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

Share Repurchase Disclosure Modernization, File No. S7-21-21

Dear Ms. Countryman:

Thank you for inviting comments on the SEC's proposal to modernize the disclosure of share repurchases. I am a Professor of Finance at London Business School, and was previously a tenured professor at Wharton; I am the co-author of "Principles of Corporate Finance" (with Brealey, Myers, and Allen), a leading finance textbook. I focus on corporate governance, in particular the use of rigorous academic research to guide policy. I have written extensively on share repurchases, and importantly am not ideologically against (or for) repurchases; my writings aim to be based on evidence and as a result they acknowledge both sides of the debate. For example:

- My article "The Case for Stock Buybacks"[1] in the *Harvard Business Review* and "Should the US Rein In Share Buybacks?"[2] in the *Financial Times* (a debate in which I took the "No" side) highlights the many positive uses of share buybacks.
- My book, "Grow the Pie"[3], has an entire chapter (Chapter 7) on the benefits of buybacks and why they should not be restricted.
- The UK government commissioned me (joint with PwC) to conduct a study into the alleged misuse of share buybacks.[4] We did not find a single case in which share buybacks were used to inflate executive pay.
- On the other hand, Edmans, Fang, and Huang ("EFH", forthcoming in the *Journal of Accounting Research* and cited by S7-21-21)[5] suggests that CEOs' short-term concerns may encourage them to undertake buybacks even if doing so is not beneficial to long-term firm value.

[1] Edmans, Alex (2017): "The Case for Stock Buybacks." *Harvard Business Review*, September 15, 2017.
[2] Palladino, Lenore and Alex Edmans (2018): "Should the US Rein In Share Buybacks?" *Financial Times*, December 9, 2018.
[3] Edmans, Alex (2020): "Grow the Pie: How Great Companies Deliver Both Purpose and Profit." Cambridge University Press.
[4] PwC (2019): "Share Repurchases, Executive Pay, and Investment." Report to Department for Business, Energy, and Industrial Strategy. BEIS Research Paper 2019/011.
[5] Edmans, Alex, Vivian W. Fang, and Allen Huang (2022): "The Long-Term Consequences of Short-Term Incentives." *Journal of Accounting Research* 60, 1007-1046.

My pro-buyback writings have been referenced by comment letters opposing the SEC's proposal. In addition, I am not ideologically pro-transparency. For example, my *Wall Street Journal* article "How the SEC's Swaps Proposal Could Choke Off Shareholder Activism"[6] highlights concerns with the proposal to increase transparency of security-based swaps, and Edmans, Heinle, and Huang (2016, *Review of Finance*)[7] highlights how disclosure can harm the real economy – even if it helps markets function more efficiently.

However, despite generally being pro-buybacks, and recognizing the costs of transparency, I believe that one of the SEC's proposals is justified – requiring an issuer 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". My comments will focus exclusively on this proposal.

The Link Between Share Buybacks and Stock Sales

EFH have the following findings that are relevant to the SEC's proposal:

- Vesting equity is significantly positively associated with share buybacks – a CEO is more likely to buy back stock when she has more equity vesting. We use vesting equity as a measure of short-term concerns because it is determined by equity grants made several years prior, and is thus exogenous to other factors that may determine buybacks, such as current undervaluation. To validate this measure, we find that vesting equity is significantly correlated with equity sales.
- We acknowledge that short-term concerns need not lead to myopic buybacks; instead, they may lead to efficient buybacks. For example, if CEOs generally overinvest, short-term concerns can encourage them to "get their act together", scrap unprofitable projects and return the cash to shareholders. We thus study the long-term returns associated with buybacks, and find that they are significantly decreasing in the amount of vesting equity.
- To study whether CEOs benefit from the short-term stock price increase associated with buyback announcements, we explore whether CEOs concentrate their equity sales shortly after repurchases in months in which they have equity vesting. We find that CEOs sell significantly more equity shortly after repurchase announcements than before, consistent with an independent analysis by former SEC Commissioner Robert Jackson, Jr.[8] Thus, CEOs are doing the opposite with their own money (selling stock) to what they are doing with company money (buying stock).
    - Such stock sales are inconsistent with one common justification of buybacks, which is that the stock is undervalued.
    - One might argue that stock sales are inconsistent with a second common justification – buybacks are the best possible use of cash once all positive investment projects have been undertaken. Critics may argue that, if the firm is taking value-maximizing decisions, the CEO should want to remain invested in the firms. However, the CEO may have liquidity needs or diversification motives, which prompt her to sell even if she is running the company well. Indeed, the SEC's proposal is not to ban stock sales surrounding buybacks, since they may be innocuous, but to mandate their disclosure so that investors know to particularly scrutinize such buybacks and ensure they are truly creating value.

[6] Edmans, Alex (2022): "How the SEC's Swaps Proposal Could Choke Off Shareholder Activism." *Wall Street Journal*, April 2, 2022.

[7] Edmans, Alex, Mirko Heinle and Chong Huang (2016): "The Real Costs of Financial Efficiency When Some Information Is Soft." *Review of Finance* 20, 2151-2182.

[8] Jackson, Robert J., Jr. (2018): "Stock Buybacks and Corporate Cashouts." June 11, 2018.

The U.S. Chamber of Commerce ("CC") has released a response to S7-21-21 which cites my study with PwC, my *Harvard Business Review* article, and my book very fairly.[9] It does not cite EFH, not because it contradicts the CC's position but because it was already cited by S7-21-21, and the CC's main objective was to draw the SEC's attention to relevant research that was not cited in S7-21-21. However, the response refers to frequent claims that share repurchases are manipulative, and rebuts such claims – for example, it states that "claims of opportunistic or manipulative use of share repurchases by insiders are no supported by economic analysis." The CC response also cites in some detail a working paper by Dittmann et al. which is related to EFH and references it nearly always very fairly. However, it does state that "Edmans et al. (2021) … present evidence consistent with stock price manipulation" and that "we can confirm the results in Edmans et al. (2021), but do not find them to be convincing evidence of stock price manipulation."

In fact, EFH never claim that our results are evidence of manipulation; we do not use the words "manipulation" or "opportunism" (nor related words such as "manipulative" or "opportunistic") at all in our paper. This is far from just a semantic issue. Our hypothesis is that, when considering whether to undertake a share buyback, *one* factor that may influence the CEO's decision is whether she personally benefits – not that the CEO is using repurchases to deliberately manipulate the stock price. Vesting equity is one of many factors, and hence we control for several other determinants of the repurchase decision. The personal benefit will not be the only, or even most important, factor (as the terms "manipulation" or "opportunism" would suggest) but it may be a consideration. Thus, one does not need to believe that share buybacks are used for manipulation – a high hurdle – to find merit in the SEC's proposal. Similarly, financial advisors are required to disclose the commissions they receive on financial products to their clients, even though commissions are hopefully not the most important driver of their recommendation.

Do Blackout Periods Erode The Link Between Share Buybacks and Stock Sales?

The CC response also cites Dittmann et al. (2022) for suggesting that any link between equity sales and share buybacks goes away once you control for blackout periods. It is indeed important to control for omitted variables in the vast majority of empirical analyses. However, in this particular setting, it is not necessary to control for blackout periods. Regardless of whether the equity sales are prompted by blackout periods or not, the CEO is still able to benefit from share buybacks if she sells her shares shortly afterwards. EFH fully recognize the existence of blackout periods; indeed, it is one of the motivations for our analysis on the timing of sales:

One concern is that the CEO may not be able to benefit from repurchases and M&A because blackout policies restrict him from selling shortly afterward—Bettis, Coles, and Lemmon [2000] find that 78% of firms have blackout policies. We thus study whether the CEO's equity sales are concentrated in a small window following repurchases and M&A. If so, this demonstrates that he is able to benefit from these events, either because the firm does not have a blackout policy, because the policy allows the blackout window to end upon these events, or because he schedules these actions to take place just before a trading window.

Thus, our analysis explicitly recognizes the existence of blackout periods; indeed, such periods are the motivation for our analysis of the timing of stock sales. If the repurchases occurred during blackout periods, then the CEO would not be able to sell equity shortly afterwards, and we would not find that equity sales are concentrated in a short window after the repurchase announcement. The fact that we do find concentration suggests that the repurchase announcements are timed (either intentionally or unintentionally) on dates at which the CEO is able to cash out afterwards, due to the absence of a blackout period afterwards. Thus, Dittmann et al.'s finding that repurchases occur at the end of blackout periods is fully consistent with our own hypothesis and results.

[9] U.S. Chamber of Commerce (2022): "Corporate Liquidity Provision & Share Repurchase Programs." March 22, 2022.

EFH build on a prior paper that I co-authored, which introduced vesting equity as a measure of short-term concerns[10]. That paper conducts a similar analysis of whether equity sales are concentrated shortly after earnings guidance (rather than share repurchases as in EFH) and has an even fuller description of the motive for the test:

Finding concentration would be consistent with two scenarios. First, the firm has a blackout policy, but schedules earnings guidance to fall within or just before a window that permits trading. Indeed, in our sample, 80% of guidance events are concurrent with earnings announcements, and Bettis et al. (2010) find that the most common blackout policy allows executives to trade only within a [3,12] window after an earnings announcement. Second, the firm does not have a blackout policy, and the CEO chooses to sell shortly after positive guidance. Our goal is to test whether the CEO is able to sell equity shortly after guidance, which could occur under either scenario. Regardless of whether any post-guidance sales are "voluntary" (due to the CEO choosing to sell after guidance) or "mechanical" (due to the opening of a trading window), the CEO is still able to benefit from the positive guidance event.

Thus, it *does not matter* if the equity sales are "mechanical" due to occurring after the end of a blackout period, or "voluntary". If the CEO knows that she will be able to sell equity, due to the blackout period ending, this may still influence her buyback decision. By analogy, if parents are away, a teenager is more likely to throw a party, and the party leads to the house being damaged. If you run a regression of damage on parties, you will find a positive correlation. If you control for whether parents are away, then the correlation will disappear, since it is parental absence that allows for parties in the first place (just like the end of a blackout period allows for equity sales). However, this disappearance does not change the case that parties lead to damage. The control is not necessary.

Evaluation of the SEC's Proposal

There have been many proposals to restrict share buybacks, such as taxing them or limiting them as a proportion of either trading volume or shares outstanding. I disagree with almost all of these proposals as they are too sweeping and general. There is no evidence that buybacks in general destroy long-term value; in contrast, the weight of the evidence points to the contrary.

However, there is evidence that, in specific circumstances – namely, when partly prompted by equity sales – that buybacks may be influenced by motives other than long-term value maximization. Thus, I do support proposals that are targeted at this specific concern. Even when accompanied by equity sales, repurchases may still be value maximizing; the equity sales may be undertaken for other motives such as liquidity or diversification. The SEC's proposal is not to ban, or even restrict, buybacks accompanied by equity sales, but simply to disclose equity sales. This is similar to how financial advisors need to disclose the commission on products that they are offering to their clients. It may indeed be that the product that pays the highest commission to the advisor is also in the best interest of the client, so there is no conflict. However, disclosure is useful to allow the client to take into account the possibility of a conflict. Similarly, in the buybacks setting, disclosure is useful because it alerts the market to the possibility of buybacks being at least partially influenced by the CEO's equity sales.

If discussion of these comments would be helpful to the Commission or its Staff in its consideration of the modernization of share repurchase disclosures, I would be pleased to be of assistance. Please do not hesitate to contact me at your convenience at

Sincerely,

[10] Edmans, Alex, Vivian W. Fang, and Katharina A. Lewellen (2017): "Equity Vesting and Investment." *Review of Financial Studies* 30, 2229-2271.

Professor Alex Edmans

cc: Gary Gensler, Chairman
Hester M. Peirce, Commissioner
Allison Herren Lee, Commissioner
Caroline A. Crenshaw, Commissioner
Renee Jones, Director, Division of Corporation Finance