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Federal Investments Report for CalPERS Board May 2016

I. Support for H.R. 4718, the “Gender Diversity in Corporate Leadership Act” (Rep. Maloney)

1. **Brief summary of issue.** Developments related to a bill (H.R. 4718, the “Gender Diversity in Corporate Leadership Act”) introduced by Rep. Carolyn Maloney (D-NY) to promote gender diversity on corporate boards.
2. **Specific changes/developments since last report.** The CalPERS Board voted to support H.R. 4718 with a recommendation that provisions of the bill be expanded to include a more comprehensive definition of diversity.
3. **Implications for CalPERS.** Additional corporate disclosure beyond gender about board skills, experiences, race, and ethnic diversity can help CalPERS and other investors determine whether boards have the appropriate mix of qualities to manage risk, achieve long-term business objectives, and avoid the adverse consequences of “group think.”
4. **CalPERS/Federal Representative Actions.** Work on letter to Rep. Maloney expressing support for H.R. 4718 and requesting that the scope of the bill be broadened.
5. **Recommendations for Next Steps.** Continue engagement with Rep. Maloney’s office about H.R. 4718, and consider possible engagement with other Members of Congress to help advance CalPERS’ objective of achieving broader provisions.

II. SEC Matters

1. **Brief summary of issue.** Policy developments related to the Securities and Exchange Commission (“SEC”), including nominations, rulemakings, legislation and advisory committee meetings, as well as developments concerning ExxonMobil and climate change.
2. **Specific changes/developments since last report.**
 - **Nominations.** The Senate Banking Committee approved by voice vote a package of five financial services-related nominees that included Democrat Lisa Fairfax and Republican Hester Peirce to be SEC Commissioners. The nominees will have to be approved by the full Senate, though timing of Senate floor action is unclear.
 - **ExxonMobil.** Sen. Sheldon Whitehouse (D-RI) and Rep. Ted Lieu (D-CA) sent a letter to the American Geophysical Union (“AGU”), an international non-profit scientific organization, expressing disappointment that the AGU’s board has

decided to continue accepting funding from ExxonMobil. The letter also raises concerns that AGU did not consider certain publicly available ExxonMobil documents related to climate change and a “key component” of AGU’s own organizational support policy. In addition, the letter urges the AGU to reconsider its decision.

- **Rulemakings.**

- *Consolidated Audit Trail.* The SEC voted to publish for public comment a proposed national market system plan to create a Consolidated Audit Trail (“CAT”) that would be a single, comprehensive database designed to allow regulators to more effectively monitor trading in equity and option securities in U.S. markets. The proposed plan was submitted jointly by a number of Self-Regulatory Organizations, including the Financial Industry Regulatory Authority.
- *Incentive-based Compensation Agreements.* In conjunction with five other federal agencies, the SEC issued a joint proposed rule to revise a proposed rule that was issued in April 2011. The proposed rule would limit the incentive-based compensation for senior banking executive, traders, and other covered employees. The proposal includes a tiered system that increases the restrictions on incentive-based compensation as covered institutions eclipse \$50 billion and \$250 billion. The final rule is designed to reduce excessive risk taking by individuals covered under the rule.
- *JOBS Act.* The SEC approved a final rule that amends rules related to registration requirements, including the thresholds for registration, termination of registration, and suspension of reporting under Section 12(g) of the Securities Exchange Act 1934 (the “Exchange Act”). The final rule completes the required rulemakings under the JOBS Act. Importantly, the final rule amended the definition of “held of record” to exclude securities held by people that received them under an employee compensation plan. Additionally, an issuer that is not a bank, bank holding company or savings and loan holding company, is required to register a class of equities securities under the Exchange Act if it has more than \$10 million in total assets and has less than 2,000 shareholders or 500 shareholders who are not accredited investors.

- **Legislation.**

The House passed the following bills, which have not to date been acted on by the Senate:

- H.R. 4498, the “Helping Angels Lead our Startups Act” passed the House by a vote of 325-89. Introduced by Rep. Steve Chabot (R-OH), the bill would require the SEC to amend Regulation D to allow general solicitation and general advertising presentations to angel investor groups, among other groups; and
- H.R. 5019, the “Fair Access to Investor Research Act of 2016” passed the House by a vote of 411-1. Introduced by Rep. French Hill (R-AR), the

bill would direct the SEC to provide a safe harbor for certain publications or distributions of research reports by brokers or dealers distributing securities.

The House Financial Services Capital Markets and Government Sponsored Enterprises Subcommittee held a hearing entitled “Legislative Proposals to Enhance Capital Formation, Transparency, and Regulatory Accountability.” The hearing focused on the following three legislative proposals, which have not to date been formally introduced in the House:

- The “SEC Regulatory Accountability Act.” Sponsored by Subcommittee Chairman Scott Garrett (R-NJ), the bill would heighten requirements concerning the SEC’s consideration of the costs and benefits of its regulations;
- The “Investment Advisors Modernization Act of 2016.” Sponsored by Rep. Robert Hurt (R-VA), the bill would revise certain record-keeping requirements related to investment advisors; and
- The “Proxy Advisory Firm Reform Act of 2016.” Sponsored by Rep. Sean Duffy (R-WI), the bill would require the registration of proxy advisory firms.

The Senate Banking Securities, Insurance, and Investment Subcommittee held a hearing entitled “Improving Communities’ and Businesses’ Access to Capital and Economic Development,” which focused on the following bills:

- S. 1802, the “Consumer Financial Choice and Capital Markets Protection Act.” Introduced by Sen. Pat Toomey (R-PA), the bill would allow money market funds to maintain a fixed net asset value;
- H.R. 4620, the “Preserving Access to CRE Capital Act of 2016.” Introduced by Rep. French Hill (R-AR), the bill would reduce certain risk retention requirements for transparent and high performing single asset single borrower loans, qualified commercial real estate loans, and certain subordinated tranches of commercial mortgage-backed securities; and
- H.R. 3868, the “Small Business Credit Availability Act.” Introduced by Rep. Mick Mulvaney (R-SC), the bill would expand the kinds of investments business development companies (“BDCs”) are permitted to make and would allow BDCs to maintain a higher leverage ratio.

Senator Debbie Stabenow (D-MI) introduced S. 2894, the “Pension Fund Integrity Act of 2016,” which has not to date been acted on by the Senate. The bill would reduce executive compensation for large “financially troubled” Employee Retirement Income Security Act plans. The reduction would be calculated by the Treasury Department and would be pegged to the percentage reduction for retirees most impacted by the lower benefits and would take effect if the Treasury approves a pension fund cut. “Financially troubled” pension plans would be prohibited from using plan assets to hire outside lobbyists.

- **Advisory Committees.**

- *Equity Market Structure.* The SEC's Equity Market Structure Advisory Committee (EMSAC) held a meeting to consider recommendations about a possible access fee pilot and trading venues regulation, which would have to be approved by the SEC to become effective. The Regulation NMS (National Market System) Subcommittee recommended the EMSAC to create a framework and produce data for an access fee pilot program that would measure the impact of reduced access fees, which are charged by exchanges and other venues for quotations, on current equity market structure. The Trading Venues Regulation Subcommittee made a number of recommendations related to SRO (self regulatory organization) immunity, NMS plan governance, and centralization of common regulatory functions; and
- *Small and Emerging Companies.* The SEC's Advisory Committee on Small and Emerging Companies held a meeting that focused on the definition of "accredited investor" and on unregistered securities offerings under Regulation D. At the meeting, Chair White indicated that she has requested SEC staff to prepare recommendations about how the SEC should modify the definition of "accredited investor."

3. **Implications for CalPERS.**

- Advancement of the SEC nominees could provide CalPERS and other market participants greater certainty regarding the SEC's direction and regulatory agenda;
- The SEC's proposed rule regarding the CAT would help provide the SEC an additional tool to monitor securities market activity; and
- SEC and congressional consideration of proposals designed to facilitate capital formation provides CalPERS and other investors with additional insight into the impact of these proposals on the importance of providing greater access to capital to small and emerging companies and the need to protect investors.

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

5. **Recommendations for Next Steps.** We will continue to:

- Monitor possible Senate Floor consideration of the nominations of Ms. Fairfax and Ms. Peirce; and
- Provide updates on other legislative and regulatory issues and recommend action by CalPERS, as warranted.

III. National mortgage-serving standards

1. **Brief summary of issue.** Policy developments related to the Consumer Financial Protection Bureau's ("CFPB") proposed changes to its mortgage disclosure rules and proposals to reform the housing finance system.
2. **Specific changes/developments since last report.**
 - **Mortgage Disclosures.** The CFPB announced that it will propose changes to Truth in Lending Act-Real Estate Settlement Procedures Act Integrated Disclosure ("TRID") rules in July that will provide greater clarity to the mortgage industry.
 - **Housing Finance Reform.** The Urban Institute continued its Housing Finance Reform Incubator publications. The series included a piece by Patricia Moser (former Deputy Director of the Office of Financial Research) which proposes principles and a solution for reform of the Government-Sponsored Enterprises. The series also included a piece by Marc Morial (CEO of the National Urban League) which outlines the National Urban League's Homebuyers' Bill of Rights 2.0. Finally, the series included a contribution from Gary Acosta (co-founder and Chief Executive Officer of the National Association of Hispanic Real Estate Professionals), Jim Park (CEO of the Mortgage Collaborative) and Joseph J. Murin (Chairman of Chrysalis Holding LLC and former Ginnie Mae President) that proposes to use a Ginnie Mae model as the backbone of the future housing finance system.
3. **Implications for CalPERS.** Stakeholders are hopeful that CFPB's proposed changes will address assignee liability for TRID errors in order to make CalPERS and other investors more comfortable buying these assets, though it is unclear at this juncture. Additionally, credible proposals to reform the housing finance market could provide CalPERS and other investors in mortgage-backed securities greater regulatory clarity and certainty.
4. **CalPERS/Federal Representative Actions.** Ongoing monitoring of relevant regulatory and legislative developments related to the housing finance 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.

IV. Enhanced corporate disclosures processes

1. **Brief summary of issue.** Policy developments related to efforts to enhance corporate disclosures.

2. **Specific changes/developments since last report.**

- **Investment Companies.** SEC Chair Mary Jo White delivered the keynote address at the Investment Company Institute's 2016 General Meeting in which she emphasized the need for additional disclosures in the mutual fund industry.
- **Small and Emerging Companies.** Chair White delivered a speech at a panel convened by the International Organization of Securities Commissions in which she indicated that SEC staff is reviewing the degree to which SEC rules can be improved for the benefit of smaller companies as part of the SEC's Disclosure Effectiveness Initiative.
- **Stein Speech.** SEC Commissioner Kara Stein delivered a speech at the 48th Annual Rocky Mountain Securities Conference in which she said that the SEC's "Disclosure Effectiveness" project is an ongoing effort by the SEC to "improve communications between companies and investors." Commissioner Stein said that "[s]ustainability disclosure differentiates companies and may foster investor confidence, trust, and employee loyalty. Studies indicate that today's investors are considering strategies that take into account environmental, social and corporate governance criteria."

3. **Implications for CalPERS.** SEC efforts to enhance its disclosure regime could impact the accurate and timely reporting of operational, financial and governance information about public companies to help CalPERS and other investors to make effective investment decisions.

4. **CalPERS/Federal Representative Actions.** Continue to develop a strategy for CalPERS response to the SEC's concept release regarding Regulation S-K.

5. **Recommendations for Next Steps.** We will:

- Finalize the strategy for CalPERS response to the Regulation S-K concept release;
- Monitor developments concerning disclosures related to stock buybacks, political spending, climate risk and board diversity; and
- Provide updates on other legislative and regulatory issues and recommend action by CalPERS, as warranted.