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Federal Investment Policy Report for the CalPERS Board
April 2016

I. Securities

1. **Brief Summary of Issue.** Policy developments related to the Securities and Exchange Commission ("SEC"), including its budget, corporate disclosures, nominations, rulemakings, stock backs, credit ratings and legislative proposals to spur capital formation.

2. **Developments Since Last Report.**
   - **Exxon Mobil.**
     - *Lieu-DeSaulnier Letter*. Reps. Ted Lieu (D-CA) and Mark DeSaulnier (D-CA) sent a letter requesting CalPERS to divest from ExxonMobil based on the company's actions concerning climate change. Reps. Lieu and DeSaulnier had previously requested the Department of Justice to investigate whether statements Exxon made to investors about climate risks were consistent with the company's own scientific research; and
     - *Proxy Statement*. Exxon Mobil filed its Notice of 2016 Annual Meeting and Proxy Statement with the SEC. Exxon recommended that attendees at its annual meeting vote against a shareholder proposal to put a climate expert on its board. Exxon also recommended that attendees vote against a proposal, which was submitted by the New York State Common Retirement Fund and is supported by CalPERS as part of its environmental agenda, to require the company to report on the impact of climate change on its business.
   - **Climate Risk Disclosure.** SEC Chair Mary Jo White stated that the SEC's existing guidance on climate risk illustrates the agency's focus on materiality with respect to disclosures. She indicated that the SEC continues to hear from various constituencies about these issues as part of its ongoing Disclosure Effectiveness Initiative.
   - **Political Disclosure.** Chair White also indicated that the SEC has no plans to act on a political disclosure rulemaking this year.
   - **SEC Budget.** The Senate Appropriations Financial Services and General Government ("FSGG") Subcommittee held a hearing to review the President's Fiscal Year 2017 Budget Request for the SEC, which requests $1.781 billion for the agency (an 11 percent increase over its FY16 appropriated budget).
   - **Nominations.** The Senate Banking Committee met to vote on a package of five finance-related nominees, including Democrat Lisa Fairfax and Republican Hester Peirce to be SEC Commissioners. However, Senate Banking Committee Chairman Richard Shelby (R-AL) postponed the vote in response to bipartisan opposition. Sens. Charles Schumer (D-NY), Robert Menendez (D-NJ), Jeff Merkley (D-OR), and Elizabeth Warren (D-MA) expressed opposition to the SEC nominees for not taking a position on an SEC political disclosure rulemaking. Sen. Tim Scott (R-SC) signaled his opposition to Ms. Fairfax based on her perspective about the role of regulators and on her level of practical experience. It is not yet clear when the Committee will reconvene to consider the nominations.
   - **SEC Rulemakings.**
     - *Disclosure Effectiveness*. The SEC issued a concept release that seeks public comment on the modernization of certain business and financial disclosure requirements in

Regulation S-K. Regulation S-K encompasses the SEC's rules related to the business and financial information outside the financial statements that companies are required to provide in their filings. The public will have until July 21, 2016 to comment on the concept release.
  - *Security-based Swaps*. The SEC adopted final rules establishing business conduct requirements for security-based swap ("SBS") dealers and major SBS participants. The rules cover supervision, designation of a chief compliance officer, requirements to disclose certain information to counterparties and additional requirements for transactions with special entities such as pension plans and local governmental bodies. The rules also address the cross-border application of the requirements and the availability of substituted compliance. The rules become effective on June 27, 2016.
- **Stock buybacks.** Sen. Tammy Baldwin (D-WI) indicated her intent to submit comments on the SEC's concept release related to the modernization of certain business and financial disclosure requirements. Sen. Baldwin has previously raised concerns about the impact of stock buybacks on workers and economic growth and security. She has also raised concerns about the use of stock buybacks by companies to increase executive compensation and about whether the SEC should require issuers to disclose additional information about their buybacks.
- **Credit Ratings.** The House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee held a hearing entitled "Continued Oversight of the SEC's Offices and Divisions." In response to a question from Chairman Scott Garrett (R-NJ), Thomas Butler, Director of the Office of Credit Ratings, testified that the scope of the SEC's authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act is limited to references to credit ratings in federal regulations and does not extend to pension fund investment guidelines.
- **Legislation.** The House Capital Markets and Government Sponsored Enterprises Subcommittee held a hearing entitled "The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation." The Subcommittee examined the following four legislative proposals to amend the Jumpstart Our Business Startups ("JOBS") Act:
  - H.R. 4850, the "Micro Offering Safe Harbor Act." Introduced by Rep. Tom Emmer (R-IN), the bill would exempt certain micro-offerings from SEC registration requirements;
  - H.R. 4852, the "Private Placement Improvement Act of 2016." Introduced by Rep. Scott Garrett (R-NJ), the bill would direct the SEC to revise regulations related to exemptions from registration requirements for certain sales of securities;
  - H.R. 4854, the "Supporting America's Innovators Act of 2016." Introduced by Rep. Patrick McHenry (R-NC), the bill would amend the Investment Company Act to expand the investor limitation for qualifying venture capital funds under an exemption from the definition of an investment company; and
  - H.R. 4855, the "Fix Crowdfunding Act." Introduced by Rep. McHenry, the bill would amend provisions of the JOBS Act related to crowdfunding to increase the dollar amount limit and to clarify certain requirements and exclusions for funding portals established by the Act.

3. **Implications for CalPERS.**
   - Divestment from Exxon would hinder CalPERS' ability to remain engaged to affect positive, lasting corporate changes on climate change and in other areas;
   - Efforts to provide investors with additional disclosures related to corporate political spending and the risks associated with climate change could provide CalPERS and other investors a broader scope of information on which to assess investment risks; and
   - The SEC's recently issued concept release could present CalPERS an opportunity to provide its views about stock buybacks as well as help to advance CalPERS' disclosure priorities in other areas. CalPERS intends to provide comment on this issue.

4. **CalPERS/Federal Representative Actions.**
   - Engaged with staff to Reps. Ted Lieu (D-CA) and Mark DeSaulnier (D-CA) about the Exxon divestment letter and sent a letter in response;
   - Engaged with Rep. Carolyn Maloney's (D-NY) staff about her bill (H.R. 4718, the "Gender Diversity in Corporate Leadership Act") to promote gender diversity on corporate boards;
   - Sent letter from Investment Committee Chair Henry Jones to Rep. Maxine Waters (D-CA);
   - Provided analysis about the SEC's adoption of final rules establishing business conduct requirements for SBS dealers and major SBS participants;
   - Monitored closely the Fairfax and Peirce nomination process;
   - Monitored policy developments related to climate change and the Obama Administration's Clean Power Plan ("CPP"); and
   - Monitored and reported on other relevant regulatory and legislative developments.

5. **Recommendations for Next Steps.** We will continue to:
   - Engage with Rep. Maloney's office about H.R. 4718;
   - Monitor Congressional action related to climate change and climate risk disclosures;
   - Monitor the Senate Banking Committee's possible reconsideration of the nominations of Ms. Fairfax and Ms. Peirce;
   - Monitor possible responses to the Supreme Court's stay of the CPP; and
   - Provide updates on other legislative and regulatory issues and recommend action by CalPERS, as warranted.
   - Assist CalPERS in developing its comments on the SEC Concept Release.

II. Derivatives

1. **Brief Summary of Issue.** Policy developments related to the Commodity Futures Trading Commission's ("CFTC") reauthorization and funding and a push for greater CFTC and SEC coordination on the SEC's expected Consolidated Audit Trail ("CAT").

2. **Developments Since Last Report.**
   - **CFTC Reauthorization.** The Senate Agriculture Committee marked up and approved the CFTC reauthorization bill by a party-line vote of 11-9. Chairman Pat Roberts (R-KS) called the bill a compromise measure to help provide some relief, clarity, and certainty to the futures and derivatives markets. Ranking Member Debbie Stabenow (D-MI) indicated her concern about CFTC underfunding and expressed disappointment that the bill was not

bipartisan. The Committee did not adopt Ranking Member Stabenow's amendment that would have provided a fee for service to fund the CFTC.

- **CFTC Budget.** The Senate Appropriations FSGG Subcommittee also reviewed the President's Fiscal Year 2017 Budget Request for the CFTC, which requests $330 million for the agency (a 32 percent increase over its FY16 appropriated budget). In his testimony, CFTC Chairman Timothy Massad emphasized the importance of ensuring that the CFTC is adequately funded to address emerging risks in the derivatives markets.
- **Consolidated Audit Trail.** Sen. Mark Warner (D-VA) sent a letter to CFTC Chairman Massad requesting interagency cooperation between the CFTC and the SEC on the SEC's expected completion of a CAT by the end of the year. The CAT is designed to try to provide financial market regulators greater insight into the operation of markets, products and participants.

3. **Implications for CalPERS.** Advancement of a CFTC reauthorization bill and legislation to sufficiently fund the CFTC would provide the agency the tools needed to effectively regulate the derivatives and futures markets and would furnish CalPERS and other market participants greater certainty. Given the interaction between the futures and equities markets, cooperation between the CFTC and SEC on a CAT could also help to advance this objective.

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

5. **Recommendations for Next Steps.**
   - Monitor action on the CFTC reauthorization bill and appropriations measures;
   - Monitor the Senate Agriculture Committee's possible confirmation hearings for Mr. Brummer and Mr. Quintenz; and
   - 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 the secondary mortgage market and proposals to reform Fannie Mae and Freddie Mac (the "GSEs").

2. **Developments Since Last Report.**
   - **GSE Recapitalization.** Rep. Mick Mulvaney (R-SC) introduced a bill that would recapitalize the GSEs by amending the Senior Preferred Stock Purchase Agreements with the Treasury Department. Upon passage, the Treasury would be considered repaid in full without further contributions from the GSEs and the recapitalization would be accomplished by amending the Senior Preferred Stock Purchase Agreements to allow the GSEs to keep all net income. The GSEs would maintain their ability to make further draws from the Treasury. The bill would also eliminate affordable housing allocations (Capital Magnet Fund and the Housing Trust Fund) and create a private right of action for the shareholders. This bill has not garnered any co-sponsors and is seen as supportive for the GSEs shareholder interests. Introduction of the bill continues the drumbeat for

recapitalization that now has the marked characteristic of both Democratic and Republican support.

- **FSGG Bill.** Senate Appropriations FSGG Subcommittee Chairman Senator John Boozman (R-AK) signaled that he has been working closely with Chairman Shelby to determine which of the 52 provisions of Chairman Shelby's "Financial Regulatory Improvement Act of 2015" will be included in the FSGG bill. Sen. Boozman noted that he does not intend to include the entire banking bill and indicated concerns about "overregulation," particularly for community banks, which seems to signal that Chairman Shelby may prioritize community banking provisions over housing or other provisions.
- **Housing Finance Reform.** Led by industry stakeholders, there has been a push in Washington, D.C. to restart discussions about comprehensive reform of the GSEs. With the predominant narrative of the past few months focused on recapitalization of the GSEs and release from conservatorship to continue operating under their original charters (mostly promulgated by the GSE shareholders), this push is a reaction against that proposal as impractical and offers counterproposals. As part of the effort to restart these discussions, the Urban Institute's Housing Incubator series has featured a number of different housing finance proposals from stakeholders. Jim Millstein (a former Treasury Department official) and Tim Howard (a former Fannie Mae executive) published papers on the topic. Additionally, the Housing Incubator featured proposals from Alex Pollock (a former Federal Home Loan Bank of Chicago executive) and Mark Zandi (Chief Economist at Moody's Analytics). Jim Carr (a former Fannie Mae executive who is now associated with the Roosevelt Institute) also contributed to the series. The Housing Incubator also included publications by Andrew Davidson (a leader in risk analytics and mortgage-backed securities) and Mark Calabria (Director of Financial Regulation at the Cato Institute).

3. **Implications for CalPERS.** Stakeholder and legislative proposals related to GSE reform could spur the resumption of broader discussions in Congress about changes to the housing finance market, which could impact CalPERS' investment returns for shareowners.

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

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