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Federal Investments Report for CalPERS Board
March 2017

I. Securities and Capital Markets

1. **Brief summary of issue.** Policy developments concerning the Securities and Exchange Commission ("SEC") and legislation related to the capital markets.
2. **Specific changes/developments since last report.**
   - **Nominations.** The Senate Banking Committee ("SBC") held a hearing to consider the nomination of Jay Clayton, an attorney in private law practice, to be the Chairman of the SEC. During the hearing, Mr. Clayton did not indicate with specificity his approach to SEC rulemakings related to pay-ratio, climate risk, and political spending. However, he did state that the "touchstone" of SEC disclosures is the issue of materiality. At this juncture, it is not yet clear when the Committee will vote on the nomination.
   - **Investor Advisory Committee.** The SEC's Investor Advisory Committee ("IAC") held a meeting to discuss financial literacy and unequal voting rights of common stock. In his opening remarks, Acting Chairman Michael Piwowar stated that the "IAC's recommendations have been an invaluable source of insight and have greatly contributed to the SEC's work." Commissioner Kara Stein used her opening remarks to express interest in "learning about new ways to use technology to maximize investor engagement and understanding." She also said that "voting rights have been a foundational component of sound corporate governance" and that "unequal voting rights present complex and new issues that need to be understood and addressed."
   - **Pay Ratio Rule.** Led by Sen. Bob Menendez (D-NJ), a group of nine Senate Democrats sent a letter to Acting Chairman Piwowar expressing concerns about his decision to open a second comment period on the pay-ratio disclosure rule. The Senators also expressed concerns that Acting Chairman Piwowar's "remarks appear to solicit comments from issuers only, improperly overlooking the views of the thousands of investors that submitted comments to the SEC prior to its adoption of the final rule." Sen. Tammy Baldwin (D-WI) sent a similar letter to Acting Chairman Piwowar about the rule.
   - **Rulemakings.** The SEC advanced the following notable rulemakings and regulatory actions:
     - Final rule related to exhibit hyperlinks and HyperText Markup Language ("HTML") or web page format. The rule will require registrants that file SEC registration statements or certain other reports to include a hyperlink to each exhibit listed in the exhibit index of such filings and to submit the registration statements and reports to the SEC's EDGAR filing system in HTML format. The rule will become effective on September 1, 2017;
     - Final rule to shorten by one business day the standard trade settlement cycle for most broker-dealer securities transactions. The amended rule shortens the settlement cycle from three business days to two. Broker-

dealers will be required to comply with the amended rule beginning on September 5, 2017;

- Proposed rule related to municipal securities disclosures. The proposed rule would require brokers, dealers and municipal securities dealers who underwrite certain primary offerings of municipal securities to provide access to information about certain financial obligations incurred by issuers and obligated persons that could affect such entities' liquidity and creditworthiness. An obligated person is any person legally committed to support payment of a municipal securities issuance. Comments are due by May 15, 2017; and
- Request for comment related to certain disclosures by bank holding company ("BHC") registrants. The SEC requested public comment about whether the agency's Industry Guide 3 "continues to elicit information that investors need for informed investment and voting decisions" and about whether the guide should be revised. Industry Guide 3 is a reference for BHCs about the statistical disclosures that the SEC's Division of Corporation Finance seeks in registration statements and other disclosure documents. Comments are due by May 8, 2017.

- **Securities Bills.** The SBC marked up and reported favorably to the full Senate a package of bipartisan securities bills. The House Financial Services Committee ("HFSC") also held a markup, during which it reported the House version of those bills and one additional securities bill favorably to the full House. The SBC approved the bills by voice vote, though Sens. Jack Reed (D-RI) and Elizabeth Warren (D-MA) requested to be recorded as voting "no." There were recorded votes on all of the bills considered by the HFSC. It is not yet clear when either chamber will take up the legislation. A full list of the bills and the corresponding HFSC roll call votes are below.
  - S. 327, the "Fair Access to Investment Research Act of 2017." Introduced by Sen. Dean Heller (R-NV), S. 327 would direct the SEC to create a safe harbor for certain publications or distributions of research reports by brokers or dealers distributing securities. Specifically, the bill states 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. Rep. French Hill (R-AR) introduced a companion bill (H.R. 910) in the House. The HFSC reported the bill favorably to the full House by a vote of 56-2;
  - S. 444, the "Supporting America's Innovators Act of 2017." Introduced by Sen. Heidi Heitkamp (D-ND), S. 444 would amend the Investment Company Act of 1940 to expand the investor limitation for qualifying venture capital funds under an exemption from the definition of an investment company. Rep. Patrick McHenry (R-NC) introduced a companion bill (H.R. 1219) in the House. The HFSC reported the bill favorably to the full House by a vote of 54-2;

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- S. 462, the "Securities and Exchange Commission Overpayment Credit Act." Introduced by Sen. Heller, S. 462 would require the SEC to refund or credit certain excess payments made by national securities exchanges and other Self-Regulatory Organizations to the SEC. Rep. Gregory Meeks (D-NY) introduced a companion bill (H.R. 1257) in the House. The HFSC reported the bill favorably to the full House by a vote of 59-0;
- S. 484, the "U.S. Territories Investor Protection Act of 2017." Introduced by Sen. Bob Menendez (D-NJ), S. 484 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. Rep. Nydia Velazquez (D-NY) introduced a companion bill (H.R. 1366) in the House. The HFSC reported the bill favorably to the full House by a vote of 58-0;
- S. 488, the "Encouraging Employee Ownership Act." Introduced by Sen. Pat Toomey (R-PA), S. 488 would direct the SEC to revise regulations to require issuers to furnish investors with additional specified disclosures regarding compensatory benefit plans if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds $10 million, indexed for inflation every five years. Rep. Randy Hultgren (R-IL) introduced a companion bill (H.R. 1343) in the House. The HFSC reported the bill favorably to the full House by a vote of 48-11; and
- H.R. 1312, the "Small Business Capital Formation Enhancement Act." Introduced by Rep. Bruce Poliquin (R-ME), H.R. 1312 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 HFSC reported the bill favorably to the full House by a vote of 58-0.

- **Financial CHOICE Act.** HFSC Chairman Jeb Hensarling (R-TX) signaled his intent to introduce in the near future a number of stand-alone bills that comprise the Financial CHOICE Act. Chairman Hensarling introduced the CHOICE Act in the last term of Congress to comprehensively reform the Dodd-Frank Wall Street Reform and Consumer Protection Act.

3. **Implications for CalPERS.**
   - Advancement of Mr. Clayton's nomination could provide CalPERS and other market participants additional certainty about the SEC's direction and regulatory agenda;
   - Reconsideration of the pay ratio rule could impact the ability of CalPERS and other investors to achieve executive compensation that is fully disclosed and that aligns interests between executive management and shareowners; and
   - Legislation designed to reform Dodd-Frank and revise certain other securities market rules could impact the ability of CalPERS to protect and strengthen shareowner rights and to promote investor confidence in the financial markets.
4. **CalPERS/Federal Representative Actions.**
   - CalPERS signed a letter with other industry stakeholders regarding implementation of the pay ratio rule;

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- Conducted ongoing monitoring of Mr. Clayton's nomination;
- Consistent with CalPERS' Federal Investment Priorities for the 2017-18 Congressional session (the "Priorities"), we conducted ongoing monitoring of the financial reform bills discussed above and do not recommend action at this time; and
- Consistent with the Priorities, we conducted ongoing monitoring of the SEC rulemakings discussed above and do not recommend action at this time.

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 concerning the Commodity Futures Trading Commission ("CFTC") and the derivatives markets.
2. **Specific changes/developments since last report.**
   - **Nominations.**
     - President Donald J. Trump nominated Acting CFTC Chairman J. Christopher Giancarlo to be the permanent Chairman of the CFTC. The nomination was widely expected and must be confirmed by the Senate. At this juncture, it is not yet clear when the Senate Agriculture Committee will convene a confirmation hearing to consider the nomination.
     - President Trump withdrew from Senate consideration the nominations of Democrat Chris Brummer and Republican Brian Quintenz to be CFTC Commissioners. Mr. Brummer and Mr. Quintenz were nominated by former President Obama to be CFTC Commissioners during the last term of Congress and were re-nominated in January before the end of the Obama Administration. The nominees enjoyed bipartisan support from members of the Senate Agriculture Committee. It is not yet clear who the President will nominate to fill the two seats on the five-member CFTC.
   - **CFTC Agenda.** Acting Chairman Giancarlo delivered a speech entitled "CFTC: A New Direction Forward" at the 42nd Annual International Futures Industry Conference. In his speech, Acting Chairman Giancarlo stated that the CFTC must "interpret its regulatory mission" through the following three-part agenda: (1) fostering economic growth. Acting Chairman Giancarlo announced the creation of "Project KISS" ("Keep It Simple Stupid"), which will be a comprehensive review of CFTC rules and regulations to make them "simpler, less burdensome and less costly"; (2) enhancing U.S. financial markets. He stated that the CFTC should put in place a "better regulatory framework for swaps trading"; and (3) right-sizing its regulatory footprint." Acting Chairman Giancarlo said that the CFTC "must run a tighter ship operationally" and that he has already identified ways to do so, as part of an extensive CFTC budget and spending review.
   - **Swaps.** The CFTC announced that it has extended for an additional 60 days the comment period for its proposed rule that would establish minimum capital requirements for swap dealers and major swap participants that are not subject to

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prudential regulation. The original comment period was set to end on March 16, 2017. The new comment period will end on May 15, 2017.

3. **Implications for CalPERS.**
    - The President's announcements about CFTC nominations and Acting Chairman Giancarlo's speech about the CFTC's upcoming regulatory agenda could provide CalPERS and other derivatives market participants a greater level of certainty about potential efforts to ensure the integrity and stability of the derivatives markets; and
    - The CFTC's extension of the comment period for its proposed rule related to swap dealers and major swap participants will provide the CFTC additional time to consider the potential impact of the rule on liquidity in the derivatives markets, which could benefit market users that trade derivatives to increase shareowner value and mitigate portfolio risk.
4. **CalPERS/Federal Representative Actions.**
    - Conducted ongoing monitoring of the CFTC nominations process; and
    - Consistent with the Priorities, we conducted ongoing monitoring of the CFTC's swaps rulemaking discussed above and do not recommend action at this time.
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 housing finance reform.
2. **Specific changes/developments since last report.**
    - **Nominations.** The Senate confirmed Dr. Ben Carson to be the Secretary of the Department of Housing and Urban Development by a vote of 58-41. During his confirmation hearing in January, Dr. Carson indicated that he supports "some type of backstop" for the GSEs, though he also stated that he was "very much in favor of introducing more private entities into the market."
    - **Common Securitization Platform.** The Federal Housing Finance Agency ("FHFA") announced an update to the timeframe for Release 2 of the Common Securitization Platform ("CSP"). Previously expected to be implemented in 2018, Release 2 is now planned to be implemented in the second quarter of 2019. Under Release 2, the GSEs will use the CSP to issue a single, common security that will be known as the "Uniform Mortgage-Backed Security." FHFA Director Melvin L. Watt stated, "I encourage all market participants to begin moving forward with their preparations to make the changes they will need to accompany implementation of the Single Security Initiative."
    - **GSE Reform.**
        - Mark Calabria, chief economist to Vice President Mike Pence, stated that the Trump Administration intends to establish a group that will focus on housing finance policy. He also said, "[y]ou will see in a few months a set of principles, and then we'll go from there." According to Mr. Calabria,

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"[w]e don't want to be in a situation where we have to put tens of billions of dollars into [the GSEs] or their potential successors."

- Moody's Investors Service announced that it has completed a report entitled "Reform of Fannie Mae and Freddie Mac Has Potential to Reshape U.S. Mortgage Markets." The report addresses the potential implications of reforming the GSEs. According to Moody's, "[e]ven proposals whose impact would seem straightforward at a high level, could have unintended consequences in practice." In this regard, Moody's states "[o]ne possible outcome could be a broad increase in interest rates on new mortgages, which would have meaningful and often negative credit implications across most housing-related sectors." Moody's states that, "if [the GSEs] were reprivatized, rates could rise if higher capital requirements put pressure on the GSEs to raise guarantee fees." Moody's also indicates that, "[i]n some scenarios, a lack of explicit government backing could also result in less favorable regulatory treatment of the mortgage-backed securities that they guarantee."

- **GSE Recapitalization.** A group of civil rights advocacy organizations and mortgage lending trade associations sent a letter to Secretary of the Department of the Treasury Steve Mnuchin and Director Watt expressing concerns about the declining capital buffers at the GSEs. In addition, the groups urged Secretary Mnuchin and Director Watt to "take immediate steps to shore up [the GSEs'] capital position in order to prevent a draw on the U.S. Department of the Treasury's commitment of taxpayer funding for any non-credit related losses." The groups requested the FHFA to suspend the GSEs' "dividend payments to the U.S. Treasury this month and allow the [GSEs] to rebuild their capital buffers" to avoid such a draw.

3. **Implications for CalPERS.**
   - Modifications to housing finance policy could affect market liquidity, mortgage interest rates and CalPERS investment returns.
4. **CalPERS/Federal Representative Actions.**
   - Consistent with the Priorities, we conducted ongoing monitoring of the FHFA's announcement about the CSP and do not recommend action at this time; and
   - Conducted ongoing monitoring of other 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.