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CHIEF COMPLIANCE OFFICER LETTER

The Enterprise Compliance Office (ECOM) of the California Public Employees' Retirement System (CalPERS) is responsible for coordinating, supporting, and promoting an effective enterprise-wide ethics and compliance program. ECOM is at the forefront of compliance and ethics at CalPERS, working to protect the enterprise by ensuring we follow all the laws and regulations that govern our business.

The Annual Compliance Report outlines key accomplishments on ethics and compliance activities covering fiscal year (FY) 2018-19. This report is included as a complement to the Comprehensive Annual Financial Report (CAFR).

Consistent with CalPERS' values of Integrity, Openness, and Accountability, ECOM is keenly aware of our responsibility to set the example of ethical behavior and practices. We embrace partnerships across the organization with other program areas to leverage our effectiveness and maximize our impact. Our work relies on these partnerships to help inform and raise awareness about the importance of compliance and ethics.

ECOM also recognizes that effective compliance programs grow organically and that team members know how they can positively impact our organization. For instance, we have embedded compliance liaisons serving as first-line compliance experts in every CalPERS program area.

Marlene Timberlake D'Adamo

Marlene Timberlake D'Adamo
Chief Compliance Officer

CULTURE OF COMPLIANCE

We strive to embed compliance into CalPERS' culture, strategy, and day-to-day business operations. All ECOM activities and accomplishments directly support our organization's strategic plan and core values.

In 2004, CalPERS established a separate and distinct compliance office to support an enterprise-level commitment to strong ethics, compliance, and risk management practices. Since then, the office has continued to evolve and mature. In 2015, ECOM developed a new multi-year compliance plan, strengthening the compliance practices already in place.

The five-year compliance plan aims to mature the program by building and enhancing compliance capabilities 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 the tools and information necessary to fulfill their oversight responsibilities.

We have just completed the fourth year of the compliance plan, during which we assessed our compliance program against industry peers. Our assessment score of 3 (out of 5) was consistent with compliance industry benchmarks. We are now on track to begin implementing our FY 2019-20 planned activities.

Figure 1: Five-Year Compliance Plan
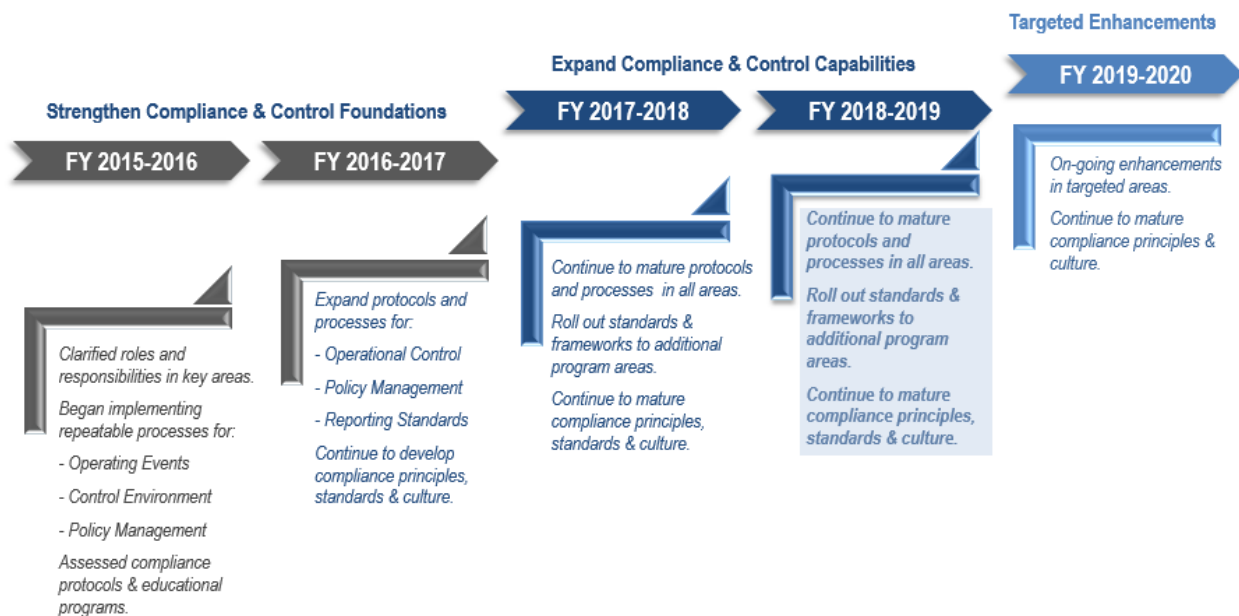
INTERGRATED ASSURANCE MODEL: THREE LINES OF DEFENSE

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

Figure 2: Integrated Assurance Model
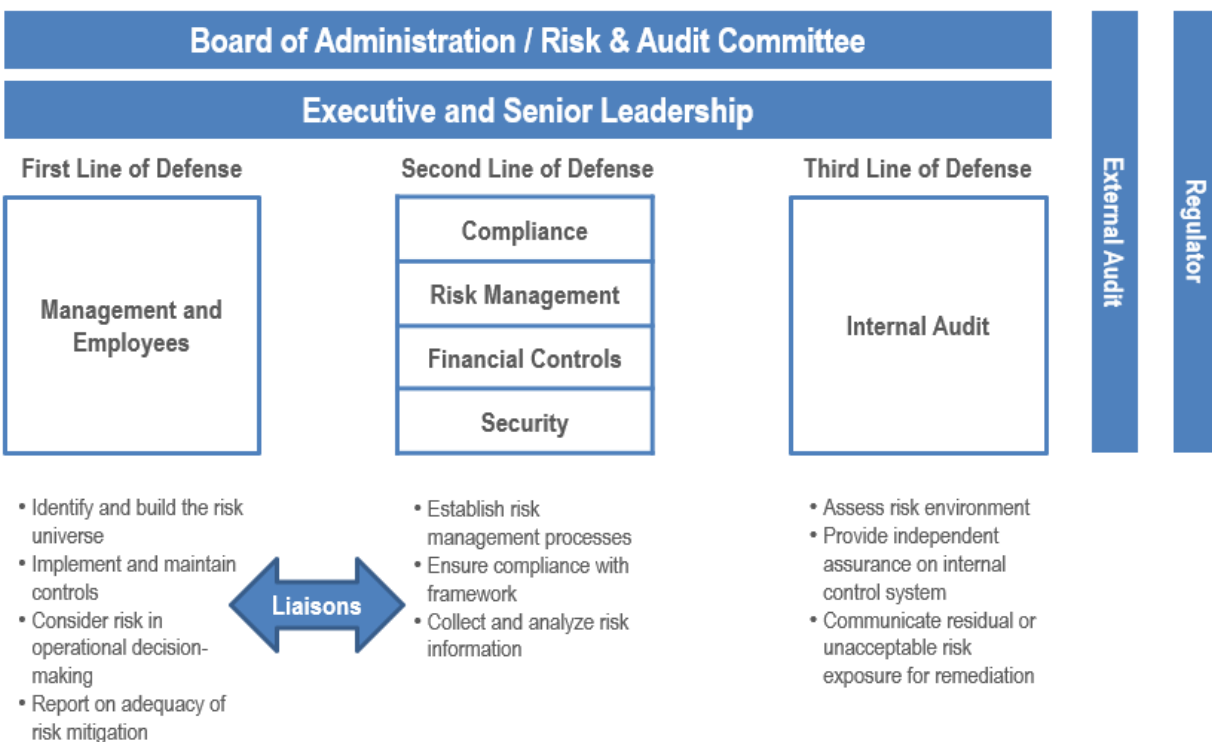
- **First Line of Defense** – The first level of the control environment are the program areas that perform day-to-day risk management activities. In addition to performing day-to-day operations, the program areas are responsible for compliance and risk mitigation.

- **Second Line of Defense** – ECOM and the Enterprise Risk Management Division (ERMD) partner to provide oversight, guidance, and monitoring of governance, risk, and compliance activities. This partnership enables us to support the organization by mitigating strategic and operational risks while strengthening the organization's control environment and promoting strong ethical business practices. To demonstrate this alignment, both divisions 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 ERMD and ECOM. This coordination helps CalPERS develop a shared 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 do-the-right-thing culture. By fostering a work environment based on our six Core Values, CalPERS recognizes that compliance is every team member's responsibility. The business partners within the Integrated Assurance Model hold monthly working sessions to discuss, plan, and receive feedback on each partner's inter-related efforts. These monthly meetings help ensure cooperation, improve timing of reviews by reducing over-lapping efforts, and encourage collaboration among the program areas.

ETHICS AND COMPLIANCE PROGRAM INITIATIVES HIGHLIGHTS, FY 2018-19

ECOM is guided by compliance standards set out in a variety of federal and state guidelines. The Federal Sentencing Guidelines for Organizations 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 California's state agencies.

ENTERPRISE COMPLIANCE OFFICE

ECOM is committed to ensuring CalPERS maintains compliance with the letter and spirit of all applicable laws, regulations, and policies in partnership with other CalPERS program areas. ECOM is comprised of four units:

- Enterprise Compliance Monitoring and Oversight
- Enterprise Ethical Standards and Investigations
- Enterprise Policy and Delegation Management
- Enterprise Compliance Operations, Communications, and Reporting

Enterprise Compliance Monitoring and Oversight Unit

This unit is responsible for developing consistency in program area compliance activities, as well as ongoing monitoring and reporting on areas such as Personal Trading and Targeted Compliance Reviews.

Policy Management

- Monitored and reported on the timely completion (99 percent) of CalPERS' mandatory trainings.
- Developed an enterprise-wide mandatory training policy

Compliance Monitoring and Oversight

- Developed a compliance and risk assessment process consistent with compliance and risk standards.
- Conducted a compliance and risk assessment to identify key compliance risks and to initiate targeted compliance reviews to mitigate identified risks.

Embedded Compliance Program

- Embedded compliance and risk liaisons into remaining program areas so every branch now has representation.
- Developed and administered a training program for new embedded compliance liaisons.

Compliance Reporting

- Developed branch-level compliance reporting for senior leaders and executives.

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, a reporting tool for complaints that are assigned to and investigated by appropriate program areas.

Form 700

- Developed new training material to educate program areas on Form 700 requirements for consultants and vendors who contract with CalPERS.

- Launched monthly, small group, training sessions for all new employees identified in CalPERS Conflict of Interest Code.
- Increased the percentage of timely filings by CalPERS Team Members, Board Members, and Board Designees (96.8 percent to 97.7 percent).

Ethics Helpline

- Standardized the intake, investigation, and reporting of ethics-related complaints to ensure all areas responsible for conducting investigations are processing cases with procedures consistent with industry best practices.
- Transitioned all ethics-related investigations to an online case management system providing a single system of record for the intake, assignment, tracking, and reporting of all ethics-related cases.

Enterprise Policy and Delegation Management Unit

This unit is responsible for coordinating CalPERS centralized governance management program and providing advice and oversight to program areas as they update their policies, delegations of authority, and other internal rules and guidance. CalPERS has established enterprise-wide standards for policy management and delegations of authority consistent with professional best practices. These standards establish a basic framework and expectations to support the regular, thoughtful review of existing governance documents. This in turn helps program areas identify gaps and provides the organization with reasonable assurance that existing documents stay up to date and work as intended.

Annual Governance Review

- Launched our first-ever comprehensive annual governance review.

  o Met with all CalPERS Branches and Divisions to create an accurate inventory of all policies, delegations of authority, and charters currently in effect.
  o Partnered with program areas to develop a risk-intelligent plan to update and improve the effectiveness of CalPERS internal governance documents, while also improving consistency in document format, structure, and approach.

Policy Management

- Developed CalPERS first-ever Code of Conduct that consolidates all ethics and conflict of interest rules, along with CalPERS mission and values, to clearly articulate the culture of CalPERS.

- Developed CalPERS Governance Management Policy to ensure consistency and effective management of enterprise-wide governance documents.
- Refined existing policy governance procedures and framework
- Refined on-demand policy training materials to help CalPERS team members navigate each step of the enterprise policy lifecycle.

Delegation Management

- Assumed lead responsibility for the Board Committee Delegation of Authority annual review process.
- Finalized development of a framework to ensure Board Committee reporting complies with Committee delegations of authority.

Compliance Operations, Communications, and Reporting Unit

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

Communications

- Completed successful Culture of Integrity and Key Policy Awareness Spark communication campaigns (former internal social media tool as of April 1, 2019).
- Hosted our Third Annual National Compliance and Ethics Week in November 2018
  - o Recognized team members across the organization with CalPERS Compliance, Risk, and Security ACE awards.
  - o Promoted an anti-retaliation campaign among all CalPERS managers and executives.
  - o Conducted a compliance and ethics speed mentoring event with senior leaders and team members.

Compliance Reporting

- Improved compliance reporting to the Board and executive management to increase reporting efficiency and data integrity.

Compliance Operations

- Implemented a new, branch-wide project management and workflow system.

Legislative Change Implementation

- Completed a new Legislative Change Implementation process to help ensure CalPERS complies with any new legislation.

EMBEDDED COMPLIANCE PROGRAM

Partnering with embedded compliance liaisons in key program areas is an important strategy ECOM uses to help maximize compliance efforts. These partnerships provide a reporting mechanism and helps solidify an enterprise-wide culture of compliance. Embedded liaisons are team members whose job function partly includes helping their program areas promote, coordinate, and facilitate compliance efforts. Sometimes referred to as Compliance Champions, the embedded compliance liaisons often help bridge compliance concerns between ECOM and program area team members.

Customer Services and Support Branch

The Customer Services and Support (CSS) Branch administers pension benefits and related services to our members and business partners. We deliver end-to-end customer service adaptive to our customers' needs. Our embedded compliance program supports a coordinated effort to ensure compliance with all applicable laws, regulations, and polices that govern our business.

Compliance Highlights

- Reduced the unclaimed benefit account by millions of dollars and clearly defined the process for handling unclaimed benefits in accordance with findings from the Office of Audit Services.
- Collaborated with the Legal Office to ensure compliance with Federal tax regulations for members who purchased service credit and elected a tax-deferred payment schedule
- Implemented a new Service Credit Purchase Election at Retirement packet for members with a service credit purchase balance and a retirement date.
- Clearly defined tax recovery process for unclaimed benefits and death overpayments
- Expanded the services delivered by our death verification provider to include continuous monitoring of updated death reports against CalPERS payee data more frequent than our previous monthly reporting.
- Collaborated with the Information Security Office to enhance MSS security.
    - Implemented security incident workflows
    - Masked account and routing numbers in MSS payment option pages.
    - Enhanced user requirements to validate direct deposit changes.
    - Implemented Knowledge Based Authentications for secure transactions.
    - Implemented two-factor authentication capabilities.

- In partnership with ERMD, rolled Operational Risk Event reporting out to every CSS division.

Financial Office

The Financial Office (FINO) safeguards our members' financial security through control, coordination, and centralization of all CalPERS financial activity, budgeting, and risk management. The following program areas are part of FINO:

- Enterprise Risk Management Division
- Financial Planning, Policy & Budgeting Division
- Financial Reporting & Accounting Services Division
- Pension Contracts and Prefunding Programs

Compliance Highlights

- Enhanced Financial Office communication efforts regarding mandatory training and form 700 filing requirements.
- Partnered with ECOM to establish a plan to update Financial Office policies, procedures, accounting statements, and guidelines to ensure all are working as intended and in compliance with CalPERS standards.
- Partnered with ECOM to ensure compliance-risks were mitigated during selection of a new third-party administrator for CalPERS defined contribution retirement plans.
- ERMD communicated and trained all Financial Office team members on Operational Risk Event reporting.

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 comprised of the following divisions:

- Health Account Management Division
- Health Plan Administration Division
- 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.
- Established process to resolve business partner audit observations reported by the Office of Audit Services that includes a timeline, communication plan, and dedicated audit liaison to bring employers into compliance.

Compliance Reporting

- Developed and submitted annual report on health premium increases and decreases.

Health Benefits Program

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

Investment Office

The Investment Compliance and Operational Risk (ICOR) Office serves as an embedded compliance function and assists our Investment Office team members by ensuring compliance with key policies, laws, and regulations that impact the Investment Office.

Compliance Highlights

- Designed pre- and post-travel compliance workflows for the Travel Review and Expense Claim system.
- Implemented changes to public-facing content to comply with recent web accessibility requirements.

Operations and Technology Branch

The Operations and Technology (OPT) Branch's Embedded Compliance Team acts as branch liaisons between OPT, ECOM, ERMD, and the Office of Audit Services. They help ensure compliance with mandatory training and disclosures, assist with policy creation and updates, and ensure compliance with contracting delegations of authority. Additionally, they coordinate the resolution of audit findings within OPT.

Compliance Highlights

- In partnership with ERMD, conducted 17 Operational Risk Event Reporting trainings for all OPT divisions and submitted 16 Operational Risk Events.
- Developed branch-specific Quarterly Compliance, Risk, and Audit reporting
- Updated and communicated the Badge Access Card Policy to require new photos every five years.
- Created Temporary Badge Card Guidelines and Card Access Request Guidelines
- Conducted three badge card audits.
- Drafted, received Legal approval, and communicated the addition of a new Criminal Background Check Certification to the contract template.
- Worked with ECOM on all OPT Annual Governance Reviews (policies, delegations, and charters).
- Facilitated 100 percent on-time completion of OPT's Annual Form 700 submission, Form 700 Ethics Training, and all Mandatory Trainings.

SUMMARY

The compliance program 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. Compliance elements are interwoven into all six of CalPERS' Core Values of Quality, Respect, Accountability, Integrity, Openness, and Balance. ECOM takes pride in leading these efforts and will continue to give guidance and direction as CalPERS strives to build a sustainable future based on a strong foundation of ethics and compliance.