



## Agenda Item 6a

June 18, 2013

**ITEM NAME:** Investment Office Non-Advisory Services Standard Contract Terms and Conditions – Alignment of Terms and Services

**PROGRAM:** Total Fund

**ITEM TYPE:** Action

### **RECOMMENDATION**

Approve recommendation to allow the Investment Office to use a Risk Assessment Worksheet to modify three standard contract terms and conditions (Indemnification, Limited Liability, and Fiduciary) for a subset of investment consulting contracts – those contracts that do not include investment advisory services.

### **EXECUTIVE SUMMARY**

This item clarifies the initial exclusion of “investment consulting contracts” from the October 2012 Finance & Administration, Agenda Item 5a “Standard Contract Terms and Conditions Modifications” (Attachment 1) modifications.

This item clarifies that the modified standard terms and conditions (T & C Modifications) approved by the Finance & Administration Committee in October 2012 can be used for investment services contracts where the consultant is not providing investment advice to CalPERS.

### **STRATEGIC PLAN**

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. The T & C Modifications will support CalPERS staff in achieving the System’s investment objectives through timely engagement of qualified consultants.

### **BACKGROUND**

In October 2012, the Operations Support Services Division (OSSD) in collaboration with many areas of the enterprise presented Agenda Item 5a, “Standard Contract Terms and Conditions Modifications,” to the CalPERS Finance & Administration Committee.

The T & C Modifications were proposed to resolve issues with three main contractual terms – Indemnification, Unlimited Liability, and Fiduciary Responsibility – terms which routinely prolonged the contract negotiations and at times resulted in parties refusing to execute contracts with CalPERS.

In the October 2012 agenda item, OSSD requested approval of staff's recommendation to modify the three standard contract terms (Indemnification, Unlimited Liability, and Fiduciary Responsibility) and have the usage of these modified terms based upon the completion and approval of a Risk Assessment Worksheet that deem a contract to be low, medium or high risk.

Although this item was developed with many areas of the enterprise, due to timing issues, INVO was not included as one of the areas that could utilize this process. In addition, the agenda item arguably excluded investment consulting contracts by stating,

*"...the Legal Office did an analysis to define which contracts should include fiduciary responsibility language. The fiduciary language currently is (and will continue to be) in all contracts for investment managers, investment advisors, investment consulting contracts including pools ([Private Equity], Real Estate, etc.), plan custodian and plan administrators (health-related administrators, benefit and investment plan administrators)."*

## **ANALYSIS**

Although INVO contracts were not included in the October 2012 OSSD agenda item, OSSD's recommendation to the Finance & Administration Committee is consistent with findings from a 2011 INVO Rapid Results project which reviewed existing contracting processes and was conducted in coordination with the CalPERS Legal Office. This project recommended using the OSSD Risk Assessment Worksheet with an enhancement that includes investment specific risk criteria.

Using the Risk Assessment Worksheet, with added investment risk criteria, INVO staff will identify investment non-advisory services contracts that are low, medium, and high risk contracts and will utilize the T & C Modifications for those contracts assessed as low to medium risk as follows:

- Indemnification: adding "gross" to the negligence portion of the clause
- Fiduciary: Removing the word "fiduciary" from the standard conflict of interest clause as well as the fiduciary provision unique to INVO's consulting contracts (Attachment 2)
- Unlimited Liability: capping liability to a multiple of the contract amount

This process will be utilized only for investment non-advisory service contracts where the contractor has no discretion to make investment decisions on behalf of CalPERS and that therefore do not warrant application of a fiduciary duty standard of care.

Investment non-advisory services typically include:

- Strategic planning
- Organizational development
- Project management
- General administration
- Operational improvements
- Investment technology services
- Valuation services which do not make nor recommend specific investment or portfolio allocation decisions
- Due diligence services without a recommendation
- Monitoring

These types of contracts are typically low to medium risk and therefore qualify to be assessed by the Risk Assessment Worksheet, as developed by OSSD and modified by INVO with additional investment specific risk criteria.

### **BENEFITS/RISKS**

By modifying three areas of the standard contract terms and conditions on a risk assessed basis, CalPERS will benefit through:

- Reduced staff time spent on lengthy contract negotiations for lower risk contracts.
- Ability to execute contracts in a timelier manner.
- Improve the quality of the consultant pool that will be willing to contract with CalPERS.
- Align INVO's processing of low and medium risk non-advisory contracts with the rest of the enterprise.

Potential risks may include:

- Program requesting a project or additional work through a contract amendment or letter of engagement could potentially change the risk level of the contract.
  - This risk is mitigated since contract amendments and letters of engagement will go through the risk assessment process.
  - This risk is also mitigated by the new policy requiring the Board's approval on any contract activity over \$1 million.
- Low dollar contracts currently have an unlimited liability provision and stronger indemnification language. Under the modified terms, the liability of a contractor under a \$25,000 contract will be limited to \$50,000 (for a low risk contract) or \$100,000 (for a medium risk contract).
  - There is a small exposure that a low dollar contract could have reputational impacts and a small amount would be recovered.

**ATTACHMENTS**

Attachment 1 – Finance & Administration, Agenda Item 5a (October 15, 2012)

Attachment 2 – Stricken Fiduciary provision unique to INVO's consulting contracts

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