CalPERS

STATE LEADERSHIP ACCOUNTABILITY ACT REPORT

California Public Employees' Retirement System

December 2019

CONTENTS

JULIE LEE

Acting Secretary

California Government Operations Agency
915 Capitol Mall, Suite 200
Sacramento, CA 95814

Dear Ms. Julie Lee,

In accordance with the State Leadership Accountability Act (Leadership Accountability), the Public Employees' Retirement System submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2019.

Should you have any questions please contact Forrest Grimes, Chief Risk Officer, at (916) 795-3616, Forrest.Grimes@calpers.ca.gov.

GOVERNANCE

As the nation's largest public pension fund, the California Public Employees' Retirement System (CalPERS) manages pension benefits for approximately 2 million California public employees, retirees, and their families.

MISSION & STRATEGIC PLAN

As the nation's largest public pension fund, the California Public Employees' Retirement System (CalPERS) manages pension benefits for approximately 2 million California public employees, retirees, and their families. CalPERS' membership is divided among current and retired employees of the state, schools, and participating public agencies. Additionally, CalPERS' Health Benefits Program covers more than 1.5 million active and retired members and their families.

CalPERS was established by legislation in 1931 and became operational in 1932 with the mission of providing secure retirement benefits to state employees. In 1939, new legislation allowed public agency and classified school employees to participate in the system. CalPERS began administering health benefits to state employees in 1962. Expansion in 1967 allowed public agencies to join the health program on a contract basis. CalPERS began offering long-term care insurance on a not-for-profit basis in 1995.

VISION – A respected partner, providing a sustainable retirement system and health care program for those who serve California.

MISSION – Deliver retirement and health care benefits to members and their beneficiaries.

The CalPERS 2017–22 Strategic Plan focuses on the following five strategic goals and 14 strategic objectives:

FUND SUSTAINABILITY
Strengthen the long-term sustainability of the pension fund

- Fund the system through an integrated view of assets and liabilities
- Mitigate the risk of significant investment loss
- Deliver target risk-adjusted investment returns
- Educate employers, members, and stakeholders on system risks and mitigation strategies
- Integrate environmental, social, and governance considerations into investment decision making

HEALTH CARE AFFORDABILITY
Transform health care purchasing and delivery to achieve affordability

- Restructure benefit design to promote high-value health care

- Improve the health status of our employees, members and their families, and the communities where they live
- Reduce the overuse of ineffective or unnecessary medical care

REDUCE COMPLEXITY
Reduce complexity across the enterprise

- Simplify the programs to improve service and/or reduce cost
- Streamline operations to gain efficiencies, improve productivity, and reduce costs

RISK MANAGEMENT
Cultivate a risk-intelligent organization

- Enhance compliance and risk functions throughout the enterprise
- Continue to evolve the cyber security program

TALENT MANAGEMENT
Promote a high-performing and diverse workforce

- Recruit and empower a broad range of talents to meet organization priorities
- Cultivate leadership competencies and develop succession plans across the enterprise

CONTROL ENVIRONMENT

CalPERS Board of Administration and executive team sets the ethical tone for the organization. Integrity and ethical values are communicated through the following established CalPERS Core Values and guiding behaviors to ensure a common understanding of what each value means:

QUALITY
- Strives to exceed customers' needs and expectations through competence, innovation, and teamwork
- Proactively explores policy and product opportunities to better serve our customers
- Seeks to "do it right" the first time
- Considers, understands, and manages risk

RESPECT
- Treats every person with kindness and humility
- Values and recognizes every individual for their unique skills, talents, and contributions
- Stays present in the moment and actively listens to understand others
- Is courteous, responsive, and professional

ACCOUNTABILITY
- Takes ownership of, and responsibility for, actions, risks, and results and uses outcomes as learning opportunities

- Makes sound decisions from experience, good judgment, and collaboration
- Gives and seeks clear expectations
- Finds solutions that contribute to desired results

INTEGRITY
- Acts in all endeavors with an ethical, honest mindset, and in a professional manner
- Honors commitments, keeps promises, and builds trust
- Is truthful in all actions and communications

OPENNESS
- Approaches every situation with good intentions
- Is receptive to new and diverse ideas
- Listens, cooperates, and shares across the organization
- Encourages a trusting environment by being genuine and transparent in actions and communications

BALANCE
- Supports a healthy personal and professional balance
- Maintains focus on long-term goals while meeting short-term needs
- Embraces opportunities for personal and professional development

- Supports an environment that is optimistic and enjoyable in which relationships can prosper across our organization and communities

CalPERS strives to foster a work environment based on these core values and to help the organization meet professional standards. The CalPERS Ethics Helpline was created to confidentially report potential unethical behavior. Reporting is done through a third-party company, seven days a week, online, by phone; available 24 hours a day.

CalPERS also requires all team members to complete mandatory Speaking Up About Misconduct training each fiscal year. The training course specifically addresses why maintaining a culture of integrity is important, how to recognize potential misconduct, and the roles and responsibilities of team members and leaders in reporting potential workplace misconduct.

Additionally, the CalPERS Fraud Policy facilitates the development of controls which aid in the detection and prevention of fraud against CalPERS. It is the intent of CalPERS to promote consistent organizational behavior by providing guidelines and assigning responsibility for reporting fraud and conducting investigations.

OVERSIGHT

CalPERS is governed primarily by California Public Employees' Retirement Law (PERL), Government Code Section 20000 et seq. CalPERS is administered by the 13-member Board of Administration (Board) who are elected, appointed, or hold office ex officio. Composition is mandated by law which can only be changed by a majority of the registered voters in the state. Constitutional and statutory laws give the Board exclusive control of the administration and investment of retirement fund assets, the authority to administer membership and benefit issues, and all powers reasonably necessary to carry out the health benefits program. The Board has the vested fiduciary duty to manage and control the following retirement systems, programs, and plans:

- Public Employees' Retirement Fund
- California Employers' Retiree Benefit Trust Fund
- California Employers' Pension Prefunding Trust Fund
- Judges' Retirement Fund
- Judges' Retirement Fund II
- Legislators' Retirement Fund
- Public Employees' Deferred Compensation Fund
- Public Employees' Health Care Fund
- Public Employees' Long-Term Care Fund
- Supplemental Contributions Fund

In addition to attending board meetings, board members may also serve on committees to review specific programs, projects, or issues and make recommendations to the Board. The Board has delegated authority for specific roles to six committees:

- Board Governance
- Finance & Administration
- Investment
- Pension & Health Benefits
- Performance, Compensation, & Talent Management
- Risk & Audit

The Risk & Audit Committee's (RAC) primary function is to assist the board in fulfilling its oversight responsibilities by creating a comprehensive approach to anticipate, identify, prioritize, and manage key risks to our business objectives. The committee will assist the board with its governance and risk management framework and processes to make sure they continue to meet or exceed best practice standards required of a public pension system. RAC provides oversight regarding the alignment of internal business practices to ensure consistency with our risk management philosophy and core values at CalPERS.

The Integrated Assurance Risk Council (IARC) oversees day-to-day management and mitigation of enterprise risk. IARC members focus on providing executive oversight of CalPERS risk management framework to ensure that risks are being managed within the risk appetite set by the Board. IARC promotes the development of a risk-intelligent organization using an integrated assurance three lines of defense model to implement and embed risk management and compliance responsibilities throughout the organization.

The Senior Leadership Council (SLC) is comprised of all CalPERS division chiefs and is responsible for stimulating cross-functional communication, collaboration, and resource-sharing on enterprise-wide business activities. SLC participates in the review and development of enterprise policies, while strategizing enterprise-wide initiatives for discussion and implementation with the executive team.

CalPERS Board Governance Policy provides the Board delegation of authority to the Chief Executive Officer (CEO) who then delegates appropriate authority to deputy executive officers and specific division chiefs based on operational needs. CalPERS organizational structure is centralized with executive level leadership positions overseeing the following nine branches:

- Actuarial Office
- Communications & Stakeholder Relations
- Customer Services & Support
- Enterprise Compliance
- Financial Office
- General Counsel Office
- Health Policy & Benefits
- Investment Office
- Operations & Technology

Each division/office operates direct reporting structures based upon their program area functions to achieve their objectives in support of CalPERS' mission and strategic goals.

CalPERS maintains a system of internal control through documented delegation of authority from the Board to the CEO down to executive level staff and select management. Enterprise policies have been established to set guidelines and best practices throughout the nine operational branches. Operational procedures and guidelines document the controls at the program level put in place by management to mitigate program risks and help achieve business objectives.

WORKFORCE PLANNING

CalPERS establishes a competent workforce through its 2018-22 Workforce Plan which provides a strategy to recruit and retain high caliber talent needed to achieve CalPERS mission and maintain its reputation as a destination employer. The plan addresses workforce gaps by establishing three workforce goals: expand focused recruitment strategies to attract diverse and competent workforce, integrate a culture that protects institutional knowledge to ensure business continuity, and make use of existing resources to align enterprise projects, business cycles, and increase efficiencies.

CalPERS is committed to team member development to meet current and future business needs. CalPERS provides a training program to allow team members opportunities to continually build their skills. CalPERS offers a diverse training catalog of instructor-led courses, workshops, conference opportunities, and a virtual learning center with hundreds of web-based courses. CalPERS offers mandatory and on-going leadership training to provide varying levels of management with the opportunity to advance

their skills and knowledge to be successful in their leadership roles. CalPERS Emerging Leader Program offers a way to bridge the learning and experience gap between journey-level analysts and first-line leadership classifications. The program introduces skills needed to be an effective leader through classroom training, experiential learning, self-reflection, teamwork, and mentoring. CalPERS also supports informal mentoring through a variety of approaches to allow team members to share ideas and knowledge with the goal of learning in an unstructured, informal environment.

CalPERS retains its team members through a culture of engaged and supportive leadership, which provides challenging work in a collaborative environment. CalPERS provides the opportunity for team members to share their feedback about their role within the organization through the annual employee engagement survey, administered by a third-party provider for confidentiality. The survey allows the leadership team to understand and act on team member feedback for areas of improvement.

ACCOUNTABILITY

Accountability is one of CalPERS' Core Values. From the initial onboarding of each team member, our core values are highlighted, and expectations are set, that everyone is expected to adhere to and reinforce that includes accountability. We have established guidelines of what accountability looks like at CalPERS:

- Takes ownership of, and responsibility for, actions, risks, and results; and use outcomes as learning opportunities
- Makes sound decisions from experience, good judgment, and collaboration
- Gives and seeks clear expectations
- Finds solutions that contribute to desired results

CalPERS fosters an environment where accountability is part of our culture. As part of each senior leader's performance plan (that is monitored and measured), the CEO and executive team set expectations with their direct reports that accountability must be promoted and enforced. This year, the executive team and senior leaders created a series of skits that portrayed characters displaying different aspects of accountability.

Managers also conduct regular 1:1 meetings with team members to discuss accountability and set expectations. CalPERS uses a probation period to reinforce our core values and ensure new hires will adhere to the organizations culture of accountability.

In addition, the Ethics Helpline allow team members to report incidents of non-accountability without reprisal.

INFORMATION & COMMUNICATION

CalPERS 2017-22 Strategic Plan provides direction for the organization to achieve its mission. Annual business plans are developed by all program areas to align business plan objectives to strategic goals and objectives. Management provides quarterly status reports to the Board as part of the Enterprise Performance Report framework, which currently tracks 34 strategic plan measures, 28 business plan initiatives, and 60 operational key performance indicators.

CEO board meeting summaries are provided to all team members to highlight important decisions made by the Board and its subcommittees. The summary provides context on how Board decisions will impact the organization and any future changes that can be expected.

Quarterly brown bag sessions were inspired by feedback from the 2017 Employee Engagement Survey and insights gained through senior and executive management relationship focus groups. Each lunchtime session

EXTERNAL COMMUNICATION

features senior leaders from throughout the enterprise and provides an opportunity for team members to connect and interact.

CEO sessions are held monthly where a select number of team members attend an informal lunch to engage with the CEO to learn about the current focus of CalPERS and ask their own questions. The informal lunch setting allows the CEO to hear directly from different team members across the organization.

CalPERS program areas conduct regular team meetings and periodic all staff meetings to provide an opportunity for management and executive leaders to share important organizational information, engage and listen to feedback, and recognize team members for their hard work and contributions. CalPERS also maintains an internal intranet to house all relevant information for team members to utilize in their work as well as an online Knowledge Management System (KMS). The KMS is a central repository used by specific team members to access policies, procedures, guidelines, and reference materials.

CalPERS coordinates stakeholder engagement and outreach events designed to provide information, access, and transparency to representatives of member organizations. These events include pre-board briefings, regular roundtable meetings with key leaders, employer dialogues across the state, and many issue-specific meetings as policy issues arise.

CalPERS also coordinates and supports speaking events for our executive leaders at stakeholder conferences. We directly plan, coordinate, and participate in over 150 stakeholder touchpoints annually.

CalPERS communicates with stakeholders and members through a number of different channels. Emails are sent to targeted audiences with information about specific events such as the CalPERS Benefits Education Events, the CalPERS Educational Forum, and Open Enrollment. Our public website features display ads that point to specific topics of interest; viewers and members can also access a vast amount of information and data about CalPERS and their benefits.

CalPERS is very active on several social media sites, including Twitter, Facebook, Instagram, and LinkedIn, posting on most sites daily. We issue over 50 news releases annually. In addition, three times a year we publish a newsletter containing stories on a wide-array of important pension and health topics. We also publish a quarterly newsletter aimed at the employers that contract with CalPERS to administer their pension and health programs.

TEAM MEMBER REPORTING

The CalPERS Ethics Hotline provides a way for team members to safely report concerns about conduct that may be unethical, illegal, or in violation of professional standards. Team members who contact the helpline can remain anonymous. The Ethics Helpline is operated by an independent, third-party provider who helps ensure the anonymity of calls.

Operational risk event reporting provides a process for team members to report inadequate or failed internal control processes to management. The focus of risk event reporting is to determine what internal control failed to strengthen or implement the necessary mitigating controls.

INFORMATION SYSTEMS

CalPERS business operations are primarily supported by the myCalPERS platform. A custom developed solution, myCalPERS launched in 2011, replacing more than 49 legacy systems and 60 support systems, as well as, the health and pension infrastructure. The system has three main audiences:

Internal: Used by CalPERS team members to manage pension and health administration activities such as processing retirement applications, executing benefit payments, administering health enrollment transactions, and creating annual tax, health, and retirement statements.

Employers: Used by external business partners (State of California departments and agencies, schools, public agencies, reciprocal retirement systems, health carriers, and medical vendor groups) to maintain the pension and health related information of participants.

Members: Used by CalPERS active members, retirees, beneficiaries, and health subscribers to process online transactions such as address changes, beneficiary designations, retirement estimate calculations, digital statements, direct deposit updates, and retirement applications.

For enterprise resource planning needs, CalPERS utilizes human capital management and financials and supply chain management applications.

MONITORING

The role of the executive monitoring sponsor includes facilitating and verifying that the Public Employees' Retirement System monitoring practices are implemented and functioning.

MONITORING

The information included here discusses the entity-wide, continuous process to ensure internal control systems are working as intended. The role of the executive monitoring sponsor includes facilitating and verifying that the Public Employees' Retirement System monitoring practices are implemented and functioning. The responsibilities as the executive monitoring sponsor(s) have been given to: Michael Cohen, Chief Financial Officer.

Risk management is integral to achieving CalPERS' Strategic Plan goal of cultivating a risk-intelligent organization. In support of this effort CalPERS uses an integrated assurance three lines of defense model to implement and embed risk management and compliance responsibilities throughout the organization. Program areas are the first line of defense and internal control processes have been established to confirm that operations comply with laws, regulations, and policies to mitigate risks. Management across the enterprise continues to contribute to a risk management framework that includes consideration of risk in decision making, planning, and prioritization of business activities to achieve strategic and operational objectives.

The Enterprise Risk Management Division (ERMD) and the Enterprise Compliance Division (ECOM), are among divisions included in the second line of defense. ERMD is responsible for overseeing the enterprise risk management framework that includes the Enterprise Risk Management Dashboard, Enterprise Risk Profiles, and Risk Management Heat Map. This team also facilitates risk management training, collects and analyzes emerging risk information, facilitates program risk assessments, and develops tools to assist the board, executive team, and program areas in identifying, monitoring, and mitigating risks. ECOM is responsible for oversight of program area compliance with laws, regulations, and policies. This team designs, implements, tests, and monitors compliance processes within the program areas to evaluate the effectiveness of existing compliance strategies. ECOM also conducts compliance training and collaboratively promotes compliance throughout the enterprise.

The Office of Audit Services (OFAS) represents the third line of defense, by providing objective and independent validation through an independent reporting relationship to the Board. This team conducts

assessments of the design and operating effectiveness of internal controls over business and technology operations, compliance with laws and policies, and effective management of risks.

The RAC exercises oversight and monitoring of risk through periodic reports on the functioning of CalPERS' risk management, compliance, and audit activities. Additionally, audits are performed by an independent financial statement auditor and other external auditors. Both management and the board receive copies of all internal and external audit reports for review.

CalPERS' leadership groups are responsible for oversight of CalPERS' program area risks. Executive management meets formally monthly to review risk, compliance, and audit reports and findings, monitor performance and mitigation efforts, identify issues and concerns, and prioritize resources.

ADDRESSING VULNERABILITIES

CalPERS Audit Resolution Policy provides a system to track corrective actions or acceptance of risk taken by management on reported audit issues and to convey these actions to executive management and to the board. Management has a responsibility to promptly evaluate reported audit findings, determine appropriate actions, and ensure resolution within an established time frame. Quarterly status reports are provided to the Board and executive management on outstanding findings from internal audits, public agency reviews, and external audits.

COMMUNICATION

CalPERS has several oversight leadership groups, including Strategic Operations Committee, IT Governance Council, Integrated Assurance Risk Council, and Senior Leadership Council that meet regularly to discuss issues, concerns, and foster improved communication across program areas. In addition, CalPERS utilizes risk reporting tools that include the Risk Dashboard, Risk Profiles, and the Risk Heat Map to track and communicate the status of the enterprise risks to the board and executive management. These documents are reviewed by the Risk and Audit Committee annually and shared with all leadership and integrated assurance teams.

At the team level, select embedded risk and compliance liaisons are tasked to assist with the communication and education of employees in the areas of risk and compliance. Additionally, the liaisons conduct ongoing internal control monitoring, including the identification, resolution, and documentation of issues.

ONGOING MONITORING COMPLIANCE

The Public Employee's Retirement System has implemented and documented the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to the entity systems of controls and monitoring.

RISK ASSESSMENT PROCESS

Brainstorming meetings, employee engagement surveys, ongoing monitoring activities, audit/review results, other/prior risk assessments, external stakeholders, questionnaires, consideration of potential fraud, and performance metrics.

RISK ASSESSMENT PROCESS

The following personnel were involved in the entity risk assessment process: executive management, middle management, frontline management, and staff.

The following methods were used to identify risks: brainstorming meetings, employee engagement surveys, ongoing monitoring activities, audit/review results, other/prior risk assessments, external stakeholders, questionnaires, consideration of potential fraud, and performance metrics.

The following criteria were used to rank risks: likelihood of occurrence, potential impact to mission/goals/objectives, and timing of potential event.

RISK IDENTIFICATION

CalPERS conducts an annual risk assessment with cross-functional teams and senior leaders across the organization to review and update current and emerging enterprise risks. Results of the risk assessment are documented in the Enterprise Risk Profiles and are provided to the Board annually. The profiles are comprised of the following components:

Strategic alignment: each risk is defined by alignment to a strategic plan goal, the functional objective the organization is seeking to accomplish, and a risk statement that defines the consequence of the risk occurring.

Risk analysis: a brief assessment of the inherit risk environment and evaluation of current control assurance to inform scoring.

Risk score: the results of the scoring exercise.

Risk drivers and mitigations: the identification of key factors that influence the ability of the organization to meet the functional objectives. For each risk driver, current mitigations and controls are documented, along with future mitigations that have been approved through the budgeting process.

RISK RANKING

Risks are 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 parameters, the scoring exercise includes the concept of materiality, which is the level of impact at which a risk occurrence will threaten the achievement of a strategic or business objective, to help establish common baselines for the risks. The scoring results are reflected in CalPERS Risk Heatmap and Dashboard and in the finalized Risk Profiles, which are presented to the Board annually.

The top risks to CalPERS are provided in this report. The full listing of enterprise risks can be found in the November 2019 Board item, Enterprise Risk Management Framework, reported to the RAC on November 19, 2019 in agenda item 7a.

RISKS & CONTROLS

Benefit Administration

Health Care Administration

Information Security

Pension Funding

RISK: BENEFIT ADMINISTRATION

FUNCTIONAL OBJECTIVE

To ensure accurate and timely benefits and information to members, retirees, and beneficiaries.

RISK STATEMENT

Inability to provide benefits timely and/or accurately to members, retirees, and beneficiaries.

The identified risk drivers are:

1. Inaccurate controls to edit and confirm employer data
2. Lack of team member knowledge and awareness of relevant laws, regulations, and policies
3. Inaccurate benefit and system calculations
4. Increase to the complexity of the benefit plan design due to external influences
5. Inability to implement statutory and regulatory changes

If this risk were to occur CalPERS' ability to provide benefits to members, retirees, and beneficiaries may be compromised.

Control A: myCalPERS Automated Controls

The myCalPERS platform allows employers to maintain employment data for use in the calculation of benefits for CalPERS participants. The automated controls within myCalPERS reduces keying errors and improves participant data quality, thereby improving the accuracy and reliability of the retirement system calculations for state, school employers, and each contracting public agency.

Control B: Comprehensive Team Member Training

CalPERS team members in contact centers and regional offices receive extensive, comprehensive training before assisting members and employers with their health and retirement needs. The training combines all relevant law, regulations, and policies into an engaging and supportive learning environment to support optimal retention of information. Comprehensive training increases team member awareness in their customer service roles by ensuring proper information is provided to members, retirees, and beneficiaries regarding their benefit.

Control C: Knowledge Management System

CalPERS Knowledge Management System (KMS) is the central repository used by team members to access policies, procedures, guidelines, and reference materials. KMS empowers team members to quickly and efficiently provide quality service to internal staff, members, and business partners. KMS clearly documents program area controls and updates are made in real-time.

Control D: Employer and Stakeholder Communication

CalPERS regularly communicates and engages with employers and stakeholders to seek and provide guidance, answer questions, and collaboratively resolve issues around benefit administration. CalPERS hosts an annual Education Forum where employers can learn more

about relevant issues, engage with CalPERS leadership, and schedule one-on-one consultations with the CalPERS team. CalPERS uses various communication mediums to provide updates of changes affecting employers and stakeholders as well as provide employer training. Examples of employer education and resource materials CalPERS offers include, but are not limited to: online employer reference and student guides, computer-based training modules, Circular Letters, and Employer Bulletins. CalPERS also operates eight Regional Offices located throughout the state where team members assist members with a variety of services and educational events. These communication strategies help members, retirees, and beneficiaries understand more about their benefit and the steps CalPERS is taking to protect it.

Control E: Legislative Impact Analysis

CalPERS is actively involved at all levels of the organization with monitoring and reviewing legislative activity at the state and federal levels to determine the potential impacts to the retirement system and benefit administration design should they take effect. With complexity reduction being one of our strategic goals, CalPERS conducts these reviews to create awareness around potential impacts to our plan design.

RISK: HEALTH CARE ADMINISTRATION

FUNCTIONAL OBJECTIVE

To offer high quality, accessible, affordable, and sustainable health care.

RISK STATEMENT

Inability to offer high quality, accessible, affordable and sustainable health care at a competitive price.

The identified risk drivers are:

1. Increases in health care costs
2. Increases in pharmaceutical costs
3. Public agencies and schools electing to leave CalPERS' Health Benefit Programs
4. Unfavorable changes in state and federal policies and regulations
5. Sustainability of the Health Care Fund
6. Health plan contract management non-compliance
7. Inability to maintain high quality health care benefits for members

If this risk were to occur CalPERS' ability to deliver health care benefits to member, retirees, and beneficiaries may be compromised.

Control A: Market Evaluation Checks

CalPERS manages increases in health care and pharmaceutical costs by analyzing under/over utilization of health products in the market and conducting annual market checks of prescription drugs. This measure is to verify that CalPERS' estimates reflect market standards and are priced competitively.

Control B: Rate Development Process

CalPERS works closely with health plans across regions in California to negotiate favorable health premiums through a year-long rate development cycle. CalPERS incorporates these health plans within the CalPERS' Health Benefit Program to provide public agencies with flexible options in health care accessibility and care opportunities.

Control C: Contract Management

CalPERS sets five-year health plan contracts that include negotiated fees for the five-year term and performance measures with financial penalties if health plan carriers fail to meet target measures. Health plans present quarterly business reviews at CalPERS to demonstrate adherence to target goals set by the contract.

Control D: State and Federal Legislation Engagement

CalPERS actively monitors and engages with on-going legislative and regulatory processes on the state and federal level. This practice ensures that CalPERS is up-to-date on current policies and how they will affect future negotiations with health plans.

Control E: Health Care Fund Reserves

To maintain the sustainability of the Health Care Fund, CalPERS maintains proper actuarial reserves which are monitored through strategic risk measures annually.

Control F: Population Health Management Dashboard

CalPERS tracks member health status on the Population Health Management Dashboard. Members may evaluate their plan's clinical performance to provide feedback for CalPERS' Health Benefits Program. This initiative enables members to file grievances and appeals regarding their healthcare to ensure benefits are being accessed fairly.

RISK: INFORMATION SECURITY

FUNCTIONAL OBJECTIVE
To ensure CalPERS' information assets are safeguarded.

RISK STATEMENT
Failure to protect and secure information assets.

The identified risk drivers are:

1. Lack of employee awareness of information security practices among all account holders
2. Failure to adequately identify, assess, and respond to a data breach and security incidents
3. Inability to balance business innovation and strategic security risks
4. Failure to enforce role-based access to all users and data
5. Failure to protect all critical business systems and applications
6. Failure to mature the enterprise data management program
7. Inability to enforce a third-party vendor information security risk management program

If this risk were to occur through a data breach member privacy and the safety of CalPERS' information assets may be compromised.

Control A: Annual Independent Security Assessments

In efforts to test, improve, and validate the CalPERS Cybersecurity Program, CalPERS annually hires third-party experts to perform independent security assessments. CalPERS uses the findings to strengthen the existing cybersecurity program by identifying opportunities for improvement, making necessary adjustments, and thereby reducing information security risk.

Control B: Information Security Policy

CalPERS Information Security Policy specifies the rules that must be followed to protect CalPERS' information, information systems, equipment, software, and people from a wide spectrum of threats and risks. All CalPERS' employees and contractors annually acknowledge their responsibility in protecting CalPERS' information assets and compliance with CalPERS Information Security Policies and control standards.

Control C: Information Security Control Standards

CalPERS maintains an Information Security Control Library with up-to-date Information Security Control Standards that pertain to all employees, including third-party consultants and contractors, involved in conducting business for or on behalf of CalPERS. The library also has a glossary, which includes terms related to information security.

Control D: Information Security Training

Annual Mandatory Information Security Training and ongoing phishing awareness training is completed by all CalPERS team members. CalPERS is currently in the process of strengthening our information security training program to be role based and we are requiring that all third-party

contractors attest and provide proof they have successfully completed annual security awareness training provided by their employers. Annual and ongoing training reduces information security risk by equipping employees with the knowledge required to assess information security requirements, propose information security controls and ensure controls function effectively.

Control E: Information Security Monitoring and Detection

CalPERS actively monitors information technology security activities and investigates security incidents in compliance with Information Security Policies and Control Standards.

Control F: Information Security Roadmap

CalPERS is currently in the process of strengthening information security processes, system, and policies through an Information Security Roadmap Business Initiative. Through this initiative, CalPERS will enhance our cyber intelligence, advance our security posture and continually mature our operations.

RISK: PENSION FUNDING

FUNCTIONAL OBJECTIVE
To ensure the sustainability of the pension system to deliver retirement benefits.

RISK STATEMENT
Failure to meet pension benefit obligations.

The identified risk drivers are:

1. Financial markets suffer a severe downturn
2. Investments underperform the discount rate on an extended year-over-year basis
3. Low funded status limits investment options
4. Government constraints and regulations reduce portfolio diversification
5. Employers default on contracted pension contribution payments
6. Portfolio size and complexity challenges efficient investment processes and limits investment universe
7. Actual experience deviates significantly from the actuarial assumptions
8. Benefit design enhancements
9. Employer contribution rate increases are insufficient to reduce unfunded liabilities over time
10. Pension reform legislation or referendums that reduce employer obligation to honor pension contracts
11. Judicial decisions that alter benefit design or contribution requirements
12. Changes to actuarial standards

If market volatility, experience deviating from assumptions, and unanticipated legislation or referendums occur CalPERS' mission to deliver pension and health care benefits to members and their beneficiaries may be compromised.

Control A: Asset Liability Management (ALM) Policy

CalPERS Asset Liability Management (ALM) Policy seeks to ensure contributions, plus investment returns, are sufficient to pay the benefits and expenses of the system. The ALM Policy provides a governance platform for implementing the CalPERS Pension and Investment Beliefs, pursuing the key strategic goal of strengthening long-term pension fund sustainability, and carrying out the fiduciary duty owed to members. The strategic objective of the ALM Policy is to strengthen the sustainability of the system. A key process supporting this objective is the ALM Review Cycle, which takes place every four years. This policy establishes how employees oversee and coordinate the four-year ALM Review Cycle.

Control B: Stakeholder Education and Engagement

CalPERS regularly communicates and engages with stakeholders to educate them on system priorities, answer questions, and seek feedback. CalPERS hosts an annual Education Forum where employers can learn more about relevant issues, engage with CalPERS leadership, and schedule one-on-one consultations with the CalPERS team. The first Stakeholder Forum is planned for 2020 to facilitate greater dialogue between stakeholders.

Control C: Funding Risk Mitigation Policy

The Funding Risk Mitigation Policy seeks to reduce CalPERS funding risk over time. It establishes a mechanism whereby CalPERS investment performance that significantly outperforms the discount rate triggers adjustments to the discount rate, expected investment return, and strategic asset allocation targets. The policy aims to reduce the volatility of investment returns, thereby increasing the long-term sustainability of CalPERS pension benefits for members.

Control D: Total Fund Investment Policy

The Total Fund Investment Policy sets forth CalPERS' investment beliefs and overarching investment purposes and objectives with respect to all its investment programs. The policy provides the framework for the management of CalPERS assets and establishes the asset allocation targets based on the portfolio the board selected during the ALM process. The policy also sets the guidelines the Investment Committee deems appropriate and prudent for the CalPERS investment program.

Control E: Actuarial Amortization Policy

The Actuarial Amortization Policy establishes the amortization methods intended to eliminate unfunded liabilities in a manner that maintains benefit

security for the members of the system while minimizing substantial variations in employer contribution rates. The amortization methods are aimed at ensuring that future contributions and current plan assets will be sufficient to provide for all benefits expected to be paid to members and their beneficiaries.

Control F: Actuarial Assumptions Policy

The Actuarial Assumptions Policy establishes the process of developing actuarial assumptions to measure and manage the liabilities of the system. By providing for projections of future estimated costs, this policy establishes a sound basis for CalPERS to develop funding goals that support CalPERS' ability to meet its benefit obligations, which will improve the long-term sustainability of the system.

Control G: Actuarial Cost Method Policy

The Actuarial Cost Method Policy establishes the cost methodologies CalPERS will use to estimate pension costs. By providing for projections of future estimated costs, this policy establishes a sound basis for CalPERS to develop funding goals that support CalPERS' ability to help employers meet their expected benefit payments, which will improve the long-term sustainability of the system.

Control H: Contribution Allocation Policy

The Contribution Allocation Policy provides guidance to CalPERS actuaries regarding the timing and methods used in the allocation of employer contributions to each employer's plan. The policy addresses how contributions will be allocated from employers to the employers' plans using actuarial methods.

Control I: Treasury Management Policy

The Treasury Management Policy seeks to ensure that CalPERS' treasury management practices recognize the fiduciary duty owed to members as stated in the CalPERS' pension beliefs. The policy helps ensure the payment of member benefits and enterprise obligations without interruption regardless of financial markets and environmental conditions, provides an integrated process for the oversight and management of enterprise cash and liquidity during normal, stressed and crisis events, maintain appropriate coverage levels for programs and the enterprise, and oversee enterprise liquidity risk.

Control J: Treasury Management Reserve Policy

The Treasury Management Reserve Policy governs the practices related to the Treasury Management Policy to help ensure payment of member

benefits and other obligations without interruption while optimizing the use of fund assets. Treasury Management Reserves are liquid assets dedicated to the payment of member benefits and other obligations during a stressed or crisis event. The policy establishes reserves and targets for each retirement fund.

Control K: Annual Review of Funding Levels and Risk Report

The Annual Review of Funding Levels and Risks report presented to the Finance and Administration Committee provides information necessary for the CalPERS Board to assess the soundness and sustainability of the various plans within the Public Employees' Retirement System. The report provides the funding position and risks of falling to low funding levels in the future as well as current mitigation strategies and next steps.

Control L: Actuarial Experience Study

The Actuarial Experience Study reviews actual experience of the system in relation to the current actuarial assumptions to recommend changes to the assumptions for the rates of decrement, salary increases, and economic assumptions. The report is derived from data collected during specific fiscal year periods and performed every four years based on current board policy.

Control M: Pension Outlook

The Pension Outlook tool is intended to be an educational tool to help employers anticipate future costs and understand pension costs drivers under various assumed investment return and actuarial experience scenarios. The tool aids interested parties by calculating hypothetical projections of future costs and annual changes in funding requirements. The tool can also calculate the potential impact of additional discretionary payments and help employers plan for contingencies or reserves. Presently, the tool is available to limited stakeholders with the intent to roll out to additional stakeholders at a future date.

CONCLUSION

The Public Employees' Retirement System strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies as appropriate. I certify our internal control systems and monitoring systems are adequate to identify and address current and potential risks facing the organization.

MARCIE FROST
Chief Executive Officer

CC: California Legislature [Senate (2), Assembly (1)]
California State Auditor
California State Library
California State Controller
Director of California Department of Finance
Secretary of California Government Operations Agency