CATO INSTITUTE | Center for Monetary and Financial Alternatives

April 1, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: *File No. S-721-21*
Share Repurchase Disclosure Modernization

Dear Ms. Countryman:

My name is Jennifer Schulp, and I am the director of financial regulation studies at the Cato Institute's Center for Monetary and Financial Alternatives. I appreciate the opportunity to comment on the Securities and Exchange Commission's proposed amendments intended to "modernize and improve disclosure about repurchases of an issuer's equity securities that are registered under Section 12 of the Securities and Exchange Act of 1934."[1] The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace, and the Center for Monetary and Financial Alternatives focuses on identifying, studying, and promoting alternatives to centralized, bureaucratic, and discretionary financial regulatory systems. The opinions I express here are my own.

The amendments that the Commission proposes will impose heavy burdens on companies that seek to repurchase outstanding stock. Those burdens will have the effect—intended or not—of discouraging companies from engaging in repurchase activity that they may have otherwise judged to be in the best interest of the company's shareholders. This impact alone raises the concern that what the Commission seeks to do with these proposed disclosure requirements is regulate corporate decision-making about share repurchases. When combined with the lack of evidence that share repurchases are systematically pursued to unlawfully manipulate share prices or related metrics—an issue over which the Commission has authority—and the fact that the disclosures proposed will have little impact on preventing such manipulation—other than through deterring repurchases generally—these proposed amendments are unjustified. The Commission should refrain from regulating corporate decision-making and focus its efforts on enforcing its antifraud and manipulation rules, with which share repurchases already must comply.

[1] Notice of Proposed Rule ("Notice"), "Share Repurchase Disclosure Modernization," SEC Release Nos. 34-93783; IC-34440; File No. S7-21-21 at 1, https://www.sec.gov/rules/proposed/2021/34-93783.pdf.

There Is Little Evidence That Share Repurchases Are Routinely Motivated by Unlawful Manipulation

A share repurchase, also known as a buyback, is a decision by an issuer to purchase its own shares from the marketplace. At its most basic, a buyback transaction has two results. First, shareholders receive cash in exchange for their shares. In this way, buybacks are like dividends, which also return the company's cash to shareholders. While buybacks have become more prevalent than dividend payments in recent years, the value of buybacks relative to market capitalization has remained relatively constant over the past decade.[2]

Second, after a buyback transaction, fewer shares of the company are outstanding. Generally, this means that the stock price can be expected to rise, spreading the company's valuation over fewer outstanding shares.

As the Commission recognizes, there are a myriad of reasons that a company may want to repurchase its shares.[3] One of the most straight-forward reasons is that companies may choose to return cash to shareholders when the company does not have profitable investment opportunities for it. This maximizes shareholder value by returning cash that would be sub-optimally invested to shareholders who can make choices about where to reinvest that cash. Among other reasons, companies may also choose to repurchase shares to change the company's capital structure, effect tax strategies, or signal views about the company's stock price. Some also suggest that repurchases can be motivated solely by a desire to manipulate the price or the company's earnings per share, usually in connection with executives' compensation tied to those metrics.

Most of the reasons for a company to repurchase shares are far afield from the Commission's regulatory authority and mission, relating primarily to choices the company is making about maximizing shareholder value. If a share repurchase is undertaken with the intent to fraudulently manipulate the price of a stock, however, such misconduct would fall within the Commission's regulatory ambit. But, as the Commission itself recognized in its report to Congress on December 23, 2020—supported by a review of both the academic literature and market data—most buybacks are not motivated by a desire to manipulate a company's stock price.[4]

All repurchases, of course, must comply with applicable laws, rules, and regulations, including those that relate to market manipulation and insider trading. Imposing burdensome new disclosure rules to blunt the rare instances of manipulation, however, is unjustified. First, the Commission already has tools to address manipulation that violates antifraud rules. Indeed, the Commission has been focused broadly on investigating potential manipulation of earnings per

[2] Securities and Exchange Commission, "Response to Congress Negative Net Equity Issuance" (December 23, 2020) ("Report") at 13, https://www.sec.gov/files/negative-net-equity-issuance-dec-2020.pdf.
[3] *See* Notice at 40-41; Report at 27-43.
[4] Report at 6, 45.

share (EPS) through its EPS Enforcement initiative, which applies data analytics to analyze earnings management practices for accounting and disclosure violations.[5]

Second, there is little indication that these burdensome disclosure rules would have any significant impact to prevent manipulation. The Commission justifies these additional disclosures by asserting that the additional information will "help investors to assess whether the issuer or its insiders are potentially engaged in self-interested or otherwise inefficient repurchases."[6] This justification is far broader than preventing unlawful manipulation. Information about the company's plan is the most relevant to such aims, but it is already common for companies to provide at least some level of detail about their repurchase plan.[7] Daily disclosure about purchases, which are the most onerous portion of the disclosure requirements proposed, provides little useful detail about the motives for the repurchase.

Finally, there are clear and substantial costs associated with the proposed rule amendments. The Commission acknowledges these costs, calling the direct costs of compliance "potentially significant"[8] and recognizing indirect costs may result "in a negative effect on efficiency."[9] These costs are not limited to individual issuers; the Commission recognizes that a decrease in share repurchase activity may "limit the ability of investors to efficiently reallocate cash to other, higher-net present value investment opportunities, potential resulting in inefficiencies aggregate allocation of capital across issuers."[10] These costs should not be taken lightly, especially when compared to the marginal benefits, if any, that these disclosure obligations may bring to deterring fraudulent manipulation. The costs here simply outweigh any potential benefit.

The Commission Should Not Regulate Corporate Decisions about Share Repurchases

It is easy to conclude that the Commission's aim with these proposed rule amendments extends to deterring share purchases more broadly. Such an aim, however, seeks to regulate boardroom decisions over which the Commission has no authority.

Share buybacks have become increasingly controversial over time, drawing ire from certain corners of Capitol Hill and other commentators,[11] who view a company's decision to repurchase

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[5] *See, e.g.,* Mark Maurer, "SEC Digs Deeper Into Companies' EPS Manipulation," *Wall Street Journal*, October 10, 2021, https://www.wsj.com/articles/sec-digs-deeper-into-companies-eps-manipulation-11633870803.
[6] Notice at 24.
[7] *See, e.g.*, Skadden, Arps, Slate, Meagher & Flom LLP, "Share Repurchases," March 16, 2020, https://www.skadden.com/insights/publications/2020/03/share-repurchases (advising that companies should publicly disclosure share repurchase programs in some detail to avoid potential liability for insider trading);
[8] Notice at 53.
[9] *Id*. at 56-57.
[10] *Id.* at 57.
[11] *See, e.g.,* Thomas Franck, "Elizabeth Warren rips stock buybacks as 'nothing but paper manipulation,'" CNBC, March 2, 2021, https://www.cnbc.com/2021/03/02/elizabeth-warren-rips-stock-buybacks-as-nothing-but-paper-manipulation.html; William Lazonick, Mustafa Erde Sakinç, and Matt Hopkins, "Why Stock Buybacks Are Dangerous

its own shares as a poor one that decreases investment in the company's workforce and research and development. But this viewpoint is far from universal,[12] and it ignores the many legitimate reasons that a company might buy back its shares.[13] It also is inconsistent with evidence showing that buybacks have not had systematically negative effects on corporate reinvestment. Buybacks have not drained companies of cash; over the past decade, the cash held by large companies has been rising, not falling.[14] And research and development has been steadily rising as a portion of GDP, not falling.[15]

Moreover, those who seek to limit buyback activity often ignore the positive role that buybacks can play in efficiently allocating capital. As then Commissioner Roisman recognized in his dissent to this rule proposal, "allowing some companies to hoard cash will not only hurt other companies, who could put the money to very good use, but will likely hurt the broader economy."[16]

Regardless of whether a buyback is a good use of a company's capital, though, the Commission does not have a role to play in the boardroom decisions about undertaking repurchase transactions. The duties owed by a corporate board to the company's shareholders are generally governed by state law. The Commission's proposed rules interfere with those state law duties by discouraging and deterring companies from undertaking repurchases that they otherwise judge to be in shareholders' interest, but for the regulatory burden imposed by the Commission on the execution of the plan.

It is worth noting that many corporations, acting through the lens of their state law duties, already consider the possibility of stock price manipulation through share repurchases both when setting executive compensation and when making decisions about whether to pursue a repurchase plan. As the Commission itself recognized in its December 2020 report to Congress, "82% of the firms reviewed either did not have EPS-linked compensation targets or had EPS

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for the Economy," Harvard Business Review, January 7, 2020, https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[12] *See, e.g.,* Alex Hendrie, "Senator Toomey is Right When it Comes to Stock Buybacks," Americans for Tax Reform, February 14, 2019, http://atr.org/senator-toomey-right-when-it-comes-stock-buybacks/;
Alex Edmans, "The Case for Stock Buybacks," Harvard Business Review, September 15, 2017, https://hbr.org/2017/09/the-case-for-stock-buybacks; Clifford Asness, "Buyback Derangement Syndrome," *Wall Street Journal*, August 16, 2018, https://www.wsj.com/articles/buyback-derangement-syndrome-1534460606.

[13] *See, e.g.,* Michael C. Jensen, "Agency Cost of Free Cash Flow, Corporate Finance, and Takeovers," American Economic Review, Vol. 76, No. 2 (May 1986), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=99580; Paul Asquith and David W. Mullins, Jr., "Signalling with Dividends, Stock Repurchases, and Equity Issues," Financial Management, Vol. 15, No. 3 (Autumn 1986), http://web.mit.edu/15.434/readings/signalling.PDF; Amy K. Dittmar, "Why do Firms Repurchase Stock," The Journal of Business, Vo. 73, No. 3 (July 2000), https://www.jstor.org/stable/10.1086/209646?seq=3.

[14] *See* Mark J. Roe, "Looking for the Economy-Wide Effects of Stock Market Short-Termism" *SSRN*, December 14, 2021, at 6-7, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3986570.

[15] *Id.*

[16] Elad Roisman, "Dissenting Statement on Proposed Rules Regarding Share Repurchases," December 15, 2021, https://www.sec.gov/news/statement/roisman-buybacks-20211215.

targets but their board considered the impact of repurchases when determining whether performance targets were met or in setting the targets."[17] (This fact, of course, is another example demonstrating that unlawful manipulation is not a systematic problem in connection with buybacks.)

The Commission should not substitute its judgment for the corporation's as to the best use of the corporation's resources. As Commissioner Hester Peirce noted in her dissent to this proposal, "[h]istory is replete with examples of central planners allocating resources poorly, and I expect this experiment will end no better."[18] This is all the more concerning when considering the redistributive effects of the proposed disclosure: daily transaction disclosures may allow trading ahead of the company's repurchases, artificially raising the stock price for everyone and shifting gains from the shareholders who hold the stocks to those who have chosen to sell.[19] The Commission should not be in the position of picking and choosing who gains from share repurchases or influencing corporate cash management decisions.

Under these circumstances, the Commission should avoid an expansive, and expensive, disclosure regime that has implications for the corporate activity beyond ensuring compliance with the antifraud provisions of the securities laws.

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Thank you for the opportunity to comment on these proposed rule amendments, and I am happy to answer any questions or further engage on this topic.

Sincerely,

Jennifer J. Schulp
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Center for Monetary and Financial Alternatives
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[17] Report at 42.
[18] Hester Peirce, "Dissenting Statement on Proposed Rules Regarding Share Repurchases," December 15, 2021, https://www.sec.gov/news/statement/peirce-buyback-20211215. *See also* Daniel J. Hemel and Gregg D. Polsky, "There's a Problem With Buybacks, But It's Not What Senators Think," Tax Notes, Volume 162, Number 7, February 18, 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3360569 (explaining that restrictions on buybacks could lead to greater concentrations corporate power by making it more likely that companies will use cash to acquire rivals and consolidate market share).
[19] *See* Notice at 55-56, noting that the "cost to issuers would be a wealth transfer to other market participants, which would have otherwise been less informed about the issuer's outlook on its future share price."