Americans for Financial Reform Education Fund

April 1, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St. NE
Washington, DC 20549

Re: Share Repurchase Disclosure Modernization (File No: S7-21-21)

Dear Secretary Countryman,

The Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the proposal of the Securities and Exchange Commission (the Commission) to modernize and improve disclosures about repurchases of an issuer's equity securities that are registered under the Securities Exchange Act of 1934.

We welcome and support this proposed rule, as share repurchases have become an increasingly significant portion of corporate expenditures while their specifics have remained opaque. If implemented, the proposed rule requiring daily disclosures of share repurchases would constitute a major, welcome step toward reducing information asymmetries between corporate insiders and investors, analysts, workers, and policymakers. These disclosures are also critical for the Commission's ability to enforce existing laws against market manipulation and insider trading.

In addition to supporting the Commission's proposals, we also make recommendations to further strengthen protections against market manipulation and insider trading that we believe would improve long-term financial stability and growth. Steep increases in share repurchases have come at the expense of longer-term investments, including human capital and worker compensation, that contribute to innovation and equitable and sustainable economic growth over time.[1] This trend, which has exacerbated inequality and the racial wealth gap, can be traced, in

[1] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity; William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

part, to the Commission's deregulatory actions on share repurchases in 1982.[2] The Commission has an opportunity to change course to protect investors and our economy as a whole from the harms associated with excessive share repurchases.

Below, we outline: 1) the recent history of share repurchases; 2) a number of the implications of increased share repurchases for our economy; and 3) how the Commission can protect investors from the market distortions that can accompany runaway share repurchases.

Recent History of Share Repurchases

The initial mandate for the Commission in relation to share repurchases was to prevent market manipulation. Before 1982, companies could potentially be held liable for market manipulation under Sections 9(a)(2) and 10(b) of the Securities Exchange Act of 1934 when they engaged in share repurchases in the open market. Later, the Williams Act of 1968 clarified that it is unlawful for issuers to repurchase their own securities if the purchase "is in contravention of such rules and regulations as the Commission . . . may adopt (A) to define acts and practices which are fraudulent, deceptive, or manipulative, and (B) to prescribe means reasonably designed to prevent such acts and practices."[3] A proposed rule preceding the one that was ultimately adopted by the Commission—Proposed Rule 13e-2—would have: 1) imposed stricter limits on share repurchases than those ultimately adopted; 2) made share repurchases beyond those limits unlawful; and 3) required insiders to disclose whether they were considering trading during repurchases.[4]

The Commission ultimately adopted Rule 10b-18 instead, which created a safe harbor delineating certain limits and conditions under which share repurchases would not be considered market manipulation. These limits are very expansive. For example, Apple can spend $1.5 billion a day on share repurchases and stay within the safe harbor provision.[5] The overly generous limits of the safe harbor have led experts to conclude that "[i]n essence, Rule 10b-18 legalized stock market manipulation through open-market repurchases."[6] Even with these expansive limits, the rule did not outlaw share repurchases outside of the safe harbor or even create a presumption of market manipulation for share repurchases falling outside the safe

[2] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity.

[3] Lenore Palladino & William Lazonick, "Regulating Stock Buybacks: The $6.3 Trillion Question," 5-6, Roosevelt Institute, May 2021, *available at*. https://rooseveltinstitute.org/wp-content/uploads/2021/04/RI_Stock-Buybacks_Working-Paper_202105.pdf; Williams Act, Pub. L. No. 90-439, 82 Stat. 455 (1968).

[4] Lenore Palladino & William Lazonick, "Regulating Stock Buybacks: The $6.3 Trillion Question," 6, Roosevelt Institute, May 2021, *available at*. https://rooseveltinstitute.org/wp-content/uploads/2021/04/RI_Stock-Buybacks_Working-Paper_202105.pdf.

[5] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity.

[6] *Id*.

harbor.[7] Additionally, the Commission did not require the disclosures necessary to detect whether issuers' share repurchases were staying within the safe harbor.[8] Current disclosure requirements are only quarterly, disaggregated by month.

Since the enactment of Rule 10b-18, share repurchases have skyrocketed.[9] In the 2010s, companies spent a total of $6.3 trillion in share repurchases in the open market—equivalent to 4% of that decade's U.S. GDP.[10] During the pandemic, companies spent $521 billion on share repurchases,[11] even as many employees were losing their jobs and many others were being forced to work in unsafe conditions.

Implications of Increased Share Repurchases for Our Economy

1. The Current Regulatory Framework Facilitates Market Distortion.

The current regulations governing share repurchases facilitate market distortion by opening the door to market manipulation and insider trading. As mentioned above, the current safe harbor parameters under which share repurchases are not considered market manipulation are extremely generous, allowing for massive share repurchase programs that some consider to be, in essence, "legalized stock market manipulation."[12] Additionally, the Commission does not currently require the disclosures necessary to detect whether an issuer's share repurchases fall outside of the safe harbor.

Lastly, the current regulatory framework does not meaningfully protect against insider trading by executives during a share repurchase program. Indeed, a study found a positive correlation between share repurchases and insider sales: a 10% change in share repurchases is associated with a half-percent change in insider sales."[13] However, this correlation was found by quarter. Without more frequent and detailed disclosures, it is impossible to know for certain if

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[7] Lenore Palladino & William Lazonick, "Regulating Stock Buybacks: The $6.3 Trillion Question," 7, Roosevelt Institute, May 2021, *available at*. https://rooseveltinstitute.org/wp-content/uploads/2021/04/RI_Stock-Buybacks_Working-Paper_202105.pdf.
[8] *Id*.
[9] *Id*. at 16.
[10] *Id*.
[11] Bob Pisani, "Stock buybacks surge to likely record highs, but a tax from Congress poses a threat," CNBC, Oct. 27, 2021, *available at* https://www.cnbc.com/2021/10/27/stock-buybacks-surge-to-likely-record-highs-but-a-tax-from-congress-poses-a-threat.html; "Tax Corporate Stock Buybacks that Enrich Executives and and Worsen Inequality," 1, Americans for Financial Reform & Take On Wall Street, Nov. 2021, *available at* https://ourfinancialsecurity.org/wp-content/uploads/2021/11/AFR-TOWS-buyback-tax-FS-11-21.pdf.
[12] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity.
[13] Lenore Palladino, "Do corporate insiders use stock buybacks for personal gain?" 168, International Review of Applied Economics, Jan. 16, 2020, *available at* https://doi.org/10.1080/02692171.2019.1707787.

some insiders strategically plan their trading to benefit from non-public information about share repurchases.[14]

2. Runaway Share Repurchases Come at the Expense of Longer-Term Investments Necessary for Equitable and Sustainable Economic Growth.

Runaway share repurchases come at the expense of investments in human capital, workers' wages and benefits, research and development, customer experience, and climate action plans, among other longer-term investments that contribute to innovation and equitable and sustainable economic growth over time.[15] In 2018, share repurchases by S&P 500 companies were 68% of net income, while dividends were 41%.[16] With shareholder returns equivalent to 109% of net income, companies have little left to invest elsewhere. Indeed, studies have found that share repurchases are correlated with layoffs and wage stagnation,[17] and in 2018, only 43% of S&P 500 companies spent any money on research and development.[18]

Experts say a company's "knowledge base," which includes "the knowledge and skills of its employees" as well as employees' rewards "for their contributions to the company's productivity," is what "fuel[s] innovations in products and processes that enable [a firm] to gain and sustain an advantage over other firms in its industry."[19] Therefore, overspending on share repurchases reflects an overinvestment in short-term investor returns and an underinvestment in the long-term stability and growth that benefits longer-term investors.

3. Ever Increasing Share Repurchases Exacerbate Economic Inequality.

The significant increase in share repurchases exacerbates economic inequality in several ways. First, to the extent that money spent on share repurchases comes at the expense of investments in human capital and worker compensation, share repurchases can result in wage

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[14] *Id*.

[15] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity; William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[16] William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[17] Lenore Palladino, "Financialization at work: Shareholder primacy and stagnant wages in the United States," Competition and Change, Jun. 22, 2020, *available at* https://journals.sagepub.com/doi/abs/10.1177/1024529420934641; William Lazonick, "Stock buybacks: From retain-and-reinvest to downsize-and-distribute," Brookings Institute Center for Effective Public Management, Apr. 17, 2015, *available at* https://www.brookings.edu/research/stock-buybacks-from-retain-and-reinvest-to-downsize-and-distribute/.

[18] William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[19] *Id*.

stagnation and increased worker precarity. Second, share repurchases enrich CEOs and other top executives, as their compensation has become increasingly tied to corporate equity. Indeed, while equity-based compensation did not account for any part of the median executive's compensation at S&P 500 companies in 1984,[20] the five hundred highest-paid public company executives received, on average, 83% of their compensation from stock options and stock awards in 2012.[21] Third, the wealthiest 10% of households control 88% of the stock market and the top 1% alone owns 53% of the market.[22] Meanwhile, the half of households with the lowest net worth own less than 1% of the stock market.[23] Lastly, share repurchases enrich "opportunistic *share sellers*"—which in addition to executives whose pay is largely based on stocks, include investment bankers and hedge-fund managers—at the expense of workers and long-term investors who hold on to their shares.[24]

4. Ever Increasing Share Repurchases Exacerbate the Racial Wealth Gap.

Rampant use of share repurchases also exacerbates the racial wealth gap. White households, as of the fourth quarter of 2021, owned 89.4% of corporate equity and mutual fund value, while Black households owned 1.1% and Latinx households owned 0.4%.[25] Additionally, an in-depth study found that the proportion of the racial wealth gap attributable to corporate equity ownership has grown over time.[26]

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[20] Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, 21, Berrett-Koehler Publishers, 1st Edition (May 7, 2012).
[21] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity.
[22] "Tax Corporate Stock Buybacks that Enrich Executives and and Worsen Inequality," 2, Americans for Financial Reform & Take On Wall Street, Nov. 2021, *available at* https://ourfinancialsecurity.org/wp-content/uploads/2021/11/AFR-TOWS-buyback-tax-FS-11-21.pdf; Board of Governors of the Federal Reserve System, "DFA: Distributional Financial Accounts," "Distribution of Household Wealth in the U.S. since 1989," *available at* https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/chart/#quarter:125;series:Corporate%20equities%20and%20mutual%20fund%20shares;demographic:networth;population:all;units:shares;range:1989.3,2020.4.
[23] "Tax Corporate Stock Buybacks that Enrich Executives and and Worsen Inequality," 2, Americans for Financial Reform & Take On Wall Street, Nov. 2021, *available at* https://ourfinancialsecurity.org/wp-content/uploads/2021/11/AFR-TOWS-buyback-tax-FS-11-21.pdf; Board of Governors of the Federal Reserve System, "Survey of Consumer Finances (SCF)," "Survey of Consumer Finances, 1989-2019," *available at* https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:Stock_Holdings;demographic:nwcat;population:all;units:have;range:1989,2019.
[24] William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.
[25] Board of Governors of the Federal Reserve System, "DFA: Distributional Financial Accounts," "Distribution of Household Wealth in the U.S. since 1989," *available at* https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/table/#frb-rs-dfa-table;quarter:120;series:Corporate%20equities%20and%20mutual%20fund%20shares;demographic:race;population:1,3,5,7;units:shares.
[26] Lenore Palladino, "The Contribution of Shareholder Primacy to the Racial Wealth Gap," 15, Roosevelt Institute, Feb. 2020, *available at* https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI_TheContributionofShareholderPrimacy_Working-Paper_202001.pdf.

How the Commission Can Protect Investors from the Market Distortions That Can Accompany Runaway Share Repurchases

1. Require Detailed, Daily Disclosures.

We fully support the Commission's proposal to require disclosure of share repurchases within one business day of execution of a repurchase order. This quick disclosure would go a long way in addressing the information asymmetries that currently exist between insiders and investors, analysts, workers, and policymakers. It would also allow the Commission to have the data necessary to enforce laws against market manipulation and insider trading.

Question 6 of the proposed rule asks whether to adopt the proposed Form SR disclosure requirements, whether any of the requirements should be modified or eliminated, and whether any disclosure requirements should be added. The Commission specifically mentions the highest and lowest price paid per share for open market purchases as a potential additional required disclosure. We agree that the highest and lowest price paid per share should be a required disclosure, and recommend adding the ratio of shares purchased to outstanding shares to proposed Form SR disclosure requirements as well. Both disclosures would provide investors and other stakeholders with more data and context to understand how share repurchases are affecting share price.

2. Establish a Bright-Line Rule to Prevent Market Manipulation.

We appreciate that if the proposed disclosures are implemented, the Commission, for the first time, will be able to determine whether issuers' share repurchases fall outside of the safe harbor. However, the Commission can take two further steps to avoid market manipulation.

First, we recommend the Commission replace the safe harbor provision with a bright-line rule, deeming share repurchases that fall outside of the bright-line rule market manipulation, or at least presumptively market manipulation. Currently, share repurchases falling outside of the safe harbor are not deemed or presumed to be market manipulation, and the Commission's proposed rule, as written, would not change that.

Second, we recommend the Commission make the parameters of the bright-line rule stricter than the current safe harbor provision. As mentioned earlier, some experts believe the current safe harbor provision allows, in essence, "legalized stock market manipulation through open-market repurchases."[27] Under the current parameters, Apple can spend up to $1.5 billion a day in share repurchases, while ExxonMobil can spend about $300 million.[28] We recommend

[27] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity.
[28] *Id*.

the Commission study issuers' share repurchasing behavior and its market effects to determine the best parameters for the bright-line rule. In the meantime, we recommend the Commission establish parameters adopted by comparable markets. These include limiting share repurchases to 10% of outstanding shares, as is the case in Germany, Canada, Switzerland, and France,[29] and imposing stricter time limits. For example, in France, issuers cannot repurchase shares for fifteen days prior to the public announcement of annual reports; and in the United Kingdom, issuers cannot repurchase shares during periods when insiders are not allowed to trade, which include the half a month prior to preliminary announcements of an issuer's performance.

3. Establish Bright-Line Rules to Prevent Insider Trading.

We appreciate the steps the Commission is taking to prevent insider trading, including by proposing the disclosure of whether insiders traded within ten days of a share repurchase announcement, as well as the disclosure of any internal policies issuers may have to prevent insider trading associated with share repurchases. However, we recommend the Commission itself establish bright-line rules delineating when it is not permissible for insiders to trade in relation to share repurchases. Of course, if the Commission were to establish bright-line rules, they would constitute a floor, and issuers themselves would be able to set higher standards to ensure compliance with insider trading laws.

Specifically, we recommend the Commission prohibit trading by insiders before, during, and after share repurchase announcements *and* executions. Comparable markets already restrict trading by insiders during share repurchase activities, including the United Kingdom, Japan, France, Hong Kong, Canada, and the Netherlands.[30] We recommend the Commission conduct a study to determine which parameters would be most effective at preventing insider trading in connection with share repurchases. In the meantime, we recommend the Commission prohibit trading during share repurchase announcements and executions, as well as within ten days before and after these events. These restrictions would mirror the Commission's proposal to require disclosure of trades conducted by insiders within ten days of a share repurchase announcement. However, we recommend expanding it to share repurchase execution as well.

4. Require Disclosure of Other Uses the Issuer Considered for the Funds Spent on Share Repurchases, and How the Repurchases Were Financed.

Question 17 of the proposed rule asks, in part, whether the Commission, in addition to requiring issuers to "describe the objective or rationale for their share repurchases and process or criteria used to determine the amount of repurchases, as proposed," should require disclosure of

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[29] Canada's amount is limited to 10% of outstanding shares *minus* shares held by insiders.
[30] Lenore Palladino & William Lazonick, "Regulating Stock Buybacks: The $6.3 Trillion Question," 11, Roosevelt Institute, May 2021, *available at*. https://rooseveltinstitute.org/wp-content/uploads/2021/04/RI_Stock-Buybacks_Working-Paper_202105.pdf.

whether issuers "specifically considered other uses for the funds being used for the share repurchase" and "information regarding how share repurchases are financed or their anticipated or actual impact on leverage ratios or the cost of capital." We strongly recommend adding both of these sets of disclosures.

Alternate uses for the funds considered and rejected by issuers in favor of share repurchases is important information for investors. As discussed above, there is a record of share repurchases coming at the expense of investments that contribute to innovation and equitable and sustainable economic growth over time. For long-term investors who are looking to remain shareholders (as opposed to share-sellers) for the foreseeable future, these disclosures would allow them to evaluate whether the issuer's decision to repurchase shares puts the longer-term financial health and growth of the issuer at risk. As experts note: "all companies have to invest broadly and deeply in the productive capabilities of their employees in order to remain competitive in global markets. Stock buybacks made as open-market repurchases make no contribution to the productive capabilities of the firm. Indeed, these distributions to shareholders, which generally come on top of dividends, disrupt the growth dynamic that links the productivity and pay of the labor force. The results are increased income inequity, employment instability, and anemic productivity."[31]

Disclosure of how share repurchases are financed and their impact on leverage ratios and the cost of capital would also be valuable for investors. The proportion of share repurchases financed by corporate bonds reached 30% in 2016 and 2017.[32] In its "Global Financial Stability Report," the International Monetary Fund warned that "[d]ebt-funded payouts can considerably weaken a firm's credit quality."[33] Indeed, experts say that using debt to finance share repurchases "is bad management, given that no revenue-generating investments are made that can allow the company to pay off the debt."[34] Therefore, for long-term investors wanting to ensure the financial stability of the issuer, information on share repurchase financing and its implications for leverage ratios and the cost of capital would be valuable.

We thank the Commission for engaging in this rule-making process to bring much-needed transparency to the practice of share repurchases, as the current regulatory regime leaves the door wide open to undetectable market manipulation and insider trading. If the proposed rule is implemented, the Commission will, for the first time, have the tools necessary to

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[31] William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[32] *Id*.

[33] *Id*.; "Global Financial Stability Report: Lower for Longer," 28, International Monetary Fund, Oct. 2019, *available at* https://www.imf.org/en/Publications/GFSR/Issues/2019/10/01/global-financial-stability-report-october-2019.

[34] William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

detect and hold accountable those engaged in market manipulation and insider trading in connection with share repurchases. Additionally, these new disclosures would allow the signers of this letter, other non-profit organizations, researchers, and additional policy makers to both provide an extra layer of accountability for investors through data analysis, education, and outreach, and to more effectively study and understand the effects of share repurchases within companies, industries, and our economy as a whole.

We appreciate the Commission's consideration of our recommendations to make the rule as effective as possible. For further discussion, please contact Natalia Renta at natalia@ourfinancialsecurity.org.

Sincerely,

Americans for Financial Reform Education Fund
AFL-CIO
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American Federation of Teachers (AFT)
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