

**Federal Investment Policy Report for the CalPERS Board
 January 2016**

I. Securities

1. **Brief Summary of Issue.** Policy developments related to corporate governance, investor protection and capital formation.
2. **Developments Since Last Report.**
 - **SEC Nominees.** Senate Banking Committee Chairman Richard Shelby (R-AL) predicted that there may not be much progress on Committee consideration of pending financial regulator nominees before his primary election on March 1, 2016. Consequently, it remains unclear when the Committee will convene hearings to consider the nominations of Hester Peirce (a Republican) and Lisa Fairfax (a Democrat) to be SEC Commissioners. Since the departures last year of former Commissioners Daniel Gallagher and Luis Aguilar, the five-member SEC is currently operating with three Commissioners.
 - **Political Disclosure.** The U.S. District Court for the District of Columbia granted the Securities and Exchange Commission's ("SEC") motion to dismiss a lawsuit (*Silberstein v. SEC*) brought to force the SEC to take up a rulemaking that would require publicly traded companies to disclose their use of corporate funds for political activities. In dismissing the lawsuit, the court said that, since the SEC has not denied Mr. Silberstein's 2014 petition in favor of such a rulemaking and he has not asserted that the SEC "failed to act in response to a clear legal duty," it follows that he failed to state a valid Administrative Procedure Act claim upon which relief can be granted.
 - **Board Diversity.** Rep. Carolyn Maloney (D-NY), a senior member of the House Financial Services Committee, urged the SEC to adopt an amendment to proxy statement disclosures to require that each board nominee's gender, race, and ethnicity be indicated. Rep. Maloney also signaled that she is drafting a bill that would request the SEC to recommend strategies for increasing the representation of women on corporate boards. The bill is also expected to require public companies to report on their policies to encourage the nomination of women for board seats and to report on the proportion of women on their boards and in senior executive leadership roles.
 - **Credit Rating Agencies.** SEC staff issued an annual report to Congress and an annual examination report on credit rating agencies registered as nationally recognized statistical rating organizations ("NRSROs"). The annual report to Congress focuses on transparency and the state of competition in the credit rating industry, as well as conflicts of interest at NRSROs. The annual examination report provides a summary of SEC staff findings from the examinations of each NRSRO and notes that these NRSROs have further enhanced operational improvements made in prior years.
 - **Emerging Growth Companies.** The SEC adopted interim final rules to implement the two provisions of the recently enacted highway bill (the Fixing America's Surface Transportation Act or the "FAST Act") that make changes to the treatment of Emerging Growth Companies ("EGCs") and their registration with the SEC. According to the SEC, the rules will reduce personnel time and costs for impacted companies and could lower the time required to complete the initial registration statement for an initial public offering

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thereby improving the ability of issuers to raise capital in a timely manner. Effective January 19, 2016, the rules:

- Revise SEC registration statements (Forms S-1 and F-1) to provide that EGCs may omit certain historical period financial information prior to a securities offering so long as the company's registration statements include all required financial information at the time of the offering; and
- Permit smaller reporting companies to use incorporation by reference for future filings made under the federal securities laws after the registration statement becomes effective.

The public has until February 18, 2016 to comment on whether the rules should be expanded to encompass other SEC registrants or forms.

- **Definition of Materiality.** The SEC's Investor Advisory Committee ("IAC") approved a comment letter requesting the Financial Accounting Standards Board ("FASB") to maintain its current definition of "materiality" or to withdraw its proposed changes. The FASB's proposed changes would define materiality as a legal concept that is consistent with the definition used by the U.S. Supreme Court in securities fraud cases. Under this definition, information is material if there is "a substantial likelihood that the omitted or misstated item would have been viewed by a reasonable person as significantly altering the total mix of facts about a company." The IAC expressed concerns that the proposed changes would narrow the application of the definition and grant issuers greater latitude that could reduce disclosures and harm investors.
3. **Implications for CalPERS.** Most notably, the court's decision in *Silberstein*, which follows Congressional enactment of provisions to prohibit the SEC from writing political disclosure rules, will likely impact efforts to further enhance the SEC's disclosure regime. In contrast, measures in Congress to provide investors an opportunity to assess board quality and diversity when exercising voting rights would help to broaden the SEC's disclosure regime and provide CalPERS and other investors with valuable information on which to base investment decisions.
 4. **CalPERS/Federal Representative Actions.**
 - Sent congratulatory letters to Lisa Fairfax (a Democrat) and Hester Peirce (a Republican), nominees to be SEC Commissioners;
 - Monitored the Fairfax and Peirce nomination process closely; and
 - Monitored and reported on other relevant regulatory and legislative developments.
 5. **Recommendations for Next Steps.** We will continue to monitor the Senate Banking Committee's possible consideration of the pending nominees to be SEC Commissioners. We will continue to provide updates on other legislative and regulatory issues and recommend action by CalPERS, as warranted.

II. Derivatives

1. **Brief Summary of Issue.** Policy developments related to the Commodity Futures Trading Commission's ("CFTC") regulatory agenda.

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2. **Developments Since Last Report.**

- **CFTC Regulatory Agenda.** CFTC Chairman Timothy Massad previewed the CFTC's regulatory agenda for early 2016. Chairman Massad said that he will request the CFTC to consider a number of changes to swap execution facility trading and to finalize proposed rules on cross-border application of the recently adopted rules related to margin for uncleared swaps. He also stated that he expects the CFTC to consider proposals to further standardize data reporting standards and to revise CFTC rules related to commercial end users. In addition to focusing on cybersecurity and automated trading, Chairman Massad indicated that the CFTC would also explore whether it can determine standards for the stress testing of central counterparties.
- **Position Limits.** CFTC Commissioner Sharon Bowen predicted that the CFTC could finalize and begin implementing its position limits rule this year. She predicted that the CFTC would soon take up the second change to its current position limits proposal that would revise the rule's approach to anticipatory hedging and risk management. Commissioner Bowen anticipated that, once the position limits rule is finalized, the CFTC may consider whether limits are necessary on carbon emissions, renewable energy credit derivatives or other products.

3. **Implications for CalPERS.** Informed predictions by CFTC Chairman Massad and Commissioner Bowen about the CFTC's upcoming regulatory agenda provide CalPERS and other derivatives market participants some certainty about forthcoming efforts to ensure the integrity and stability of the derivatives markets.

4. **CalPERS/Federal Representative Actions.** Ongoing monitoring of relevant legislative and regulatory developments related to the CFTC.

5. **Recommendations for Next Steps.** We will provide updates and recommend action by CalPERS, as warranted, including commenting on relevant rulemakings and legislative proposals.

III. **Housing Finance**

1. **Brief Summary of Issue.** Policy developments related to housing finance, including the secondary mortgage market.

2. **Developments Since Last Report.**

- **FHLBank Membership Rules.** The Federal Housing Finance Agency adopted a final rule, which will become effective on February 19, 2016, to modify the eligibility for membership in the Federal Home Loan Bank ("FHLBank") system. The following two key provisions were changed in the final rule from the previous proposal:
 - The final rule will exclude captive insurers from membership in the FHLBank system. This will negatively impact real estate investment trusts ("REITs") by excluding them from future membership through their preferred mechanism of captive insurers. To date, a small number of REITs, representing about \$35 billion of financing, utilized captive insurers to access the FHLBank system of advances. There is a modified phase

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- out for current REIT members over 5 years for long standing members and one year for more recently admitted entities; and
- The final rule will eliminate a controversial asset test that would have required all FHLBank members to hold between 1 and 10 percent of their assets in residential mortgage loans at all times. During the active comment period prior to final rule adoption, small lenders argued that the proposed asset test would have been exceedingly costly for them.
 - **Mortgage Underwriting Lawsuit.** A federal district court in Michigan dismissed *Quicken v. United States*, a lawsuit brought by Quicken Loans, Inc. against the U.S. Department of Justice (“DOJ”) and the U.S. Department of Housing and Urban Development (“HUD”). The court’s decision in *Quicken* ratifies the DOJ and HUD methodology for penalizing lenders who make errors in the underwriting process. The net effect of the court’s decision is that lender interest in offering Federal Housing Administration (“FHA”) loans remains tepid for fear of reprisals. Although some large lenders such as JPMorgan Chase have already decided to exit the FHA business, observers continue to monitor Quicken’s next steps as the nation’s largest FHA lender. If Quicken starts to reduce its FHA activity, there could be a deficit for a period of time that reduces Ginnie Mae production.
3. **Implications for CalPERS.** Changes to housing finance policy could affect market liquidity and stability thus impacting CalPERS investment returns.
 4. **CalPERS/Federal Representative Actions.** Ongoing monitoring of relevant regulatory and legislative developments, including possible introduction of legislation by House Financial Services Committee Chairman Jeb Hensarling (R-TX) to mandate greater credit risk sharing between the GSEs and the private sector.
 5. **Recommendations for Next Steps.** We will provide updates and recommend action by CalPERS, as warranted, including commenting on relevant rulemakings and legislative proposals.