribution rates would be 50 percent and 26 percent respectively.
- A nine percent investment return over ten years would result in an estimated 38 percent safety and 19 percent miscellaneous contribution rates respectively.
- A five percent investment return over ten years would result in an estimated 61 percent safety and 33 percent miscellaneous contribution rates respectively.

Proposed Fund Sustainability Measures future reporting

Pending affirmative Committee direction, ERMD will incorporate the three proposed Fund Sustainability measures within the Strategic Risk Measures Dashboard and begin reporting on them at the FY quarter three RAC meeting. We also recommend that the current 30-year measures be discontinued. These measures will continue to be reported to the FAC in the annual Funding Levels and Risk Report presented by the actuarial office.

Budget and Fiscal Impacts

Not Applicable

Attachments

Attachment 1 – Enterprise Risk Measures Dashboard

Attachment 2 – Enterprise Risk Measure

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