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Federal Investments Report for CalPERS Board
July 2017

I. Securities and Capital Markets

1. **Brief summary of issue.** Policy developments related to the Securities and Exchange Commission ("SEC") and the securities and capital markets.
2. **Specific changes/developments since last report.**
   - **Nominations.** The White House announced that it has submitted to the Senate the nomination of Hester Peirce (a Republican) to be a Commissioner at the SEC for a term expiring on June 5, 2020. The five-member SEC is currently comprised of Chairman Jay Clayton (a Republican) and Commissioners Kara Stein (a Democrat) and Michael Piwowar (a Republican). Ms. Peirce is currently the Director of the Financial Markets Working Group and a Senior Research Fellow at the Mercatus Center at George Mason University. She also serves on the SEC's Investor Advisory Committee, and previously served as a Senate staff member and SEC lawyer. President Trump is still thought to be considering nominating Robert Jackson, a professor at Columbia Law School, to fill the vacant Democratic Commissioner seat at the SEC. Mr. Jackson is the director of the Program on Corporate Law and Policy at Columbia, and has focused his research on executive compensation and corporate governance issues.
   - **Chairman Clayton Speech.** Chairman Clayton delivered a speech in which he outlined the following eight principles that will guide his chairmanship: (1) "the SEC's mission is our touchstone"; (2) "our analysis starts and ends with the long-term interests of the Main Street investor"; (3) "the SEC's historic approach to regulation is sound"; (4) "regulatory actions drive change, and change can have lasting effects"; (5) "as markets evolve, so must the SEC"; (6) "effective rulemaking does not end with rule adoption"; (7) "the costs of a rule now often include the cost of demonstrating compliance"; and (8) "coordination is key." In addition, Chairman Clayton identified a number of "opportunities" to apply these principles to the SEC's agenda, including promoting capital formation, making revisions to equity market structure, considering action on a fiduciary duty rule for broker-dealers, and improving disclosures for investors.
   - **SEC Agenda.** The Office of Management and Budget's Office of Information and Regulatory Affairs released the Unified Agenda of Regulatory and Deregulatory Actions for the SEC and certain other administrative agencies. The SEC's regulatory agenda lists thirty-three rulemakings that the SEC expects to propose or finalize in the next twelve months. The list includes rulemakings related to Business and Financial Disclosure Required by Regulation S-K, Disclosure Update and Simplification, and Disclosure of Order Handling Information. Listed among the rulemakings that the SEC does not expect to act on within the next twelve months are proposals related to pay vs. performance, universal proxy, corporate board diversity and incentive-based compensation arrangements. Importantly, the regulatory agenda was finalized in March 2017,

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prior to Chairman Clayton's confirmation to head the SEC, and reflects the priorities of then-Acting SEC Chairman Piwowar.

- **SEC Budget.**
  - The Senate Appropriations Financial Services and General Government ("FSGG") Subcommittee held a hearing on the Fiscal Year ("FY") 2018 Budget Request for the SEC, at which Chairman Clayton testified. President Trump's Budget Request for FY 2018 would fund the SEC at $1.6 billion. In his written testimony, Chairman Clayton described how the SEC proposes to use its resources in the following areas: (1) effective agency management; (2) protecting investors; (3) facilitating capital formation; (4) leveraging technology; and (3) acquiring a successor lease for the SEC's headquarters.
  - The House Appropriations Committee approved by a vote of 31-21 the FSGG Appropriations Bill for FY 2018. The bill would fund the SEC at $1.6 billion. Notably, the bill also includes a "policy rider" that would prohibit the SEC from advancing a rulemaking to require the disclosure of corporate political spending.
- **House Republican Budget.** House Republicans released their proposed FY 2018 Budget Resolution and Blueprint entitled "Building A Better America: A Plan for Fiscal Responsibility." The Blueprint states that the Budget Resolution provides a path to achieve various objectives, but subsequent legislation will be required. The Blueprint indicates that H.R. 10, the "Financial CHOICE Act" ("FCA"), a House-passed bill to reform the Dodd-Frank Wall Street Reform and Consumer Protection Act, stands on (among other things) the principle that "[e]conomic growth must be revitalized through competitive, transparent, and innovative capital markets." The Blueprint states that the FCA is "the legislative manifestation" of polices that the House Budget Committee has long recommended and continues to recommend in the FY 2018 Budget Resolution.
- **Capital Formation.** The House Financial Services Capital Markets, Securities, and Investment Subcommittee held a hearing entitled "The Cost of Being a Public Company in Light of Sarbanes-Oxley and the Federalization of Corporate Governance." During the hearing, Chairman Bill Huizenga (R-MI) said that it's difficult for companies to go public and remain public because of the costs related to compliance with the Sarbanes-Oxley Act ("SOX"), as well as the existing regime of federal corporate governance regulations. Ranking Member Carolyn Maloney (D-NY) stated that it's important to remember the accounting scandals that necessitated enactment of SOX in the first place. Vice Chairman Randy Hultgren (R-IL) indicated that he has been focused on reforming SEC Rule 14a-8 (shareholder proposals), which he said has been "high-jacked" to achieve social objectives that have "nothing to do with investor protection or capital formation." During his line of questioning, Rep. Sean Duffy (R-WI) expressed concerns about the extent to which there is transparency, competition and accountability for the two leading proxy advisory firms.

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3. **Implications for CalPERS.**
   - Chairman Clayton's announcement about his priorities as head of the SEC and the White House's announcement of Ms. Pierce's nomination could provide CalPERS and other securities market participants additional certainty about the SEC's regulatory direction;
   - Efforts in Congress and at the SEC to facilitate capital formation while safeguarding investors could provide CalPERS and other providers of capital to the public markets additional investment opportunities that could result in long-term value for shareowners, economic growth and job creation;
   - Sufficient funding for the SEC would help to ensure that the agency has the resources needed to address emerging risks in the securities markets and to promote investor confidence therein; and
   - Efforts to reform federal financial regulations could impact the SEC's ability to foster fair, orderly and efficient securities markets and the ability of CalPERS to protect shareowner rights.
4. **CalPERS/Federal Representative Actions.**
   - Consistent with the CalPERS' Federal Investment Priorities for the 2017-18 Congressional session, the CalPERS CEO signed a letter in support of S. 536, the "Cybersecurity Disclosure Act." Introduced by Sen. Jack Reed (D-RI), the bill would require the SEC to promulgate rules to require issuers to disclose whether any members of their board of directors have cybersecurity expertise (similar to existing financial expert disclosures) and, if board members do not have such expertise, why having this expertise on the board is not necessary because of other cybersecurity steps taken by the issuer. S. 536 would not require cybersecurity expertise, only disclosure. The bipartisan legislation is cosponsored by Sens. Mark Warner (D-VA) and Susan Collins (R-ME);
   - Conducted ongoing monitoring of the SEC nominations and Congressional appropriations processes; 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.** The Senate Agriculture Committee has scheduled a hearing for Thursday, July 27, 2017 to consider the nominations of Dawn Stump, Brian Quintenz and Russ Behnam to be Commissioners at the CFTC. The five-member CFTC is currently comprised of Acting Chairman J. Christopher Giancarlo (a Republican) and Commissioner Sharon Bowen (a Democrat), and has three vacant seats. The Agriculture Committee has approved the nomination of Acting Chairman Giancarlo to be the Chairman of the CFTC for a full term, though the

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nomination has not yet been acted on by the full Senate. Commissioner Bowen has announced her intent to resign from the CFTC "within the next few months," or possibly sooner if another nominee is confirmed. After Commissioner Bowen's departure from the agency, the President will have an opportunity to nominate a replacement.

- **CFTC Budget.** The Senate Appropriations FSGG Subcommittee hearing (discussed above) also focused on the FY 2018 Budget Request for the CFTC and featured testimony from Acting Chairman Giancarlo. President Trump'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 is slightly above the funding level provisioned in the FY 2018 Agriculture Appropriations Bill ($248 million) that the House Appropriations Agriculture Subcommittee approved. 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 his written testimony, Acting Chairman Giancarlo described how the CFTC proposes to utilize its resources in the following areas: increased economic cost benefit analysis, examinations to cover increased designated clearing organizations, and further implementation of FinTech initiatives. He also highlighted measures that the CFTC proposes to undertake to more effectively use its resources.
- **Swaps Reporting.** The CFTC's Division of Market Oversight announced that it is beginning a comprehensive review of certain CFTC swap data reporting regulations that is expected to be completed by the end of 2019. According to the Division of Market Oversight, the review will focus on "changes to the existing regulations and guidance with two goals at the forefront: (a) to ensure that the CFTC receives accurate, complete, and high quality data on swaps transactions for its regulatory oversight role; and (b) to streamline reporting, reduce messages that must be reported, and right-size the number of data elements that are reported to meet the agency's priority use-cases for swaps data." Public comments on the review are due by August 21, 2017.

3. **Implications for CalPERS.**
   - Consideration by the Senate of the pending CFTC nominations could provide CalPERS and other derivatives market participants greater certainty about the CFTC's regulatory direction; and
   - Adequate funding for the CFTC would help the agency to fulfill its mission by assuring the integrity and stability of the futures and swaps markets; and
   - The Division of Market Oversight's review of the CFTC's swap data reporting regulations could help to ensure that the agency has an optimal swap reporting regime that facilitates the identification of potential problems in the derivatives markets that need to be addressed.
4. **CalPERS/Federal Representative Actions.**
   - Conducted ongoing monitoring of the CFTC nominations and Congressional appropriations processes; and

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- 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 the Federal Housing Finance Agency ("FHFA"), Fannie Mae and Freddie Mac (the "GSEs") and the broader secondary mortgage market.
2. **Specific changes/developments since last report.**
   - **FHFA Housing Goals.** The FHFA proposed 2018-2020 single-family and multi-family housing goals for the GSEs. For single-family, the FHFA proposes the following goals for the GSEs: low-income home purchase goal at 24 percent; very low-income home purchase subgoal at six percent; low-income areas home purchase subgoal at 15 percent; and low-income refinance goal at 21 percent. For multi-family, the FHFA proposes the following goals for the GSEs: low-income goal at 315,000 units; very low-income subgoal at 60,000 units; low-income small multi-family subgoal at 10,000 units. An FHFA summary of the proposed goals is available here. Public comments on the proposed rule are due by September 5, 2017.
   - **Housing Finance Reform.**
     - The Senate Banking Committee ("SBC") held a hearing entitled "Principles of Housing Finance Reform." In his opening statement, Chairman Mike Crapo (R-ID) said that "[r] eforming the housing finance system is one of my key priorities this Congress" and that "the status quo is not a viable option." Sen. Bob Corker (R-TN) indicated that recapitalizing the GSEs and releasing them back into the market without significant reforms is also not a solution. Further, he expressed support for reform that assures credit availability through all cycles, simplicity, as well as participation for small lenders. Sen. Corker is currently working on a bipartisan reform bill with Sen. Mark Warner (D-VA). Among the aspects of the bill thought to be under consideration is a proposal to break up the GSEs.
     - The SBC also held a hearing entitled "Housing Finance Reform: Maintaining Access for Small Lenders." During the hearing, Chairman Crapo outlined the following six housing finance reform principles that he said enjoy bipartisan support: (1) "[w]e need to preserve the to-be-announced market and an affordable, accessible 30-year fixed rate mortgage"; (2) "[w]e must have multiple levels of taxpayer protection standing in front of any government guarantee, including down payments, loan-level insurance, and – very importantly – substantial, robust, loss-absorbing private capital"; (3) "[p]rivate capital rather than taxpayers should bear non-catastrophic credit risk"; (4) "[w]e must have an orderly

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transition that utilizes existing market structure, where possible, and minimizes market disruption"; (5) "[t]he current conservatorships [of the GSEs] are unsustainable and Congress must find a long-term solution"; and (6) "[w]e need a level playing field to ensure that small lenders can access the secondary market equitably."

  - The SBC also held a hearing entitled "The Semiannual Monetary Policy Report to the Congress," at which Federal Reserve Chair Janet Yellen testified. In response to a question from Chairman Crapo about housing finance reform, Chair Yellen said that "[i]t's been almost a decade since the GSEs were moved into receivership" and that "it's important to move forward with reforms." Chairman Crapo has indicated that housing finance reform is one of his top priorities during the current term of Congress.
  - Federal Reserve Governor Jerome Powell delivered a speech entitled "The Case for Housing Finance Reform" at the American Enterprise Institute, a conservative think-tank based in Washington, D.C. In the speech, Governor Powell stated that, "[i]f Congress does not enact reforms [to the housing finance system] over the next few years, we are at risk of settling for the status quo--a government-dominated mortgage market with insufficient private capital to protect taxpayers, and insufficient competition to drive innovation." In addition, he outlined the following five principles for reform: (1) "make the possibility of future housing bailouts as remote as possible"; (2) ensure that any government guarantee of the system is explicit and transparent and that it applies to securities, not to institutions; (3) promote greater competition in the housing finance market; (4) consider "simple approaches that restructure and repurpose parts of the existing architecture of our housing finance system"; and (5) identify and build upon areas of bipartisan agreement.

- **House Republican Budget.** The House Republican Budget Resolution proposes to prohibit the GSEs' guarantee fees from being used to offset federal spending. Among the objectives that would require subsequent legislation is the proposal contained in the Blueprint to privatize the GSEs. According to the Blueprint, "[i]n 2008, the federal government placed [the GSEs] in conservatorship to prevent them from going bankrupt. The Treasury has already provided $187 billion in bailouts to [the GSEs], and taxpayers remain exposed to $5 trillion in [the GSEs'] outstanding commitments, as long as the entities remain in conservatorship. Our budget recommends putting an end to corporate subsidies and taxpayer bailouts in housing finance." Further, the Blueprint states "[n]ot only are taxpayers exposed to the risks of [the GSEs], but they are also vulnerable to having to bail out another housing giant, the Federal Housing Administration [("FHA")]." The Blueprint states that "[t]he government should adopt measures to control the assumption of risk by the FHA, as other government-backed entities wind down."

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3. **Implications for CalPERS.**
    - Efforts to reform the housing finance system and/or the GSEs - either through targeted policy proposals or wholesale structural reform proposals - could affect market liquidity, mortgage interest rates and long-term investment returns for CalPERS shareowners.
4. **CalPERS/Federal Representative Actions.**
    - Conducted ongoing monitoring of other regulatory and legislative developments related to housing finance reform, the GSEs and other secondary mortgage market activities.
5. **Recommendations for Next Steps.** We will provide updates and recommend action by CalPERS, as warranted, including commenting on relevant rulemakings and legislative proposals.