



September 20, 2011

VIA E-MAIL AND US MAIL

Valentina Joyce
Fair Political Practices Commission
428 J Street, Suite 800
Sacramento, CA 95814

RE: Proposed Regulation 18728.6

Dear Ms. Joyce:

The California Public Employees Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) submit the following comments in regard to proposed Regulation 18728.6. CalPERS and CalSTRS support the Fair Political Practices Commission's (FPPC) efforts in addressing this issue and support clarifying what mutual funds and similar financial products should be subject to reporting requirements. We agree with most of the recent changes to the proposed regulation and recommend a few additional revisions for consideration.

Comments regarding section (a) of Regulation 18728.6

First, we believe section (a) should specifically reference certain other types of tax deferred retirement accounts. Section (a) currently references funds held in accounts pursuant to IRC section 401(k), 403(b), 457 and other similar provisions. We recommend that funds held in accounts pursuant to IRC sections 401(a) and 408 also be added to section (a). In particular, CalPERS offers some of its members the Peace Officers and Firefighter's Supplemental Plan (POFF) and the Supplemental Contribution Plan as tax qualified money purchase pension plans pursuant to IRC section 401(a). These plans currently offer funds that meet the general criteria of the proposed regulation. In addition, individual retirement accounts (IRAs) similarly allow individuals to hold funds that meet the general criteria of the proposed regulation pursuant to IRC section 408. These types of accounts are extremely common and are held by many individuals who would be subject to the provisions of proposed Regulation 18728.6. As such, we believe that both IRS sections 401(a) and 408 should be added to section (a) as follows, "... closed-end fund or plan qualified under Section 401(a), 401(k), 403(b), 408, 457 or similar provision of the Internal Revenue Code (qualified plan),...."

Second, we agree that subdivisions (a)(1) and (a)(2) are appropriate criteria for determining when a fund is substantially similar to a diversified mutual fund registered

with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940. In addition, we agree that to meet the exception, the public official should "not influence or control the selection of any specific investment purchased and sold on behalf of the fund" as required by subdivision (a)(3). We do not, however, agree with the provisions of subdivision (a)(3) to the extent it excludes the proposed fund exemption from public officials who "influence or control the selection of any specific investment purchased and sold on... behalf of any agency." We disagree with the inclusion of this portion of subdivision (a)(3) for the following reasons:

1. There is no statutory basis in the Political Reform Act for treating public officials differently in applying the definition of investment. Subdivision (a)(3) nevertheless creates such a distinction by excepting the proposed fund exclusion from certain classes of public officials. While the reporting obligations of different classes of public officials may be tailored through an agency's conflict of interest code, there is no basis for doing so in a regulation interpreting the definition of investment.
2. We believe it is extremely unlikely that public officials who influence the control or selection of investments have the ability to influence the value of any fund that meets the remaining criteria within section (a). In particular, CalPERS and CalSTRS are unaware of any scenario where a CalPERS or CalSTRS public official could privately benefit from such a fund investment based on a CalPERS or CalSTRS decision. Unless such a scenario exists, this requirement places an unnecessary burden on a large class of employees across the state to report ALL fund investments. To the extent a situation can be identified by the FPPC where a public official could benefit from his or her investment based on their employer's action, an exception to such a scenario should be narrowly drafted to address the potential conflict rather than require broad disclosure of all fund investments by this large class of public officials.
3. While the justification for this requirement may be to allow the public to receive information on how public officials who invest public funds invest their own money, the current position of the FPPC is that these investments need not be reported. By letter dated April 6, 2011, the FPPC provided CalPERS Board Member and employee J.J. Jelincic with a letter addressing the reporting obligation of Savings Plus Program funds not registered with the SEC. (Copy attached.) This letter reflects the common understanding and practice of most Form 700 filers that funds available in the Savings Plus Program are not reportable even though they are not registered with the SEC. We see no reason to vary from this approach since it is consistent with common sense and is very likely the current understanding of thousands of state employees.
4. In the event the FPPC moves forward with this requirement disallowing certain public officials from utilizing this exception, we recommend that the regulation use the well-developed and understood definition of a "public official who

manages public investments” or otherwise reference Section 87200 filers instead of the unrecognized phrase, “public official who has an investment in the fund does not exercise responsibility for the management or investment of government funds.” While this language presumably captures Section 87200 filers, it is nevertheless unclear whether the language extends beyond Section 87200 filers or instead only captures a subset of Section 87200 filers.

5. The proposed regulation is inconsistent with the September 12, 2011 Staff Memorandum accompanying the proposed regulation. On page three in the first full paragraph, the Staff Memorandum states that:

By adding the more focused language [in (a)(3)] we retain disclosure by persons who exercise responsibility for the management or investment of government funds, but only to the extent that they are the specific investments purchased and sold by the fund. [Emphasis added.]

The underlined language is not, however, reflected in the proposed regulation. To the contrary, the regulation requires any public official who influences or controls the selection of any specific investment purchased and sold on behalf of any agency to report ALL funds that otherwise meet the criteria in section (a) of the proposed regulation.

Notwithstanding our comments in section 2 above, we believe there might be an appearance of conflict (but not an actual conflict) where a public official owned the same fund which he or she decided to purchase on behalf of his or her agency. To the extent, therefore, that the FPPC insists on excluding certain public officials from utilizing this exception, it should be narrowly applied as recommended in the FPPC staff memorandum.

To accomplish this purpose we recommend rewriting subdivision (a)(3) as suggested below and that the FPPC reinsert subdivision (a)(4) from the originally noticed proposed regulation. These revisions would read as follows:

(a)(3) The public official did not influence or control the decision to purchase or sell the specific fund on behalf of his or her agency during the applicable reporting period.

(a)(4) The public official does not influence or control the selection of any specific investment purchased and sold on behalf of the fund.

Comments regarding section (d) of Regulation 18728.6

1. Section (d) is unnecessary since the criteria identified in section (a) are sufficient for determining whether a fund is diversified. As stated above, we do not believe there is a potential for a conflict-of-interest involving any fund that meets the

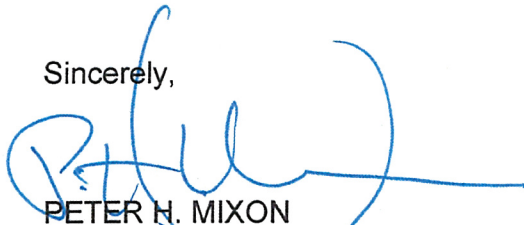
criteria in (a)(1), (a)(2), and (a)(3). We therefore recommend deleting (d) in the proposed regulation.¹

2. To the extent subdivision (d) remains in the proposed regulation, we cannot determine why this subdivision is a standalone provision rather than simply part of subdivision (a). Has the FPPC identified situations where registered investment funds are not sufficiently diversified and require disclosure even though disclosure is not currently required and has not been historically required?
3. The requirement that the fund "not have a policy of concentrating its holdings in the same industry or business" is vague and unclear. For example, what is the "same industry or business?" If a fund has a stated policy of requiring 51 percent of the companies in the fund to be "technology related companies" is it "diversified?" Does the answer change if the requirement is only 25 percent? What are some examples of an industry or business? In particular, would a registered mutual fund that invests in health care companies not be considered diversified even if its holdings were spread out among multiple drug companies, separate health-related insurance companies, medical equipment companies, and hospitals? The FPPC should tackle these issues now rather than on a case-by-case basis by examining a variety of available ETFs and registered mutual funds to provide clearer guidance and examples of diversified and un-diversified funds.


Thank you for your consideration of our concerns.

Please let us know if you have any questions or can be of further assistance.

Sincerely,



PETER H. MIXON
CalPERS General Counsel



BRIAN J. BARTOW
CalSTRS General Counsel

Attachment

¹ If the FPPC agrees, the term "diversified" in (a)(1) should also be deleted.

April 6, 2011

J. J. Jelincic
3828 Hillcrest Lane
Sacramento, CA 95821

**RE: Your Request for Advice
Our File No. 11-033**

Dear Mr. Jelincic:

This letter is in response to your request for advice regarding the statement of economic interest disclosure provisions of the Political Reform Act (the "Act").¹

You have asked several questions regarding the reporting of interests in the state's Savings Plus Program, the Schwab Personal Choice Retirement Account offered under the Savings Plus Program and exchange traded funds.

The Commission is reviewing the disclosure and conflict-of-interest rules relating to investments. We anticipate the Commission will consider these issues in the near future. Until then, you need not report the investments described in your letter.

Sincerely,

John W. Wallace
Assistant General Counsel

By: Valentina Joyce
Counsel, Legal Division

¹ The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.