

MEETING
STATE OF CALIFORNIA
PUBLIC EMPLOYEES' RETIREMENT SYSTEM
BOARD OF ADMINISTRATION
RISK AND AUDIT COMMITTEE
OPEN SESSION

ROBERT F. CARLSON AUDITORIUM
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SACRAMENTO, CALIFORNIA

TUESDAY, SEPTEMBER 17, 2019

10:15 A.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
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A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. David Miller, Chairperson
Ms. Lisa Middleton, Vice Chairperson
Ms. Margaret Brown
Ms. Fiona Ma, represented by Mr. Matthew Saha
Ms. Stacie Olivares
Mr. Jason Perez
Ms. Betty Yee, represented by Ms. Lynn Paquin

BOARD MEMBERS:

Mr. Rob Feckner
Ms. Eraina Ortega
Ms. Mona Pasquil Rogers
Mr. Ramon Rubalcava

STAFF:

Ms. Marcie Frost, Chief Executive Officer
Mr. Matthew Jacobs, General Counsel
Ms. Marlene Timberlake D'Adamo, Chief Compliance Officer
Mr. Forrest Grimes, Chief Risk Officer
Ms. Carrie Lewis, Committee Secretary

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1 P R O C E E D I N G S

2 CHAIRPERSON MILLER: Okay. Good morning. I'm
3 going to call the Risk and Audit Committee to order.

4 COMMITTEE MEMBER BROWN: They're not listening.

5 CHAIRPERSON MILLER: There we go. That's okay.
6 They don't need to listen. I'll whisper and then they'll
7 listen.

8 (Laughter.)

9 CHAIRPERSON MILLER: Okay. So we're getting
10 started here with Risk and Audit Committee this morning.
11 And we'll start with a call to order and roll call,
12 please.

13 COMMITTEE SECRETARY LEWIS: David Miler?

14 CHAIRPERSON MILLER: Here.

15 COMMITTEE SECRETARY LEWIS: Lisa Middleton?

16 VICE CHAIRPERSON MIDDLETON: Present.

17 COMMITTEE SECRETARY LEWIS: Margaret Brown?

18 COMMITTEE MEMBER BROWN: Here.

19 COMMITTEE SECRETARY LEWIS: Matthew Saha for
20 Fiona Ma?

21 ACTING COMMITTEE MEMBER SAHA: Here.

22 COMMITTEE SECRETARY LEWIS: Stacie Olivares?

23 COMMITTEE MEMBER OLIVARES: Here.

24 COMMITTEE SECRETARY LEWIS: Jason Perez?

25 COMMITTEE MEMBER PEREZ: Here.

1 COMMITTEE SECRETARY LEWIS: And Lynn Paquin for
2 Betty Yee?

3 ACTING COMMITTEE MEMBER PAQUIN: Here.

4 CHAIRPERSON MILLER: Okay. We'll go with the
5 approval of the September 17th, 2019 Risk and Audit
6 Committee timed agenda.

7 COMMITTEE MEMBER BROWN: Move approval.

8 CHAIRPERSON MILLER: Moved by Ms. Brown.

9 ACTING COMMITTEE MEMBER PAQUIN: Second.

10 CHAIRPERSON MILLER: Seconded by Ms. Paquin.

11 I'll call for the question.

12 All in favor?

13 (Ayes.)

14 CHAIRPERSON MILLER: Any nays?

15 Any abstentions?

16 No. The motion carries.

17 And onto the Executive Report with Ms. Timberlake
18 D'Adamo.

19 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

20 Good morning, Mr. Chair, Madam Vice Chair,
21 members of the Committee and Board members. Marlene
22 Timberlake D'Adamo, CalPERS team member.

23 Today, we have two information items for your
24 review, the 2018-19 Annual Compliance Report that covers
25 ethics and compliance program initiative highlights for

1 the fiscal year ending June 30th, 2019. And we also have
2 a fourth quarter update for the Enterprise Risk Management
3 Strategic Risk Measures. In response to Committee
4 direction to explore short- and long-term metrics, three
5 new fund sustainability measures are also included in this
6 report.

7 The next Risk and Audit Committee meeting is
8 scheduled for November 19th, 2019 and includes the
9 independent auditor's report for fiscal year 18-19, the
10 review of the independent auditor's management letter, and
11 the enterprise risk management framework.

12 Thank you, Mr. Chair. This concludes my report.
13 And I'd be happy to take any questions.

14 CHAIRPERSON MILLER: Seeing no questions.

15 We'll move to Item 4, Action Consent Items,
16 approval of the June 18th, 2019 Risk and Audit Committee
17 meeting minutes.

18 COMMITTEE MEMBER BROWN: Move approval.

19 CHAIRPERSON MILLER: Moved by Ms. Brown.

20 COMMITTEE MEMBER PEREZ: Second.

21 CHAIRPERSON MILLER: Seconded by Mr. Perez.

22 I'll call for the question.

23 All in favor?

24 (Ayes.)

25 CHAIRPERSON MILLER: Any opposed?

1 No abstentions.

2 Motion carries.

3 So Item 5 is information consent items. I've
4 asked for 5b to be pulled. So if there's nothing else to
5 be pulled --

6 COMMITTEE MEMBER BROWN: 5d for me.

7 CHAIRPERSON MILLER: 5d. Okay. So this will be
8 5 A, C, E, and F. So I'll call for the question.

9 All in favor?

10 (Ayes.)

11 CHAIRPERSON MILLER: Any opposed?

12 Abstentions?

13 Do I need a second on that? Is there a committee
14 vote, so I probably need a second.

15 GENERAL COUNSEL JACOBS: These are information
16 consent, you don't need a motion.

17 CHAIRPERSON MILLER: So I don't. Okay. No vote.
18 Okay. Great. I'm learning as we go.

19 So let's start then with 5b, draft agenda for the
20 November 19th, 2019 Risk and Audit Committee meeting. And
21 I will recognize Ms. Middleton on this one.

22 There you go.

23 VICE CHAIRPERSON MIDDLETON: Okay. Thank you,
24 Mr. Chair.

25 Ms. Brown has approached both of us by electronic

1 communication asking for a review of our policies when it
2 comes to the confidentiality of audit reports. I think
3 that's a very appropriate thing for the Committee to do.
4 With the consent of the Committee, I would like to ask
5 staff in the November report to us to include an overview
6 of our current practices as it relates to the
7 confidentiality of audit reports, to review best practices
8 for organizations in the maintenance of confidentiality of
9 reports, current law, and to provide staff's
10 recommendations for changes, if any, to our current
11 practices.

12 CHAIRPERSON MILLER: And the Chair would concur
13 with that. And I want to go to Margaret. There you go.

14 COMMITTEE MEMBER BROWN: Thank you, Ms.
15 Middleton. I appreciate you adding that to the agenda.
16 And I'd just like to make sure it includes any written
17 policies and procedures we currently have in place as
18 well. So I really appreciate you bringing that up, so we
19 all can be very clear on what we're doing moving forward.

20 Thank you.

21 CHAIRPERSON MILLER: Yeah. Thanks to you, both.
22 I think that's direction.

23 Okay. And we've got 5d, if there's nothing
24 further on 5b. So that's back to Margaret Brown.

25 COMMITTEE MEMBER BROWN: Great. So could we put

1 up attachment 1, page 1 of 1? That's that really simple
2 little bar chart that shows exceptions to the audit
3 report. Do we have someone that can pull that up?

4 It's not.

5 So basically we get these simple little bar
6 charts, Ms. D'Adamo that tell us sort of the progress of
7 the audits. And it talks about the public agency, how
8 many are resolved and how many are open. The internal
9 audits, these are the ones I have a question about that
10 we're going to talk about whether or not they should be
11 public or they need to stay confidential.

12 But the real problem is, is there's 27 open
13 audits, two have been resolved. But we actually as a
14 Committee never discussed those, not in open session or in
15 closed session. We don't discuss what those open audits
16 are and if any of them are truly material. I mean, if
17 they're -- if they're an audit finding, then technically
18 they're material. And I just think that we are not
19 providing our duty of oversight if we aren't discussing
20 those. And we actually can't discuss those, because
21 they're confidential currently right now.

22 So I just want to bring that up, because it's
23 probably -- we could do financial statements and we can do
24 public agency -- all the agencies we evaluate, but not the
25 internal audits as they relate to CalPERS. And I think

1 that really is a problem as a fiduciary and as for
2 transparency to our members.

3 So I just want to say that I'd like to go into
4 that further, but I'm not permitted to at this time. So
5 thank you.

6 CHAIRPERSON MILLER: Okay. Any further comments
7 or questions on this?

8 Okay. We'll move on to Item 6, Information
9 Agenda Items starting with 6a, 2018-2019 Annual Compliance
10 Report. Back to you again, Ms. D'Adamo.

11 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:

12 Thank you. Each year, CalPERS compiles an annual
13 compliance report. The report is a summation of
14 compliance activities performed by many of our first and
15 second line of defense partners.

16 The format and organization of this report is
17 very similar to last year's report. It consists of
18 compliance highlights from several partners -- corners of
19 the organization, including Enterprise Compliance and our
20 embedded compliance liaisons.

21 To better align with industry best practices, and
22 in consultation with our independent auditor and Financial
23 Office, the annual compliance report this year will be
24 posted to the CalPERS website, rather than be made a part
25 of the CAFR that -- the Consolidated Annual Financial

1 Report. And we're doing that because we want to keep the
2 CAFR pure as an audited document. The annual compliance
3 report is not an audited document. It is a summation of
4 activities that are occurring within the organization.

5 The overview of the report, it is, as you have it
6 with you, it is an overview document that talks about our
7 three lines of defense. It talks about the compliance
8 activities that have been performed by the Enterprise
9 Compliance Department and then as well as highlights
10 activities -- compliance activities that have been
11 performed by our embedded compliance and risk liaisons.

12 And so with that, I will take any questions if
13 anyone has any on the report.

14 CHAIRPERSON MILLER: I'm seeing no requests for
15 questions.

16 Thank you very much.

17 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:
18 Great. Thank you.

19 CHAIRPERSON MILLER: On to 6b, Strategic Risk
20 Measures. Team member Forrest Grimes. Welcome.

21 CHIEF RISK OFFICER GRIMES: Thank you.

22 (Thereupon an overhead presentation was
23 presented as follows.)

24 CHIEF RISK OFFICER GRIMES: Good morning, Mr.
25 Chair, Committee members, members of the Board and thank

1 you for attending.

2 Item -- I'm Forrest Grimes, CalPERS team.

3 Item 6b consists of two parts, quarterly
4 enterprise risk measures dashboard and exception reports.
5 This was first presented to the Risk and Audit Committee
6 in June of 2019. These can be seen on page 69 through 73
7 of your Board books.

8 And the proposed new measures for fund
9 sustainability in response to Vice Chair Middleton's
10 request for medium- and short-term measures. And you can
11 view those on pages 74 and 75 of your Board books.

12 And I would like to focus our discussion on the
13 proposed new measures, unless you have questions on the
14 dashboard or exception reports.

15 So, Mr. Chair, I'm going to stop here and see if
16 there are questions on those prior documents.

17 CHAIRPERSON MILLER: Oh, I am seeing. Here's an
18 opportunity for Ms. Middleton to ask her question.

19 VICE CHAIRPERSON MIDDLETON: I knew I needed to
20 ask for this. But looking at pages 74 and 75 did not make
21 dinner any easier to get through.

22 (Laughter.)

23 CHIEF RISK OFFICER GRIMES: You should have
24 waited till after dessert probably. I should have warned
25 you about that.

1 (Laughter.)

2 VICE CHAIRPERSON MIDDLETON: There are -- these
3 numbers are alarming, so -- as we start to look at our
4 budgetary processes in municipalities. Can you talk about
5 the methodology used in coming up with these numbers?

6 CHIEF RISK OFFICER GRIMES: Certainly. So I'll
7 just start getting into those two pages. So for the rest
8 of the Committee and Board members, please focus your
9 attention on pages 74 and 75. Basically, these measures
10 really do highlight, as Ms. Middleton suggested, the
11 inverse relationship between investment returns and
12 contribution rates, those two pages.

13 And the new measures were really developed in
14 conjunction with the Actuarial Office. And they were
15 approved by ALMAC, which is the Asset Liability Management
16 Advisory Committee, an internal committee.

17 Now, these measures I will point out do dovetail
18 quite nicely with the pension navigator tool that was
19 presented in the Finance and Administration Committee this
20 morning, which is really kind of how we got the ideas to
21 come up with them.

22 But, you know, as was pointed out, they're
23 alarming if you start looking at the higher and lower
24 limits. But I think the measures, just even today, tell a
25 very interesting story, because you can see that the

1 short-term measure is yellow, the intermediate-term
2 measure is red, and the long-term measure is green.

3 So you can kind of look at it as a -- we consider
4 ourselves long-term investors.

5 VICE CHAIRPERSON MIDDLETON: Um-hmm.

6 CHIEF RISK OFFICER GRIMES: So really, as Kerry
7 pointed -- Kerry and Scott in their presentation to FAC,
8 you know, moments ago.

9 Really, you have to kind of look at this as a --
10 over the long term. And so I think, Ms. Middleton, in
11 your role as a city councilperson, you would probably have
12 those kind of discussions regarding the upper and lower
13 ends of performance and then decide how you would deal
14 with them accordingly. And I think that's really what
15 these measures point out, which I think is a much more
16 useful discussion and much more useful measures than
17 certainly once in a 30-year opportunity --

18 VICE CHAIRPERSON MIDDLETON: Right.

19 CHIEF RISK OFFICER GRIMES: -- that you were
20 talking about last time that we presented this.

21 VICE CHAIRPERSON MIDDLETON: Agreed. And could I
22 take you back a couple of pages to page 69?

23 CHIEF RISK OFFICER GRIMES: Yes.

24 VICE CHAIRPERSON MIDDLETON: And could you talk
25 about the -- what is in red, the potential for both high

1 or sharp contribution increases on the part of employers
2 and the probability indexes that you have for them?

3 CHIEF RISK OFFICER GRIMES: Certainly. If you
4 want to get into any detail, I'm going to ask one of the
5 actuaries to come up.

6 VICE CHAIRPERSON MIDDLETON: Okay.

7 CHIEF RISK OFFICER GRIMES: But I'm going to
8 start at a high level and then you can really ask for more
9 detail, if you'd like.

10 VICE CHAIRPERSON MIDDLETON: You'll probably blow
11 by me at the high level, so...

12 CHIEF RISK OFFICER GRIMES: Okay. So the thing
13 here is that this particular -- these measures really
14 originated in the funding levels and risk report that is
15 presented to the FAC normally in November. I believe it
16 is that kind of a time frame.

17 And they really are saying what is the
18 opportunity for these sharp spikes or high contribution
19 rates between now and 30 years from now in any given year?
20 Which I think last time you pointed out to us, well,
21 that's really not helping me, because I think I want to
22 quote you as saying I'm going back to tonight to approve a
23 budget for my city tomorrow. And I'm really not going to
24 be thinking about 30-year time horizons. So that's really
25 what we're talking about.

1 And I think it's a useful piece of information at
2 the funding level and risk report. But in terms of this
3 Committee and this Board's kind of discussions and
4 decisions that you all make --

5 VICE CHAIRPERSON MIDDLETON: Um-hmm.

6 CHIEF RISK OFFICER GRIMES: -- I think that it's
7 far too -- too long term.

8 VICE CHAIRPERSON MIDDLETON: All right. That's
9 very helpful to know that that is a probability for any
10 given year --

11 CHIEF RISK OFFICER GRIMES: Yes.

12 VICE CHAIRPERSON MIDDLETON: -- over the course
13 of 30. That is --

14 CHIEF RISK OFFICER GRIMES: Yes, that's right.

15 VICE CHAIRPERSON MIDDLETON: Thank you. That's
16 helpful.

17 CHAIRPERSON MILLER: Okay. Ms. Brown.

18 COMMITTEE MEMBER BROWN: Thank you. I'll stay on
19 that same page as Ms. Middleton. When we look at fund
20 sustainability and we look at the probability of high
21 employer contribution rates, you know, there's a 30
22 percent probability, which means -- help me with the -- so
23 70 percent that we won't get there, is that correct,
24 right, is how we work that?

25 All right. So, I mean, because you see red and

1 we see red, right?

2 It's not helpful.

3 CHIEF RISK OFFICER GRIMES: Yes.

4 COMMITTEE MEMBER BROWN: Although, there's a 77
5 percent probability that safety will have a higher
6 employer contribution rate. Now, is that already in
7 the -- so would an employer put that in their Insight Tool
8 that -- can they differentiate between -- they can,
9 between regular employees and safety employees. They can.
10 So they can say that one is going to go up and that one is
11 not. All right. Always a little distressing when you see
12 that.

13 So let's go to 74, which was my real question,
14 which is, for those of you who don't have page number 6b,
15 attachment meant 2. So when I look at this -- this
16 investment return, this is for the entire PERF.

17 CHIEF RISK OFFICER GRIMES: The -- are you on
18 pages 74 and 75?

19 COMMITTEE MEMBER BROWN: Yep. Yep.

20 CHIEF RISK OFFICER GRIMES: Okay. Those are for
21 typical -- and I'm going to call these typical
22 miscellaneous and typical safety plans, two individual
23 plans. And the actuaries just actually generated these
24 numbers based on what they're considering typical.

25 COMMITTEE MEMBER BROWN: Um-hmm.

1 CHIEF RISK OFFICER GRIMES: So I don't know
2 exactly how they determined that. And if you want to
3 know, I'm going to ask Kerry to come back up and help us.

4 COMMITTEE MEMBER BROWN: Right. So this is the
5 kind of information though that I think would be helpful
6 when people are -- when managers -- budget managers are
7 using the Insight Tool to say year 1 is 6.7, if that's
8 still the correct number. And then for the next 5 years,
9 it's 5.8, right? And then the next -- so that would be
10 years 2 through 6. And then the next 10 years, there's
11 going to be a 9.1.

12 I think maybe those are the scenarios we plug in
13 the system. I don't know. But the problem is, you know,
14 when you look at 5.8, that means if, in fact, we drop that
15 low in year 2, that means the unfunded liabilities are
16 going to grow. Unless they come up with a lot of money,
17 their current risk will look really ugly.

18 Okay. I don't like these numbers. Maybe we can
19 change them. Like could we get some white-out or
20 something and --

21 (Laughter.)

22 CHAIRPERSON MILLER: Sharpie.

23 COMMITTEE MEMBER BROWN: Sharpie. Oh.

24 (Laughter.)

25 CHIEF RISK OFFICER GRIMES: We'll send for some

1 right away.

2 COMMITTEE MEMBER BROWN: Yeah. All right. I
3 just -- I know Ben will fix this for us. So anyways, this
4 is a little distressing too. I agree with Ms. Middleton,
5 but it is helpful to know -- it's better to know this
6 information and have nightmares than to just guess what's
7 going to happen.

8 CHIEF RISK OFFICER GRIMES: Well, just in a -- as
9 a quick response to your comments, I think we may have
10 stumbled upon a very good risk measure, because truly
11 these are forward-looking indicators. This would make the
12 better measures in the risk side of the equation. And
13 they truly should have you concerned and thinking about
14 all of those things that could get in the way of us
15 achieving our strategic goals and objectives, because to
16 me, that's what this particular Committee is supposed to
17 be thinking about. And the fact that you're thinking like
18 you are, as -- I'm thinking that that's an optimistic
19 thing from a risk person's perspective, but we're kind of
20 half empty people also.

21 COMMITTEE MEMBER BROWN: Yeah. Well, that must
22 be why I'm on this Committee.

23 Thank you.

24 CHAIRPERSON MILLER: Great. I see no further
25 requests for questions.

1 And I don't have any requests for public comment.

2 So I think, unless I've missed something, we are
3 adjourned. And we'll be --

4 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:
5 Summary of committee direction.

6 CHAIRPERSON MILLER: Okay. Summary of committee
7 action, 6c. Okay.

8 CHIEF COMPLIANCE OFFICER TIMBERLAKE D'ADAMO:
9 Okay. So I took away from 5b a review of
10 policies generally regarding the confidentiality of
11 audits. Specific requests are an overview of practices,
12 information around best practices of organizations
13 regarding maintenance, and compliance with law. Third
14 item is to provide staff recommendations for edits and/or
15 changes. And then the fourth item is written procedures
16 and policies, if they exist, which was Ms. Brown's
17 request.

18 And then for Item 5d, I did not take away any
19 specific -- okay. So that was what I have.

20 CHAIRPERSON MILLER: Okay. Great. Thank you.

21 I've got a note that we are going to break for
22 lunch before we do the PCTM open, which will be at 1:30.
23 And meanwhile, we're going to then go into our closed
24 session for Risk and Audit after we clear the room.

25 /////

(Thereupon the California Public Employees'
Retirement System, Board of Administration,
Risk & Audit Committee open session
meeting adjourned at 10:35 a.m.)

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C E R T I F I C A T E O F R E P O R T E R

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Risk & Audit Committee open session meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 21st day of September, 2019.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063