OPERS

Ohio Public Employees Retirement System

November 22, 2021

Submitted via electronic filing: rule-comments@sec.gov

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File Number S7–12–15, Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation

Dear Ms. Countryman:

The Ohio Public Employees Retirement System (OPERS) is responding to the Securities and Exchange Commission's (SEC or Commission) Reopening Release for the Proposed Rule (Clawback Proposal) to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[1] We continue to support the Commission's efforts to implement Section 954 and appreciate the opportunity to supplement and clarify our initial comments regarding the Commission's Clawback Proposal. We urge the SEC to adopt a final clawback rule without further delay.

OPERS is the largest public retirement system in Ohio, with more than 1.1 million active, inactive, and retired members. Nearly one out of every 10 Ohioans has some connection to our System, and for many of them, OPERS represents the only retirement income they will ever receive. We invest more than $125 billion on our members' behalf and we make every effort to maximize the value of those investments, including regularly engaging with stakeholders on issues affecting long-term shareholder value.

We are encouraged that the SEC has decided to return to its Clawback Proposal. As noted above, OPERS was supportive of the Commission's Proposing Release in 2015 and that support continues unabated. We view the Clawback Proposal as a common-sense corporate governance reform, allowing issuers (and by extension, their shareholders) to recoup executive compensation that was paid based on erroneous information.

In our previous comments regarding the Clawback Proposal, we stated 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 [the] application of a company's clawback policy."[2] At the time, we believed the Commission's proposal was sufficiently broad to ensure that

[1] Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 10,998, Exchange Act Release No. 93,331, Investment Company Act Release No. 34,399, 86 Fed. Reg. 58,232 (Oct. 21, 2021), https://www.govinfo.gov/content/pkg/FR-2021-10-21/pdf/2021-22754.pdf.

[2] *See* OPERS comment letter in response to the SEC's Clawback Proposal, p. 2 (Sept. 14, 2015), https://www.opers.org/pdf/government/FederalResponses/2015/OPERS%20Clawback%20Policy%20Letter%20.pdf

unearned performance-based compensation could be returned to shareholders if it was awarded based on an accounting error, regardless of how that error was subsequently restated. As such, we did not address the possibility that the Clawback Proposal might be limited to situations in which issuers use formal restatements to correct material errors, as opposed to the (more frequent) situations where issuers determine that errors are immaterial and thus, can simply be revised in a current period financial report.

In light of the Commission's comments on this issue in the Reopening Release, we wish to reiterate that *any* revision to previously issued financial statements should trigger the clawback process, and as such, we respectfully request that the SEC clarify that its proposed definition of "accounting restatement" includes *all* required restatements made to correct errors in previously issued financial statements.

Definition of "Accounting Restatement"

In response to the SEC's questions regarding the appropriate definition of an "accounting restatement," OPERS supports the promulgation of a meaningful clawback rule that is triggered whenever there is a revision to previously issued financial statements. We believe that a broadly applicable clawback provision is necessary to ensure that shareholders can recover erroneously paid executive compensation when appropriate.

While OPERS generally supported the SEC's decision to provide issuers with discretion not to pursue a clawback of erroneously paid executive compensation where there were cost of recovery or materiality concerns, we did not address the possibility that issuers would use that discretion to avoid triggering the Commission's Clawback Proposal in all but the most significant cases of error or misstatement.

It is disappointing to think that the Commission's Clawback Proposal was limited only to instances involving formal restatements of material errors because (1) the trend among issuers to revise, rather than formally restate, prior period financial statements was already well established in 2015 and continues to accelerate, and (2) this trend, if left unaddressed, could erode the effectiveness of the Commission's efforts on this issue and blunt the impact of Section 954 before it has even been implemented.

As a long-time member of the Council of Institutional Investors, which participated in the drafting of Section 954, we find it difficult to believe that the architects of the Dodd-Frank clawback provision intended to leave such a large and growing loophole in their plans to improve accountability by requiring the return of unearned executive compensation to shareholders only in instances where there is a formal restatement.

As such, OPERS believes the SEC should clarify that its definition of "accounting restatement" includes *all* required restatements made to correct an error in previously issued financial statements, regardless of whether they are formal restatements or revisions. This definition comports with what shareholders have believed throughout this rulemaking process, namely that issuers would not be able to avoid the application of a Section 954 clawback provision simply by using their discretion to determine that an error is immaterial.

As noted above, the use of formal restatements to correct errors is shrinking relative to the use of revisions and has been trending downward for several years.[3] While this is generally a positive development, especially if the decline in formal restatements suggests a commensurate decline in the number or frequency of material errors, recent research suggests another explanation, namely that issuers may be deeming issues immaterial even though they meet at least one of the criteria for materiality described in SEC Staff Accounting Bulletin No. 99.[4]

Understanding that issuers retain broad discretion regarding the materiality of accounting errors and that there could be valid reasons why an issuer would choose to revise, rather than formally restate, an error, we are concerned that issuers may be incentivized to find that an error is immaterial if such a designation would allow them to avoid triggering the Commission's Clawback Proposal.

There is evidence to suggest that issuers may be approaching their materiality determinations in an opportunistic manner and that there could be a link between the presence of a clawback provision and issuers' propensity to deem errors immaterial and subject to revision, rather than formal restatement.[5] Specifically, it seems that avoiding the application of a clawback provision could be a factor weighing in favor of determining and justifying that an error is immaterial.[6]

To be clear, OPERS is not seeking to increase the number of formal restatements, which can be disruptive and costly for both issuers and shareholders. Rather, we are suggesting that if there are, in fact, circumstances where the presence of a clawback provision serves as an incentive for issuers to revise errors, rather than formally restate them, the SEC can address that incentive by clarifying that its definition of "accounting restatement" applies to *all* restatements made to correct errors in previously issued financial statements. Such an interpretation would be consistent with the intent and objectives of Section 954 and would help to establish a meaningful enforcement mechanism that could be used to ensure recovery of executive compensation that was paid but unearned because of an error.

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[3] *See* Choudhary, Merkley, and Schipper, *Immaterial Error Corrections and Financial Reporting Reliability*, pp. 14-15 (June 15, 2001), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2830676 ("Both graphs show declining frequencies in material error corrections (restatements) over the sample period and increasing frequencies in immaterial error corrections, particularly revisions, since 2008. … Regardless of the cause or combination of causes, the over-time pattern is an increase in immaterial error corrections, particularly revisions, and a decrease in material error corrections reported by Audit Analytics since 2008.").

[4] *See* Thompson, *Reporting Misstatements as Revisions: An evaluation of Managers' Use of Materiality Discretion*, pp. 2, 8-9 (Sept. 17, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3450828 ("My analysis shows that 33% of the revisions in my sample are "suspect" in that they meet at least one of the observed *quantitative* or *qualitative* materiality criterion. This significant percentage of misstatements that are revised despite meeting materiality criteria suggests that managers often use their materiality discretion to report misstatements as revisions rather than restatements." … "Interestingly, however, a significant percentage, 33%, of misstatements that are *revised* also meet at least one of the criteria for materiality, suggesting that it is not uncommon for a firm to deem a misstatement immaterial (i.e., revise) despite it meeting an observable materiality indicator.").

[5] *See id* at 29 ("Moreover, the reporting of these "suspect" revisions appears to be opportunistic in that it varies predictably with one of managers' incentives to avoid restatements, namely restatement-triggered clawback provisions. More specifically, … managers are more likely to revise misstatements when they are subject to clawback provisions, and this effect is even stronger when the likelihood of a clawback is higher (i.e., when the misstatement correction significantly reduces prior year's net income or the clawback trigger is less restrictive.").

[6] *See id* at 5 ("Specifically, … in the presence of restatement-triggered clawback provisions managers are more likely to use discretion afforded by the materiality rules to report revisions instead of restatements.").

In contrast, a narrow interpretation of "accounting restatement" could limit the application of the Commission's Clawback Proposal to a small and shrinking number of cases and could possibly make it easier for issuers to avoid the clawback provision altogether by reducing it to a single factor in their decision-making processes regarding the materiality of their errors.

Application of the Three-Year Lookback Period

Regarding the Commission's question on whether it should remove the "reasonably should have concluded" standard from the list of triggers for the three-year lookback period described in the Clawback Proposal, OPERS is not inclined to support the removal of this language without some research into how the removal could impact the implementation or effectiveness of a final clawback rule.

In light of the comments discussed above, the possibility of providing issuers with additional discretion regarding the application of the Commission's Clawback Proposal is concerning. OPERS believes that the Commission was right to incorporate the triggering events, including the "reasonably should have concluded" standard in its Clawback Proposal, and cannot support the removal of any of the Commission's guardrails absent evidence suggesting a real and pressing problem with the administrability of the Clawback Proposal.

Conclusion

OPERS appreciates the opportunity to expand upon its support for the Commission's Clawback Proposal. As the SEC works to finalize this important and long overdue rule, we believe it should clarify that the definition of "accounting restatement" used in its Clawback Proposal includes *all* restatements made to correct errors to previously issued financial reports. This approach is consistent with the intent and objectives of Section 954, as well as the expectations of shareholders. OPERS urges the Commission to act quickly to adopt and implement a final clawback rule.

Sincerely,

Patti Gazda

Patti Gazda
Corporate Governance Officer
Ohio Public Employees Retirement System