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Sent via electronic mail

January 24, 2021

Mr. Steven G. Hearne, Senior Special Counsel

Dear Steven:

Subject: File No. S7-21-21
Share Repurchase Disclosure Modernization
Comments from Pay Governance–January 20, 2022—Ira T. Kay [Managing Partner] and Mike Kesner [Partner]

Thank you for the opportunity for Pay Governance and others to provide commentary on the "modernized" rules about disclosure of corporate share buybacks.

Pay Governance is one of the largest independent advisors to corporate boards on executive compensation. We provide advice to companies that "balances the inherent agency tension" in motivating executives to maximize the value for all stakeholders and address other constituencies' interests, including the proxy advisory firms, which have a significant impact on "Say on Pay" votes and other corporate governance matters. Share buybacks are one of several major and controversial economic/governance matters that executives need to consider in this paradigm.

For the absence of doubt, Pay Governance is not qualified to opine on the specific legal/regulatory/disclosure solutions that are being proposed by the SEC to address possible shortcomings in the disclosure of share buybacks. We advise companies on how to administer the impact of share buybacks in their cash and stock incentive plans. We have also conducted and published unique research on important matters that impact executive pay and shareholder relations, including share buybacks. It is within that context that we are offering our views, experience, and findings. We provide our views on certain significant critiques of buybacks, several of which we empirically dispute. We offer this in the spirit of ensuring that the business/regulatory case for these regulatory/disclosure changes is transparent, fact-based, and substantive using the empirical data.

We provide our clients with perspectives and research on the relationship between executive pay and share buybacks to ensure executive rewards are aligned with sustained value creation. We have tested the relationship of total shareholder return (TSR), capital investment, and use of buybacks using S&P 500 companies, and we found that share buybacks did not damage long-term performance or capital investment (see attached article). Our analysis indicates that shareholder returns were higher for companies that utilize buybacks as part of their capital allocation strategy, and shareholders do not appear to consider these buyback programs to be problematic or create stock price or earnings (earnings per share [EPS]) "myopia" among management teams.

Shareholders may indeed benefit from enhanced and more timely disclosure of the status of share buybacks. Our research and experience, however, demonstrate that shareholders overall currently benefit from buybacks, and investment does not appear to suffer. Further, the claim that buybacks are utilized to manipulate/increase EPS, metrics that are used to increase the payouts of incentive plans, needs additional explanation as discussed below. In the research, we are testing the larger common criticisms of whether share buybacks are part of the overall putative problem of the management of U.S. corporations being myopic or short-term oriented at the expense of longer-term performance.

We do find that companies with incentives based on EPS do indeed, at the median, make larger buybacks than those with other metrics. It is also valid that buybacks, by explicit design, reduce shares outstanding, which mechanically increases EPS. However, is this myopic and problematic to shareholders? Our perspective is that it is not. Corporate boards of directors have various potential shareholder neutral or positive responses to this impact that are already utilized in the board's management of incentive plans. These include: 1) forecasting the buyback's positive impact on EPS when setting goals at the beginning of the year, 2) adjusting the denominator of non-GAAP EPS metric in incentive plans at the end of the period by adding back the amount of shares bought, or 3) viewing buybacks as a capital allocation strategy and evaluating the success of such on a subjective basis in terms that include the strategic implications/success and stock price performance. We have seen each of these approaches utilized at several successful companies. As shown below and in the paper, shareholders benefit from this policy.

In addition, while we find that companies that utilize stock options as part of their long-term incentive program also tend to have larger buybacks than companies that do not use options, it appears that shareholder returns and capital investment do not suffer from this combination. Further, we test whether companies that have strong short-term stock price performance have lower long-term stock price performance. This analysis is a direct, but not definitive, assessment of whether U.S. management teams are myopic and shareholder value is suffering. As explained in the attached research paper, "Are Share Buybacks a Symptom of Managerial Short-termism?", the longer-term TSR for those companies is generally higher than the companies with lower short-term performance and, again, capital investments do not appear to suffer. Much of our research agrees with Harvard Law School's Professor Jesse Fried's findings on buybacks and investments.[i]

Our approach and summary findings and conclusions from our research paper are found in the link below:

https://www.paygovernance.com/viewpoints/are-share-buybacks-a-symptom-of-managerial-short-termism

Many corporate critics believe that excessive share buybacks are an example of harmful executive short-term behavior that creates long-term damage via underinvesting in the core business.

To evaluate buybacks, we split a sample of the S&P 500 into companies that engaged in small and large buyback activity from 2010 to 2014. We then evaluated TSR, capital expenditures (CapEx), and other corporate performance metrics after the buyback period (2014-2018).

Four-year post-buyback performance on TSR and CapEx growth were higher for the companies in the large buyback sample than for the companies with smaller buybacks. This indicates that share buybacks likely did not damage long-term performance or investment.
Higher short-term (one-year) TSR is associated with higher long-term subsequent (three-year) TSR and CapEx investment. This finding suggests that companies generally do not sacrifice long-term returns or investments for short-term gains.

The use of stock options and EPS-based incentive plans, rather than encouraging short-term gains at the expense of long-term performance, are correlated with higher long-term TSR.

Our research shows that buybacks do not appear to be harmful to long-term corporate performance. Companies need to continue to align executive incentives with capital decisions to continue their success.
A recent client example demonstrates the capital allocation tradeoff among numerous alternatives. This financial services company is making a substantial acquisition to enhance its geographic scope. In the press release on the acquisition, the company explicitly says they will halt their ongoing share buyback strategy to focus their capital on the acquisition.

The purpose of this submission is to address some of the specific criticisms of buybacks, which are referenced in the SEC document. Our research shows that the conventional wisdom on the damage caused by buybacks is mostly rebuttable and does not appear appropriate or necessary to support the SEC's business case for the proposed rule change. However, as mentioned, Pay Governance is not qualified to opine on the specific legal/regulatory/disclosure solutions that are being proposed by the SEC to address possible shortcomings in share buybacks.

Thank you for allowing us to comment on this important governance area.

Regards,

Ira T. Kay, Managing Partner

Michael (Mike) Kesner, Partner

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i **Jesse M. Fried. "Share Repurchases, Equity Issuances, and the Optimal Design of Executive Pay." Texas Law Review. 2011. https://dash.harvard.edu/handle/1/4905394.**