V. Contractor Disclosure Guidelines

**Background:**

The Fair Political Practices Commission (FPPC) requires government entities to establish reporting and monitoring policies and practices, within the FPPC guidelines, on board members, employees and vendors. This process is designed to provide information on financial interests that may present a conflict in the course of the duties or services provided to the government.

The disclosures are general in nature and cover:

- Investment interests
- Real property interests
- Business interests; income and business positions
- Loans
- Gifts
- Travel payments

The shortcoming of the reporting process is it focuses on specific financial interests of a designated person but does not elicit detail of company financial interests, or details of other benefits that may be received.

In addition to the FPPC requirements, contractors should comply with all other applicable disclosure requirements that are included in California laws.

**Recommended Guidelines:**

Contractors may act in the capacity of a fiduciary. They may also provide information that could influence a client in forming his or her estimate of the advantages or disadvantages of a proposed agreement, policy or relationship. Understanding how they are paid and what other compensation or financial interests they may have is important to you ensuring that you have independent advice that suits the best interest of your organization.

The following disclosures are required for the business entity and any key employees; those who work directly on the contract or are in a management or ownership position with the contracting firm.

**What is the minimum we need to know?**

*The pool should gain a basic understanding of contractual and business relations that may influence the decisions and recommendations of your contractor.*

**Each Contract should have the following parts:**

- **Scope:** this clarifies what services and duties the agreement covers. It is an important part of the contract to assure you summarized the expected services clearly.
- **Indemnification & Insurance:** Fidelity bond if they write checks or have custody of assets. When a contractor is providing you services or acting in your behalf, they may be considered your agent. As such, you may be sued or held liable for their acts. Indemnification clauses help protect you from their acts. Insurance requirements will
depend on the contractor, but typically you would require general liability, errors and omissions or professional liability.

- **Compensation:** defining what compensation is in a contract on its face seems pretty straightforward, is it a fixed fee or a rate per hour. However, contractors may participate in acquiring services for you or helping you make purchasing decisions. Often they may have relationships with these other service providers that will pay a commission or other benefits.

- **Term:** the period of the contract should be specific to ensure that there is a fixed and periodic review of the services and fees.

- **Cancellation:** every good contract addresses exit clauses to provide an opportunity to cancel the agreement if you are not satisfied or if there is some reason the services are no longer needed.

- **Ownership of records:** this is a key provision to ensure that you have the information critical to your operations. The records often provide historical activity, calculation and formula that are part of the core of your operations. An ownership provision should not only indicate that you ultimately own your own data, but for this data to be of use to you, you must be able to access it in the proper computer readable format. For example, if you changed claims administrators and the prior administrator just gave you the paper files and not the electronic files in a usable database format, the paper files would be very difficult to summarize and use as a historical database.

- **Disclosure of Conflicts:** Disclosures about relationships and interests that may in fact or in appearance influence the advice or decisions of the contractor. For example; the brokerage company you deal with has an ownership interest in the insurance company recommended.

- **Fines & Penalties (W/C only):** Workers compensation laws have many requirements for notices and payments to meet certain due dates. If these are not met then a self-assessed penalty must be made. Typically, these penalties are the responsibility of the claims administrator (where it was a result of their staff, and not the member). By requiring the claims administrator to pay these amounts, it may make them more diligent in meeting regulatory deadlines.

- **Alternative Dispute Resolution (ADR):** Resolving disputes through mediation and binding arbitration is usually quicker and less expensive. Legal liabilities and defenses are not changed by ADR.
Insurance Brokers

When purchasing insurance, the most important factors for a Joint Powers Authority to consider are:

- The scope of coverage,
- The cost of the coverage,
- The quality and value of services to be received from the insurer, and
- The financial stability and credit rating of the insurer.

Most JPA’s retain the services of a broker to obtain insurance or reinsurance. Accordingly, it is important that JPA’s are equally diligent about understanding:

- The markets the broker will approach and any intermediaries the broker will engage in the process,
- Ownership ties that exist between the JPA’s broker, involved intermediaries and insurers or reinsurers,
- The experience, credentials and reputation of the insurance broker,
- The content and appearance of underwriting data that the broker will present to the market on behalf of the JPA, and
- The services the broker will provide and the method and amount of compensation the broker will receive for such services.

Brokerage compensation arrangements can be quite complex and not all aspects of them are necessarily transparent. If the JPA is comparing brokers it is important to ensure there is a level playing field. This requires a precise understanding of all factors in the list immediately above this paragraph.

The agreements between JPA’s and insurance brokers should ensure that the items listed above are addressed in the agreement or in periodic meetings or disclosures.

To ensure that there is sufficient transparency to disclose the vendor relationships with the Joint Powers Authority, and to provide disclosures as appropriate on related financial arrangements, clients may want to consider additional disclosures covering the items listed below:
Guidelines for disclosures between Brokers and their client
Joint Powers Authorities

For purposes of this section, financial interest is defined as: any ownership interest, joint contractual relationships with this JPA or others to bundle services or jointly provide services.

1. Brokers should be required to disclose financial interests with related vendors, directly or indirectly providing services to the JPA such as:
   i. Program Administrator
   ii. Claims administrators
   iii. Bill review services
   iv. Loss control consultants
   v. Insurance and reinsurance carriers
   vi. Surplus lines brokers, managing general agents, reinsurance brokers and similar intermediaries
   vii. Others serving this JPA

2. Brokers should be required to disclose compensation arrangements earned under or affected by this contract; including but not limited to:
   a. Is the broker sharing of compensation with outside parties?
   b. What is the form and amount of compensation?
   c. Does the broker receive supplemental compensation from carriers or upstream intermediaries based on placement volume or profitability?
   d. Are there any retrospective bonus arrangements?
   e. Are there any other incentive pay arrangements the broker participates?
   f. Does the broker receive any third party payments? Such as, receipt or potential receipt of income from a third party, which income derives in whole or in part from a transaction on behalf of the client.

   i. Examples of what incentive compensation may include:
      1. placing a particular volume of business with the insurer.
      2. achieving a particular growth target
      3. securing a target rate of retained business with the insurer
      4. placing or keeping business with an insurer that achieves a particular loss ratio or target profitability, however stated
      5. obtaining anything else of material value from the insurer.
In addition to the above items;

3. Specifics to be disclosed related to the above arrangements by the broker should include:
   a. Disclosure of the relationship
   b. Disclosure of the amounts
   c. Disclosure of the basic terms on which income may be derived

4. Scope: when fulfilling the disclosure obligation, the broker should ensure that direct dollars, including the wholesale relationship, be disclosed.
   a. The broker may consider materiality when making the disclosure but the dollar amount or range must be disclosed.
   b. If certain amounts are unknown, the broker must disclose the method for calculating it and a “reasonable estimate” of the amount. If the specific amount is not known, a good faith range or estimate is an appropriate substitute. By making a reasonable attempt, this would not be a breach of the disclosure obligation.

5. Other:
   a. Consider some attestation that the broker completed this disclosure with due diligence.
   b. Consider whether this be a limited use disclosure where reliance may only be the specific parties of the contract.
   c. If there is a relationship, the JPA should review the disclosures and consider if they need to make further inquiries.
   d. Form; the JPA and or broker may create a format that is sufficient to meet these disclosure guidelines.
   e. Recommend this be an annual disclosure requirement.
   f. Have the disclosures subject to audit as may become necessary.
   g. Include a formal report and sign-off by an officer of the broker agency.

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