CalPERS' 2021 Federal Legislative and Policy Priorities

Investments

Millions of Americans, including CalPERS' members, rely on the financial markets for their retirement security. For CalPERS, 55 cents of every dollar we pay in benefits come from investment returns. With a $445 billion pension fund and liabilities for decades ahead, we need to generate a 7% rate of return per year. The sustainability of portfolio companies and safety, soundness and efficiency of financial markets are of vital importance. Long-term value creation requires effective management of three forms of capital: financial, physical and human. In furthering this goal, we will advocate that Congress and financial regulators focus on the following priorities:

- **Sustainable Capital Formation**
  The acceleration of several ongoing trends is encouraging companies to stay private longer, resulting in many early-stage growth investment opportunities occurring in the private markets. These trends leave the majority of retail investors out of important growth opportunities, exacerbate wealth concentration and inequality, and cause institutional investors like CalPERS and other pension funds to pay higher fees relative to the public markets. More specifically, the increased activity by Special Purpose Acquisition Companies (SPACs), which are formed to raise capital through an initial public offering (IPO) in order to acquire an existing private company has helped fuel these trends. Given their "blank check" nature, limited visibility of the IPO and acquisition processes, and questionable economics, compensation, alignment of interest and structure, the SEC should enhance investor protections through increased disclosure and regulatory scrutiny of SPACs, and other similar structures.

- **Market Manipulation**
  Recent trading in Gamestop shares has highlighted that the SEC does not have an effective anti-manipulation and anti-disruptive trading rule. The SEC should strengthen its ability to investigate and curtail market manipulation. The SEC also should ensure that exchanges develop rules to eliminate improper manipulation.

- **Sustainable Equity Market Structure**
  We invest in global equity markets for their ability to provide exposure to economic growth and serve as a reliable source of liquidity. While our recently implemented factor-weighted strategies have helped to reduce overall volatility and provide some diversification of equity risk in our portfolio, they cannot fully mitigate the growing concentration of equity markets in mega-capitalized companies. We will advocate for policy proposals that strike an appropriate balance between encouraging entrepreneurship and capitalism, with the need for strong antitrust policy and curbs on monopolistic competition by the Department of Justice and the Federal Trade Commission.

- **Misaligned Incentives and Conflicted Order Routing Practices**
  Brokers are agents of investors, and they have a duty of best execution, which should mean they get their customers the best prices for their trades. However, the SEC and the Financial Industry Regulatory Authority (FINRA) have permitted brokers (even when acting as agents) to accept incentives for order routing, which they can keep and not disclose to their customers. These payment arrangements are considered "payment for order flow" for retail traders, however, the

same phenomenon happens with institutional traders like pension funds. In both cases, the customers often get worse prices, while their brokers make more money. In response to calls from numerous pension and mutual funds, the SEC adopted a fee pilot program in 2018 that would have eliminated those payments for up to two years to study the impact, however the program was halted by a Federal Court of Appeals last year. We supported the original fee pilot and will continue to advocate for reinstituting the program or another market-based response to the issue of payments for order flow.

- **Enhance Market Liquidity**
  The two major financial market shocks of 2008 and 2020 led the Treasury Department and Federal Reserve to develop several asset purchase and lending facilities that provided liquidity for companies and government entities authorized to participate. As major market participants, pension funds can also benefit from access to these types of emergency liquidity facilities during periods of major market stress. We will engage with policymakers and regulators to explore future opportunities for pension funds to participate in these types of programs designed to improve the effective flow of capital and support sustainable economic growth.

- **Housing and Infrastructure**
  CalPERS is committed to investing in California. We seek competitive risk-adjusted returns while contributing to the well-being of the state, its localities, and residents by increasing or improving the supply of affordable and workforce housing and developing critical infrastructure, as well as providing the conditions for business growth and stimulating job creation. Key to these efforts are reaching a long-term housing finance system design that, among other things, preserves the liquidity of the mortgage backed securities market and protects taxpayers from uncompensated catastrophic housing risk exposure. We will advocate for housing finance reforms and national mortgage-serving standards that protect investors, honor the seniority of debt holders, and provide enhanced data access. In addition, we will engage with policy makers and regulators to explore future opportunities for public pension funds and other institutional investors to facilitate and make investments in essential infrastructure assets suitable to our specific risk-return objectives.

- **Financial Disclosure of Carbon Risk**
  The International Accounting Standards Board (IASB) has issued guidance that promotes including certain climate risk items in financial statements. This is an important development that we will promote, and we will advocate that the SEC adopt similar policies in line with ensuring that climate risk is properly portrayed in financial statements.

- **Climate Change**
  Climate change presents serious long-term risks and opportunities to our portfolio. This risk must be addressed in a number of ways, including advocating for a carbon pricing regime that actually reduces carbon emissions, and for disclosures focused on governance, strategy, risk management, and metrics and targets.

- **Shareholder Charitable and Political Spending Transparency**
  We will support proposals that require public companies to disclose information related to their expenditures on charitable and political activities at the local, state, and federal levels, including

amounts donated to a third party to influence elections of candidates, ballot measures, or government actions.

- **Human Capital Management Disclosures**
  Enhance human capital management reporting requirements, including the addition of certain line-item disclosures regarding workforce demographics, health and safety, workforce productivity and compensation, diversity, equity and inclusion, and human rights.

- **Reestablish Shareholders' Rights to Allow for Private Ordering**
  Investors' focus on sustainability is reflected in an increasing number of sustainability related shareholder proposal filings at public companies. A troubling development in recent years has been the willingness of Securities and Exchange Commission (SEC) officials to provide "no action" relief to companies seeking to keep such proposals off the ballot and the new rules raising the thresholds under Rule 14a-8, thereby impeding shareholders' ability to submit proposals. The effect of these actions is to disenfranchise most shareholders, including CalPERS, which in turn will disparately impact proposals on issues such as climate change, diversity, and other environmental, social and corporate governance (ESG) issues. If private ordering is to be effective, the SEC must return to its historical mission of investor protection by: (1) making pro-investor no-action determinations regarding "ordinary business" which make clear that sustainability proposals are not ordinary business and should properly be the subject of a shareholder vote; and (2) rescinding the new requirements and resubmission thresholds under Rule 14a-8.

- **Reestablish PCAOB's Focus on Examinations, Enforcement, and Auditor Independence**
  A robust and engaged Public Company Accounting Oversight Board (PCAOB) is vitally important to ensure investor confidence in the quality of corporate financial reporting. The work of the PCAOB should be reimagined to include monitoring compliance, providing guidance on climate risk reporting, and other issues important to investors, such as human capital management. The PCAOB should work with auditors to determine whether companies are properly considering climate and other risks relevant to sustainable investment. Additionally, PCAOB should rescind the proposed rules amending the interim independence standards. These proposed rules will weaken auditor independence and will impede the ability of regulators to monitor and address auditor independence at the proper level, while also making it harder for investors and audit committees to fill the oversight gap left by the regulators.

- **Restore the Integrity of the Proxy Voting Advice Process**
  The SEC has issued new guidance determining that proxy voting advice generally constitutes a "solicitation" under the federal proxy rules and enabling increased company involvement in the proxy voting advice process. As a client of proxy advisory firms, CalPERS does not agree with the SEC's interpretation, and believes that if the client is satisfied with the service they are being provided, the SEC need not get involved. Additionally, the increased company involvement reduces the objectivity and independence of proxy voting advice. To better protect investors, the SEC should rescind exemptions from the proxy rules for proxy voting advice and its interpretation and guidance regarding the applicability of proxy rules to proxy advisory firms' advice.

Health

CalPERS is the largest employer health benefits purchaser in California and the second largest employer purchaser in the nation after the federal government. We purchase health benefits for approximately 1.5 million active and retired state, local government, and school employees and their family members. In 2021, CalPERS expects to spend approximately $10.2 billion to provide health benefits to our members. Of this expected $10.2 billion spend, approximately $2.6 billion will be for outpatient prescription drugs alone. CalPERS strongly supports legislative and regulatory changes that improve health care quality, access, and affordability for our members. Specific priorities during this Congress include:

- **Strengthen COVID-19 Response**
  - We support efforts that ensure federal Food and Drug Administration (FDA) approved vaccines are distributed and administered as quickly and equitably as possible. We also support efforts to align federal regulations for COVID-19 treatment with all other healthcare conditions once the public health crisis ends, including such things as ending the waiver of cost sharing, and addressing the uncertainty of future healthcare costs associated with the disease.
  - Any stimulus measure should provide relief to all impacted sectors of the economy to allow for a full and long-term economic recovery, including State and Local governments to assist in maintaining vital services to the public.

- **Lowering Prescription Drug Prices**
  Rising prescription drug costs are driven largely by the growing number and increasing launch prices of specialty drugs and gene therapies, which represent a small fraction of drugs prescribed and administered but account for a large portion of the overall CalPERS spend. We support proposals that maintain appropriate quality of and access to brand name, generic, biosimilar, and interchangeable drugs, as well as proposals to end anti-competitive arrangements used by some brand name and biological companies to block or delay the market entry of lower-cost generic drugs and biosimilar products.

- **Curb Anti-Competitive Practices**
  Consolidation of health care facilities, providers, and health plans have increased costs and reduced access over time. We support proposals that expand state and federal authority to prevent anti-competitive practices, including the prohibition of “anti-tiering” and “anti-steering” clauses in contracts between providers and health plans that restrict plans from directing patients to use specific providers and facilities with higher quality and lower prices.

- **Improve Behavioral Health Treatment**
  The burden of untreated and undertreated behavioral health conditions is both a major population health problem and a delivery system challenge. While statewide and national efforts, including parity legislation, stigma-reduction efforts, and large-scale federal waivers have made some important improvements in care delivery, most behavioral health systems lack the necessary tools to track outcomes at the patient and population levels. We support additional delivery system reforms that take a population-based approach, using data and patient-reported outcomes to drive change at the patient, practice, and population levels. We also support proposals that integrate behavioral health and medical services to improve patient outcomes, save money, reduce stigma related to behavioral health, as well as proposals that develop

improved behavioral health models consistent with these principals and encourage their adoption though payment incentives established by the Centers for Medicare and Medicaid Services (CMS).

- **Promote Healthcare System Improvement**
  Initiatives by the CMS Innovation Center have accelerated the shift from a volume-based healthcare system to a value-based healthcare system. For example, there are currently 33 CMS Innovation Center models being tested in California, involving 436 healthcare facilities. We support expansion of its portfolio of various payment and service delivery models that aim to achieve better care for patients, smarter spending, and healthier communities. We also support proposals to strengthen the Medicare program to ensure quality and affordable coverage for our participants, such as those to constrain cost growth, speed the shift away from fee-for-service, and sustain the Medicare Trust Fund.

- **Ending Surprise Billing**
  CalPERS supports the newly enacted federal ban on the practice of surprise balance medical billing, but we are concerned that requiring arbitration of billing disputes has the potential to increase complexity and cost. We will engage in the rulemaking process as necessary to implement this important new legislation to ensure it is as protective of health care consumers as possible.

- **Review Certain Executive Orders and Rules Released During the Prior Administration**
  In November 2020, the federal Department of Health and Human Services released a final rule to require insurance companies and their pharmacy benefit managers to pass through rebates they receive from drug makers to patients at the pharmacy counter under Medicare's Part D program. The rule is currently being challenged in court and provisions of the rule that were scheduled to take effect January 2022, which include the elimination of safe harbors for drug rebates, have been ordered postponed until January 2023. CalPERS has opposed this rule in comment letters and supports efforts to rescind this proposed rule.

Retirement Security

CalPERS is the nation's largest public pension system, with approximately 2 million members from California's state, school, and public agency employers. Despite the economic uncertainties brought on by the COVID-19 pandemic, we continue to strive to meet our mission to deliver the benefits our members have earned. In order to achieve the CalPERS Strategic Plan goal to enhance the long-term sustainability of the pension fund, we will work to inform Congress, the Administration, and other national opinion leaders about defined benefit plans and the value they provide, not only to public sector employees, but to the general economy. Specific priorities in this Congress include:

- **Advance Retirement Savings and Security for All Employees**
  In our leadership role, CalPERS advocates for retirement security for America's workers and for the value of defined benefit plans, retirement savings accounts, and Social Security. We will support proposals that reduce the negative impacts of Social Security's Windfall Elimination Provision (WEP) and Government Pension Offset (GPO), as well as proposals that maintain state and local government options to elect participation in Social Security.

- **Protect Defined Benefit Plans**
  We will oppose proposals that provide federal incentives or options to replace defined benefit pension plans, or proposals that encourage federal intervention in state and local pension plans.

- **Appropriate Plan Funding and Accountability**
  We will support proposals for transparent financial reporting using industry-recognized accounting and actuarial standards and oppose proposals for retirement benefit plan changes that would result in an unfunded liability without proper actuarial funding to address the liability.

- **Review Certain Executive Orders and Rules Released During the Prior Administration**
  - **Rescind Rule on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights**
    Recently, the federal Department of Labor (DOL) proposed regulatory changes to prohibit fiduciaries of retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) from casting proxy votes on matters that do not have an economic impact on pension and 401(k) plans, and to require such fiduciaries to maintain records on proxy voting activities and the basis for specific votes. In addition, the Rule would prevent fiduciaries from voting on "environmental, social, or public policy agendas that," in the opinion of the DOL, "have no connection to increasing the value of investments used for the payment of benefits or plan administrative expenses."

  - **Rescind Rule on Financial Factors in Selecting Plan Investments**
    The DOL also adopted a final rule to, among other things, require ERISA plan fiduciaries to select investments and investment courses of action based solely on financial considerations relevant to the risk-adjusted economic value of that specific investment or action. This approach not only elevates fiduciary duty requirements to an inappropriate level that is inconsistent with prior judicial rulings, it also limits the use of factors that increasingly make a difference to long-term risk adjusted returns. CalPERS and other leading institutional investors believe that investing based on ESG factors meets the prudence requirements of fiduciary duty. While CalPERS is not subject to ERISA, we are subject to common law principles of fiduciary duty. As such, we are concerned that the Rule will make it far more expensive for ERISA fiduciaries to fulfill their fiduciary duties without providing any recognizable investment benefits.