



Ohio Public Employees Retirement System

July 22, 2016

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington D.C. 20549-1090

File Number: S7-07-16 - Comment on Proposed Rulemaking on Incentive-based Compensation Agreements

Dear Mr. Fields:

The Ohio Public Employees Retirement System (“OPERS”) appreciates the opportunity to submit comments regarding the proposed rule promulgated by the Securities and Exchange Commission (“SEC” or “Commission”), the OCC, FDIC, FHFA, and NCUA (collectively, the “Agencies”) to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank” or “Act”). Section 956 requires that the Agencies jointly issue regulations or guidelines: (1) prohibiting incentive-based payment arrangements that, in the determination of the Agencies, encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss; and (2) requiring those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate Federal regulator.

With assets of more than \$87 billion, OPERS is the largest public retirement system in Ohio and the 11th-largest public pension fund in the United States. We serve more than one million members who live primarily in Ohio but also across the United States and in many other countries. We have provided secure retirement benefits to our members for more than 80 years.

As an institutional investor, we are active capital market participants and prudently manage and invest the funds entrusted to us by our members, consistent with our fiduciary duty. As such, we are dependent on the integrity of the financial marketplace and meaningful disclosures by public companies of risks, including their Board’s incentive-based compensation metrics, so that we can make wise decisions regarding investment strategy. In turn, these disclosures assist us as we make informed proxy voting decisions regarding the election of directors, ratification of auditors, and other proposals on the ballot.

OPERS believes that investors should be able to establish a dialogue with directors and senior management that leads to long-term relationships. We recognize that our investment returns are tied to the long and short-term targets and capital allocation decisions made by the boards of directors of the companies in which we invest. Therefore, we engage directly and diplomatically with board members and senior executives, encouraging them to adopt and adhere to industry-best practices in the boardroom and in matters affecting the rights and investments of all shareholders.



OPERS has supported the SEC's efforts to implement the various corporate governance reforms enacted by Congress as part of the Dodd-Frank Act. The current request for comments on incentive-based compensation arrangements and disclosure builds on previous rule-making activity under the Act. In this Notice and Request for Comment, it is clear that the Agencies recognize that there can be a link between incentive-based payment arrangements and inappropriate risk-taking that leads to material financial losses. The ability of investors to evaluate payment arrangements will require a greater level of transparency and disclosure than currently exists.

A discussion on executive pay and compensation practices must start off with a discussion of the fundamental principle behind these pay packages. OPERS recognizes that companies need to recruit and retain top talent to meet global demands. Therefore, we have established Proxy Voting Guidelines ("Guidelines") to inform our votes on executive pay and compensation packages and evaluate the Board's role in establishing and monitoring compensation arrangements. Directors of public companies serve as our representatives in the boardroom. If a director serves as a member of the Compensation Committee, OPERS expects that he or she will consider the impact to long-term shareowner (a term that OPERS uses to more accurately describe our ownership as a shareholder) value when voting on compensation policy and incentive-based payment arrangements.

For example, under OPERS' "Boards of Directors" Guidelines:¹

Boards of Directors are shareowners' representatives at the company. As such, OPERS believes Directors should be held accountable for the consistent implementation of the best practices standards outlined in these Guidelines. This accountability will vary from director to director, depending on the director's role on the board and on various committees. **For instance, if executive compensation is excessive relative to performance, the directors on the Compensation Committee should be held accountable for the poor implementation of compensation practices and policies that link pay to performance for the purpose of building sustainable, long-term shareowner value** [emphasis added].

When a company has a declassified board structure, directors are nominated by the Company each year to serve on the board. Even with classified board structures, at least one-third of the directors will be nominated to serve and shareowners will have the ability to cast a "For" or "Withhold" vote for each director. If a director served as chair or a member of the Compensation Committee, OPERS will withhold our vote against them if the incentive-based compensation received by executives was not adequately linked to performance or exposed the company to unnecessary risk-taking.

With regard to compensation policies, OPERS believes that compensation should include more than one set of metrics to appropriately gauge performance and ensure that executives are in alignment with shareowners (i.e., they have their own "skin in the game," with share ownership requirements).

¹ OPERS Proxy Voting Guidelines, Guideline IV, Section A – Boards of Directors, Page 3, <https://www.opers.org/pdf/governance/proxy-voting-guidelines.pdf>, last revised December 2013.



For example, under OPERS' "Compensation Policy" Guidelines:²

The board should maintain a **compensation policy that provides details on the method and measures the company uses to link pay to performance and the allocation of company stock to executives as part of their compensation. This policy should also include limits on stock option grants to executives after taking into consideration the potential dilution to its shareowners.** The key terms of this policy should be disclosed to shareowners [emphasis added].

The Guidelines also provide clarity on how OPERS considers the link between pay and performance. Specifically, the role of the members on the Compensation Committee is highlighted, to clarify how OPERS considers certain pay arrangements in comparison to a company's peers. The Guidelines also define the range of pay elements in relation to each other within the overall compensation arrangement.

For example, under the "Compensation Committee" portion of OPERS' "Board Structure Principles" Guidelines:³

One key measure of board performance is how effectively the company's executive compensation practices and policies link pay to performance for the purpose of building sustainable, long-term shareowner value. **OPERS believes executive compensation should be linked directly with the performance of the business the executive is charged with managing, it should not have an unreasonable annual cost, and it should be benchmarked against appropriate peer groups.** The compensation committee should develop, approve, monitor, and disclose the company's compensation philosophy with respect to the **entire range of pay elements including, mix of cash and equity awards, goal for distribution throughout the company, use of employment contracts, perquisites, supplemental executive retirement plans, and philosophy regarding dilution.** The compensation committee should also be authorized to retain outside advisors. Equity compensation plans and material revisions to those plans must now be put to shareowner vote for approval. **OPERS considers plan administration, the method and terms of exercise, repricing history, express or implied rights to reprice, and the presences provisions when evaluating equity compensation plans** [emphasis added].

In light of the foregoing, OPERS would like to respond to certain questions and provisions as detailed below.

1.1 Timing- OPERS believes that sufficient time has already been provided for the regulated

² OPERS Proxy Voting Guidelines, Guideline IV, Section A, Subsection ii, Item (d) – Compensation Policy, Page 5, <https://www.opers.org/pdf/governance/proxy-voting-guidelines.pdf>, last revised December 2013.

³ OPERS Proxy Voting Guidelines, Guideline IV, Section A, Subsection iii, Item (b) – Independence of Key Committees, Page 6, <https://www.opers.org/pdf/governance/proxy-voting-guidelines.pdf>, last revised December 2013.



entities. The need for full transparency and disclosure of payment arrangements and any related risks is Paramount. With the advent of the required "Say on Pay" advisory vote that public companies must provide to shareowners, the regulated entities should have already taken significant steps forward; therefore, additional time to implement these standards should not be necessary.

1.2 Compliance date- OPERS appreciates that fact that some companies have a fiscal year that commences at the beginning of the calendar year or at the beginning of a specific month. Some consistency in the implementation of the rule would be appreciated by shareowners in order to have the final rule implemented in a uniform manner within 365 days of final promulgation.

2.5 Consolidation- OPERS recognizes that financial institutions may be created under a parent company structure, with subsidiaries and holding companies serving specific purposes under the laws and rules governing them. To the degree that there can be consistent policies in place for the entire consolidated organization, it would be beneficial to investors. Some investors may not realize the depth of a company's organizational structure. If the board of directors has oversight for senior executives of subsidiaries and/or holding companies, then the rules should apply uniformly.

2.7 Asset thresholds- OPERS respects the need to consider the size and scope of covered institutions under the rule. As in the implementation of the Sarbanes Oxley Act, the rules provided additional time for smaller public companies to put practices in place and spread the costs and expenses for implementation over a longer period of time. If the goal is to provide greater transparency and disclosure, OPERS would prefer that the requirements apply across the financial institution spectrum unless current law and rules will conflict.

2.15 Definition of senior executive officer- OPERS generally agrees that the definition of "executive officers" should include principal financial officers and principal accounting officers (or if there is no such accounting officer, the controller). In the same way, it is conceivable that other officers by virtue of their position may qualify as "executive officers." The proposed rule asks whether individuals that occupy positions within information technology management should be included in the definition. The ability to manage information technology requires individuals that have a seasoned perspective on risks associated with cyber breaches of security, global network structures, and business impact if and when a failure occurs. For purposes of including certain officers within the definition, we would suggest that job titles are not as important as job duties. Individuals, who perform policy-making functions for a financial institution, its subsidiaries, or other legal entities, play an important role in the determination of risk and financial reporting. There is an element of reliance here as well. To the extent an individual is relied upon (either by the board, other executives, or even shareholders) for setting policy or reporting financial performance and receives incentive-based compensation, the proposed rules should apply.

2.19 Threshold for salary and incentive-based compensation- OPERS believes that compensation structures, including base salary and other elements of compensation, such as short- and long-term incentives, are best left to the boards of directors to consider. OPERS also believes that the more that boards utilize short-term incentives to reward executives for annual performance measures, without balancing the measures with long-term incentives, the more



unreasonable risks to investors could occur. OPERS prefers that long-term incentives stretch beyond three or four years in order to balance out short-term measures and buffer risk. A set threshold of one-third for each incentive may work for some companies that need specific markers but it should not be a meaningless target.

2.30 Dollar threshold test- OPERS recognizes that some companies may wish to have a set dollar threshold to peg compensation and any additional incentive-compensation measures. Boards should be able to set compensation measures that provide value back to shareowners. Compensation Committee members are vested with this responsibility and if they do not establish and monitor effective compensation plans, then shareowners should withhold their votes for these directors. The test really boils down to whether compensation is sufficient to retain and adequately reward executives for their efforts, without encouraging or incentivizing them to take unacceptable risks. In order to safeguard and direct their investments, shareowners should have sufficiently detailed information to compare a company's compensation practices with the company's peers and industry leaders.

2.41 Pensions in relation to compensation- OPERS believes it is important for shareowners to understand the structure of any pension-related compensation in relation to salary and incentive-based compensation. If pension contributions are made to senior executives, they have value, and as such, should be included as compensation whether they are awarded as an incentive or part of the overall pay and post-retirement packages.

2.26 Clawbacks, forfeiture and downward adjustment- OPERS has commented before on proposed clawback rules. We are sensitive to the fact that defining incentive-based compensation as "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure" could cause some public companies to shift to non-incentive-based compensation in order to avoid application of clawback policies. Some observers have suggested that companies could attempt to circumvent the requirements simply by "moving away from incentive-based compensation to other kinds of pay, such as salary; or by tying incentive-based compensation to non-financial metrics, such as operational measures." If a company makes changes to how it awards incentive-based compensation and those changes appear to function as an evasion of the proposed clawback policy, shareowners must be able to rely upon the clear disclosure of that fact so that they can take appropriate steps through engagement and/or proxy voting.

7.17 Options- OPERS agrees that the use of options and the granting of stock options which occurred heavily in the past can be fraught with risks for investors. When a compensation program is properly structured by a board for senior executives to include an appropriate mix of short-term and long-term incentives, as well as adequate salary and related compensation, the use of options could be acceptable; however, OPERS believes hedging and pledging activities should be discouraged.

7.30 Clawback requirements at the SEC- OPERS has commented on the SEC's proposed clawback rules in the past. A copy of that letter is available on the OPERS website.⁴

⁴ OPERS Comment on Proposed Listing Standards for Recovery of Erroneously Awarded Compensation, <https://www.opers.org/pdf/government/FederalResponses/2015/OPERS%20Clawback%20Policy%20Letter%20.pdf>, September 14, 2015.



8.1, 8.2, 8.3 *Hedging*- OPERS believes that the restrictions on hedging activity in order to assure the value of deferred equity compensation will help moderate risk for shareowners. The risks and financial rewards for all shareowners should be considered; allowing executives to hedge their future deferred compensation dilutes the value of deferred compensation arrangements.

Executive pay and overall compensation structures are linked together and as such are critical elements of best practices for corporate governance. The proposed rule would provide shareowners with beneficial information relating to the decisions of the Compensation Committee and that of the board regarding incentive-based compensation and risk.

Thank you again for the opportunity to submit comments on this proposed rule. If you have questions regarding OPERS' position, please do not hesitate to contact our Chief External Affairs Officer, Carol Drake, at [REDACTED].

Sincerely,

A handwritten signature in cursive script that reads "Karen E. Carraher".

Karen E. Carraher
Executive Director