
December 18, 2017

Item Name: Responsible Contractor Program Annual Report

Program: Sustainable Investment

Item Type: Information

Executive Summary

This agenda item provides the required annual update on the Real Assets program's compliance with CalPERS' Responsible Contractor Program (RCP) Policy. For fiscal year 2016-17, 99.97% of qualifying contract payments were made to certifying responsible contractors.

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

Responsible Contractor Program Policy

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.

Annual Report

This agenda item is the second report under the revised and enhanced RCP Policy approved by the Investment Committee in March 2015. The RCP Policy seeks to secure the condition of workers employed by CalPERS and investment managers without adverse effect on investment returns, access to investment opportunities, or significant cost impacts.

The compliance information presented is limited to contracts of \$100,000 and above, and applies to all domestic Real Estate and Infrastructure investment managers, joint ventures, and

partnerships where CalPERS has greater than 50% ownership interest and the standards of the RCP Policy are met.

2015 Responsible Contractor Program Policy Revision

In March 2015, the Investment Committee amended the RCP Policy to incorporate the 2010 Neutrality Trial RCP Policy, initiate a new Neutrality Trial applicable to select non-core Real Estate and Infrastructure managers, and establish a more comprehensive Certification of Responsible Contractor Status (Contractor Certification). On July 1, 2015, Real Estate and Infrastructure managers began operating under the revised and enhanced Policy. This is the second report under the revised and enhanced policy. Prior to 2015, the RCP Policy was revised in February 2012, when 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 were established.

Analysis

Annual Report Fiscal Year 2016-17

For the Fiscal Year 2016-17, Real Estate, Infrastructure, and Housing Program managers paid in excess of \$1.18 billion toward RCP contracts with a combined compliance rate of 99.97%. Core investment managers paid 100% and non-core investment managers paid 99.9% of their total qualifying contracts to certifying responsible contractors under the Policy (Attachment 1).

Under the RCP Policy, compliance for existing Housing Program managers is not mandatory, though strongly recommended. All Housing Program managers have voluntarily submitted annual compliance reports. For Fiscal Year 2016-17, Housing Program investment managers awarded 99.95% of the qualified capital expenditure contract payments to certifying responsible contractors (Attachment 2).

Responsible Contractor Certifications

For the Fiscal Year 2016-17, all Real Estate and Infrastructure investment managers subject to the RCP Policy, and all Housing Program managers voluntarily complying, have certified in writing that, to the best of their knowledge, they and their delegates and sub-delegates have complied with the RCP Policy and, more specifically, with the roles and responsibilities stated within the Policy.

Manager Responsibilities

The 2015 RCP Policy includes a new manager responsibilities questionnaire. For Fiscal Year 2016-17, 19 of the 19 managers that reported assets subject to the RCP Policy submitted information under the enhanced reporting requirements. The following is a summary of their responses.

- All 19 managers maintained written policies and procedures for implementing and complying with the RCP Policy. All managers provided employee training on administering the Policy.
- All managers with active RCP contracts communicated the RCP Policy, and its own written policies or procedures relating to the RCP Policy, to all of their contractors.
- Sixteen managers reviewed lists of current and pending RCP Contracts provided by each of their contractors¹.

¹ Of the three remaining managers, two are Housing Managers that comply with the Policy on a voluntary basis and the last had no RCP contracts for the year.

- All managers monitored and enforced their and their contractors' compliance with the Policy, including the investigation of potential violations.
- Six managers reported expanding into new areas during the reporting period. All six managers notified, or are in the process of notifying, trade/service unions of their expansion.
- All managers that bid contracts during Fiscal Year 2016-17 reported using or causing contractors to use a 30-day pre-bid procedure when appropriate under the circumstances.
- More than half of managers provided comments regarding additional activities undertaken to administer the RCP Policy. Most activities reported were communication or engagement with labor.
- All Core managers and two non-core managers reported costs related to administering the RCP. Of those managers that reported costs, most estimated between \$25,000 and \$200,000 to administer the policy. Estimates vary according to the number of qualifying contracts and the unique staffing and implementation practices of each manager.
- No managers reported the Policy had material impact on CalPERS investment returns.

Notification

The RCP Bidding Notification Method and Contact Sheet (Attachment 3) includes names of managers, notification methods, and email addresses. In addition to being publicly available on the CalPERS website, staff emails this list to all interested parties whenever it is requested.

RCP Policy and Total Fund Labor Formal Complaints and Issues

The Investment Office continues to address labor issues as they occur, in accordance with the RCP Policy and the Investment Beliefs. These issues continue to absorb a significant amount of staff time. No formal complaints were filed during the reporting period.

Neutrality Trial

The current Neutrality Trial went into effect on July 1, 2015 and applies to select non-core Real Estate and Infrastructure funds on a voluntary basis. All funds participating in the trial have agreed to voluntarily comply through December 31st, 2017. To date, only one manager has reported having qualifying contracts under the Neutrality Trial. The manager awarded four qualifying contracts totaling approximately \$4.8 million. This manager reports that the Neutrality Trial did not affect the bidding process and ultimate awarding of any new service contracts.

Staff recommends that new opportunistic Real Estate and Infrastructure funds continue to operate on a voluntary basis under the Neutrality Trial in order to continue to collect additional data around potential material impacts to CalPERS investments. Staff will report annually the status of new funds and results of the Neutrality Trial to the Investment Committee.

Budget and Fiscal Impacts

Existing budgetary resources fund the ongoing costs for implementation, administration, and management of the RCP Policy for the CalPERS Investment Office. During Fiscal Year 2016-2017, the Investment Management Engagement Program's (IMEP)² approximate cost to support the RCP Policy and engage on labor issues was \$77,000 (which included estimated staff costs of \$50,000 and consultant services of \$27,000). Fiscal Year 2015-16 costs of \$79,250 were similar.

² In September 2017, ownership of the RCP Policy and total fund labor relations work streams shifted from IMEP to the Sustainable Investment Program.

In addition to IMEP's costs, there is an ancillary fiscal impact to the CalPERS Investment Office and CalPERS Legal and Executive Offices and the Board of Administration that the Investment Office is not able to quantify.

Benefits and Risks

Strong governance, along with effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long-term and manage risk effectively.

Attachments

Attachment 1 – Responsible Contractor Program Annual Report Presentation

Attachment 2 – Investment Manager Combined Compliance Report

Attachment 3 – Voluntary Participation Report: Housing Program

Attachment 4 – RCP Bidding Notification Method and Contact Sheet

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