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Hon. Michael Barr, Vice Chair for Supervision
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Hon. Michael Hsu, Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

Hon. Martin Gruenberg, Chairman
Federal Deposit Insurance Corporation
550 17th St NW
Washington, DC 20429

December 22, 2023

Subject: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity (Federal Reserve Board Docket No. R–1813, RIN 7100–AG64; OCC Docket ID OCC–2023–0008; FDIC RIN 3064–AF29)[1]

Dear Vice Chair Barr, Acting Comptroller Hsu, and Chairman Gruenberg,

On behalf of the California Public Employees' Retirement System (CalPERS), I write to share our concerns with one element of the banking regulators' above-referenced proposal to revise capital rules for large banking organizations and banking organizations with significant trading activity. Specifically, as further discussed below, we urge you to revise the Proposal to more accurately and consistently reflect the actual credit risks posed by highly regulated, transparent, low-risk public pension funds.

CalPERS is the largest public defined benefit pension fund in the United States, managing approximately $480 billion in global assets. We work constantly to improve our ability, and that of the broader investor community, to identify both investment risks and opportunities in support of our mandate to provide retirement benefits for over two million members. We seek long-term, sustainable, risk-adjusted returns through efficient capital allocation and

[1] *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, Office of the Comptroller of the Currency, Federal Reserve System, and FDIC, 88 Fed. Reg. 64028, Sept. 18, 2023, *available at* https://www.govinfo.gov/content/pkg/FR-2023-09-18/pdf/2023-19200.pdf.

stewardship aligned with our fiduciary duty. We are guided by our Investment Beliefs[2], which recognize that "[l]ong term value creation requires effective management of three forms of capital: financial, physical and human." CalPERS routinely transacts with a number of large banking organizations subject to the Proposal to obtain an array of financial products and services, including derivatives, so that we may grow and manage our fund on behalf of our beneficiaries.

In particular, CalPERS regularly engages in over-the-counter and listed derivative, repurchase agreement, and securities lending transactions to (1) manage liquidity and cash flows, (2) better manage our market risk, and (3) generate additional income from our collateral. These activities enable to us to better manage liquidity for our recurring monthly pension benefit payments and serve to reduce the overall costs of managing the portfolio.

We understand that you believe that "it is critical that we propose and implement the Basel III endgame reforms, which will better reflect trading and operational risks in our measure of banks' capital needs."[3] In general, the Proposal seems designed to remove some of the flexibility that banking organizations have traditionally enjoyed in determining the risks, and therefore the capital requirements attendant to, their assets.

To that end, the Proposal would generally seek to "replace the current advanced approaches with the new expanded risk-based approach, consisting of the new standardized approaches for credit, operational, and CVA risk, and the new market risk framework."[4] The standard approaches would generally not change materially, with the exception of changes to the "market risk" component.

We understand why decreasing banks' discretion related to their assessments of risk and capital would be a focus for regulators, even before the banking turmoil of March 2023. To that end, we do not have any specific comments on the appropriate overall levels of regulatory capital for banks.

However, we do have specific concerns on the relative risk assessments assigned to highly regulated, transparent, low-risk public pension funds that may not have issued publicly-traded securities.

Question 39 of the Proposal asks if

> the agencies [should] consider applying a lower risk weight than 100 percent to exposures to companies that are not publicly traded but are companies that are ''highly regulated?'' What, if any, criteria should the agencies consider to identify companies that are ''highly regulated?'' Alternatively, what are the advantages and disadvantages of assigning lower risk weights to

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[2] *See* https://www.calpers.ca.gov/page/about/organization/calpers-story/our-mission-vision

[3] Recent Bank Failures and the Federal Regulatory Response before the Senate Committee on Banking, Housing, and Urban Affairs, 118th Cong. 2023, *available at* https://www.federalreserve.gov/newsevents/testimony/barr20230328a.htm (written testimony of Hon. Michael Barr).

[4] Proposal, at 64168.

> highly regulated entities (such as open-ended mutual funds, mutual insurance companies, pension funds, or registered investment companies)?[5]

Similarly, questions 164 and 165 ask for

> comments on the appropriateness of the proposed risk weights of Table 1 to § ll.222 for financials, including government-backed financials. What, if any, alternative risk weights should the agencies consider? Please provide specific details and supporting evidence on the alternative risk weights.
>
> [and]
>
> comments on the appropriateness of treating the counterparty credit risks of public-sector entities and the GSEs in the same way as those of government-backed non-financials, education, and public administration. What, if any, alternatives should the agencies consider to more appropriately capture the counterparty credit risk for such entities?[6]

While we understand that there may be sound public policy justifications for treating all government entities, and particularly public pension funds, as having lower credit risk, we believe that there are unintended consequences in the Proposal, which would impose a uniform credit valuation adjustment on public sector entities that is not representative of those entities' risk or creditworthiness.

Highly regulated, transparent, low-risk public pension funds should receive risk weightings that are commensurate with other entities that pose similar credit risks. That is not what the Proposal would do. Instead, highly regulated, transparent, low-risk public pension funds that offer significant transparency and accountability (and exhibit low actual credit risks) would be treated as posing higher credit risks than many issuers of publicly traded securities that have materially higher actual credit risks.

We understand that focusing on whether an entity has publicly traded securities could be "a simple, objective criterion" to assess the credit risks of entities.[7] As the Proposal explains, tying risk weightings to the issuance and rating of publicly traded securities is intended to ensure that the entities are subject to transparency and market discipline that will "complement a banking organization's due diligence and internal credit analysis."[8]

Specifically, issuers of publicly traded securities provide investors and the public with audited financial statements and relevant disclosures related to their governance, operations, and risks.

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[5] Proposal, at 64054.
[6] Proposal, at 64156-157.
[7] Proposal, at 64054.
[8] Proposal, at 64054.

That information is used by credit rating agencies and investors to assess the creditworthiness of those entities.

Under the federal securities laws, an issuer of publicly traded securities must disclose basic information about its business, risk factors, legal proceedings, financial condition, executive compensation, governance (including the identities and dealings with executives and directors), and accounting matters.

CalPERS provides at least as much transparency into its activities as most publicly-traded companies. For example, each year, CalPERS is statutorily required to publicly release an Annual Comprehensive Financial Report[9], which includes audited financials that are compliant with the Government Accounting Standards Board reporting requirements.[10] That document also includes information related to the governance, risks, and funded status of the public pension fund.[11] CalPERS also releases a statutorily-required[12] Annual Investment Report that provides complete transparency into its holdings.[13] Webcasts and transcripts of all CalPERS' Board of Administration meetings are publicly available.[14] CalPERS' is subject to the California Public Records Act, which provides the public, investors, and banks with far greater access to documents and information about CalPERS than is generally available regarding issuers of publicly traded securities.[15] CalPERS also publishes all of its investment policies on its website.[16] Put simply, while not being subject to the exact same federal regulatory requirements as publicly-traded issuers of securities, highly regulated, transparent, low-risk public pension funds also have significant statutory and regulatory safeguards that compel the disclosure of that same type of information to the public.

The credit risk profile of CalPERS is also very different from many issuers of publicly traded securities because of its governmental status.[17] Specifically, the State of California provides unique protections to those doing business with (including providing credit to) CalPERS, including that it:

1. statutorily requires CalPERS to fulfill its obligations;[18]

2. allows CalPERS to set required employer contribution amounts;[19]

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9 *See* California Government Code §20228

10 CalPERS, Annual Comprehensive Financial Report: Fiscal Year Ended June 30, 2023, *available at* https://www.calpers.ca.gov/docs/forms-publications/acfr-2023.pdf.

11 *Id.*

12 *See* California Government Code §20238

13 *See*, e.g., CalPERS, Annual Investment Report: Fiscal Year Ended June 30, 2022, *available at* https://www.calpers.ca.gov/docs/forms-publications/annual-investment-report-fy-2022.pdf.

14 The Bagley-Keene Open Meeting Act requires that CalPERS hold its Board of Administration meetings in public, accept public testimony on decisions coming before the Board, and provide the public access to meeting records. *See* *https://oag.ca.gov/system/files/media/bk-open-meeting-act-guide-2023.pdf*.

15 *See* Government Code § 7931.000, *et. seq.*

16 *See* *https://ww.calpers.ca.gov/page/investments/about-investment-office/policies*

17 We note that not all government-related entities may enjoy the credit risk-reducing protections that are afforded to CalPERS, as these may be functions of variable state and local laws.

18 *See* California Constitution, Article XVI, section 17

19 *See* California Government Code §20814

3. establishes employee contribution rates;[20] and

4. has empowered CalPERS to raise employer contributions to meet future liabilities.[21]

In addition, the CalPERS Total Fund Investment Policy approved by the CalPERS Board of Administration places constraints and limitations on leverage, derivatives and securities lending, among other risk-mitigating practices.[22]

These unique protections greatly reduce the credit risk to banks doing business with CalPERS, and the Proposal should be revised to accurately reflect this reality.

Lastly, we note that by hinging risk weightings on whether an entity has issued publicly traded securities, the Proposal would also perversely punish entities – including public pensions – that may be statutorily restricted from selling publicly traded securities.

Again, we understand that the Proposal provides for lower risk weightings for issuers of publicly traded securities that are rated "investment grade" precisely because those issuers are subject to heightened transparency and accountability. While CalPERS does not currently offer publicly traded debt securities, if it did, because of the transparency and accountability features detailed above, its securities would undoubtedly be rated investment grade. Nevertheless, the Proposal would punish CalPERS – and its two million beneficiaries – because it does not issue publicly traded debt securities. That error should be remedied.

Proposed Revision

We urge you to revise the Proposal to treat highly regulated, transparent, low-risk public pension funds like CalPERS similarly to investment grade-rated entities. While there are many ways to potentially define "highly regulated, transparent, low-risk public pension funds," some factors to consider include:

- Whether the public pension fund provides at least annual disclosure of audited financials that are prepared in accordance with GASB reporting standards;
- Whether the public pension fund provides at least annual disclosure of its holdings and related risks;
- Whether the public pension fund provides at least annual disclosure of its executive team[23] and directors[24];
- Whether the public pension fund is subject to a public records disclosure requirement akin to the California Public Records Act;
- Whether the public pension fund is statutorily required to fulfill its obligations; and

[20] *See* California Government Code §7522.30 and Title 2, Division 5, Part 3, Chapter 8, Article 1 thereof
[21] *See* California Government Code §20203
[22] *See* Sections V, VI and XVI of https://www.calpers.ca.gov/docs/total-fund-investment-policy.pdf
[23] *See* https://www.calpers.ca.gov/page/about/organization/executive-officers
[24] *See* https://www.calpers.ca.gov/page/about/board/board-members

- Whether the public pension fund has the authority to raise sufficient assets to meet obligations, such as by raising contribution rates.

Further, as a precaution, we would not object to a requirement that in order to receive the lower risk weighting, a bank should have a reasonable basis to believe that if the public pension fund were to offer securities to the public, that they would be rated investment grade.

Conclusion

We appreciate your mandate to promote the safety and soundness of the banking system upon which we rely. However, by exclusively hinging assessments of credit risk on whether the entities have publicly traded securities, the Proposal would create an artificial distinction between entities with similar actual risk profiles. Worse, it would inexplicably punish highly regulated, transparent, low-risk public pensions that have not issued publicly traded securities, even if they objectively offer greater transparency and pose lesser credit risks than some private entities that have issued such securities.

We urge you to revise the Proposal to ensure that the risk weightings for highly regulated, transparent, low-risk public pension funds are comparable to those for investment grade-rated issuers of publicly traded securities.

Thank you for your consideration. If you have any questions or would like to follow up, please contact Brian Leu at (916) 795-4666 or Brian.Leu@calpers.ca.gov.

Sincerely,

Marcie Frost
Chief Executive Officer