

Federal Investments Report for CalPERS Board November 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 Senate Banking Committee (“SBC”) approved by voice vote the nominations of Robert Jackson (a Democrat) and Hester Peirce (a Republican) to be Commissioners at the SEC and of David Ryder to be the Director of the U.S. Mint. At this juncture, it is unclear when the full Senate will take up the nominations.
 - **Chairman Hensarling Retirement.** House Financial Services Committee (“HFSC”) Chairman Jeb Hensarling (R-TX) announced that he will not seek reelection to Congress in 2018. In a statement, Chairman Hensarling said that, “[s]ince my term as Chairman of the [HFSC] comes to an end next year, the time seems right for my departure.” However, he also indicated that there are fourteen months remaining in his current term and that “[m]uch work remains at the [HFSC] in the areas of housing finance reform, regulatory relief, cyber security and capital formation to name just a few.”
 - **SEC Budget.** The Senate Appropriations Committee released a draft of its Financial Services and General Government (“FSGG”) Appropriations Bill, which proposes to fund the SEC at \$1.8 billion. The amount is consistent with President Trump’s Budget Request for FY 2018, and includes \$245 million for the potential relocation of the SEC’s headquarters. The House FSGG Appropriations Bill proposes to fund the SEC at \$1.6 billion.
 - **PCAOB Budget.** The Public Company Accounting Oversight Board (“PCAOB”) unanimously approved a \$259.9 million budget for Fiscal Year (“FY”) 2018, a reduction of 3.2 percent from FY 2017. The PCAOB’s budget must be approved by the SEC. The SEC is expected to consider the PCAOB’s budget by the end of the year. PCAOB Chairman James R. Doty’s term has expired and the SEC is currently seeking a replacement.
 - **Financial Regulatory Reform.** SBC Chairman Mike Crapo (R-ID) introduced bipartisan financial regulatory reform legislation (S. 2155, the “Economic Growth, Regulatory Relief and Consumer Protection Act”). An SBC section-by-section summary of the bill is available here. In a statement, Chairman Crapo stated that the legislation is “targeted toward helping community banks, credit unions, mid-sized banks, regional banks and custody banks. He said the bill “includes important consumer protections, particularly for veterans, senior citizens and victims of fraud.” In a statement expressing opposition to the bill, SBC Ranking Member Sherrod Brown (D-OH) said that he “disagree[s] on the wisdom of rolling back so many of Dodd-Frank’s protections with almost no gains for working families.” The following Republicans are original cosponsors

of the legislation: Sens. Bob Corker (R-TN), Tim Scott (R-SC), Tom Cotton (R-AR), Mike Rounds (R-SD), David Perdue (R-GA), Thom Tillis (R-NC), John Kennedy (R-LA), and Jerry Moran (R-KS). The following Democrats are original cosponsors: Sens. Joe Donnelly (D-IN), Heidi Heitkamp (D-ND), Jon Tester (D-MT), Mark Warner (D-VA), Tim Kaine (D-VA), Angus King (I-ME), Joe Manchin (D-WV), Claire McCaskill (D-MO), and Gary Peters (D-MI). The SBC will convene a markup of the bill on December 5, 2017.

- **Chairman Clayton Speech.** SEC Chairman Jay Clayton delivered a speech entitled “Governance and Transparency at the Commission and in Our Markets” at the Practising Law Institute’s 49th Annual Institute on Securities Regulation. In his speech, Chairman Clayton signaled that the SEC’s near-term agenda will be shorter than in the recent past and that he is “giving a lot of thought to the SEC’s agenda over a longer period,” with mandatory rulemakings under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) being “top of mind.” Chairman Clayton expressed his view that: the SEC should reconsider reopening the comment file on the 2010 “Proxy Plumbing” concept release to receive updated feedback; the trend in the 2017 proxy season of retail shareholders beneficially-owning 30% of shares in U.S. companies while 29% of those shares voted “may be a signal that our proxy process is too cumbersome for retail investors and needs updating”; and “there seems to be little ground for building consensus” on shareholder proposals, but he is “searching for a way to reconcile the multiple positions and find common ground.”
- **Consolidated Audit Trail.** Chairman Clayton issued a statement indicating that the SEC would not grant exemptive relief to the Self-Regulatory Organizations (“SROs”) from the initial deadline under the Consolidated Audit Trail (“CAT”) for one year and other deadlines by a year or more. The SROs sought to delay the requirements to meet the deadlines based on concerns about potential cybersecurity vulnerabilities. The SEC adopted rules requiring the establishment of the CAT to be a single, comprehensive database designed to allow regulators to more effectively monitor trading in equity and option securities in U.S. markets.
- **Legislation.** The House passed the following bills:
 - H.R. 3973, the “Market Data Protection Act of 2017.” Introduced by Rep. Warren Davidson (R-OH), a member of the HFSC, the bill would direct the SEC, Financial Industry Regulatory Authority and the operator of the CAT to develop internal risk control mechanisms to protect and govern the storage of market data before collecting such data in the CAT. Thesys Technologies is the company that will operate the CAT. The House passed H.R. 3973 by voice vote;
 - H.R. 2201, the “Micro Offering Safe Harbor Act.” Introduced by Rep. Tom Emmer (R-MN), the bill would exempt certain micro-offerings from the registration requirements of the Securities Act of 1933 (the “Securities Act”). Under the bill, small businesses would not violate the Securities Act when making a non-public securities offering if all of the following requirements are satisfied: (1) each purchaser has a substantive pre-existing relationship with an officer, director, or shareholder with 10

percent or more of the issuer's shares; (2) the issuer reasonably believes that there are no more than 35 purchasers of securities from the issuer that are sold in reliance on the exemption during the 12-month period prior to the transaction; and (3) the aggregate amount of all securities sold by the issuer does not exceed \$500,000 over a 12-month period. The bill would prohibit bad actors from participating in micro-offerings. The House passed H.R. 2201 by a vote of 232-188;

- H.R. 3911, the "Risk-Based Credit Examination Act." Introduced by Rep. Ann Wagner (R-MO), the bill would amend the Securities Exchange Act of 1934 (the "Exchange Act") to allow the SEC to conduct risk-based examinations of the Nationally Recognized Statistical Rating Organizations. The House passed H.R. 3911 by a vote of 389-32; and
- H.R. 2148, "Clarifying Commercial Real Estate Loans." Introduced by Rep. Robert Pittenger (R-NC), the bill would allow the appraised value of real property to count toward a 15 percent equity threshold in order to be exempted from a High Volatility Commercial Real Estate ("HVCRE") designation as required under Basel III. The bill would provide an "off-ramp" from the HVCRE designation when a loan matures and qualifies for underwriting standards for permanent financing. The bill would exempt loans made prior to January 1, 2015 (when the Basel III rule took effect). The House passed H.R. 2148 by voice vote.

At this juncture, it is not yet clear if or when the Senate will consider the legislation.

In addition, the HFSC held a markup of twenty-three (23) bills, all of which were reported favorably to the full House. The bills are designed to provide regulatory relief to community banks, credit unions, and small financial institutions, and to promote capital formation. At this juncture, it is unclear when the full House will consider the legislation. Of the 23 bills, the following are of particular note for CalPERS:

- H.R. 4015, the "Corporate Governance Reform and Transparency Act of 2017." Introduced by Rep. Sean Duffy (R-WI), the bill would provide for (among other things) the registration of proxy advisory firms with the SEC, disclosure of proxy firms' potential conflicts of interest and codes of ethics, and the disclosure of proxy firms' methodologies for formulating proxy recommendations and analyses. The bill was approved by a vote of 40-20;
- H.R. 3093, the "Investor Clarity and Bank Parity Act." Introduced by Rep. Mike Capuano (D-MA), the bill would correct a statutory error in Section 619 (the Volcker Rule) of Dodd-Frank that the five federal regulators charged with implementing the Volcker Rule (the Federal Reserve Board ("FRB"), the SEC, the Commodity Futures Trading Commission ("CFTC"), the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) cannot resolve through the use of existing regulatory authority. When the federal regulators adopted

the Volcker Rule in December 2013, the final rule limited the ability of bank holding companies and their affiliates, which includes investment advisers, to sponsor hedge funds and private equity funds (also known as “covered funds”). Consequently, the bill provides that a covered fund cannot use the name of a sponsor. The legislation would eliminate this prohibition and amend the Volcker Rule to allow an investment adviser to share a similar name with a covered fund. The bill was approved by voice vote;

- H.R. 4247, the “Restoring Financial Market Freedom Act of 2017.” Introduced by Rep. Ted Budd (R-NC), the bill would repeal Title VIII of Dodd-Frank, which gives the Financial Stability Oversight Council (“FSOC”) the authority to designate certain payments and clearing organizations as systemically important “financial market utilities” (“FMUs”) with access to the FRB’s discount window. The bill would also repeal all previous FMU designations announced by the FSOC from July 18, 2012. The bill was approved by a vote of 33-25;
- H.R. 4248. Introduced by Rep. Bill Huizenga (R-MI), the bill would repeal Section 1502 of Dodd-Frank, which requires public companies to disclose in annual reports filed with the SEC whether the company sources “conflict minerals” (e.g., tin, tungsten, tantalum, and gold) from the Democratic Republic of Congo and its nine neighboring countries. The bill was approved by a vote of 32-27;
- H.R. 4263, the “Regulation A+ Improvement Act.” Introduced by Rep. Tom MacArthur (R-NJ), the bill would increase the amount that companies can offer and sell under SEC Regulation A, Tier II (also known as “Regulation A+”), from \$50 million to \$75 million, adjusted for inflation by the SEC every two years to the nearest \$10,000. The bill was approved by a vote of 37-23;
- H.R. 4267, the “Small Business Credit Availability Act.” Introduced by Rep. Steve Stivers (R-OH), and cosponsored by Reps. Gwen Moore (D-WI), Patrick McHenry (R-NC), and Brad Sherman (D-CA), the bill would amend the Investment Company Act of 1940 to modernize the regulatory regime for business development companies (“BDCs”). The bill would require the SEC to streamline the offering, filing, and registration processes for BDCs to eliminate significant regulatory burdens and increases a BDCs’ ability to deploy capital to businesses by reducing its asset coverage ratio—or required ratio of assets to debt—from 200% to 150% if certain requirements are met. The bill was approved by a vote of 58-2;
- H.R. 4279, the “Expanding Investment Opportunities Act.” Introduced by Rep. Trey Hollingsworth (R-IN), the bill would direct the SEC to amend its rules to enable closed-end funds that meet certain requirements to be considered “well-known seasoned issuers” and would conform the filing and offering regulations for closed-end funds to those of traditional operating companies, thereby simplifying the registration process and

enabling these funds to more easily provide information to investors. The bill was approved by a vote of 58-2;

- H.R. 4281, the “Expanding Access to Capital for Rural Job Creators Act.” Introduced by Rep. Rueben Kihuen (D-NV) and cosponsored by Rep. Alex Mooney (R-WV), the bill would amend the Exchange Act to have the SEC’s Advocate for Small Business Capital Formation identify any unique challenges to rural area small businesses when identifying problems that small businesses have with securing access to capital. The bill would also require that the annual report made by the SEC’s Small Business Advocate include a summary of any unique issues encountered by rural area small businesses. The bill was approved by a vote of 60-0;
- H.R. 4289. Introduced by Rep. Mooney, the bill would repeal Section 1503 of Dodd-Frank, which requires mining companies to include information about mine safety and health violations, orders, citations, legal actions, and mining-related fatalities in quarterly and annual reports filed with the SEC. The disclosure requirements are largely based on the safety and health requirements that apply to mines under the Federal Mine Safety and Health Act of 1977, administered by the Mine Safety and Health Administration. The bill was approved by a vote of 33-25.

3. **Implications for CalPERS.**

- Greater clarity about the future composition of the SEC and who could potentially Chair the HFSC in the next term of Congress, could provide CalPERS and other investors more certainty about the future regulatory and legislative activities;
- Completion of the CAT and the SEC’s other regulatory initiatives, as expressed by Chairman Clayton, could enhance the ability of regulators to provide oversight to the evolving securities markets thereby improving market stability for CalPERS and other investors;
- 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;
- Adequate funding for the PCAOB would enable it to fulfill its investor protection responsibilities through oversight of the audits of public companies, other issuers, as well as broker-dealers; and
- Efforts to reform federal financial regulations comprehensively or through stand-alone legislation 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.**

- Work on a letter to SBC Chairman Crapo and Ranking Member Brown that requests the inclusion of certain bipartisan House bills in S. 2155 during the SBC’s markup of the legislation; 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 CFTC and the derivatives markets.
2. **Specific changes/developments since last report.**
 - **CFTC Budget.** The Senate FSGG Appropriations Bill proposes to fund the CFTC at \$250 million for FY 2018. President Trump’s Budget Request for FY 2018 would fund the CFTC at \$250 million, which is consistent with the 2017 enacted level. 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. The House FSGG Appropriations Bill proposes to fund the CFTC at \$248 million.
 - **Chairman Giancarlo Op-ed.** *The Wall Street Journal* published an op-ed entitled “An EU Plan to Invade U.S. Markets” by CFTC Chairman J. Christopher Giancarlo. In the op-ed, Chairman Giancarlo states that, “[i]f the European Union mishandles Britain’s exit, the consequences for U.S. businesses and consumers could be serious.” He particularly expresses concerns about EU proposals that would enable the European Securities and Markets Authority “to demand on-site inspections of U.S. businesses such as the Chicago Mercantile Exchange,” without informing the CFTC, and that would allow the European Central Bank to “impose additional regulations on those same U.S. businesses,” without consulting the CFTC. According to Chairman Giancarlo, “[s]uch overlapping and uncoordinated regulation by the EU would be disruptive, expensive and detrimental to the U.S. trading markets and economy.” He concludes by noting that, “[i]f the U.S. accepts European regulation of American financial companies, it would set a dangerous precedent - potentially opening the door to all manner of other interference.”
 - **Commissioner Quintenz Speech.** CFTC Commissioner Brian Quintenz delivered the keynote address at a conference hosted by the Mercatus Center at George Mason University and the Institute for Financial Markets, during which he discussed the CFTC’s swap dealer *de minimis* registration threshold. The CFTC recently issued an order indicating that the threshold will remain at \$8 billion until December 2019, instead of falling to \$3 billion at the end of 2018 as scheduled. He said that the threshold “is Exhibit A of the prior CFTC leaderships’ one-size-fits-all philosophy,” in that it “imposes broad costs and regulatory burdens on generic activity without regard for achieving stated policy goals and mitigating identified risks.” Commissioner Quintenz said that the CFTC should explore the following potential modifications to the *de minimis* exception policy: “(i) broadening the Insured Depository Institution[] exclusion to align it with current lending practices, (ii) excluding swaps that are cleared, and (iii) treating all hedging swaps consistently and excluding them from the threshold.”
 - **Commissioner Behnam Remarks.** CFTC Commissioner Rostin Behnam delivered remarks entitled “The Dodd-Frank Inflection Point: Building on Derivatives Reform” at the Georgetown Center for Financial Markets and

Policy. In his remarks, Commissioner Behnam expressed his opinion that we have arrived at an inflection point on the path to implementation of Dodd-Frank. Among other things, Commissioner Behnam said that the CFTC must prioritize building upon Dodd-Frank's swap data reporting requirements "in a way that sets clear parameters for what data must be collected and submitted." He noted that the CFTC has not yet finalized rules on capital requirements for swap dealers who aren't prudentially regulated. He also said "regulators must continue to monitor market ecosystems to ensure that regulations, including capital and margin requirements, are properly set to ensure market resiliency, safety, and liquidity at times of market stress." He also emphasized the importance of international cooperation on regulations and addressing cybersecurity risks.

3. Implications for CalPERS.

- The comments from Chairman Giancarlo and Commissioners Quintenz and Behnam could provide CalPERS and other derivatives market participants a greater sense of the CFTC's priorities and regulatory direction.

4. CalPERS/Federal Representative Actions.

- 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 Administration ("FHA"), Fannie Mae and Freddie Mac (collectively, the "GSEs") and the secondary mortgage market.

2. Specific changes/developments since last report.

- **Nominations.** The SBC approved the nomination of Brian Montgomery to be an Assistant Secretary at the Department of Housing and Urban Development/FHA Commissioner. The vote was 18-5. All Republicans supported the nomination. The following Democrats supported the nomination: Sens. Bob Menendez (D-NJ), Jon Tester (D-MN), Warner, Heidi Heitkamp (D-ND), Joe Donnelly (D-IN) and Chris Van Hollen (D-MD). The following Democrats opposed the nomination: Ranking Member Sherrod Brown (D-OH) and Sens. Jack Reed (R-RI), Elizabeth Warren (D-MA), Brian Schatz (D-HI) and Catherine Cortez Masto (D-NV). Mr. Montgomery is currently Vice Chairman of The Collingwood Group, a company focused on business consulting, risk management and compliance in the financial services industry. He was previously Assistant Secretary/FHA Commissioner and Acting Secretary of HUD. It is not yet clear when the full Senate will take up the nomination.
- **GSE Reform Working Group.** House Financial Services Housing and Insurance ("H&I") Subcommittee Chairman Duffy and Ranking Member Emanuel Cleaver (D-MO) continue to collaborate on bipartisan housing finance reform legislation, under the auspices of their GSE reform working group.

Chairman Duffy has indicated his intent to “continue to work with anyone on either side of the aisle who brings constructive ideas” about GSE reform. Ranking Member Cleaver has stated that, “[j]ust embracing legislation through the lens of Democratic or Republican ideology will accomplish little,” while “[b]ipartisanship, on the other hand, can produce value for the country.” HFSC Chairman Hensarling recently signaled that, “[a]t the end of the day, I’m looking for something that improves the status quo and right now that’s a pretty low threshold.” SBC Chairman Crapo and Ranking Member Brown, and Sens. Corker and Warner are continuing their bipartisan efforts to reach agreement on reform legislation in the Senate.

- **H&I Subcommittee Hearing.** The H&I Subcommittee held a hearing entitled “Sustainable Housing Finance, Part III.” During the hearing, Chairman Duffy said that there is currently an opportunity to work across party lines to create a solution on housing finance reform, which should include bringing more private capital into the market, ensuring market discipline, and making sure borrowers have access to mortgages that they can afford. Ranking Member Cleaver stated that reform efforts must include a strong plan that makes homeownership options more available for qualified borrowers and that addresses rental housing issues.
3. **Implications for CalPERS.**
 - Senate confirmation of Mr. Montgomery could provide additional certainty about the regulatory agenda of the FHA; and
 - Efforts to reform the GSEs, and the broader housing finance system, could impact 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.