

Washington Outlook

**Presentation to
The California State Teachers' Retirement Board**

John S. Stanton
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Key Federal Initiatives

- **Washington Update – Latest Developments**
- **WEP Offset Relief Legislation**
- **Investor Protection and Corporate Governance – SEC Disclosure Projects, Proxy Advisor Rule, Shareholder Resolution Rule**
- **Proxy Voting on ESG Issues**
- **ESG Disclosure Legislation – ESG, Climate, Human Capital Management, Diversity of Board, Management, and Workforce, Executive Com, Cyber**
- **Other Investor Protection – GPs v. LPs, Proxy Plumbing, Unequal Voting Rights**
- **Climate Change -- Business, Financial Regulators Urge Action, Regulation**
- **Promoting Retirement Savings – SECURE Act 2.0**
- **Infrastructure Legislation**

WEP Offset Relief Legislation – D's and R's Go Separate Ways

House W&M Chairman Neal (H.R. 2337)

- **Relief for Current Retirees**
Current retirees affected by WEP get flat \$150 monthly payment
- **Future Retirees (after 2021)**
 - Higher of:
 - Current benefit, as reduced by WEP or
 - New method based on actual earnings and work history, not current arbitrary formula.
- **Current WEP Exemptions**
Retains current law exemptions, including:
 - No government plan pension received for non-covered State or local service – addresses CalSTRS concern over non-vested CalSTRS members

GOP Ranking Member Brady

- **Relief for Current Retirees**
Flat \$100 per month
- **Future Retirees**
 - 2022 – 2060: Higher of the two
 - 2061 onward: New method only
- **Current WEP Exemptions**
Retains current law exemptions for those retiring through 2060. Then no exemptions

WEP Offset Relief Legislation – WEP, GPO Repeal

“Social Security Fairness Act”

- H.R. 82 (Rep. Rodney Davis (R-III.))
- S. 1302 (Sen. Sherrod Brown (D-Ohio))
- Lot of co-sponsors, but revenue cost of full repeal of WEP, GPO prohibitive

Investor Protection and Corporate Governance – SEC Disclosure Projects

- **Climate Risk Disclosure**

- Consistency and comparability between companies, today and over time
- “Decision useful” – helpful information for investors; not generic boilerplate
- Qualitative – how company leadership manages climate risks and opportunities and how that fits into corporation’s strategy
- Quantitative – metrics on greenhouse gas emissions, financial impacts of climate change, and progress toward company’s climate-related goals
- Considering whether to have specific metrics for particular industries – e.g., banking, insurance, transportation
- Scenario analyses – how company might adapt to range of possible physical, legal, regulatory, market, and economic changes in the future
- Business Roundtable calls for SEC climate risk disclosure – principles-based, but also some specific metrics

Investor Protection and Corporate Governance – SEC Disclosure Projects – Slide 1

- **Human Capital Management/Workforce Disclosure**
 - SEC Chair: “Information that a shareholder would want about human capital management practices and workforce diversity at the companies in which they are investing.”
- **Board and Senior Management Diversity**
 - Racial, ethnic, and gender composition of board and senior management
 - Corporate plan to promote diversity
 - Nasdaq Listing Rule approved – Gender, racial, LGBTQ+ status of board members. Explain why not have at least 2 board members in above category, including at least one female and one minority or LGBTQ+.

Investor Protection and Corporate Governance – SEC Disclosure Projects – Slide 2

- **Executive Compensation**

- Improve transparency of pay-for-performance arrangements
- More disclosure by fund managers of their proxy votes on say-on-pay
- Implement executive compensation clawbacks where earnings restated
- **Rule 10b5-1 executive trading plans**
 - SEC Chair: Address “gaps” in current law safe harbor, including multiple plans and swift re-adoption of plans to facilitate “opportunistic trading”
 - Particular attention to possible “cooling off” periods and use of a single plan, instead of multiple plans

- **Chinese Companies Listing in U.S.**

- PCAOB must be able inspect issuer’s accounting firm audit every 3 years (recent statute)
- Disclosures where shell entities used for U.S. listings in Chinese sectors where no foreign ownership/listing permitted. Shell contracts with Chinese operating company; no equity permitted

Investor Protection and Corporate Governance – SEC

- **Recent SEC Rule on Proxy Advisory Firms – Suspended**
 - Proxy advice deemed proxy solicitation, triggering securities fraud liability for any false or misleading statement/failure to disclose a material fact
 - Includes failure to disclose methodology, sources of information, or conflicts that could be misleading
 - Company must be given opportunity to review and respond to proxy advisor's report
 - Original rule would have given company a look at draft report before proxy advisor's client
 - SEC suspends enforcement of proxy advisor rule. NAM challenges suspension in court.
- **Recent SEC Rules on Shareholder Resolutions – Being Revisited**
 - Substantially raises required threshold of past shareholder support to re-submit resolution
 - Now 15% if voted on twice in past 5 years; 25% if voted on 3 times in that period
 - Likely to hinder efforts to gradually build support for resolutions over time
 - SEC revisiting rule to see if changes should be made

Corporate Governance and Proxy Voting – SEC/DoL

- **Proxy Voting by Investment Advisors/Plan Fiduciaries**

- SEC Rules for Investment Advisors – Still in Place**

- Advisor must demonstrate is voting proxies in best interest of its client
- Must make reasonable, factual investigation into matters to be voted on (can't just rely on proxy advisor's recommendation)
- Not obligated to vote every proxy
- Must exercise oversight over proxy advisory firm

- Trump DoL Rule for Private Plan Fiduciaries – Biden DoL Will Not Enforce**

- Must demonstrate direct economic benefit to plan from proxy issue being voted on
- Must investigate all material facts underlying proxy issue (not just rely on proxy advisor recommendation)
- Intended to discourage private plans from proxy voting – too time-consuming, costly
- Could chill willingness of private plan fiduciaries and investment managers to join in a proxy vote being championed by CalSTRS and other public plans

Proxy Voting on ESG Issues by Private Pension Plans

Trump DoL Tried to Discourage ESG Investments by Private Plans – Biden DoL Reverses and Permits ESG Investments

- Rule added new hurdles to ESG investing under plan fiduciary duty by requiring detailed justification with clear, quantifiable showing of economic returns and risks
- DoL: “Unlawful to sacrifice returns, or accept additional risk, through investments intended to promote a social or political end.”
- While rule applied only to private plans, investor concern over chilling effect on ESG investment by private plans – could influence the landscape of ESG investment in the marketplace
- Biden DoL reverse Trump rule and permits private plans to consider ESG factors in making plan investments

Corporate Governance Improvement and Investor Protection Act H.R. 1187 – Rep. Juan Vargas (D-Ca.) – House Passed, Sent to Senate

ESG Disclosure

- Requires public companies to disclose ESG metrics
- Report annually in proxy statements—
 - Company’s views on links between ESG metrics and long-term business performance
 - Company’s process for determining such links and impact
 - Such ESG metrics automatically deemed “material” to investors
- SEC required to define and establish ESG metrics in a rule

Climate Risk Disclosure

- Requires public company disclosure in annual reports of financial and business risks associated with climate change
- Requires SEC to develop climate-related metrics and guidance
 - Industry-specific
 - Both quantitative and qualitative disclosures

Corporate Governance Improvement and Investor Protection Act

H.R. 1187 – Rep. Juan Vargas (D-Ca.)

Human Capital Management/Workforce Diversity Disclosure

- Directs SEC to issue standards for human capital management disclosure in a broad range of areas specified in the legislation

Promoting Diversity in Corporate Boards, Senior Management

- Requires public companies to annually disclose gender, race, ethnicity, veteran status of board of directors, nominees, senior management
- Requires corporate disclosure of plan, policy, or strategy to promote such diversity
- Provision had bipartisan support in the House

Executive Compensation Disclosure

- Comparison of senior management and rank-and-file compensation

Political Spending Disclosure

Cybersecurity Disclosure

Other Investor Protection Issues

Interplay between Private Equity/Hedge Fund GPs and their LP Investors

- SEC Chair: SEC staff examining possible regulatory project to ensure GP “investment managers living up to both contractual duties and duties under law” to LP investors

“Proxy Plumbing” and Universal Proxy Card

- SEC staff continues its work on possible proposals to improve the mechanics of the proxy voting process, including consideration of use of a universal proxy card

Legislation to “improve governance of multi-class stock companies” with unequal voting rights

- Would require newly-listed companies with multi-class stock structure with unequal voting rights to sunset multi-class structure after 7 years, unless shareholders vote to extend

Climate Change – Business Groups, Financial Regulators Urging Action and Regulation

- **CEO Climate Dialogue** (Shell, BP, PG&E, Exelon, DuPont, Ford, Citi) urge use of market-based approach of economy-wide carbon pricing, with goal of 80% emissions reduction by 2050
- **Climate Leadership Council** (some of same energy companies) urge carbon tax paired with cash dividends to consumers
- **Business Roundtable** calls for substantial greenhouse gas reduction; supports price on carbon; calls for SEC disclosure rules
- **FASB** opens rulemaking on climate risk disclosure in financial statement reporting
- **Financial Regulators** note financial system risk – Treasury Financial Stability Oversight Council, Fed, CFTC, G-20 Central Banks
- **Impact–**
 - Climate change issue remains a long game, but this business/energy coalition and financial regulator warnings on financial system risk are important steps toward building broad consensus for Federal action on climate change

Promoting Retirement Savings – SECURE Act 2.0 (H.R. 2954)

- New incentives for smaller employers to offer retirement plans.
- New incentives for lower income employees to participate in plans
- More flexibility and portability of lifetime income options under DC and section 403(b) and 457 plans
- Minimum Distribution Rules – raise the age from 72 to 73, then 75 in 2029
- Innovative approach to encouraging younger workers still burdened by student loans to begin to save for retirement by treating student loan payments as amounts for which employer can make a “matching employer contribution” to a section 403(b) or 457 plan (or 401(k) plan).
- Section 403(b) and 457 plans can adopt a special, higher employee “catch-up” contribution of \$10,000 for workers aged 62, 63, or 64.
- Existing employee catch-up contribution of up to \$6,500 to a section 403(b) or 457 plan now to be on after-tax “Roth contribution” basis, rather than current tax-deductible approach.
- More flexibility for use of group trusts by 403(b) plans

Infrastructure Investment and Jobs Act (H.R. 3684)

- Democrats are a direct spending and tax-exempt bond crowd
 - Little interest in public-private partnerships
- Republicans had surprisingly little interest in PPPs – hold over from Trump who didn't like PPPs?
- Legislation has passed Senate; pending in House – caught up in fracas over social spending in budget reconciliation legislation