September 14, 2015

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

File Number: S7-12-15 - Comment on Proposed Listing Standards for Recovery of Erroneously Awarded Compensation

Dear Mr. Fields:

The Ohio Public Employees Retirement System (hereafter, "OPERS") appreciates the opportunity to submit comments regarding the Securities and Exchange Commission's (hereafter, "SEC" or "Commission") proposed rule directing the national securities exchanges and national securities associations to prohibit the listing of any security of a company that has not developed, implemented and disclosed a policy providing for the recovery of certain incentive-based compensation ("hereafter, "clawback policy").

With assets of more than $91 billion, OPERS is the largest public retirement system in Ohio and the 11th-largest public pension fund in the United States. We have successfully provided secure retirement benefits to our members for more than 80 years.

Like many other public retirement systems, we are active market participants and make every effort to prudently manage and invest the funds entrusted to us by our members. As a result, we are dependent on the integrity of the financial marketplace and the meaningful disclosures of public companies so that we can make wise decisions regarding investment strategy, as well as informed proxy votes supporting corporate governance best practices.

OPERS believes that prudent investing involves active engagement with directors and senior management. As an institutional investor, we recognize that our returns are tied to the capital allocation decisions made by the boards of directors of the companies in which we invest. Therefore, we engage directly with board members and senior executives, quietly and diplomatically encouraging them to maximize long-term shareholder value by adopting and adhering to industry-best practices in the boardroom and in matters affecting the rights and investments of all shareholders.

Our System has generally supported the SEC's efforts to implement the various corporate governance reforms enacted by Congress as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereafter, "Dodd-Frank"). It should come as no surprise then that we also support the Commission's current proposal requiring all public companies to develop, implement and disclose a meaningful clawback policy.

OPERS has taken the general position that (1) all public companies should adopt and implement a meaningful clawback policy, (2) public companies should be clear and transparent in how their clawback policies are being implemented and be able to disclose the results of efforts to enforce their clawback policies, and (3) public companies should be consistent in how they report and enforce their clawback policies. The Commission's proposal satisfies all three requirements by mandating that virtually every public company adopt, implement and disclose a compliant clawback policy; requiring that these policies be disclosed to shareholders and others; and establishing a template for what will constitute a meaningful and compliant clawback policy moving forward.

We have provided additional comments regarding the Commission's proposal below.

<u>Restatements – Restatements Triggering Application of Recovery Policy</u>

OPERS generally agrees that any revision to a previously issued financial statement that results in a reduction in incentive-based compensation received by an executive officer should trigger application of a company's clawback policy. If the incentive-based compensation in question is unearned, OPERS believes the company has a duty to shareholders to attempt recovery of those funds.

We believe the current proposal is a natural extension of the clawback model that was enacted as part of the Sarbanes-Oxley Act (hereafter, "SOX") in 2002. That policy, which was enacted in the aftermath of the Enron and WorldCom corporate scandals, was limited in both scope and reach. Since that time, a majority of public companies have adopted individual clawback policies, either in response to the SOX model or in response to shareholder proposals. Of these, many are similarly limited. The Commission's proposed clawback policy attempts to address these limitations.

Under the Commission's proposal, all corporate clawback policies would feature a common trigger: recovery would be required if a restatement of financial information reveals that incentive-based compensation was paid in error. We welcome this expansion and the increased consistency it brings. According to a 2014 Proxy Disclosure Study conducted by PWC, among companies that had adopted a clawback policy, 83 percent predicated recovery on some form of executive misconduct (financial or otherwise).[1] The current proposal expands on this model, mandating recovery, in the event of a restatement, regardless of whether executives were at fault or not. In so doing, the proposal focuses on the relationship between executive compensation and company performance, to wit, if specified performance goals were not met, performance-based compensation should not have been paid.

In light of the fact that the SEC has proposed a mechanism whereby companies can decline to pursue recovery if the cost of such efforts would outweigh any recovery the company might receive, and considering that any recovery is subject to considerations of materiality, OPERS supports the Commission's proposal regarding the application of corporate clawback policies. We believe that the Commission's proposal will benefit shareholders by providing an opportunity to recover *all* unearned incentive-based compensation, and serving as a deterrent to executives who may believe that 'creative' accounting practices or lax reporting are acceptable. Finally, as noted above, using any revision to a previously issued financial statement that results in a reduction of incentive-based compensation as a trigger for the recovery process ensures a degree of consistency and transparency among corporate clawback policies, and increases shareholder awareness of how clawback policies will be enforced.

[1] Ken Stoler et al, PWC, Executive Compensation: Clawbacks, 2014 Proxy Disclosure Study, p.7, January 2015, http://www.pwc.com/en_US/us/hr-management/publications/assets/pwc-executive-compensation-clawbacks-2014.pdf

Application of Recovery Policy – Executive Officers Subject to Recovery Policy

OPERS generally agrees that the Section 10D 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, not included in the Commission's proposal should, by virtue of their position, qualify as "executive officers" for purposes of Section 10D. Though we decline to suggest specific job titles that should be included (which could differ from company to company), we believe, in the proposal's words, that meeting the statutory goal of Section 10D requires the inclusion of "officers with policy-making functions and important roles in the preparation of financial statements, [who] set the tone for and manage the [company]".[2]

For purposes of defining "executive officers", we are in agreement with the Commission that job titles are not as important as job duties. The SOX clawback policy was limited to chief executive officers and chief financial officers. Though not wholly satisfying, this limitation made sense at the time given the corporate scandals that led to the passage of SOX and the public interest in ensuring that companies could recover incentive-based compensation in situations – like Enron and WorldCom – where the activities of senior executives contributed significantly to a restatement of previously issued financial statements. But this policy and the countless others it inspired ignore the fact that other officers – other persons, in fact – can, by virtue of their position, influence or impact a company's policies and/or financial statements.

The Commission's proposed rule addresses these limitations by including in the definition of "executive officers" those officers or other persons who perform policy-making functions for the company, as well as those officers with an important role in 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, he or she should be held to a higher standard and subjected to the clawback policy.

By focusing on job responsibilities, the current proposal minimizes the possibility that companies will adjust job titles to avoid application of the clawback policy. Additionally, the proposal ensures a degree of consistency between various clawback policies – management structures may change across different companies, but certain policy-making and recordkeeping functions remain the same.

Application of Recovery Policy – Incentive-Based Compensation – Incentive-Based Compensation Subject to Recovery Policy

OPERS generally agrees that "incentive-based compensation" should be defined in a principles-based manner. We share the SEC's belief that any such definition should be flexible enough to accommodate the development of "new forms of compensation and new measures of performance upon which compensation is based".[3]

We also recognize 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

[2] 80 Fed. Reg. at 41,153

the clawback policy. 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".[4] Therefore, it may be beneficial to include anti-evasion language pertaining to the use of incentive-based compensation that is tied to subjective or operational measures that are, in fact, based on financial information metrics. 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, shareholders must be able to rely upon the proposed rule to offer a remedy beyond shareholder engagement, including regulatory oversight and penalties.

We believe that this proposal is intended, in part, to introduce an additional measure of accountability into the executive compensation process. In the aftermath of Enron and WorldCom, there was debate regarding the ability of companies to seek repayment of incentive-based compensation in instances of fraud or misconduct by senior executives. Now, that debate has shifted to the ability of companies to recover unearned incentive-based compensation in situations where executives act irresponsibly (if not fraudulently) or carelessly. The definition of incentive-based compensation should be structured in such a way that the deterrence factor remains, so that executives in policy-making or financial reporting roles understand that they have some 'skin in the game.'

Finally, with regard to the recovery of compensation based on stock price performance or total shareholder return (hereafter "TSR"), we are not opposed to the Commission's proposal. Consistent with the concerns described above, we agree with the SEC that not including stock price performance or TSR could incentivize companies to modify their compensation arrangements in such a way as to avoid application of the clawback policy. We are aware that some observers have suggested that this measure will be "particularly challenging to implement," alleging that the requirement that companies reasonably estimate the relationship between restatements of financial information and impact on stock price or TSR will result in uncertainty and excessive costs.[5] However, we appreciate the SEC's efforts to mitigate these concerns by providing an exemption by which companies can weigh the benefits and costs of pursuing recovery and act accordingly. Generally speaking, we believe the current proposal addresses the corporate and regulatory environments as they are, not as they should be. Given the concerns described above, we believe this is the most appropriate approach.

<u>Application of Recovery Policy – Recovery Process – Board Discretion Regarding Whether to Seek Recovery</u>

OPERS believes that the proposed discretion not to pursue recovery of incentive-based compensation in limited circumstances is appropriate and wholly consistent with the purpose of Section 10D. Dodd-Frank Section 954 was intended to address shareholder rights in the context of recovering unearned incentive-based compensation. The language of Section 954 however, is silent regarding whether companies retain any discretion to forgo recovery once it has been triggered. If we assume that the language is prescriptive, and the board retains no discretion regarding the application of the clawback policy, it no longer comports with what we know to be the intent of Section 954: enhancing shareholder rights. A rigid interpretation of the language would force companies to pursue recovery even when it is not in their or shareholders' best

[4] Yin Wilczek, "SEC Clawback Proposal to Trigger Big Shifts in Current Pay Practices," http://www.bna.com/sec-clawback-proposal-n17179933397/, July 10, 2015.
[5] Davis Polk, LLC, Client Memorandum, SEC Proposes Dodd-Frank Clawback Rule, July 8, 2015.

interests. It is our belief that Congress did not intend to provide companies and shareholders with a new tool and then require that they use it to harm themselves.

Understanding this, the SEC has fashioned a reasonable compromise: discretion with accountability. Under the current proposal, companies are permitted to weigh the benefits and costs before deciding whether to pursue recovery. This grant of discretion enhances shareholder rights by ensuring that they will be applied appropriately and effectively. Additionally, the proposed requirements that companies must (1) first make a reasonable attempt at recovery before determining that it is impracticable and (2) disclose all such attempts at recovery allow the proposal to provide necessary discretion while also honoring Section 954's accountability improvements.

Finally, we are aware that some observers have criticized the Commission's proposal for removing board discretion regarding when and how to apply corporate clawback policies.[6] While it is true that the current proposal prioritizes recovery and specifies how that process must occur, companies retain discretion to consider the impact of pursuing recovery and the right to avoid seeking recovery where the cost of such efforts would be prohibitive. This right governs every other provision within the SEC's proposal. Under normal circumstances, in the event of a restatement, where recovery is warranted, it should occur *unless* it would harm the company or its shareholders. OPERS supports this grant of discretion, contingent upon the adoption of the proposal's reasonable attempt and disclosure provisions.

Disclosure of Issuer Policy on Incentive-Based Compensation

OPERS generally believes that the Commission's proposal provides an appropriate level of detail regarding the implementation and application of corporate clawback policies. We appreciate that the SEC has proposed specific guidelines for disclosures so as to ensure a level of consistency and comparability across companies.

For each restatement, the current proposal requires companies to provide: (1) the date on which the company was required to prepare a restatement; (2) the aggregate dollar amount of excess incentive-based compensation attributable to such restatement; (3) the aggregate dollar amount of excess incentive-based compensation that remains outstanding at the end of the last completed fiscal year; (4) the estimates used to determine excess incentive-based compensation if the relevant financial reporting measure related to a stock price or TSR metric; (5) the name of each person from whom recovery was not sought, as well as the amounts forgone and the reasons for electing not to pursue recovery; and (6) the name of, and amount due from, each person for whom, at the end of the last completed fiscal year, excess incentive-based compensation had been outstanding for 180 days or longer.

Though it might also be helpful to know the events or occurrences that precipitated the restatement, each of the required disclosures would provide shareholders with useful, relevant information at a time (in connection with proxy or consent solicitation materials) when they are best equipped to make use of it.

Executive pay and overall compensation structures are linked together and as such are critical elements of corporate governance. We utilize this information to assess short and long-term performance, risk within an organization, and the board of directors' (Compensation Committee members, in particular) record with regard to pay and compensation matters. The additional information provided under the current proposal

[6] Wilczek, *supra* note 4.

would allow shareholders to better consider the actions of the board in the aftermath of a restatement and evaluate their response to recovery requirements. The proposed disclosures – especially those pertaining to recoveries that were not pursued – would provide a welcome insight into the decision-making process of the board, as well as their priorities regarding recovery of unearned incentive-based compensation. For example, if a company exercises its given discretion and declines to pursue a recovery for reason of impracticability or concerns regarding the application of home country laws, shareholders should be privy to the company's research and calculations regarding that decision and the company's efforts to enforce its clawback policy.

Finally, we support the Commission's proposal to electronically tag disclosure information in XBRL format, as this will improve data usability and transparency. We agree with the SEC that tagging the data will lower the cost to investors of collecting the data and will permit this information to be analyzed in a more efficient manner.

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 Nolan Drake, at [redacted].

Sincerely,

Karen E. Carraher

Karen E. Carraher
Executive Director