



March 31, 2022

Vanessa Countryman, Secretary  
Securities and Exchange Commission (SEC)  
100 F Street, N.E.  
Washington, DC 20549

**RE: File No. S7-21-21; Share Repurchase Disclosure Modernization  
Comments from Niko Lusiani, Director, Roosevelt Institute**

Dear Ms. Countryman,

At the Roosevelt Institute's think tank, I research ways to foster a dynamic, innovative private sector that works in the service of a thriving equitable economy for all. One central line of investigation in my work focuses on capital formation and allocation strategies, and in particular the share repurchase activity of publicly listed companies. In my previous work, I also represented shareholders interested in obtaining better information about how share repurchase activity affects innovation, efficient markets, and long-term value. Much of my research relies on company filings at the SEC, and my work would be impossible without transparency around the size, scope, and timing of open-market share repurchases—or buybacks. I appreciate the opportunity to comment on File No. S7-21-21; Share Repurchase Disclosure Modernization.

To summarize my views: The SEC's proposed amendments to modernize and improve disclosure around share repurchases are welcome measures to help mitigate the harms I describe below by reducing current information asymmetries, boosting firm responsiveness to concerns around the opportunity costs of buybacks, and enhancing vigilance around their use and abuse. The enhanced transparency and real-time data will be particularly useful to researchers like myself, but also to a broader community of analysts, investors, suppliers, journalists, workers, and others.

**Harms Stemming from Opaque and Unlimited Share Repurchases**

To begin, it's worth restating why this issue is so important to our economy and to my work. The opacity and unlimited nature of open-market share repurchases in the US today harms a fair and innovative economy in four ways.

First, of utmost concern to fostering efficient and healthy markets is that unlimited share repurchases may well be distorting stock prices. Research estimates that 40 percent of share growth in recent years derives from corporations buying their own stock rather than company

fundamentals such as earnings.<sup>1</sup> In fact, buybacks represented the biggest source of demand for US stocks between 2009 and 2018.<sup>2</sup> Evidence suggests that firms may be using buybacks strategically to meet analyst earnings expectations which they would have missed otherwise.<sup>3</sup> These distortions do not augur well for the long-term health of individual firms, the capital markets, or the broader economy.

Second, and relatedly, senior management—compensated in stock and with more detailed inside information—enjoy regulatory loopholes allowing them to manipulate earnings-per-share (EPS) through the timing and scale of buybacks in ways that boost their own personal financial rewards. Recent empirical research shows a statistically significant relationship between buybacks and insider sales, suggesting that insiders are choosing to increase their use of corporate funds to conduct stock buybacks in the same quarters when they are personally profiting from higher share prices.<sup>4</sup> The potential that senior executives are making decisions about such central capital allocation matters based on their own bottom lines rather than long-term value creates a cloud of uncertainty and doubt which is harmful to fair and efficient capital markets.

Third, innovation, capital expenditure, and human capital development—all cornerstone dimensions of long-term value, capital formation, and growth—are crowded out by opaque, unlimited and tax-privileged share repurchases.<sup>5</sup> An empirical study finds that repurchases used to push EPS above analyst expectations are accompanied by a 10 percent decrease in capital expenditures and a 3 percent decrease in research and development. The study concludes that managers of US firms are able and willing to trade off investments in innovation and real investment for share repurchases that signal short-term success.<sup>6</sup> Further, share repurchases enjoy significant tax benefits compared to dividends.<sup>7</sup> This implicit government subsidy represents forgone revenue that could have been spent on needed public economic and social infrastructure

<sup>1</sup> Roberts, Lance. 2021. “40% of the Bull Market Is Due Solely to Buybacks.” *Seeking Alpha*, October 29, 2021.

<https://seekingalpha.com/article/4463446-40-percent-of-the-bull-market-is-due-solely-to-buybacks>; Garrib, Aidan. 2021. *Global Macro Views and Ideas*. Montreal: Pavilion Global Markets. <https://markethuddle.com/wp-content/uploads/2021/03/Market%20Huddle%20Podcast%20-%20March%2019%202021.pdf>.

<sup>2</sup> Ponczek, Sarah, and Lu Wang. 2018. “Goldman's Buyback Desk Was Deluged With Orders as Stocks Plunged.” *Bloomberg*, February 14, 2018, sec. Markets. <https://www.bloomberg.com/news/articles/2018-02-14/goldman-s-buyback-desk-was-deluged-with-orders-as-stocks-plunged>;

Authers, John. 2019. “Stock Buybacks Aren’t Bad. They’re a Symptom of a Larger Problem.” *Bloomberg Businessweek*, February 6, 2019, sec. Finance. <https://www.bloomberg.com/news/articles/2019-02-06/stock-buybacks-aren-t-bad-they-re-a-symptom-of-a-larger-problem?sref=gMvqgK3G>.

<sup>3</sup> Almeida, Heitor, Vyacheslav Fos , and Mathias Kronlund. 2016. “The Real Effects of Share Repurchases.” *Journal of Financial Economics* 119, no. 1 (January): 168–85. <https://www.sciencedirect.com/science/article/abs/pii/S0304405X15001476?via%3Dihub>.

<sup>4</sup> Palladino, Lenore. 2019. “Do Corporate Insiders Use Stock Buybacks for Personal Gain?” Roosevelt Institute Working Paper. New York: Roosevelt Institute. [https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI\\_Corporate-Insiders-use-Stock-Buybacks-for-Personal-Gain\\_Working-Paper-201910.pdf](https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI_Corporate-Insiders-use-Stock-Buybacks-for-Personal-Gain_Working-Paper-201910.pdf);

Jackson Jr., Robert J. 2018. “Stock Buybacks and Corporate Cashouts.” (Speech, US Securities and Exchange Commission, Washington, DC, June 11, 2018). <https://www.sec.gov/news/speech/speech-jackson-061118>.

<sup>5</sup> Turco, Enrico Maria. 2018. “Are Stock Buybacks Crowding out Real Investment? Empirical Evidence from U.S. Firms.” ExSIDE Working Paper No. 37-2021. Dusseldorf: Hans Böckler Foundation. [https://www.boeckler.de/pdf/v\\_2018\\_10\\_27\\_turco.pdf](https://www.boeckler.de/pdf/v_2018_10_27_turco.pdf).

<sup>6</sup> Almeida, Heitor, Vyacheslav Fos , and Mathias Kronlund. 2016. “The Real Effects of Share Repurchases.” *Journal of Financial Economics* 119, no. 1 (January): 168–85. <https://www.sciencedirect.com/science/article/abs/pii/S0304405X15001476?via%3Dihub>.

<sup>7</sup> Feng, Liang, Kuntara Pukthuanthong, Dolruedee Thienngtham, H. J. Turtle, and Thomas J. Walker. 2013. “The Effects of Cash, Debt, and Insiders on Open Market Share Repurchases” *Journal of Applied Corporate Finance* 25, no. 1 (April): 55–63. <https://doi.org/10.1111/j.1745-6622.2013.12006.x>.

to drive innovation and growth.

Lastly, opaque and unlimited share repurchases in the US today exacerbate economic inequality, itself a drag on economic growth. Publicly listed corporations spent \$6.3 trillion to repurchase their own shares in the decade before the pandemic. This represented on average 100 percent of the after-tax profits of nonfinancial corporations. These firms are set to spend a record \$1 trillion in buybacks this year.<sup>8</sup> Instead of investing to enhance innovation, productivity, and job creation, these actions inflate equity prices, which disproportionately benefit the top 10 percent of households—who own 89 percent of US stock.<sup>9</sup> These growing wealth disparities accentuate overall economic inequality, which S&P’s Chief US Economist, economists from the International Monetary Fund, and several others have argued stunts economic growth.<sup>10</sup>

Notably, given the lax regulatory environment, the US is by far the global leader in buyback activity, and is the only country that spends more on share repurchases than dividends.<sup>11</sup> In this sense, the harms described above from opaque, unjustified, and unlimited buybacks pose distinct competitive disadvantages for US actors operating in a global economy.

### Benefits of Modernizing Share Repurchase Disclosures

The SEC’s proposed amendments to modernize and improve disclosure around share repurchases will help to mitigate the harms described above by reducing current information asymmetries, boosting firm responsiveness to concerns around the opportunity costs of buybacks, and enhancing vigilance around their use and abuse. As such, this information will also be of utmost benefit to researchers, analysts, investors, journalists, workers, and others.

First, Proposed Form SR will help protect investors by shining more sunlight on the timing and size of share repurchases, providing a dissuasive effect to reduce potential for market manipulation and abusive insider sales.

<sup>8</sup> Dailey, Natasha. 2022. “Companies Are On Pace to Buy Back a Record \$1 Trillion in Stock This Year as Russia's War in Ukraine and the Fed's Planned Rate Hikes Rattle Markets.” *Business Insider*, March 15, 2022. <https://markets.businessinsider.com/news/stocks/stock-buybacks-1-trillion-2022-ukraine-war-fed-rate-hikes-2022-3>.

<sup>9</sup> Kakouris, Rachelle. 2020. “Fed Rally & Default Fears Bring Bifurcation back to Leveraged Loans.” S&P Global, April 30, 2020. <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/leveraged-loan-news/fed-rally-default-fears-bring-bifurcation-back-to-leveraged-loans>; Board of Governors Federal Reserve System. 2022. “DFA: Distributional Financial Accounts.” Last updated March 18, 2022. Survey of Consumer Finances and Financial Accounts of the United States. <https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/chart/#quarter:126;series:Corporate%20equities%20and%20mutual%20fund%20shares;demographic:networth:population:1.3.5.7;units:shares>.

<sup>10</sup> Bovino, Beth Ann, Gabriel J. Petek, and John B. Chambers. 2021. *How Increasing Income Inequality is Dampening US Economic Growth, and Possible Ways to Change the Tide*. New York: Standard and Poor’s Rating Services. [https://www.spglobal.com/division\\_assets/images/special-editorial/how-the-advancement-of-black-women-will-build-a-better-economy-for-all/ratingsdirect\\_28714420\\_jun-07-2021.pdf](https://www.spglobal.com/division_assets/images/special-editorial/how-the-advancement-of-black-women-will-build-a-better-economy-for-all/ratingsdirect_28714420_jun-07-2021.pdf); Ostry, Jonathan D., Andrew Berg, and Charalambos G. Tsangarides. 2014. *Redistribution, Inequality, and Growth*. Washington, DC: International Monetary Fund. <https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>.

<sup>11</sup> Focusing Capital On The Long Term Global (FCLTGlobal). 2020. *The Dangers of Buybacks: Mitigating Common Pitfalls*. Boston: FCLTGlobal. <https://www.fcltglobal.org/wp-content/uploads/The-Dangers-of-Buybacks-FCLTGlobal.pdf>.

Second, the more granular transparency around the specific timing of buybacks offered by Proposed Form SR will help investors, analysts, workers, researchers, and regulators identify repurchases that are more likely to be driven by managerial self-interest rather than value creation. In particular, Proposed Rule SR would enable the SEC to actually determine whether or not companies stay within the safe harbor, which former SEC Chair Mary Jo White explained it was unable to do with current rules.<sup>12</sup>

Third, requiring management to explain—and Boards to assess more carefully—the justification for share repurchases could, if designed right, lead to more productive supervision and debate around the trade-offs and opportunity costs of buybacks. This will allow a broad array of stakeholders to more effectively hold management and Boards accountable for narrow, short-term strategies that spend excess capital on repurchasing shares at the cost of innovation, productivity, and workforce development. In turn, more investment, more innovation, and a workforce ready for the future and treated with dignity and respect would have significant overall economic benefits.

Lastly, to the extent that it nudge issuers away from tax-privileged buybacks and toward dividends as preferred tools for distributing profits to shareholders,<sup>13</sup> the proposed rule would also benefit the American taxpayer by allowing the government to retrieve more of the revenue currently forgone from these implicit subsidies, and spend this money on needed public economic and social infrastructure to drive innovation and growth.

In these ways, the proposed new rules should lead to a variety of benefits for shareholders, analysts, workers, academics, and regulators—all of whom should be recognized as affected parties. In this sense, beyond investors, the SEC should consider including an expanded and delineated list of these and other beneficiaries of the proposed rules.

It is no surprise then that various distinct communities of practice have voiced support for new SEC rules to enhance transparency of and justification over share repurchases. The Council of Institutional Investors, for example, “advocates robust disclosure about the rationale for buybacks,” argues that “management should disclose how buybacks affect performance metrics” and “supports more rapid disclosure, on par with disclosure of trades by insiders.”<sup>14</sup> Additionally, the organization Focusing Capital on the Long Term (FCLT)—founded by CPP Investments and

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<sup>12</sup> See letter to Senator Tammy Baldwin, July 13, 2015,

<https://www.documentcloud.org/documents/2272283-sec-response-to-baldwin07132015.html#document/p1>; “The Commission therefore cannot effectively compare firm repurchase activity (reported by month) against the daily conditions, such as the daily limit on repurchase volume, of the safe harbor.”

<sup>13</sup> Matheson, Thornton, and Thomas Brosy. 2021. “1% Buyback Tax Could Lead to Higher Dividend Payouts.” *TaxVox: Business Taxes* (blog). Tax Policy Center. December 20, 2021. <https://www.taxpolicycenter.org/taxvox/1-buyback-tax-could-lead-higher-dividend-payouts>.

<sup>14</sup> Council of Institutional Investors (CII). 2019. “CII Statement on Share Buybacks.” Press release, February 5th, 2019.

<https://www.cii.org/feb5sharebuyback>; Council of Institutional Investors. 2022. “Corporate Disclosure.” CII Advocacy Priorities. [https://www.cii.org/corporate\\_disclosure](https://www.cii.org/corporate_disclosure).

McKinsey & Company, and with a wide membership of investors including BlackRock, Fidelity, State Street, and Wellington Management—recently called for stricter disclosure requirements around share repurchases, including timing restrictions, pricing restrictions, volume restrictions, and requiring more timely disclosures of share repurchase activity.<sup>15</sup>

## Responses to Specific Requests for Comment

With these benefits in mind, I would now like to address a few of the specific requests for comment posed by the SEC.

### Proposed Form SR

For the proposed rule to be effective, daily detailed disclosures are absolutely necessary. Simply put, the quality and relevance of this data relies on its timeliness. Far from creating “white noise,” this granular data would provide the core, real-time information necessary to detect patterns of potential manipulation or insider abuse, for similar reasons that Form 4 requires daily disclosure. Investors and analysts would decidedly not be overwhelmed by daily reporting in structured data language, but instead benefit greatly from this more detailed information. Weekly or monthly disclosure would defeat one of the main aims and purposes of this proposed amendment: to allow interested parties to track and prevent senior executives timing their insider sales to coincide with rapid, buyback-driven share spikes. Reporting each individual transaction is one way to meet this aim, but may not strike the right balance of cost and benefit. Daily reporting certainly would—on par with disclosure of trades by insiders required by Form 4.

Further, requiring the average price paid per share in Form SR will be necessary. However, averaging this information out will mask important intra-day swings. As such, the SEC should also consider requiring the highest and lowest prices repurchased within the day so as to allow affected parties to detect potential abuse within a particular period of high price volatility.

Lastly, foreign and private issuers selling shares in the US market should be required to have the same buyback reporting standards as US companies. Given that regulatory standards on buybacks are significantly higher amongst US trading partners, it is likely that these foreign issuers are already disclosing this information in other jurisdictions, so would not incur compliance costs.

### Amendments to Item 703

The proposed amendments to Item 703—together with daily disclosures in Proposed Form SR—

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<sup>15</sup> Focusing Capital On The Long Term Global (FCLTGlobal). 2020. *The Dangers of Buybacks: Mitigating Common Pitfalls*. Boston: FCLTGlobal. <https://www.fcltglobal.org/wp-content/uploads/The-Dangers-of-Buybacks-FCLTGlobal.pdf>.

will be very useful to give affected parties insight into how share repurchases reflect, or not, overall business strategy and the potential for long-term value creation, while also helping to detect and deter insider manipulation.

To meet those aims, analysts, shareholders, academics, workers, and others would benefit greatly from Item 703 requiring issuers to include the expected impact of stock buyback activity on the value of remaining shares, and to disclose the planned source of the funds used to execute stock buybacks, including how financing buybacks will affect leverage ratios.

### **Enhanced Disclosure a Welcome Step Even as Further Measures Needed**

In sum, the SEC proposed changes under File No. S7-21-21 should be supported by all those interested in fair, efficient, and transparent financial markets. Ultimately, though, disclosure is not a substitute for regulation. Rule 10b-18 has failed to meet its aim and purpose to limit a firm from manipulating its stock price. Once welcome transparency rules are put in place, our task in the near future will be to develop new substantive rules that get to the heart of the harms of open-market share repurchases. First, corporate insiders need to be completely prohibited from personally benefiting during periods of stock buyback activity, including buyback announcement periods. It is time we end senior executives' opportunities to squander value by self-dealing through timely buybacks. And second, the SEC should join the rest of the world's financial market regulators, who impose substantive limits on the amount of corporate funds that can be spent on open-market stock buybacks. These common-sense limits would help refocus the C-suite on investing to make our economy more innovative, more competitive, and more productive—pushing toward, rather than pulling away from, more shared long-term value.

Sincerely,



Nicholas J. Lusiani  
Director, Corporate Power

March 30, 2022

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

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

Secretary Countryman,

I appreciate this opportunity to comment on the Securities and Exchange Commission's proposal to reform disclosure of open-market share repurchases ("OMRs", also referred to as stock buybacks). I am an Assistant Professor of Economics & Public Policy at the University of Massachusetts Amherst, and I research the impacts of stock buybacks on innovation and economic growth.

Proposed Rule SR is a great improvement over the current regulatory regime, as it requires regular disclosure that will inform investors and regulators of stock buybacks in real time. This is a major step forward for transparency and would lessen the information asymmetries that currently exist between corporate management on the one hand, and analysts, workers, policymakers and the shareholding public on the other. The SEC's proposed rules would also compel firms to explain *why* their buyback decisions are beneficial, while helping to curb the incentives for corporate insiders to conduct stock buybacks with corporate funds as a method of increasing their own compensation.

While I appreciate the Commission's work on the current proposal, I believe that the SEC must go further in restricting stock buybacks under its statutory authority to prevent market manipulation. As I explain in my 2019 article in the *Yale Journal of Regulation*, the SEC began its OMR-related rulemaking process in the 1970s with the clear recognition that stock buybacks have the potential to manipulate the market price of a company's stock. Proposals in the 1970s and the regulations that are in place in other advanced financial market economies recognize that common-sense limits on stock buyback activity are appropriate and necessary to limit the potential for market manipulation. As I discuss in this Comment Letter, Rule 10b-18 does not place meaningful limits on corporate buyback activity. Given the massive growth of corporate funds spent on OMRs in the last decade, and the potential for market manipulation of such a high volume of activity, the SEC should repeal Rule 10b-18 and propose regulations that would create bright-line limits to stock buyback activity and remove the incentives for corporate insiders to personally benefit from corporate funds spent on OMRs.

In this Comment Letter I first offer my support for Proposed Rule SR and Item 703, and then turn to my recommendation for expanded policymaking. I then provide my analysis of the history of SEC proposed rulemaking regarding OMRs before 1982 and give an overview of international regulation of stock buybacks.

## **1. Support for Proposed Rule SR (Rule 13a-21) and Item 703**

The Benefits of Proposed Rule SR Next Day Reporting

Form SR (Rule 13a-21): The proposal for regular disclosure of stock buyback execution is major step forward for transparency and would finally end the information asymmetries that currently exist between corporate management on the one hand, and analysts, workers, policymakers and the shareholding public on the other. As long as Rule 10b-18, the “Safe Harbor,” remains in place, Proposed Rule SR will enable the SEC to actually determine whether or not companies stay within the safe harbor, which it has previously stated it was unable to do<sup>1</sup>.

Corporations spent \$6.3 trillion on stock buybacks from 2010-2019, ranging from billions spent by our largest corporations, such as Apple and Microsoft, to nursing home companies and producers of PPE<sup>2</sup>. Though Rule 10b-18 purports to put volume limits on stock buybacks activity, it has two flaws: it creates a daily volume limit without collecting data on daily buyback activity, and also does not create a presumption of liability for stock buybacks conducted beyond the limits of the safe harbor. Proposed Rule SR will bring transparency into the 21<sup>st</sup> century by requiring next day reporting of stock buyback execution, enhancing the ability of both investors and regulators to have the same information as corporate insiders. For researchers such as myself, it is not currently possible to obtain micro-level data on stock buybacks timing. The benefits of such disclosure to researchers, along with regulators and investors, would be to make such data available in a timely manner. The costs to corporations should be minimal given the well-established regular reporting of other financial metrics to the Commission, and the fact that companies are already reporting aggregate stock buybacks data, which must be determined from micro-level data.

### The Benefits of Item 703 Amendments

The SEC’s proposed rules include Item 703 amendments that would also compel firms to explain *why* their buyback decisions are beneficial, though additional detail should be included to ensure that statements are not simply boilerplate, as well as to clearly disclose “any policies and procedures relating to purchases and sales of the issuers’ securities by its officers and directors during a repurchase program, including any restriction on such transactions.” As I explain below, while I propose the SEC establish its own minimum standards with regard to officer and director transactions during buybacks programs for companies to build upon, the proposed additions contained in Item 703 will be useful to serve as a notice to companies that their reasons for conducting buybacks should be valid enough such that they can be fully and reasonably understood by shareholders. Within Item 703, the SEC should require stock buybacks to be publicly announced, the expected impact of stock buyback activity on the value of remaining shares, and the planned source of the funds used to execute stock buybacks, including how financing buybacks will affect leverage ratios.

## **2. The SEC Should Repeal Rule 10b-18 and Propose Common-Sense Limits to OMRs to Reduce Market Manipulation**

Common-sense restrictions to stock buybacks will prevent market manipulation and benefit investors over the long term

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<sup>1</sup> David Dayen, *SEC Admits It’s Not Monitoring Stock Buybacks to Prevent Market Manipulation*, The Intercept (Aug. 13, 2015, 9:08 AM), <https://theintercept.com/2015/08/13/sec-admits-monitoring-stock-buybacks-prevent-market-manipulation> [https://perma.cc/6RW9-NDQ5].

<sup>2</sup> Palladino L. and Lazonick W. 2021. “Regulating Stock Buybacks.” The Roosevelt Institute: <https://rooseveltinstitute.org/publications/regulating-stock-buybacks-the-6-3-trillion-question/>



The SEC should build on Proposed Rule SR and repeal the “Safe Harbor,” Rule 10b-18 and replace it with common-sense guardrails to prevent market manipulation, with bright-line limits on the volume, timing, manner, and price for open-market share repurchases. All other open-market share repurchases above the stated limits should be unlawful (note that this does not include tender offers and private transactions). The limits within the safe harbor are not sufficient to curb the potential for market manipulation, and, currently, there is no presumption of liability if a company does not stay within the safe harbor limits. The Commission places many bright-line limits on companies’ securities offerings pursuant to the 1933 and 1934 Acts.<sup>3</sup> A bright-line rule prohibiting companies from conducting repurchases over certain limits would have the effect of lowering the potential for market manipulation, while leaving room for repurchases at the lower level. While setting a precise limit should be the subject of further research and discussion, it is worth noting the limits in place in other advanced financial market jurisdictions (discussed below), as well as the proposals made by the SEC itself in 1970, in Proposed Rule 13e-2.

### Place Mandatory Limits on Corporate Insider Trading Before, During, and After Open-Market Share Repurchases

Proposed Item 703 additions would require companies to disclose: “Any policies and procedures relating to purchases and sales of the issuer’s securities by its officers and directors during a repurchase program, including any restriction on such transactions;” (p. 22). The current proposal leaves it up to businesses themselves to limit the potential for corporate insiders to personally gain from stock buybacks activity. The proposal does propose a bright-line limit for ten days before and after buyback program announcements, but not around actual buybacks execution. While companies should be free to place stricter limits on corporate insiders, the SEC should lay out a basic prohibition on corporate insider trading before, during, and after buyback announcement and execution. This should not be left to company-by-company policymaking and dependent on the ability of independent directors to craft policies that corporate management can accept. The period of time for which restrictions should be placed should be subject to further study and discussion.

The research of former SEC Commissioner Robert Jackson Jr.<sup>4</sup>, economist William Lazonick<sup>5</sup>, law professor Nitzan Shilon<sup>6</sup>, Harvard Law Professor Jesse Fried<sup>7</sup>, and my own published empirical work<sup>8</sup> have identified the legal loopholes that allow corporate insiders to sell their own personal shares when they know that buyback purchases are happening, even though such activity has not yet been disclosed to the outside world, and to use corporate funds for stock buybacks in order to effect their own long-term compensation. In my published empirical work, *Do Corporate Insiders Use Stock*

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<sup>3</sup> See generally 17 C.F.R. 230.501 (2018) (rules defining dollar thresholds for accredited investors).

<sup>4</sup> Jackson Jr., R. (2018) “Stock Buybacks and Corporate Cashouts.” Securities and Exchange Commission Speech. <https://www.sec.gov/news/speech/speech-jackson-061118>

<sup>5</sup> Hopkins, M. & Lazonick, W. (2016) *The Mismeasure of Mammon: Uses and Abuses of Executive Pay Data*. Institute for New Economic Thinking. <https://www.ineteconomics.org/research/research-papers/the-mismeasure-of-mammon-uses-and-abuses-of-executive-pay-data>

<sup>6</sup> Shilon N. (2021). “Stock Buyback Ability to Enhance CEO Compensation: Theory, Evidence, and Policy Implications.” *Lewis & Clark Law Review* 25: 303-359.

<sup>7</sup> Fried, J. (2005) Informed Trading and False Signaling with Open Market Repurchases. *California Law Review*, 93, 1323-1386.

<sup>8</sup> Palladino L. (2020) “Do Corporate Insiders Use Stock Buybacks for Personal Gain?” *International Review of Applied Economics* 34(2): 152-174.

*Buybacks for Personal Gain?* I found that, despite the lack of date-specific disclosure of when stock buybacks occur, using monthly data, I observe that large net sales of insider holdings are more than twice as likely to take place in periods of substantial buyback activity<sup>9</sup>. I examine transactions for nonfinancial corporations with publicly traded stock from 2005 to 2017 and find that net insider sales of over \$100,000 are nearly twice as common in quarters when stock buybacks are also occurring than in non-buyback quarters. I conduct an empirical analysis of the relationship between stock buybacks insider transactions and find that a ten percent change in stock buybacks is associated with a half- percent change in corporate insiders selling their personal shareholdings, holding the other factors constant. The results suggest that executives may be taking advantage of the regulatory loophole left in the regulation of stock buybacks, and that policymakers should reform the regulations governing stock buybacks and corporate insider share-selling. It is clear that without proper regulation, corporate insiders have the ability to schedule stock buybacks to coincide with their own personal share-selling, thus benefiting personally from the use of corporate funds for repurchases. Given that the securities laws generally forbid misbegotten insider benefit, it is crucial to understand the range of policy options available to restrict this opportunity for personal gain.

### **3. Policies Regulating Open Market Share Repurchases in Advanced Capital Markets Globally**

Legislation currently enacted in other countries with advanced capital markets can be useful in guiding the development of US policymaking for that scenario. Several other economies—Japan<sup>10</sup> and Canada, for example—have substantive bans on insider transactions during buyback programs or require disclosure of insider plans to sell their personal holdings before such a sale takes place. It is useful to be aware of how stock buybacks are regulated in other jurisdictions. Internationally, most countries with robust capital markets have some regulation in place for curbing stock buybacks, including both disclosure and substantive limitations. To summarize, the significant differences from the U.S. model of regulation include: requiring shareholder rather than board approval; placing bright-line limits on buybacks rather than adopting a safe-harbor approach; requiring immediate disclosure; and requiring insiders to not trade during buyback programs. Many countries follow the U.S. model with restrictions on timing, price, volume, and manner. Among the ten countries with the largest capital markets, all others place clear limits on repurchase activity, and most have more specific repurchase requirements. In the United Kingdom, approval is required at a shareholder meeting, not just from the board of directors. Open market share repurchases must be reported immediately to the Financial Supervisory Authority, and disclosure of volume and price is required. Requirements put in place by the Tokyo Stock Exchange restrict repurchases in terms of price, quantity and timing, and disclosure is required on execution at the close of the trading day. There are also restrictions on insiders, including limiting trading of an insider’s own holdings while a buyback program is underway, and mandating the establishment of trading rules to avoid conflicts of interest.

In European Union member states, approval at a shareholder meeting is also required, and the authorization is valid for eighteen months. In France, significantly, the regulatory agency (the Commission des Opérations de Bourse) must also approve the program. In Italy, shareholders must

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<sup>9</sup> Id.

<sup>10</sup> Tokyo Stock Exchange Guidelines state that an insider who is in a position to make buyback decisions cannot trade his own holdings of the firm’s shares while a buyback program is under way.

also approve the maximum number of shares to be acquired and the minimum and maximum purchase price. There is a bright-line limit that a firm cannot buy back more than 10% of outstanding shares in France, Germany, Italy, Switzerland, and the Netherlands. E.U. countries require repurchases to be made out of distributable profits, i.e., not purchased with debt. Canada's Toronto Stock Exchange ("TSE") also requires the board to seek authorization from the TSE and repurchase activity must be filed with the TSE within ten days after the end of each month. Repurchasing firms must also disclose whether insiders plan to sell their holdings during the firms' buyback program. In Switzerland, buybacks are conducted according to a second trading line, and these transactions are fully disclosed on a real-time basis, visible to the public because the firm is the only buyer of this trading line. When a repurchase program is completed, a firm must immediately make a public announcement. Several countries also disallow buybacks within ten days prior to earnings announcements.

#### **4. History of Previous SEC Proposed Rules Concerning Stock Buybacks<sup>11</sup>**

In addition to regulations in other jurisdictions, it is important for the Commission to acknowledge its own history of developing regulations for open-market share repurchases. In the 1970s, the Commission considered several proposed Rules that were meant to affirmatively curb the potential for market manipulation of stock buybacks. These Proposed Rules are worth review by today's Commission.

The Securities and Exchange Act of 1934 (the "Act") governs secondary trading of equities and lays out anti-fraud and anti-manipulation provisions to govern such activity. Prior to the adoption of Rule 10b-18, stock buybacks were subject to potential liability under several anti-fraud and manipulation statutes of the Act: Sections 9(a)(2)[1] and 10(b)[2] of the Act and its promulgating Rule 10b-5. Because there was no explicit permission nor denial of permission for stock buybacks, they operated in a legally hazy area, inhibiting their use. Congress passed the Williams Act Amendment to the Securities and Exchange Act in 1968, which focused on the tender offer process. It gave the Commission authorization to adopt rules and regulations to prohibit buybacks, by defining them as fraudulent, deceptive or manipulative, based on their role protecting investors and the interest of the public. Section (2)(e)(1) stated specifically that it is unlawful for issuers to repurchase their own securities if the purchase "is in contravention to 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 or practices." Throughout the 1970s, the Commission proposed but failed to adopt a series of rules to regulate repurchases. In 1970, Rule 13e-2 was proposed to make stock buybacks "unlawful as acts and practices which are fraudulent, deceptive or manipulative" unless the transactions were conducted according to a certain set of conditions. The conditions included: one broker per transaction; no sales before the opening transaction and a half-hour before the close of daily trading; prices could not exceed the highest current independent bid price or the last sale price, whichever is higher; and the volume was limited to not exceeding fifteen percent of the average daily trading volume in the four calendar weeks preceding the week in which the buybacks were conducted. These same conditions, with the volume increased by ten percentage points, would become the conditions for

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<sup>11</sup> Palladino, L. "New Approaches to Regulating Stock Buybacks," *Yale Journal of Regulation*. 2018 (Internal citations omitted).

the safe harbor. The critical difference in proposed Rule 13e-2 was that all other transactions were unlawful. The proposed Rule did not include specific disclosure requirements but did include a provision under which the Commission could approve repurchases on a case-by-case basis that would otherwise be unlawful.

In 1973 and 1980, amendments to proposed Rule 13e-2 were added, including a significant proposal for disclosure. In 1973, the Commission was more forthright about its purpose for the rule, describing it as “prescrib[ing] means . . . to prevent an issuer from effecting repurchases which may have a manipulative or misleading impact on the trading market in the issuer’s securities.” The Commission later described the conditions for repurchases as “designed to ensure that an issuer neither leads nor dominates the trading market in its securities.” This language points to the rationale behind the types of conditions outlined, such as disallowing issuers to set the first or last price for a trading day. The Commission included an initial disclosure regime, including several questions about whether officers or directors should be required to disclose if they are considering buying or selling securities in conjunction with a repurchase that they are in charge of executing. The language points to awareness by the Commission that officers and directors face conflicts of interest, requesting comments on “[w]hether any officers or directors intend to dispose of the issuer’s securities they might presently hold.” The proposal invited comments on the idea that the source of funds to be used for the repurchases should be disclosed, and how public such disclosures should be made, along with volume and manner disclosure requirements.

A revised proposed Rule 13e-2 also laid out the rationale for a need to limit stock buybacks. The Commission explained that the “regulatory predicate . . . [is a] need for a scheme of regulation that limits the ability of an issuer . . . to control the price of the issuer’s securities.” Such a need “stems in part from the unique incentives that an issuer . . . [has] to control the price of the issuer’s securities.” The Commission explained that the guidance was intended to help issuers avoid securities law liability that they could not otherwise predict, since the antifraud and anti-manipulative provisions of the Act are general in nature. The Commission once again explained that limits it was proposing were intended to “prevent the issuer from leading or dominating the market through its repurchase program. In fashioning those limitations, the Commission has balanced the need to curb the opportunity to engage in manipulative conduct against the need to avoid excessively burdensome restrictions.” Again the Commission left room for a case-by-case exemption of transactions that otherwise would exceed the proposed Rule.

Even though the elaborate description of the need for the proposed rule was new, the substantive conditions put in place were mainly the same as in the 1970 and 1973 proposals, with one significant difference: transactions that took place outside of its conditions would not be automatically suspect. The Commission gave specific reasoning as to why each of the volume, timing, pricing, and manner conditions were critical to designing procedures that would limit the impact of repurchases on the market. The Commission also proposed specific disclosure requirements for large-volume repurchase programs but noted that disclosure was not a substitute for substantive regulation, explaining at some length that disclosure would not be enough to curb activity that could be manipulative to the market. Disclosure would, however, “give the market an opportunity to react to the fact that the issuer may account for a substantial amount of purchasing activity in its securities.”

In 1982, rather than proposing another revision to proposed Rule 13e-2, the Commission instead proposed Rule 10b-18, which was adopted later in the year. An analysis published at the time claimed that this was a “regulatory about-face,” and that the new safe harbor should be viewed as

“constructive deregulatory action . . . [that] contrasts markedly with past Commission views on the regulation of issuer repurchases.” Rule 10b-18 stood in contrast to proposed Rule 13e-2, which had the purposes of preventing manipulation by prohibiting the issuer from raising the market price; prohibiting the perception of wide-spread interest by the use of several broker-dealers and limiting domination of the market with high repurchase volumes. The purpose of Rule 10b-18 instead was to facilitate repurchases and limit intrusive regulation into corporate decision-making. Its passage has paved the way for four decades of increasing stock buyback activity by U.S. corporations.

## Conclusion

I appreciate the Commission’s consideration of stock buybacks disclosure reform and the efforts contained in Proposed Rule SR and the Item 703 additions. I request that the Commission include an expanded and delineated list of the Rule’s intended beneficiaries, with the potential benefits quantified. Please do not hesitate to contact me for further discussion.

Sincerely,

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## Appendix: Table: Summary of International Share Repurchase Regulation

*Source:* Chen, N.-Y. & Liu, C.-C. (2021) The effect of repurchase regulations on actual share reacquisitions and cost of debt. *The North American Journal of Economics and Finance*, 55, 101298.

Country	Approval	Separate Disclosure	Time Limit
<i>English legal origin</i>			
Australia	Board meeting	Daily report	6 months
Canada	Board meeting	Monthly report	12 months
Hong Kong	Shareholder meeting	Daily report	12 months
US	Board meeting	None	36 months <sup>1</sup>
UK	Shareholder meeting	Daily report	18 months
<i>French legal origin</i>			
France	Shareholder meeting	Monthly report	18 months
Italy	Shareholder meeting	Completion Report after 18 months	18 months
Netherlands	Shareholder meeting	Daily report	18 months
<i>German legal origin</i>			
Germany	Shareholder meeting	Contingent report	18 months
Japan	Board meeting	Daily report	12 months
Korea	Board meeting	Completion report after 3 months	3 months
Switzerland	Shareholder meeting	None	36 months
Taiwan	Board meeting	Completion report after 2 months	2 months