



## Agenda Item 6c

March 16, 2015

**ITEM NAME:** Revision of the Responsible Contractor Program Policy and Integration of the Legacy Policy

**PROGRAM:** Targeted Investment Programs

**ITEM TYPE:** Policy & Delegation – Action

### **RECOMMENDATION**

Approve amendments to the Statement of Investment Policy for the Responsible Contractor Program (RCP Policy or Policy) including the incorporation of the Neutrality Trial RCP Policy into the RCP Policy and repeal of the Neutrality Trial RCP Policy. The revised Policy Statement is provided as Attachment 1 and the Neutrality Trial RCP Policy to be repealed as Attachment 2.

### **EXECUTIVE SUMMARY**

CalPERS has a deep interest in the condition of workers employed by CalPERS and investment managers at its Real Estate and Infrastructure investments. CalPERS through the RCP Policy supports and encourages fair wages and benefits for workers employed by its contractors and subcontractors, subject to fiduciary principles. CalPERS believes that an adequately compensated and trained worker delivers a higher quality product and service. In an effort to further improve the Responsible Contractor Program, staff initiated a Policy revision effort that culminates in this agenda item.

At the December 2013 Investment Committee meeting, the Board requested staff initiate a RCP Policy review process. Staff worked with labor representatives, investment managers, the Board's real estate consultant, fiduciary counsel, and Investment and Legal Office staff to discuss the Policy and suggestions identified by labor representatives. After a twelve month review, staff brought analysis and recommendations to the December 2014 Investment Committee for initial review.

As an outcome of that 2014 meeting, staff has incorporated the suggested policy revisions into the RCP Policy, and based on further exploration of key issues, is now recommending incorporating additional changes into the RCP Policies. In total, staff's recommended revisions to the Policy include:

- Core managers will be subject to heightened neutrality requirements consistent with the successful Neutrality Trial Program (NTP)
- Selected non-core Real Estate and Infrastructure managers will be subject to a new NTP

- Neutrality Trial RCP Policy will be incorporated into the RCP Policy such that all RCP-related requirements are located in a single policy document. The stand-alone Neutrality Trial RCP Policy will be repealed
- Certification of Responsible Contractor form will be clarified and strengthened
- Delegate definition will be clarified to include general contractors, resulting in clarification that bidding and notification requirements apply to general contractors
- The RCP Policy will reference CalPERS' Investment Beliefs
- The RCP Policy will be improved by other technical and clarifying edits including the addition of a table of contents.

The draft Policy represents a focused effort to have comprehensive responsible contracting Policy requirements without adverse effect on investment returns, access to investment opportunities, cost to administer the Policy, or access to responsible contractors. Staff will request managers who are subject to the RCP to report on their experience in implementing the Policy and the impact, if any, on CalPERS investments annually. The draft Policy is recommended by staff and consultants. Please see attachments for the redline version of the proposed revised RCP Policy, the Neutrality Trial RCP Policy to be repealed, and the Board's real estate consultant opinion letter.

### **STRATEGIC PLAN**

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability through actively managing business risks.

### **INVESTMENT BELIEFS**

This agenda item supports CalPERS' Investment Belief 4 to create long-term value through effective management of financial, physical, and human capital. Effective management of human capital increases the likelihood that companies will perform over the long-term and manage risk effectively. This agenda item also supports Investment Belief 3 in which CalPERS' investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.

### **BACKGROUND**

The CalPERS RCP Policy was established in 1998. Since inception it has been revised several times, most recently, in a policy review and revision process initiated in 2009 and ending in 2012. This process resulted in the establishment of the first ever NTP in 2010, as well as comprehensive revisions to the RCP Policy that were approved by the Investment Committee in February 2012. The revised Policies established specific requirements related to neutrality, clarified and strengthened bidding notification, compliance and enforcement requirements, and significantly increased manager roles and responsibilities including making managers responsible for contractor compliance with the Policies.

In December 2013 staff presented the first annual report to the Investment Committee under the revised RCP Policy. In response to issues raised by labor representatives, the Investment Committee requested staff initiate a policy review to determine if additional revisions to the Policies were necessary. This process has required significant staff and consultant time and resources.

The policy review process began with a series of dialogues with labor representatives and external managers on the revised Policies. Staff held round table conversations with labor representatives and managers to discuss the issues raised by labor representatives and hear managers' views on the Policies. Staff also engaged with labor representatives and managers in individual conversations to discuss issues of concern. In general, labor representatives proposed a series of heightened policy requirements related to neutrality, bidding notification, compliance, and enforcement.

In order to receive consistent feedback from managers on the suggested policy revisions from the labor representatives, all Core and select non-core Real Estate and Infrastructure managers were surveyed anonymously on the current Policies and labor representatives suggestions. Through written comments, verbal conversations, and survey responses, managers have indicated the proposed amendments in the draft Policy should mitigate labor risk and not substantially impact their ability to compete in the marketplace.

CalPERS has a deep interest in the condition of workers employed by CalPERS and its managers and contractors, subject to fiduciary duty. Investment Office staff, in consultation with CalPERS' Legal Office staff, the Board's fiduciary counsel, and Pension Consulting Alliance, has carefully weighed these goals and responsibilities in crafting all policy recommendations.

## **ANALYSIS**

In the December 2014 presentation to the Investment Committee, staff's recommendations fell into three categories: 1) suggested policy revisions; 2) areas for additional exploration; and 3) policy revisions not recommended by staff. Policy revisions not recommended by staff were analyzed and addressed fully at the December Investment Committee meeting. As an outcome of the December meeting, staff moved forward with implementing the suggested policy revisions, which are included in the attached revised Policy. These revisions include the following:

### **Suggested Policy Revisions**

All of the items that staff recommended be included in the RCP Policy have been incorporated into the revised RCP Policy. They are:

#### Incorporate the NTP into the RCP

There has not been robust organizing activity during the trial period. However, based on input received from managers indicating the NTP has not had

significant impact on competition or cost. Staff incorporated the NTP provisions, as currently written, into the RCP Policy. Key elements of the heightened neutrality provisions include:

- CalPERS, Core managers, contractors and subcontractors are required to remain neutral in the event of an attempt to organize workers
- Neutrality provisions apply to service contracts over \$100,000
- Professional services and construction contracts are exempt
- Managers may grant themselves exemptions under certain circumstances outlined under the Policy
- All exemptions must be reported to CalPERS' staff within specified period of time

Amend the RCP to include a table of contents

This revision will make the Policy more navigable for stakeholders.

Amend the RCP to reference the Investment Beliefs

The RCP policy is consistent with the Investment Beliefs, and has been revised to state such.

**Areas for additional exploration**

Staff also performed analysis on areas identified for further exploration. This analysis included dialogue with managers and labor representatives and requests for comments to further explore the issues. As a result of this process, additional revisions to the Policy are recommended including:

Extend the NTP to select non-core Real Estate and Infrastructure managers

In order to determine the impacts, if any, of requiring neutrality for select non-core Real Estate and Infrastructure managers and their assets, staff recommends implementation of a new NTP mandating neutrality of non-core Real Estate and Infrastructure managers, their contractors and subcontractors regarding service contracts. Key elements of the new non-core NTP would include the heightened neutrality provisions that apply to core managers. In addition:

- The new NTP would apply, on a voluntary basis, to the following non-core Real Estate and Infrastructure funds:
  - CIM's 301 Capital Mall, LP
  - Hines HC Green Development Fund, LP
  - AGI Resmark Partners Housing Fund, LLC
  - CIM Infrastructure Fund
  - Harbert Gulf Pacific Power, LLP
  - UBS Golden State Matterhorn, LLC

- Contracts would become eligible for the NTP when they are executed or amended on or after the effective date of the new NTP
- The new NTP would be effective July 1, 2015 – June 30, 2017

Enhanced and strengthened the Responsible Contractor Certification form

Staff worked with managers and labor representatives to add additional requirements to the Responsible Contractor Certification form. The improvements will provide managers with additional information on a contractor's responsible status. Managers have provided feedback that the revised Responsible Contractor Certification is unlikely to impact the number of contractors bidding or costs. Proposed revisions include:

- Contractors will be required to answer additional and enhanced questions on wages and benefits provided to workers
- Questions will be added to the certification focused on complaints stemming from labor and environmental law violations and criminal convictions related to awarding or performing government contracts
- Managers will receive more information about contractor status from the enhanced and strengthened Responsible Contractor Certification form
- The voluntary Responsible Contractor Worksheet will be eliminated

Clarify the role of general contractors in the Policy

Language clarifying the role of General Contractors as Delegates has been added to the Policy.

Review Manager reporting requirements under the Policy

Staff reviewed the current manager reporting requirements under the Policy and determined they are addressed sufficiently under the current Policy. However, staff will continue to engage with managers on providing detailed and robust information in their Annual RCP Reports.

The Annual Report on Managers' Responsibilities has been reformatted and changed to clarify that substantive and detailed information on bidding and notification is required annually. The Annual Report templates are updated annually, and thus are not part of the RCP Policy.

During the 14-month Policy review process, staff engaged with labor representatives and Real Estate and Infrastructure managers on the Policy generally, bidding and notification, general contractors, 30-day notice, and hiring of Responsible Contractors. This dialogue contributed to the suggested revisions, and has afforded staff opportunity to engage with managers on the intent and implementation of the Policy. With respect to providing notice on bidding opportunities, staff has continued to encourage all Core managers and several non-core managers to reach out to

LiUNA to engage on bidding opportunities under the current Policy. Staff has encouraged LiUNA and managers to communicate directly with one another on issues of concern to try to find common ground.

To date, this engagement has resulted in managers increasing their communication with LiUNA, establishing on-going dialogue on current and future bidding opportunities, as well as attempting to secure competitive bids from LiUNA signatories. Based on the initial outcomes from this engagement, staff believes this process to be positive and productive.

Should the Investment Committee approve the proposed draft Policy, the Policy will go into effect July 1, 2015. This implementation date will allow investment managers time to establish processes needed to comply with the revised Policy, and aligns the effective date of the Policy with the beginning of the fiscal year reporting cycle.

Note: The heightened neutrality provisions for Core, the new NTP for non-core, and infrastructure managers, in Addendum A and B, are a result of merging the RCP and NTP policies. Although Addendums A and B appear new in redline, this is the result of merging the two policies.

#### **BUDGET AND FISCAL IMPACTS**

There are costs associated with the Policy revision process and the administration and compliance with the Policy going forward.

During Fiscal Year 2013-2014, the approximate Investment Office cost to support the RCP Policies and engage on labor issues was \$270,000 (which included staff costs of \$176,000 and consultant services of \$94,000). Staff anticipates that costs for administering the Policy will rise should the current level of engagement and Policy revision continue.

Managers reported varying costs to implement and administer the Policy, ranging from \$5,000 to \$175,000 annually. Variation is primarily due to differences in total assets under management and number of RCP contracts of each manager. Approval of the revised Policy may result in increased cost to implement and administer the Policy. This is due to non-core managers being subject to a new NTP, and any additional administrative burden that may be placed on all managers as a result of the enhanced Responsible Contractor Certification process. Staff will track and report meaningful cost impacts to the Investment Committee.

#### **BENEFITS/RISKS**

The Policy encourages positive labor relationships, and is consistent with CalPERS reputation as a responsible investor. Labor risk is mitigated by reducing the likelihood of strikes, demonstrations and other labor actions related to the provision of construction and services in CalPERS-owned assets. The time and cost to administer

the Policy should be balanced by the mitigation of labor and reputational risk. As such, the Policy contributes to the Real Estate and Infrastructure Units' abilities to secure appropriate risk adjusted investment returns.

The proposed revised RCP Policy strengthens and enhances the Policy by incorporating the current NTP into the Policy for Core managers, launching a new NTP aimed at selected non-core Real Estate and Infrastructure managers, and strengthening the Responsible Contractor Certification process to help managers more accurately determine responsible contractor status.

While CalPERS investment managers have expressed willingness to proceed under the proposed Policy; they have also expressed concern that if additional requirements are imposed they may not be able to meet their core obligations to CalPERS. The Policy is, and always has been clear that fiduciary obligations are first and foremost. Staff will request investment managers to report on their experience in implementing the Policy and the impact, if any, it has on CalPERS investments.

**ATTACHMENTS**

Attachment 1 – Proposed Revised RCP Policy

Attachment 2 – Repealed Neutrality Trial Policy

Attachment 3 – Pension Consulting Alliance Opinion Letter

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