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Federal Investments Report for CalPERS Board
May 2017

I. Securities and Capital Markets

1. **Brief summary of issue.** Policy developments related to the Securities and Exchange Commission ("SEC") and the capital markets.
2. **Specific changes/developments since last report.**
   - **Nominations.** The Senate voted 61-37 to confirm Jay Clayton, an attorney in private law practice, to be the Chairman of the SEC. Chairman Clayton was sworn in as Chairman on May 4, 2017. Chairman Clayton's biography is available here.
   - **Financial Regulatory Reform.**
     - *Financial CHOICE Act*. H.R. 10, the "Financial Choice Act of 2017" ("FCA"), a bill introduced by House Financial Services Committee ("HFSC") Chairman Jeb Hensaring (R-TX) to reform the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), is scheduled to be considered by the full House during the week of June 5, 2017. A "section-by-section" summary of the bill is available here. In a speech, Chairman Hensarling stated that "[t]here are very significant portions of the [FCA] that I hope and expect… to get signed into law in this Congress," though he also noted that other aspects of the bill "may take several Congresses" to "come to fruition."
     - *Bipartisan Senate Efforts*. Senate Majority Leader Mitch McConnell (R-KY) recently indicated that he would "love" to reform Dodd-Frank, though he said that "[i]t would require some Democratic involvement in order to achieve a statutory change in the Senate." Accordingly, it appears that the Senate will likely consider its own regulatory reform bill, rather than take up the FCA. Senate Banking Committee ("SBC") Chairman Mike Crapo (R-ID) has signaled that he is working with SBC Ranking Member Sherrod Brown (D-OH) to identify bipartisan bills that the SBC could potentially advance in "the near future."
   - **Board Diversity.** Rep. Gregory Meeks (D-NY), a senior member of the HFSC, has introduced H.R. 970, the "Improving Corporate Governance Through Diversity Act of 2017," to require public companies to report to the SEC about the diversity of their boards of directors and senior executives. In particular, the bill would require public companies to report on: (1) the racial, ethnic and gender composition of their boards of directors and senior executives; (2) the affiliation of their boards of directors or senior executives with historically underrepresented groups; and (3) any plans to improve the diversity of their boards of directors or senior executives. H.R. 970 would direct the SEC to require public companies to include information in their proxy statements about a board nominee's gender, race, ethnicity and affiliation with historically underrepresented groups. The bill would also require that the information be presented in chart or matrix form. The

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Committees to which H.R. 970 was referred for consideration have not to date acted on the legislation.

- **SEC Budget.** President Trump released his Budget Request for Fiscal Year ("FY") 2018, which would fund the SEC at $1.6 billion. The proposed funding level is consistent with the FY 2016 funding level and with the recently enacted Consolidated Appropriations Act, 2017, which funds the federal government through September 30, 2017. As provisioned in the FCA, the President's Budget Request proposes to eliminate the SEC's reserve fund. Established as part of Dodd-Frank, the reserve fund is funded by the collection of SEC filing fees and can be funded up to $50 million per fiscal year. The fund cannot exceed $100 million, and excess fees are required to be submitted to the Treasury Department.
- **Legislation.** The House passed the following securities bills:
  - H.R. 910, the "Fair Access to Investment Research Act of 2017." Introduced by Rep. French Hill (R-AR), the bill would direct the SEC to create a safe harbor for certain publications or distributions of research reports by brokers or dealers distributing securities. The bill states that, if a broker dealer participates in the registered offering of a covered investment fund's securities, the investment fund research report shall not be deemed to constitute an offer for sale nor an offer to sell a security. The House passed H.R. 910 by a vote of 405-2;
  - H.R. 1312, the "Small Business Capital Formation Enhancement Act." Introduced by Rep. Bruce Poliquin (R-ME), the bill would require the SEC to respond to any findings and recommendations by the SEC's annual Government-Business Forum on Small Business Capital Formation. The House passed H.R. 1312 by a vote of 406-0; and
  - H.R. 1366, the "U.S. Territories Investor Protection Act of 2017." Introduced by Rep. Nydia Velázquez (D-NY), the bill would amend the Investment Company Act of 1940 to repeal the exemption from its coverage of investment companies created under the laws of Puerto Rico, the Virgin Islands, or any other U.S. possession. The House passed H.R. 1366 by voice vote.

  The SBC previously approved the Senate versions of Rep. Hill's bill (S. 327) and Rep. Velázquez's bill (S. 484), and the Senate Small Business and Entrepreneurship Committee discharged by unanimous consent the Senate version of Rep. Poliquin's bill (S.416). It is not yet clear when the full Senate will take up the legislation.
- **SEC Advisory Committee.** The SEC Small and Emerging Companies Advisory Committee (the "Advisory Committee") held a meeting to discuss a number of topics, including the underwriting of small securities offerings. Regarding this agenda item, J. Brandford Eichler of Stephens Inc. delivered a presentation entitled "Why Have We Seen a Slowdown in IPOs and What Could Drive an Increase?" In addition, Robert Malin of WR Hambrecht + Co delivered a presentation on the SEC's Regulation A+ (regarding small securities offerings). The Advisory Committee also received updates from SEC staff about the agency's tick size pilot program and heard recommendations on secondary

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market liquidity and broker-dealer finder status. The full agenda is available here. In his opening remarks, Chairman Clayton said that one of his priorities is for the SEC to "focus on facilitating capital-raising opportunities for all companies, including, and importantly, small- and medium-sized businesses."

3. **Implications for CalPERS.**
   - Mr. Clayton's confirmation will likely provide CalPERS and other securities market participants greater certainty about the SEC's regulatory agenda, namely an anticipated focus on capital formation;
   - Additional disclosures from issuers on the diversity of their boards of directors and senior executives could help CalPERS and other investors to determine whether boards and executives have the appropriate mix of qualities to manage risk, realize long-term business goals, and avoid the negative consequences of "group think;"
   - Adequate funding for the SEC will assure that the agency has the resources necessary to address emerging challenges and to promote investor confidence while also spurring economic growth; and
   - Financial regulatory reform efforts could impact the ability of CalPERS to protect shareowner rights and to further promote confidence in the securities markets.
4. **CalPERS/Federal Representative Actions.**
   - Conducted 13 meetings with Dan Bienvenue, Gretchen Zeagler, officials at the SEC, as well as key Members of Congress and their staff members about CalPERS' Federal Investment Priorities (the "Priorities") for the 2017-18 Congressional session. The meetings also included discussions about CalPERS' concerns regarding certain provisions of the FCA;
   - Consistent with the Priorities, we conducted ongoing monitoring of the financial reform bills discussed above and do not recommend action at this time; and
   - Conducted ongoing monitoring of other regulatory and legislative developments related to the securities markets.
5. **Recommendations for Next Steps.** We will continue to 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 the Commodity Futures Trading Commission ("CFTC") and the derivatives markets.
2. **Specific changes/developments since last report.**
   - **Nominations.** President Trump formally submitted to the Senate the nomination of J. Christopher Giancarlo (a Republican) to a full term as Chairman of the CFTC. (He is currently serving as Acting Chairman of the CFTC.) The agency is currently comprised of Acting Chairman Giancarlo and Commissioner Sharon Y. Bowen (a Democrat). President Trump recently announced his intent to nominate Republican Brian Quintenz to fill one of the three vacant slots on the five-member CFTC, and is thought to be considering nominating Republican Dawn Stump and Democrat Rostin Behnam to fill the other two slots. It is not yet clear when the Senate Agriculture Committee will consider the formally submitted nomination.

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- **Rulemaking.** The CFTC voted to issue a request for information from the public about how to make the CFTC's existing rules "simpler, less burdensome and less costly." The CFTC is seeking comments on or before September 30, 2017. Acting Chairman Giancarlo signaled that the request for information is "not about identifying existing rules for repeal or even rewrite;" but rather "[i]t is about taking CFTC's existing rules as they are and applying them in ways that are simpler, less burdensome and less of a drag on the American economy."
- **CFTC Budget.** The President's Budget Request for FY 2018 would fund the CFTC at $250 million. The proposed funding level is consistent with the FY 2016 funding level and with the recently enacted Consolidated Appropriations Act, 2017. The CFTC requested $281.5 million for FY 2018, an approximately 12 percent increase over the funding level contained in the President's Budget Request. In a statement, Commissioner Bowen expressed support for the CFTC's proposed increase "out of necessity," while expressing her view that the amount will not be sufficient to "enable [the CFTC] to credibly do our jobs and fulfill the demands that our mission requires."

3. **Implications for CalPERS.**
   - Advancement of the pending CFTC nominations could provide CalPERS and other derivatives market participants additional certainty about the CFTC's regulatory agenda;
   - The CFTC's request for information could provide interested parties an opportunity to provide their perspective to the CFTC about the importance of ensuring that the derivatives markets continue to operate safely and with integrity; and
   - Sufficient funding for the CFTC will help the agency to fulfill its mission by assuring the financial integrity of the futures and swaps markets.
4. **CalPERS/Federal Representative Actions.**
   - Conducted ongoing monitoring of the CFTC nominations process; and
   - Conducted ongoing monitoring of other 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 concerning Fannie Mae and Freddie Mac (the "GSEs") and the secondary mortgage market.
2. **Specific changes/developments since last report.**
   - **Secretary Mnuchin Testimony.** Treasury Secretary Steve Mnuchin testified for the first time before the SBC at a hearing entitled "Domestic and International Policy Update," during which he discussed housing finance reform. In response to a question from Chairman Crapo, Secretary Mnuchin expressed his commitment to housing finance reform that provides ample credit to consumers

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with very little risk to taxpayers. Chairman Crapo signaled that the SBC's consideration of housing finance reform proposals will build upon bipartisan legislation that he previously sponsored with former SBC Chairman Tim Johnson (D-SD). In an exchange with Sen. Bob Corker (R-TN), Secretary Mnuchin expressed his preference that housing finance reform be achieved through Congressional action. Further, Secretary Mnuchin expressed hope that the GSEs will continue to make dividend payments to the Treasury Department. Secretary Mnuchin's written testimony is available here.

- **FHFA Director Watt Testimony.** The SBC held a hearing entitled "The Status of the Housing Finance System After Nine Years of Conservatorship," during which Federal Housing Finance Agency ("FHFA") Director Melvin L. Watt testified. In his testimony, Director Watt indicated that he does not intend to reform the GSEs administratively. He also addressed the prospect of amending, either unilaterally or in concert with Treasury, the senior preferred stock agreements to allow the GSEs to retain capital to prevent another draw from the Treasury. However, he also indicated that such an amendment would not include "releasing" the GSEs from conservatorship. Chairman Crapo urged Director Watt to work with the SBC to ensure that the FHFA does not allow the GSEs to rebuild their capital buffers by suspending quarterly dividend payments to Treasury. According to Chairman Crapo, such a suspension of dividend payments would "lead some to believe that [GSE] reform is not urgent."
- **Housing Finance Reform.** As bipartisan discussions continue in Congress about housing finance reform, Chairman Crapo has signaled that he intends to convene an SBC hearing on the issue after Congress returns from the Memorial Day District Work Period, and hopes to have a legislative proposal prepared in the coming months. Notably, Sen. Corker expressed his view that "a lot of consensus" is developing on the issue and that he expects that reform proposals will emphasize competition and private capital while also including an "explicit but paid-for" government backstop for the GSEs.
- **Budget Projection.** As discussed above, the President's Budget Request for FY 2018 projects that the GSEs would provide $142.4 billion in profits to Treasury over 10 years to fund government programs and reduce the federal deficit. The projection follows recent testimony from Director Watt before the SBC (see above), during which he addressed the possibility of amending the senior preferred stock agreements to allow the GSEs to retain their capital. If such an action is taken either administratively or legislatively, payments in profits to the Treasury would end.

3. **Implications for CalPERS.**
    - Reformation of the housing finance market (particularly the GSEs) could impact market liquidity, mortgage interest rates and investment returns for CalPERS shareowners.
4. **CalPERS/Federal Representative Actions.**
    - Conducted ongoing monitoring of other regulatory and legislative developments related to the secondary mortgage market.

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