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Share Repurchases

Why the employees vs. shareholders debate may mask the broader economic benefits to society.

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Executive Summary

As policymakers in Washington, D.C., continue to discuss the role of stakeholder capitalism in society, a growing concern is how to assess the varying interests of stakeholders. With its recently proposed share repurchase disclosure rule, the U.S. Securities and Exchange Commission (SEC) has brought this debate to the forefront by reviewing how and why companies disburse excess capital. Some argue that profits should be returned to shareholders, while others say the excess capital should be reinvested in employees.

Corporations have used share repurchases (aka stock buybacks), since 1982 when the SEC offered liability protection, which also included additional disclosure requirements. As a result, corporations began to increasingly use repurchases as a way to efficiently distribute excess capital. Since then, policymakers and academics have disagreed on how to adequately calculate the increased level of repurchases and the extent to which certain executives use repurchases for their own personal gain.

Through a static analysis of share repurchases, critics have posited numerous proposals to prohibit or restrict repurchases. The prevailing rationale to impose restrictions focuses on the correlation between corporate notices to engage in share repurchases followed by executives selling shares and the use of excess capital to improve employee benefits. Conversely, shareholders argue that companies should return excess capital to them through dividends and by increasing the value of their shares through repurchases. They believe that critics overstate the increased use of repurchases and that existing regulations already protect against executives engaging in repurchases for nefarious purposes.

As policymakers evaluate the proposed SEC disclosure rule and other legislative and budgetary options to address share repurchases, BPC suggests that share repurchases should be evaluated under a dynamic approach that takes into consideration the best ways to ensure the most efficacious use of capital in the U.S. economy. When repurchases are analyzed not from an individual stakeholder's perspective, but rather from a macroeconomic perspective, the decision to prohibit or restrict their use may well lead to a different conclusion or at least be cause for more circumspection.

Academic studies evaluating the economic effects of repurchases have shown that they benefit a much larger group of beneficiaries than simply shareholders. When companies redeploy capital, it can increase savings, investment, and purchasing power. It can also be the catalyst for growth in small companies eager for capital. These companies are the leading job creators and are at the forefront of innovation. Repurchases affect far more than just the employees and shareholders of one company.

The question of whether a company undertakes share repurchases is ultimately made by the board of directors and management. Although oversight of these decisions is important the SEC should clearly indicate a market failure and adequately evaluate the full set of potential beneficiaries before finalizing rules that prohibit or restrict their use.

Introduction

In share repurchases (aka stock buybacks), the traditional view is that there is a dichotomy between the interests of a company's shareholders and its employees. Employee advocates argue that share repurchases inherently misuse capital and that profits should go instead to increased employee compensation, workforce development, training, and better benefits. Those arguing on behalf of shareholders say that returning excess capital to shareholders through dividends and share repurchases is the proper allocation of a return on their investments.

However, sometimes lost in the discussion are the economic benefits that repurchases provide to an expansive set of stakeholders and the U.S. economy. Too often the focus is on the actions of one company regarding the timing of the business decision to engage in repurchases and the reaction of certain shareholders to an increase in share value. Although reasonable oversight of a board and management's decisions regarding repurchases is important, there should also be an acknowledgment that boards have a fiduciary obligation to the company's long-term success. That long-term success is many times attributable to the proper allocation of capital investments. Those investments can have effects that far exceed a company's employees and shareholders.

When one looks at repurchases through a dynamic, instead of a static, approach, the benefits appear to have a much broader impact on society. Repurchases provide investors, including those beneficiaries with 401ks and pensions that are invested market wide, with additional financial resources that they otherwise would not have had. These additional resources may in turn be reinvested or saved, which can provide needed capital for small companies and others to facilitate innovation and growth. Further, this broader pool of beneficiaries will have the additional funds to make purchases that will in turn increase the demand for a broader set of products and services leading to further economic growth. Overall, the financial effects of this capital redeployment will produce benefits across society, including among employees, retirees, local communities, and small businesses.

Background on Share Repurchases

Share repurchases (“repurchases”) are a way for issuers (“companies”) to allocate excess capital after they have exhausted other investment opportunities, both internally and externally. Many consider repurchases as the most efficient use of excess capital. Repurchases as a strategic business decision began after the U.S. Securities and Exchange Commission (“SEC” or “Commission”) adopted Rule 10b-18 in 1982.¹ Prior to Rule 10b-18, companies were effectively prevented from engaging in repurchasing because of the liability provisions of the 1934 Securities Exchange Act, which prohibited business transactions that affect the price of stocks when the purpose is to ultimately sell or buy a company’s stock.² Rule 10b-18, on the other hand, created a legal “safe harbor” from those liability provisions, provided that companies follow certain disclosure provisions dealing with the timing, price, volume, and manner of repurchases.³ The purpose of the safe harbor provisions was to ensure that market participants were notified of a company’s intent to engage in repurchases and provide a record of those repurchases after they occurred.⁴ Rule 10b-18 provisions were *not* intended to protect those engaged in repurchases using either non-public information or that did so to manipulate the stock price.⁵ In short, the purpose was to allow companies, with oversight from their boards, to use repurchases as a legitimate business option.

As a result of their exponential growth among certain companies, SEC staff at the request of Congress evaluated the implications of share repurchases for companies.⁶ The SEC staff, along with leading academics, believed that to adequately evaluate repurchases, they needed to determine “net repurchases” by calculating their gross numbers by subtracting the number of new

1 SEC Release, “Purchases of Certain Equity Securities by the Issuer and Others; Adoption of Safe Harbor,” No. 34-19244 (Nov. 17, 1982) [47 FR 53333 (Nov. 26, 1982)] (“Safe Harbor Rule”); available at <https://archives.federalregister.gov/issue-slice/1982/11/26/53330-53341.pdf>

2 15 U.S.C. 78i(a)(2).

3 17 CFR 240.10b-18.

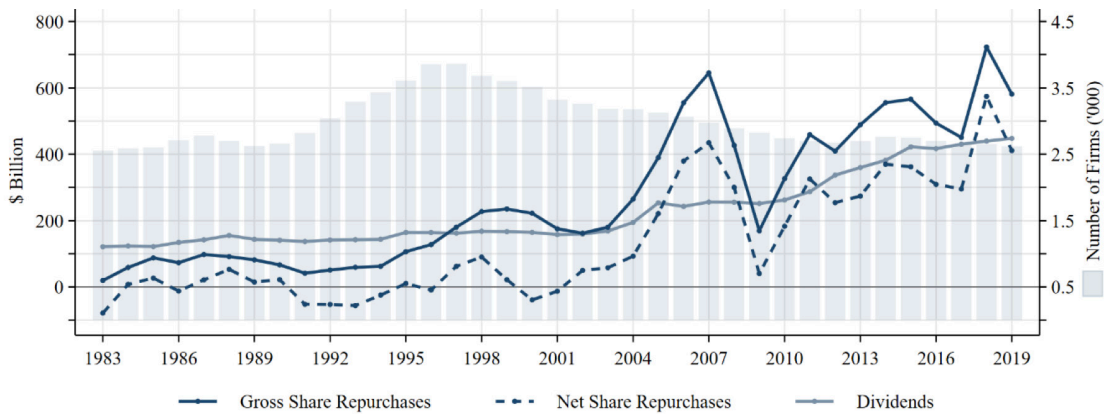
4 See SEC Release, “Purchases of Certain Equity Securities by the Issuer and Others,” No. 34-48766 (Nov. 10, 2003) (“2003 Amendments”); available at https://www.sec.gov/rules/final/33-8335.htm#P43_7089

5 See Safe Harbor Rule, *supra* note 1, and 2003 Amendments, *supra* note 4.

6 See U.S. Securities and Exchange Commission Staff Report, “Negative Net Equity Issuance,” (Dec. 23, 2020) (The report excluded financial firms) (“SEC 2020 Staff Report”); available at <https://www.sec.gov/files/negative-net-equity-issuance-dec-2020.pdf>

issuances from companies. At first glance net repurchases remained relatively steady in the first decades after Rule 10b-18 was implemented.⁷ As shown in Figure 1, SEC staff found that from 1983 through 2000 gross repurchases were effectively offset by new issuances from companies even though the amount of excess capital used to make gross repurchases increased from \$20 billion to more than \$700 billion by 2018.⁸

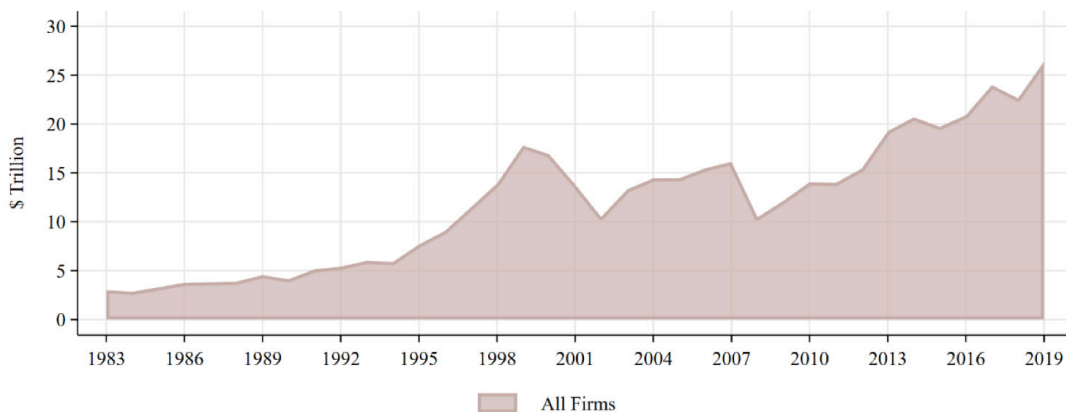
Figure 1: Repurchases and Dividends (1983 - 2019)



Source: 2020 SEC Staff Report (citing Compustat Fundamentals Annual, FRED GDP deflator).

In addition to evaluating repurchases, the SEC staff believed that an accurate assessment of repurchases had to account for the growth in market capitalization over the same period.⁹ As shown in Figure 2, the increase in repurchases has tracked closely to an increase in market capitalization, with one glaring exception just before the 2007-08 financial crisis.

Figure 2: Market Capitalization (1983 - 2019)



Source: 2020 SEC Staff Report (citing Compustat Fundamentals Annual, FRED GDP deflator).

⁷ *Id.* at 13.

⁸ *Id.*

⁹ *Id.* at 13-14.

Further, since the financial crisis, the SEC staff concluded that “repurchases as a percentage of aggregate market capitalization of public companies have remained stable at 2%.”¹⁰ Although the percentage of market capitalization has remained stable and is relatively low, the increased spending from \$20 billion to \$700 billion raised questions from regulators and elected officials about who was benefiting from this process. Critics say that there is a concerning correlation in the announcement of an intent to repurchase and the subsequent sale of shares by executives..

ADDITIONAL DISCLOSURES, RESTRICTIONS, AND TAXES

Some elected officials have called for greater disclosure from companies regarding their use of repurchases. Sens. Marco Rubio (R-FL) and Tammy Baldwin (D-WI) argued in a joint letter to the SEC that repurchases represented a shift in the capital markets toward “financial engineering” at the expense of investing in “trade and industry.”¹¹ They requested that the SEC require companies with excess capital to explain, in non-boilerplate language, why they use repurchases over other investments.¹² Sens. Rubio and Baldwin justified the increased disclosure on the capital markets enable companies to raise capital to make investments “for the good of investors, workers, communities, and, ultimately, our country as a whole.”¹³

In addition, President Biden’s proposed fiscal year 2023 budget would prohibit executives from selling their shares for three years after their company’s announced intention to implement a repurchase program.¹⁴ The president also included a 1% tax on repurchases in his “Build Back Better” plan and later included the provision in his FY2023 budget.¹⁵ In addition, for an investor to be

10 *Id.* at 13 (Companies have also increasingly used dividends as another way to return excess capital to shareholders.).

11 U.S. Sens. Marco Rubio (R-FL) and Tammy Baldwin (D-WI), joint letter to the SEC, “Share Repurchase Disclosure Modernization Rule,” (March 18, 2022) (Citing the SEC 2020 Staff report, though it is worth noting that the report indicated an *increase* in investment in intangible assets from roughly \$80 billion to \$400 billion over the time period referenced.); available at https://www.rubio.senate.gov/public/_cache/files/f0f14b27-443c-45d4-9569-c7467a1e3311/0520AD401CFBC75255A5000BED099FC9.03.18.22-rubio-baldwin-letter-comment-re-share-repurchase-disclosure.pdf

12 *Id.*

13 *Id.*

14 Alan Rappeport, “Budget Highlights: Biden Says \$5.8 Trillion Plan Shows His Priorities,” *The New York Times*, (Mar. 29, 2022) (“President Biden’s FY 2023 Budget”); available at <https://www.nytimes.com/live/2022/03/28/us/biden-budget-proposal#biden-billionaire-tax>

15 Andrew Ross Sorkin et al. “Biden Renews Pushback Against Stock Buybacks,” *The New York Times*, (Mar. 28, 2022); available at <https://www.nytimes.com/2022/03/28/>

able to take advantage of the current tax code’s capital gains tax rate benefit, the budget would increase the time a share had to be held from one to three years.¹⁶ The rationale for these policy proposals appears to rely heavily on former SEC Commissioner Robert Jackson’s 2018 speech where he explained his staff’s findings on the growing number of (gross) repurchases and sales by executives.¹⁷

SEC REPURCHASE DISCLOSURE RULE

In response to the criticism of repurchases, the SEC proposed a share repurchase disclosure rule on December 15, 2021.¹⁸ The Commission cited a number of concerns with repurchases, including “asymmetries [that] may exist” between companies, their executives, and other investors.¹⁹ It also cited concerns that the repurchase process is not transparent enough for investors.²⁰ The Commission said that some research showed that repurchases can “serve as a form of real earnings management” when they are connected to short-term objectives that result in management trying to “meet or beat consensus forecasts.”²¹ It also made reference to the inherent problem of compensation arrangements tied to share-price or earnings per share (“EPS”).²² Last, the Commission referenced

[business/dealbook/biden-stock-buybacks.html](https://www.sec.gov/news/speech/speech-jackson-061118)

16 See *President Biden’s FY 2023 Budget*, *supra* note 15.

17 SEC Commissioner Robert Jackson, “Stock Buybacks and Corporate Cashouts,” (Jun. 11, 2018) (Speech given to the to the Center for American Progress.) (“Jackson’s 2018 Speech”); available at <https://www.sec.gov/news/speech/speech-jackson-061118>

18 SEC Release “Share Repurchase Disclosure Modernization,” No. 34-93783 (Dec. 15, 2021 – *Conformed to the Federal Register Version*) (“Repurchase Disclosure Proposal”); available at <https://www.sec.gov/rules/proposed/2021/34-93783.pdf>

19 *Id.* at 10.

20 *Id.* at 8-9 (Citing Jackson’s 2018 Speech and the House testimony from Professor Jesse Fried.).

21 *Id.* at 7 (Citing footnote 78).

22 *Id.* at 42 (Citing footnote 80 “Cheng, Y., Harford, J., & Zhang, T., Bonus-Driven Repurchases, 50 J. Fin. & Quantitative Analysis 447 (2015) (finding that ‘when a CEO’s bonus is directly tied to earnings per share (EPS), his company is more likely to conduct a buyback.’); **but** also citing (Young, S. & Yang, J., Stock Repurchases and Executive Compensation Contract Design: The Role of Earnings Per Share Performance Conditions, 86 Acct. Rev. 703–733 (2011) that found (“incentives would be weaker to the extent executive compensation plans and board committees that address executive compensation account for how repurchases would affect compensation targets and the value of incentive-based compensation ... [a] different study documented a link between EPS targets and repurchases but did *not* find evidence of a negative effects on shareholders”); also cited the 2020 SEC Staff Report that found (“... based on a review of compensation disclosures in proxy statements for a sample of 50 firms that repurchased the most stock in 2018 and 2019, “82% of the firms reviewed either did not have EPS-linked compensation targets or had EPS targets but their board considered the impact of repurchases when determining whether performance targets were met or in setting the targets”).

former SEC Commissioner Jackson’s 2018 speech when it found that executives can use repurchases to “cash-in” instead of investing in workers.²³

In response to these concerns, the SEC proposed requiring more-frequent disclosures of repurchase data.²⁴ Under the current regulation’s safe harbor provisions, companies must abide by guidelines that limit the timing, manner, price, and volume so as to minimize the impact on the public market.²⁵ Companies must also file repurchase data quarterly, including compiling a table with month-to-month statistics on the number of shares purchased, the average price, and the maximum number of shares or dollar amount in a company’s purchase program.²⁶ In addition to the existing disclosure framework, the Commission proposed to enhance the disclosure by requiring companies to explain their “rationale or objective” for engaging in repurchases, and that they report any actual purchases within a day, instead of on a quarterly basis along with their other quarterly financial data.²⁷

As the increased use of repurchases drew the attention of policymakers, political lines formed consistent with the dichotomy between shareholders and employees. This resulted in a number of proposals that were intended to tilt the scale in favor of employees.

Disburse to Employees

It is certainly understandable that policymakers are interested in how successful companies allocate profits. This likely stems from the historical issue of debating pay ratios between senior executives and employees. More recently, it has become an established position to argue that repurchases divert capital away from investing in workers and other opportunities in order to enrich executives and wealthy shareholders. As a result, efforts are growing to condition repurchases on employees receiving better pay, more benefits, and greater control of the company. The correlation is based on the fact that when companies announce their intent to engage in repurchasing, the market typically

23 Repurchase Disclosure Proposal, *supra* note 19, at 8 (Citing Jackson’s 2018 Speech); also citing Thomas Frank, CNBC, “Elizabeth Warren rips stock buybacks as ‘nothing but paper manipulation’” (Mar. 2, 2021); available at <https://www.cnbc.com/2021/03/02/elizabeth-warren-rips-stock-buybacks-as-nothing-but-paper-manipulation.html>

24 Repurchase Disclosure Proposal, *supra* note 19.

25 See Safe Harbor Rule, *supra* note 1.

26 See Repurchase Disclosure Proposal, *supra* note 19.

27 *Id.* (Note: the 2003 Amendments extended the reporting requirement from a monthly to a quarterly basis to be consistent with the other financial data disclosed.).

responds positively, and the company's shares increase in value. Although the SEC regulates this practice, executives, as well as other shareholders, can and do sell some of their shares as a result of the higher value. However, some critics maintain that the repurchase announcement is a way for executives to work the financial system for their own personal gain regardless of current SEC restrictions.²⁸

PROHIBITION AND SAFE HARBOR REMOVAL

A politically instinctive reaction to a perceived abuse of process is to enact a prohibition.²⁹ In arguing for an outright ban, some critics say that repurchases are “virtually unregulated,” have a potential for market manipulation, and face “no meaningful” restrictions that could prevent executives from using them for personal gain.³⁰ Further, repurchases are “one of the drivers of [an] imbalanced economy in which corporate profits and shareholder payments continue to grow while wages for typical workers stay flat.”³¹ In lieu of a prohibition, some members of Congress have called for workers to have more say in board decisions, such as mandating that they are able to elect up to one-third of a company's board of directors.³² The assumption is that if a workers had greater representation, a board would chose to spend more of the excess capital on the workforce instead of shareholders.

Repurchases are “one of the drivers of [an] imbalanced economy in which corporate profits and shareholder payments continue to grow while wages for typical workers stay flat.”

Lenore Palladino's Congressional Testimony

28 See William Lazonick, “Clinton's proposals on stock buybacks don't go far enough,” *Harv. Bus. Rev.* (Repurchases harm workers because it diverts money toward shareholders instead.) (Aug. 11, 2015); available at <https://hbr.org/2015/08/clintons-proposals-on-stock-buybacks-dont-go-far-enough>

29 “Examining Corporate Priorities: The Impact of Stock Buybacks on Workers, Communities, and Investors” Hearing Before H. Fin. Serv. Subcomm. on Inv. Protection, Entr. and Cap. Mkts., 116th Cong. (2019-2020) (“2019 Congressional Hearing”) (Testimony of Lenore Palladino, Sr. Economist and Counsel, Roosevelt Inst.); available at <https://financialservices.house.gov/events/eventsingle.aspx?EventID=404482>

30 *Id.*

31 *Id.*

32 H.R. 3355 “Reward Work Act,” 116th Cong. (2019-2020) (Introduced by Congressman Jesus Garcia (D-IL) and proposes to mandate that 1/3 of directors to be voted on by employees.); available at <https://www.congress.gov/bill/116th-congress/house-bill/3355>

Others, such as former SEC Commissioner Jackson, have argued that the “unprecedented volume” of (gross) repurchases itself requires a call to action.³³ He cites the correlation between repurchase announcements and executives' ultimate sale of shares, which by his estimate occurs about 50% of the time.³⁴ Jackson says that on “too many occasions, companies doing buybacks have failed to make the long-term investments in innovation or their workforce.”³⁵ As a result, he argues, the SEC should rescind the 1982 safe harbor provisions.³⁶ Presumably without the liability protections afforded under the safe harbor, companies would go back to a pre-1982 mentality, and repurchases would greatly decrease.

ADJUST TAX BENEFITS FOR WORKERS

Other proposals focus more on tax implications and waiting periods. Although some of the tax-related arguments reference the Tax Cuts and Jobs Act of 2017 (“2017 tax cut”)³⁷ as a rationale for proposed changes, most policy proposals are based on the increasing use of repurchases since 1982.³⁸ However, the 2017 tax cut provided for a one-time tax waiver to repatriate excess capital held overseas.³⁹ As a result, companies took advantage of the tax provision and moved some of their overseas capital back to the United States. Critics said that companies “promised” to use the repatriated excess capital to invest more heavily in workers, but instead used the capital for repurchases. Sens. Sherrod Brown (D-OH), Chairman of the Senate Banking Committee, and Ron Wyden, Chairman of the Senate Finance Committee, proposed the Stock Buyback Accountability Act, which would impose a 2% tax on repurchases over \$1 million, unless the repurchase funded an employee pension plan or equivalent.⁴⁰

33 Jackson’s 2018 Speech, *supra* note 18.

34 *Id.*

35 *Id.*

36 *Id.*

37 See Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017) (“2017 Tax Cut”).

38 U.S. Senators Sherrod Brown (D-OH) and Ron Wyden (D-OR) referenced the 2017 Tax Cut as a reason from imposing the tax. U.S. Senator Charles Schumer (D-NY) also referenced the tax cut for his opposition to the use of repurchases, and former SEC Commissioner Robert Jackson has also indicated in his 2018 speech that the tax cut motivated him to look at repurchases.

39 See 2017 Tax Cut, *supra* note 38.

40 See S.2758 “Stock Buyback Accountability Act of 2021,” (117th Congress 2021-2022); available at https://www.brown.senate.gov/imo/media/doc/stock_buy_back_accountability_act_bill_text.pdf

MANDATE ADDITIONAL BENEFITS TO WORKERS

In addition, other elected officials have proposed to tie repurchases directly to a worker benefit. Sens. Charles Schumer (D-NY) and Bernie Sanders (D-VT), in a 2019 New York Times op-ed, wrote that companies were devoting too much of their profits to dividends and repurchases.⁴¹ They argued that because repurchases do not benefit most Americans or employees, the excess capital should be used for “R&D, equipment, higher wages, paid medical leave, retirement benefits and worker retraining” instead of giving the profits to the “wealthiest 10 percent.”⁴² As a result, they proposed a prohibition on repurchases unless a company invests in its workforce by increasing wages to “at least \$15 an hour, providing seven days of paid sick leave, and offering decent pensions and more reliable health benefits.”⁴³ In a similar attempt to tie repurchases to a mandated benefit for workers, Sen. Sherrod Brown (D-OH) introduced legislation to mandate a \$1 “worker dividend” to be paid to employees for every \$1 million of excess capital allocated to repurchases.⁴⁴

[E]xcess capital should be used for “R&D, equipment, higher wages, paid medical leave, retirement benefits and worker retraining” instead of giving it to the “wealthiest 10 percent.”

Sens. Charles Schumer (D-NY) and Bernie Sanders (D-VT)

The common theme in each of the proposed policy changes involves the perception that as corporate profits increase, shareholders are the ones who reap the financial benefits, while employees’ wages, benefits, and training opportunities remain stagnant. The perceived inequality of capital redeployment is amplified when, according to a static analysis, the immediate financial benefit goes to those with the most invested, i.e., the “wealthiest 10%.” However, the dichotomy between employees and shareholders becomes less stark when one analyzes repurchases through a dynamic approach that accounts for a broader set of beneficiaries.

41 U.S. Senators Chuck Schumer (D-NY) & Bernie Sanders (D-VT), “Schumer and Sanders: Limit Corporate Stock Buybacks,” NYT Op-ed, (Feb.3, 2019); available at <https://www.nytimes.com/2019/02/03/opinion/chuck-schumer-bernie-sanders.html>

42 *Id.*

43 *Id.*

44 S.2391 “Stock Buyback Reform and Worker Dividend Act of 2019, 116th Cong. (2019-2020); available at [https://www.congress.gov/bill/116th-congress/senate-bill/2391#:~:text=Introduced%20in%20Senate%20\(07%2F31%2F2019\)&text=This%20bill%20revises%20requirements%20related,executive%20employees%20in%20certain%20circumstances.](https://www.congress.gov/bill/116th-congress/senate-bill/2391#:~:text=Introduced%20in%20Senate%20(07%2F31%2F2019)&text=This%20bill%20revises%20requirements%20related,executive%20employees%20in%20certain%20circumstances.)

Return to Shareholders

From the shareholder perspective, investments are presumed to be made with the intent of a future return on investment. That return is either through higher value in shares held or through the disbursement of dividends. In their desire for a return on investment, shareholders prudently rely on the fiduciary duty of the board and management to make decisions in the best interest of their investment, i.e., the company.

INCREASE IN SHARE VALUE

In looking at business decisions that increase the value of one's investment, investors must consider both the short- and long-term effects. When it comes to repurchases, studies consistently show that the value of the shares increases after repurchasing announcements and that the higher value is not merely a result of the announcement itself.⁴⁵ The argument is that most announcements are a result of a company's belief that its stock is undervalued. The market typically sees repurchase announcements as a positive sign, and the stock price rises accordingly.⁴⁶ Here the studies seem to contradict former Commissioner Jackson who, in referencing a "price bump," inferred that the announcement itself was merely the cause and not the underlying rationale for engaging in the repurchase.⁴⁷ Multiple studies have shown that the vast majority of announcements are a result of management, with oversight from the board, concluding the value of the stock is in fact undervalued.⁴⁸ Further, little empirical evidence supports the claim that executives use announcements for short-term gain.⁴⁹ In fact, studies have found that "claims of opportunistic or manipulative use of share repurchases by insiders are not supported by economic analysis."⁵⁰ Other studies show that executives are less likely to even sell their individual shares when companies repurchase shares, and they found no evidence of systematic misuse of the repurchase process at the expense of shareholder value.⁵¹

45 See SEC 2020 Staff Report, *supra* note 6.

46 *Id.*

47 See Jackson's 2018 Speech, *supra* note 18.

48 Jesse Fried & Charles Wang, "Are Buybacks Really Shortchanging Investment," Harv. Bus. Rev., pp. 88-95, (March-April 2018 issue) ("Fried & Wang 2018"); available at <https://hbr.org/2018/03/are-buybacks-really-shortchanging-investment>

49 Craig Lewis & Josh White, "Corporate Liquidity Provision and Share Repurchase Programs – Addendum") report Commissioned by the U.S. Chamber of Commerce, p. 4 (Mar. 22, 2022) (Quoting Dittman) ("2022 Addendum"); available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2022/04/CCMC_StockBuyback_Addendum_v3.pdf

50 *Id.* ("There is no evidence for the notion that the CEO uses buyback announcements to create short-term private benefits.").

51 Ingolf Dittmann et al. "The impact of the corporate calendar on the timing of share repurchases and equity grants," pp. 34-5 (Jan. 21, 2022); available at

There are also claims that repurchases are used to reach earnings per share targets. However, the SEC staff found that “most repurchase activity does not represent an effort to artificially inflate stock prices or influence the value of option-based or EPS-linked compensation.”⁵² To the extent that these market manipulations occur, critics argue that investors are typically able to discern these actions through the existing regulatory framework.⁵³ As indicated at a 2019 Congressional hearing, the financial services industry has models that can determine when a company’s decision to repurchase will not have long-term value and instead focuses on short-term metrics.⁵⁴ Furthermore, the use of short-term metrics or “financial engineering” occurs in less than 1 percent of the cases.⁵⁵

Therefore, from shareholders’ perspective, provided that the decision to engage in repurchases is prudent and increases the value of their shares, the majority are likely to support the decision to repurchase.

RESPONSE TO RESTRICTIONS

Shareholders will also likely reject the posited rationale for the SEC policy changes, arguing that, without calculating net repurchases, gross repurchases are greatly exaggerated.⁵⁶ The increased use of repurchases seems to be one of the foundational arguments for proposed action. Next is the claim that companies are diverting excess capital from investments. However, studies show that “repurchases are made out of the residual cash flow after investment spending.”⁵⁷ Repurchasing decisions are typically made after the board of directors

https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID4073519_code1038875.pdf?abstractid=4004098&mirid=1

52 SEC 2020 Staff Report, *supra* note 6, at 45.

53 2022 Addendum, *supra* note 50, at 11 (Response to claims that executive misuse repurchases to achieve EPS targets.).

54 2019 Congressional Hearing, *supra* note 30, (Testimony of Derik Coffey, CFA, Portfolio Specialist, Channing Capital Management.).

55 *Id.*

56 2019 Congressional Hearing, *supra* note 30, (Testimony of Professor Jesse Fried); also 2020 SEC Staff Report, *supra* note 6; also Clifford Asness et al., “Buyback Derangement Syndrome,” *Journal of Portfolio Management* (Dec. 8, 2017); available at https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID3130896_code1770881.pdf?abstractid=3082460&mirid=1

57 Alon Brav et al., “Payout policy in the 21st Century,” *Journal of Financial Economics*, Vol. 77, Issue 3, pages 483-527 (Sep. 2005) (Survey of 384 financial executives including 23 in-depth interviews.); available at <https://www.sciencedirect.com/science/article/abs/pii/S0304405X05000528#>; see also Amy K. Dittmar, “Why Do Firms Repurchase Stock,” *The Journal of Business*, Vol. 73, No. 3, pages 331-355 (Jul. 2000); available at <https://www.jstor.org/stable/10.1086/209646?seq=1>; see also Clifford Asness, Todd Hazelkorn, and Scott Richardson, “Buyback Derangement Syndrome,” *Journal of Portfolio Management* (Dec. 8, 2017); available at <https://papers.ssrn.com/sol3/Delivery.cfm/>

has determined that other investment opportunities—such as R&D, capital expenditures, mergers and acquisitions, and work-force-related issues—have been adequately funded.⁵⁸ Further, peer-reviewed research has found that “net shareholder payouts don’t appear to impair investment capacity or firms’ ability to pay workers ... and total capital expenditures as well as R&D expenditures by public firms are both at the highest level ever.”⁵⁹

“[N]et shareholder payouts don’t appear to impair investment capacity or firms’ ability to pay workers ... and total capital expenditures as well as R&D expenditures by public firms are both at the highest level ever.”

Professors Jesse Fried & Charles Wang

DILUTION AND TAX BENEFIT

Repurchases have an additional benefit besides increasing stock value: They help to alleviate the problem of share dilution when companies grant stocks or issue stock options. Share value often falls when a company issues new stock or when those with stock options exercise the options. Dilution becomes even more of an issue with the increased use of equity-based compensation.

Shareholders also receive the benefit of increased share value without having to pay additional taxes. Unlike dividend distributions that are taxed at standard income tax rates, increases in share value are not taxed, and if the shares are held for longer than one year, selling them will result in a capital gains tax of no more than 15% (and may be lower for those with lower income).⁶⁰ Tax policy restrictions on repurchases are also concerning to shareholders. As previously discussed, arguments to impose tax-related measures appear to be, in part, a response to the 2017 tax reform.⁶¹ Although repurchases rose in 2018, studies have shown that companies also gave bonuses, raised wages, increased benefits, and hired more workers.⁶²

[SSRN_ID3130896_code1770881.pdf?abstractid=3082460&mirid=1](#)

58 2019 Congressional Hearing, *supra* note 30, (Testimony of Derik Coffey).

59 See Jesse Fried & Charles Wang “Democratic senators and the buyback boogeyman,” Harv. Law School Forum on Corp. Gov. (Mar. 13, 2019); available at <https://corpgov.law.harvard.edu/2019/03/13/democratic-senators-and-the-buyback-boogeyman/>

60 IRS, “Capital Gain Tax Rates” (Most individual have no higher than 15% capital gain tax and it can be as low as 0% if your taxable income is less than \$40,400 or \$80,080 if jointly filing.); available at <https://www.irs.gov/taxtopics/tc409>

61 Jackson’s 2018 Speech, *supra* note 18, (Former SEC Commissioner Robert Jackson’s 2018 speech has been referenced by multiple sources as the rationale to prohibit or restrict share repurchases.).

62 Paul Bedard “Boom: 164 companies give bonuses, lower fees to millions, citing Trump tax cuts,” Washington Examiner, (Jan. 14, 2018); available at <https://www>

MARKET FAILURE AND REGULATORY COSTS

Another cost that shareholders will ultimately bear is that of increased regulation through the SEC's enhanced disclosure mandates. Reasonable investors are entitled to material information with which to make sound investment decisions, but increased disclosure must be based on a "market failure." Here, the SEC indicated that more frequent disclosures and more detailed explanation of repurchases were "important" to investors. However, some argue that the benefits have not been adequately explained and that they fail to outweigh the additional costs of the proposed enhanced disclosure requirements. In testimony before Congress, Professor and former SEC economist Craig Lewis stressed that when promulgating regulations, the Commission must identify the market failure it is intending to address.⁶³ After the release of the proposed rule, Lewis indicated that he believed that the SEC's economic analysis failed to adequately identify a market failure upon which to base the rule.⁶⁴ Specifically, he argued that the SEC has ignored "empirical evidence refuting the notion that repurchases necessarily harm investment and employees."⁶⁵ If the rationale for the enhanced disclosure of repurchase data is based on a misuse of authority for personal gain, the Commission should explain how the existing regulatory framework does not protect investors, and then show how the proposed rules would protect investors, shareholders, and employees.

From a shareholder's perspective, repurchases increase share value, mitigate dilution, and produce a tax benefit. Under a static analysis, support for repurchases is certainly understandable. However, from a dynamic analysis, shareholders must realize that repurchases are not always in a company's best interest. The management and board must decide about how best to reallocate excess capital. In some cases, additional investments to improve employee morale and retention, as well as enhance retirement options, may be the most prudent use of capital.

[washingtonexaminer.com/boom-164-companies-give-bonuses-lower-fees-to-millions-citing-trump-tax-cuts](https://www.washingtonexaminer.com/boom-164-companies-give-bonuses-lower-fees-to-millions-citing-trump-tax-cuts) ; see also U.S. Chamber of Commerce, "Tax Reform: Unleashing American Growth," (Oct. 15, 2018); available at <https://www.uschamber.com/taxes/tax-reform-unleashing-american-growth>

63 2019 Congressional Hearing, *supra* note 30, (Testimony of Craig Lewis, Professor of Finance and Law, Vanderbilt Univ. on Oct. 17, 2019.) (While at the time of the hearing the SEC had not issued the 2022 proposed rule, the hearing was based on a draft billing mandating that the SEC require more details on a company's repurchase plan.).

64 See 2022 Addendum, *supra* note 50.

65 *Id* at 4.

Impact on a Broader Group of Beneficiaries

Seemingly since the 2019 Business Roundtable’s restatement of corporations’ role in society, much of Wall Street and many policymakers in Washington have focused on how stakeholder capitalism would replace the previously dominate view that companies exist to serve shareholders.⁶⁶ Even before the restatement, most agreed that in serving shareholders, well-run corporations had to consistently focus on their customers, employees, suppliers, communities, and shareholders if they were to remain profitable. However, in a static analysis, one of the inherent problems with assessing companies’ performance under a stakeholder-based system is how to effectively weigh the varying interests of individual stakeholders. Indeed, societal benefits beyond stakeholders are seldom discussed under this system. Instead of focusing on and comparing individual stakeholders, a dynamic approach allows a full examination of potential societal beneficiaries.

BENEFIT FOR EMPLOYEES

Understanding how repurchases benefit both shareholders and the broader economy is important in discussions about prohibiting or restricting its use. However, what is seldom discussed is its positive impact on workers.

Restricting repurchases may have unintended consequences for workers with equity compensation and pension plans. Traditionally thought of as a perk for executives, equity compensation plans are becoming more common.⁶⁷ It is also well established that repurchases have become an effective way to offset dilution of both employee compensation and pension plans.⁶⁸ Therefore, prohibiting or restricting repurchases may unintentionally harm the very workers many policymakers are hoping to help.

66 Business Roundtable, “Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy That Serves All Americans’” (Aug. 19, 2019); available at <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>

67 Boris Groysberg et al, “Compensation Packages That Actually Drive Performance,” Harv. Bus. Rev (Jan-Feb 2021); available at <https://hbr.org/2021/01/compensation-packages-that-actually-drive-performance>

68 See SEC 2020 Staff Report, *supra* note 6, at 3; also see Craig Lewis & Josh White, “Corporate Liquidity Provision and Share Repurchase Programs,” report Commissioned by the U.S. Chamber of Commerce, p. 13 (Sep. 24, 2021) (“U.S. Chamber 2021 Report”); available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/09/CCMC_Stock-Buybacks_WhitePaper_10.2.21.pdf

In addition, according to research by Professors Fried and Wang, almost “50% of total equity issuances are to firms’ own employees, with the vast majority (85%) of those shares going to nonexecutive employees.”⁶⁹ These findings stand in stark contrast to the claims that executives predominantly gain from repurchases at the expense of workers. Excess capital that is reinvested in non-S&P 500 companies can be of a significant benefit to the 80% of the workforce that is employed at these other companies.

“50% of total equity issuances are to firms’ own employees, with the vast majority (85%) of those shares going to nonexecutive employees.”

Professors Jesse Fried and Charles Wang

In addition to the economic benefits that accrue to 80% of workers at non-S&P 500 companies, a 2018 Gallup Poll found that “50% of Americans are invested in the stock market, and 4 in 10 dollars invested in the stock market are held in retirement funds.”⁷⁰ Those with defined contribution retirement accounts, such as 401(k)s, are not the only ones who benefit—workers’ pension plans benefit as well. This last point is worth stressing, given that many workers who are not invested in the market come to rely on their pension plan’s solvency at retirement.⁷¹

EFFICIENT USE OF CAPITAL

Many academics and economists consider repurchases to be an efficient and effective use of capital. Before enactment of the 1982 safe harbor provisions, excess capital was not always used efficaciously. As Professor Alex Edmans of the London Business School stated in opposing restrictions on repurchases, in the 1970s “CEOs simply wasted free cash on building empires ... rather than paying it out.”⁷² Further, in reviewing academic research, the SEC staff found that repurchases can “alleviate concerns that managers will spend [excess] cash in sub-optimal ways.”⁷³ The U.S. Chamber of Commerce recently cited substantial

69 Fried & Wang 2018, *supra* note 49; *see also* Edward Yardeni & Joseph Abbot, “Don’t Blame Buybacks for Boosting Stock Prices—Or Promoting Inequality,” *Barron’s* (Aug. 23, 2019) (“Buybacks benefit many workers who get some of their compensation in stock—a group not limited to the top brass.”); *available at* <https://www.barrons.com/articles/banning-stock-buybacks-is-a-bad-idea-51566583676>

70 Tom Quaadman, “3 Things You Need to Know About Stock Buybacks,” U.S. Chamber of Commerce (Oct. 28, 2021); *available at* <https://www.uschamber.com/finance/3-things-you-need-to-know-about-stock-buybacks>

71 2019 Congressional Hearing, *supra* note 30, (Testimony of Professor Craig Lewis).

72 Alex Edmans, professor of finance at London Business School, “The Case for Stock Buybacks,” *Harv. Bus. Rev.*, (Sep. 15, 2017); *available at* <https://hbr.org/2017/09/the-case-for-stock-buybacks>

73 SEC 2020 Staff Report, *supra* note 6, at 28.

evidence that “some managers would use surplus cash for projects or acquisitions that were not in the best economic interest of the company.”⁷⁴ As Warren Buffett, the longtime CEO of Berkshire Hathaway, has repeatedly stated, “Buybacks are better than most acquisitions” when done for the right reasons.⁷⁵ In short, companies should not overspend or spend inefficiently on investments. Understanding the best use of excess capital is vital to effectively managing growth and long-term value for companies.

CAPITAL FOR OTHER INVESTMENTS

Repurchases also have a rather unique quality of facilitating business growth throughout the economy. Excess capital that goes to repurchases is disbursed to companies that need an infusion of capital.⁷⁶ Understandably, much of the criticism of repurchases focuses on the implications to companies included in the S&P 500. However, those listed companies represent only 20% of the workforce and 50% of the profits.⁷⁷ As Professors Jesse Fried and Charles Wang argue, to properly assess how repurchases by S&P 500 companies affect the broader economy, one must also factor how repurchases affect *all* companies.⁷⁸ They say that criticisms focusing solely on the “payouts” of S&P 500 companies misunderstand capital flows between companies and their shareholders, and they also exaggerate the S&P 500’s role in the nation’s economy.⁷⁹ In examining capital flows to non-S&P 500 companies, Fried and Wang found that those companies were “net importers of equity capital” and that they accounted for more than 10%, or more than \$407 billion over 10 years, of excess capital from S&P 500 companies.⁸⁰ Capital flows to smaller companies are not only important because of the high percentage of workers they support, but also because so much innovation happens in these types of companies.⁸¹ In addition to the innovation, these smaller companies account for the vast majority of jobs created and grow at a faster rate than larger companies.⁸² Repurchases result in shareholders using the capital “to invest in smaller public and private firms,

74 U.S. Chamber of Commerce, *Blog*, “How Stock Buybacks Promote Efficiency and Strong Capital Markets,” (Apr. 6, 2022); available at https://www.uschamber.com/finance/corporate-governance/quick-take-how-stock-buybacks-promote-efficiency-and-strong-capital-markets?utm_medium=Email&utm_source=SFMC&utm_campaign=&utm_content=; see also 2022 Addendum, *supra* note 50.

75 Eric Rosenbaum, “Warren Buffett explains the enduring power of stock buybacks for long-term investors,” CNBC, (Sep. 1, 2018); available at <https://www.cnbc.com/2018/08/31/warren-buffett-explains-the-enduring-power-of-stock-buybacks.html>

76 2019 Congressional Hearing, *supra* note 30, (Testimony of Professor Jesse Fried).

77 Fried & Wang 2018, *supra* note 48.

78 *Id.*

79 *Id.*

80 *Id.*

81 *Id.*

82 *Id.*

supporting innovation and job growth throughout the economy.”⁸³

Repurchases result in shareholders using the capital “to invest in smaller public and private firms, supporting innovation and job growth throughout the economy.”

Professors Jesse Fried and Charles Wang

In addition to supporting smaller companies, capital from repurchases was “reinvested in firms raising capital through IPOs and in nonpublic businesses backed by venture capital and private equity.” These companies are responsible for 70% of the U.S. workforce and almost 50% of profits; they also are leaders in job growth and critical innovation, including important discoveries in pharmaceuticals and information technology.⁸⁴

Furthermore, the influx of cash from sold shares after a repurchase allows investors to use those funds for goods and services in the broader economy. Moreover, the reinvested capital may well have a greater value than investment opportunities at the companies. According to Professor Craig Lewis’s findings, “The reallocation of capital into consumption and other investments potentially redirects it to activities that have higher value than incremental investments available to firms.”⁸⁵ Further, using repurchases does not divert money away from community investments because “investors in general tend to invest in local companies.”⁸⁶ As former Goldman Sachs CEO Lloyd Blankfein tweeted, the capital from the repurchases “gets reinvested in higher growth businesses that boost the economy and jobs.”⁸⁷ Blankfein expressed frustration at the claims that repurchases divert money from investments. Companies, he said, used to be encouraged to redeploy excess capital in that way.⁸⁸

As policymakers debate various proposals to prohibit or restrict repurchases, the positive effects of repurchases on a full set of beneficiaries should be an important part of that discussion.

83 *Id.*

84 *Id.*

85 Craig Lewis “The economics of share repurchase programs,” Report commissioned by the Association of Mature American Citizens (p.2) (Feb. 2019); available at <https://amac.us/wp-content/uploads/2019/02/The-Economics-of-Share-Repurchase-Programs1.pdf>.

86 U.S. Chamber 2021 Report, *supra* note 69, at 17 (Citing Coval, J. D., & Moskowitz, T. J., “Home bias at home: Local equity preference in domestic portfolios,” *Journal of Finance*, 54(6), 2045–2073, (1999).).

87 Liz Moyer, “Bernie Sanders and Lloyd Blankfein get in Twitter fight over stock buybacks,” CNBC (Feb. 5, 2019) (Lloyd Blankfein responded via a text to a joint-op-ed in the NYT by Senators Bernie Sanders (D-VT) and Charles Schumer (D-NY) in which they claim that repurchases divert capital, from workers and other investments.); available at <https://www.cnn.com/2019/02/05/blankfein-hits-back-at-senators-over-stock-buybacks-the-money-doesnt-vanish.html>

88 *Id.*

Conclusion

One of the biggest concerns in the increased use of repurchases is the impact on employees. It is understandable that policymakers focus on the perceived inequality, given that stock buybacks are seen in static terms as a vehicle that benefits only shareholders. However, employees also benefit from repurchases through the increased value of their retirement accounts, equity-based compensation plans, and a growing job market in other companies that use increased capital to expand. Beyond employees, repurchases provide multiple benefits to shareholders, including sustained increased share value, tax benefits, and protection against dilution.

The broader economy and society also benefit from repurchases through an influx of capital to smaller companies, which leads to job creation and facilitates innovation. Through this dynamic analysis, repurchases can have a positive impact on an individual beneficiary's savings, investments, purchasing power, and job opportunities. The effects of capital redeployment can ultimately help numerous members of society, including employees, shareholders, retirees, local communities, and other growing businesses.

Although share repurchases may not always be the best option for an individual company, understanding their broader impact is vitally important. Unfortunately, when policymakers debate which stakeholders are more deserving of excess capital, they undermine the duty of management and boards to effectively operate their companies. Instead of focusing on individual stakeholders and the benefits they receive, policymakers should craft policies that recognize the importance of repurchases to society at large.



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