

MEMORANDUM

TO: CalPERS Investment Committee

FROM: K&L Gates LLP

DATE: April 30, 2015

RE: Federal Monthly Report on Investment Policy - April 2015

In April, the House Financial Services Committee, Senate Banking Committee, and House Agriculture Committee continued oversight hearings over the federal financial regulators. There continues to be a push towards creating a bipartisan bank regulatory relief bill and a capital formation (or “JOBS Act 2.0”) bill. Agreement on certain priorities, especially with respect to smaller institutions or community banks, is beginning to appear. Treasury and the FHFA also remain active in housing finance, particularly with the release of new guarantee fees.

Derivatives

The House Agriculture Committee continued to move forward with oversight hearings as part of its reauthorization of the CFTC. On April 15, the committee heard testimony from CFTC Commissioners Bowen, Giancarlo, and Wetjen on priorities for a CFTC reauthorization bill. Commissioner Wetjen called for revisions to the CFTC’s floor-trader exemption in the swap dealer registration rule in order to promote non-dealer trading on swap execution facilities (“SEFs”). Commissioner Bowen suggested the imposition of CFTC user fees (similar to those imposed by the SEC) and the creation of a separate self-regulatory organization for swaps market participants only. Finally, Commissioner Giancarlo advocated for a focus on (1) aligning its swaps trading rules more closely with the Dodd-Frank Act’s mandate and (2) redoubled efforts to more closely align CFTC rules with those of foreign regulators.

A CFTC bill is expected be released within the next two to three weeks. If passed into law, a CFTC reauthorization bill would most likely include several substantive changes to derivatives regulation (ranging from customer protection rules to the international reach of U.S. derivatives rules) impacting CalPERS.

Housing Finance

The focus in the housing finance space continues to be on the incremental changes that are accomplished without legislation, mainly through policy setting at the FHFA and the GSEs. The FHFA has had a busy month with the release of new guarantee fee paradigm. The new fees essentially maintain status quo and will not have a significant impact on credit availability nor expected GSE volume in the bulk of the GSE market. The release is significant because it is the end of FHFA policy to “crowd-in” private capital with artificially high fees. Instead, the new

policy is to price fees appropriate to the risk using implied capital costs. Higher-risk loans (lower down payments, lower FICO) continue to find the best execution in FHA, which further improves the credit risk characteristics for GSE MBS. A counterbalance to the trend of increasing quality could be the release of new GSE affordable housing goals, although we can expect a conservative approach that maintains current levels or slight reductions.

Treasury's work to help stimulate the private label security ("PLS") market by helping facilitate a benchmark transaction continues to turn out interesting proposals. The most significant is the consensus on the role of a "Deal Agent" who will look out for investors in MBS and have a duty of care and duty of loyalty as separate from the trustee. More recommendations from the U.S. Treasury project on PLS revitalization are expected in the coming weeks.

The variety and volume of credit risk transfer deals at the GSEs are gaining increasing scrutiny politically and by regulators. Volume and variety of deals in this space are expected to increase this year and the announcement of new projects, such as the "up-front" risk share touted by the MBA and private mortgage insurers will represent a departure from the typical bond-level deals and instead focus on the loan level transfer."

The Administration also came out affirmatively and clearly on its position against recapitalization of the GSEs. The Administration argues that it is not the de minimis (and rapidly reducing) GSE capital reserves that are the sources of liquidity and affordability in the market, but rather the remaining \$258 billion line of credit from Treasury that is available under the Senior Preferred Stock Purchase Agreements. The Administration believes that the only post-conservatorship option for the GSEs is comprehensive GSE reform legislation.

Credit Rating Agencies

Internationally, IOSCO has released a revised Code of Conduct Fundamentals for Credit Rating Agencies, which contains recommendations relating to managing conflicts of interest, providing transparency, and new measures on governance, training, and risk management.

Notable Developments

On April 14, the Department of Labor released its repropose conflicts of interest rule. The reproposal expands the definition of fiduciary to include any individual receiving compensation for providing advice that is individualized or specifically directed to a plan sponsor, plan participant, or IRA owner for consideration in making a retirement investment decision. Congressional and stakeholder reception to the new rule is divided. It appears that the Administration will move quickly to finalize the rule, perhaps by the end of the year.

On April 29, the SEC also proposed rules on regulation of swap dealers that are non-U.S. persons but have dealing activity that occur in the United States and the "pay versus performance" rule, which compares executive compensation with the financial performance of an issuer. Both rules will be open for comment 60 days after publication in the Federal Register.