

Federal Investments Report for CalPERS Board November 2016

I. Securities and Capital Markets

1. **Brief summary of issue.** Policy developments related to capital markets and the Securities and Exchange Commission (“SEC”), particularly its rulemakings and regulatory agenda, Investor Advisory Committee (“IAC”), as well as the announced departure of SEC Chair Mary Jo White and pending SEC nominations.
2. **Specific changes/developments since last report.**
 - **Investor Advisory Committee.** Anne Simpson, Investment Director for Sustainability at CalPERS, has been appointed to serve on the IAC. A full list of the IAC’s members is available [here](#).
 - **White Departure.** Chair White announced her intention to leave the SEC at the end of the Obama Administration. Chair White stated that her “duty has been to ensure that the [SEC] implemented strong investor and market protections, and to establish an enduring foundation for future progress in the most critical areas - asset management regulation, equity market structure and disclosure effectiveness.” President-elect Trump will have the opportunity to nominate a new SEC Chair early next year.
 - **Consolidated Audit Trail.** The SEC approved a national market system (“NMS”) plan to establish a Consolidated Audit Trail (“CAT”) that will be a single, comprehensive database designed to allow regulators to more effectively monitor trading in equity and option securities in U.S. markets. According to the SEC, within two months of approval of the NMS plan, the Self-Regulatory Organizations (“SROs”) will be required to select a plan processor to establish and operate the CAT. The SEC indicates that the SROs will be required to begin reporting to the CAT within one year of approval, while large broker-dealers will be required to begin reporting one year after the SROs begin reporting. The SEC states that small broker-dealers will be required to begin reporting one year after the large broker-dealers begin reporting.
 - **SEC Agenda.** The House Financial Services Committee (“HFSC”) held a hearing entitled “Examining the SEC’s Agenda, Operations, and FY 2018 Budget Request.” At the hearing, Chair White testified that she expects the SEC to advance rulemakings related to the following issues before the end of her tenure at the SEC: the CAT; capital, margin and asset segregation requirements for security-based swap entities; investment company use of derivatives; and electronic delivery of mutual fund documents. However, Chair White stated that it is unlikely that the SEC will consider proposals on board diversity and a uniform fiduciary duty rule for broker-dealers before the end of her tenure as Chair.
 - **Nominations.** Senate Banking Committee Chairman Richard Shelby (R-AL) signaled that the full Senate could possibly act on the pending nominations of Democrat Lisa Fairfax and Republican Hester Peirce to be SEC Commissioners

before the 114th Congress adjourns. If the Senate does not act on the nominations prior to adjournment, President-elect Trump will have the opportunity to put forward new SEC nominees for consideration in the 115th Congress to fill the two vacancies on the SEC's five-member board.

- **Legislation.** HFSC Chairman Jeb Hensarling (R-TX) signaled interest in working on and reintroducing in early 2017 a revised version of his bill (H.R. 5983, the “Financial CHOICE Act” or “FCA”) to reform the Dodd-Frank Wall Street Reform and Consumer Protection Act. Although the FCA was reported favorably to the full House on September 13, 2016, the legislation is not expected to be considered further in this term of Congress but some version of the bill will likely be the basis for possible financial regulatory reform efforts early in the 115th Congress.
 - **Proxy Advisory Firms.** The Government Accountability Office (“GAO”) released a report entitled “Proxy Advisory Firms’ Role in Voting and Corporate Governance Practices,” which reviews the state of the proxy advisory industry. The report states that “market participants with whom GAO spoke agreed that the increased demand for their services, proxy advisory firms’ influence on shareholder voting and corporate governance practices has increased.” The report states that market participants indicated that the influence of proxy advisory firms can vary based upon institutional investor size, with less influence on large institutional investors that regularly conduct their own research and have their own voting policies.
3. **Implications for CalPERS.**
- Engagement on the IAC will allow CalPERS to provide its perspective about how the IAC should appropriately advise the SEC on furthering the agency’s core mission, which could be beneficial to CalPERS beneficiaries and other investors;
 - Greater clarity about the future composition of the SEC, including the future Chair and the prospects for advancement of the pending nominees, could provide CalPERS and other investors more certainty about the SEC’s direction and regulatory agenda;
 - The completion of the CAT and the SEC’s other regulatory initiatives could enhance the ability of regulators to provide oversight to the evolving securities markets thereby improving market stability for CalPERS and other investors;
 - The potential revision and reintroduction of the FCA in the 115th Congress could provide CalPERS an opportunity to appropriately provide input on particular aspects of the legislation for the benefit of shareowners and the broader securities markets; and
 - The GAO report could provide policymakers additional information about the role of proxy advisory firms in the securities markets, in the event that Congress considers further legislative proposals in this area.
4. **CalPERS/Federal Representative Actions.**
- Worked on Investments Federal Policy Strategic Plan; and

- Conducted ongoing monitoring of the pending nominations of Ms. Fairfax and Ms. Peirce to be SEC Commissioners as well as regulatory and legislative developments related to the securities markets.
5. **Recommendations for Next Steps.** We will continue to:
- Engage with HFSC Chairman Hensarling on a possible revised version of the FCA;
 - Monitor and continue to engage on H.R. 4718, the “Gender Diversity in Corporate Leadership Act of 2016;”
 - Monitor the SEC nominations process; and
 - Provide updates on other legislative and regulatory issues and recommend action by CalPERS, as warranted.

II. Derivatives Reform

1. **Brief summary of issue.** Policy developments related to Commodity Futures Trading Commission (“CFTC”) nominations, rulemakings and regulatory agenda.
2. **Specific changes/developments since last report.**
 - **Automated Trading.** The CFTC approved a supplemental proposal to Regulation Automated Trading (“Reg AT”). The supplemental proposal would put in place certain risk controls, transparency requirements, and other measures to improve the safety and soundness of automated trading on all designated contract markets. A CFTC factsheet about the supplemental proposal is available here and a series of questions and answers about the proposal are available here.
 - **Nominations.** It remains possible that the full Senate could act on the pending nominations of Democrat Chris Brummer and Republican Brian Quintenz to be CFTC Commissioners before the 114th Congress adjourns. If the Senate does not act on the nominations prior to adjournment, President-elect Trump will have an opportunity to put forward new CFTC nominees for consideration in the 115th Congress to fill the two vacancies on the CFTC’s five-member board.
 - **Massad Statement.** Prior to the federal elections, CFTC Chairman Timothy Massad stated that he intends to remain at the CFTC at least until the end of his term in April 2017, at which point President-elect Trump will likely nominate a new CFTC Chair.
 - **Conaway Letter.** House Agriculture Committee Chairman K. Michael Conaway (R-TX) sent a letter to Chairman Massad urging him to delay or not act on certain “controversial” rulemakings during the remaining days of the Obama Administration. Chairman Conaway said that CFTC’s derivatives position limits rulemaking should be addressed by Chairman Massad’s successor and the CFTC Commissioners that will join the agency in the Trump Administration. In addition, Chairman Conaway urged Chairman Massad to extend the comment period on Reg AT by 180 days and to delay advancement of the CFTC’s cross-border application of swaps rules so that these rulemakings can be addressed by a new CFTC Chairman and Commissioners.

- **Position Limits.** Chairman Massad indicated that the CFTC continues to consider its position limits rulemaking and that he looks forward to input on the matter from CFTC Commissioners Sharon Bowen and J. Christopher Giancarlo. He also indicated that he is “committed to a smooth transition” to the Trump Administration and that “at the same time, we’ll continue with the work of the agency.”
3. **Implications for CalPERS.**
 - The CFTC’s rulemaking activity could help to ensure that the derivatives markets operate with integrity, which could benefit CalPERS and other market participants that utilize such markets to hedge investment risk; and
 - Greater clarity about the prospects for advancement of the pending CFTC nominees could provide CalPERS and other derivatives market participants more certainty about the CFTC’s direction and regulatory agenda.
 4. **CalPERS/Federal Representative Actions.** Conduct ongoing monitoring of the CFTC nominations process as well as relevant regulatory and legislative developments related to the derivatives markets.
 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. GSE Reform

1. **Brief summary of issue.** Policy developments related to Fannie Mae and Freddie Mac (the “GSEs”).
2. **Specific changes/developments since last report.**
 - **GSEs.** The GAO released a report entitled “Objectives Needed for the Future of Fannie Mae and Freddie Mac After Conservatorships.” The report was prepared in response to Chairman Shelby’s request that the GAO analyze the extent to which the Federal Housing Finance Agency’s (“FHFA”) goals for the conservatorship of the GSEs have changed and to address the implications of the FHFA’s action for the future of the GSEs. Broadly, the GAO examines the current housing finance system and addresses how the FHFA’s actions affect the secondary mortgage market. The report highlights the differences between the FHFA’s 2012 and 2014 strategic plans. In particular, the report indicates that the FHFA shifted away from shrinking the GSEs towards reducing taxpayer risk. The GAO concludes that “Congress should consider legislation that would establish clear objectives and a transition plan to a reformed housing finance system that enables the enterprises to exit conservatorship.”
3. **Implications for CalPERS.** The GAO’s report provides policymakers, CalPERS and other investors in mortgage-backed securities (“MSB”) additional information about the possible future of the GSEs, which could allow investors in MSBs to better assess the impact of a potential exit of the GSEs from conservatorship on the housing finance market.

4. **CalPERS/Federal Representative Actions.** Conducted 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.