U.S. Chamber of Commerce

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January 11, 2023

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

Re: Proposed Rule, Securities and Exchange Commission; Reopening of Comment Period for Share Repurchase Disclosure Modernization (87 Fed. Reg. 75,975-75,977, Dec. 12, 2022)

Dear Ms. Countryman:

The U.S. Chamber of Commerce ("the Chamber") appreciates the opportunity to comment on the Securities and Exchange Commission's ("the Commission") proposed Share Repurchase Disclosure Modernization Rule ("Proposed Rule"). As we have previously explained, the Proposed Rule suffers from several deficiencies.[1] Among them, the Commission has not meaningfully attempted to quantify the costs and benefits of the Rule, and the Rule unconstitutionally compels private speech. The Commission's recently issued Staff Memorandum ("Staff Mem.")[2] does nothing to address these concerns. But even setting aside other objections, at the very least the Rule must account for the Inflation Reduction Act's recent enactment of an excise tax on share repurchases—the first such tax in history.[3] We appreciate that the Staff Memorandum does attempt to address the excise tax and that the Commission has reopened the period for public comment. In doing so, the Commission and its staff rightly acknowledge that the Proposed Rule cannot be finalized until the effect of this novel tax on the Rule is adequately studied and understood.

Despite recognizing the need for public comment on the excise tax, however, the Commission has again failed to provide sufficient time to make the opportunity for public

[1] Comment of Tom Quaadman, Exec. Vice President, Ctr. for Capital Markets Competitiveness, U.S. Chamber of Comm., on Share Repurchase Disclosure Modernization (Nov. 1, 2022); Comment of Tom Quaadman, Exec. Vice President, Ctr. for Capital Markets Competitiveness, U.S. Chamber of Comm., on Share Repurchase Disclosure Modernization (Sept. 20, 2022); Comment of Tom Quaadman, Exec. Vice President, Ctr. for Capital Markets Competitiveness, U.S. Chamber of Comm., on Share Repurchase Disclosure Modernization (Apr. 1, 2022); Comment of Tom Quaadman, Exec. Vice President, Ctr. for Capital Markets Competitiveness, U.S. Chamber of Comm., on Share Repurchase Disclosure Modernization (Feb. 23, 2022).

[2] Memorandum from Div. of Econ. & Risk Analysis to Comm'n File No. S7-21-21 regarding Supplemental Analysis of the Potential Implications of the Recently Enacted Excise Tax on Share Repurchases for the Economic Effects of Share Repurchase Disclosure Modernization Amendments (Dec. 7, 2022).

[3] Inflation Reduction Act of 2022, § 10201, Pub. L. No. 117-169, 136 Stat. 1818, 1828–31 (codified at 26 U.S.C. § 4501).

comment meaningful. The Commission has allowed only 30 days to submit comments—*half* its historical standard of 60 days. Even under ideal circumstances, a 30-day window "cut[s] the comment period" required by the Administrative Procedure Act "to the bone." *Petry v. Block*, 737 F.2d 1193, 1202 (D.C. Cir. 1984). And these are far from ideal circumstances. The Securities Exchange Act imposes "a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation.'" *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c)). Satisfying this obligation requires a more rigorous economic analysis than a typical APA rulemaking, necessitating a longer—not shorter—period of time for public comment.[4]

This is especially true here where the Commission's Staff Memorandum is devoid of quantitative analysis, forcing commenters to start from scratch. To make matters worse, "the year-end holidays" fall smack in the middle of the reopened comment period, effectively "shorten[ing] the period further still." *Pangea Legal Servs. v. U.S. Dep't of Homeland Sec.*, 501 F. Supp. 3d 792, 819 (N.D. Cal. 2020). And the Commission has been simultaneously engaged "in a slew of interrelated rulemaking activity," such as its amendment to Rule 10b5-1,[5] dividing the attention of interested parties. *Cath. Legal Immigr. Network, Inc. v. EOIR*, 2021 WL 3609986, at *3 (D.D.C. Apr. 4, 2021). Under these circumstances, we agree with Commissioner Uyeda that 30 days is simply not enough time to properly comment on the effect of the new excise tax.[6]

Although we have had only a brief period to study the Staff Memorandum, it is apparent that the analysis is inadequate. The Commission has a duty to "apprise itself … of the economic consequences of a proposed regulation." *Bus. Roundtable*, 647 F.3d at 1148. That includes quantifying the proposed rule's costs and benefits whenever feasible. *Id.* at 1149. The Staff Memorandum identifies several ways in which the excise tax will decrease the net benefit (if any) of the Proposed Rule. Yet the Memorandum does not attempt to estimate the magnitude of these effects in any rigorous way. Nor does it meaningfully consider whether the Rule remains justified in light of these new circumstances.

The Memorandum identifies several ways in which the excise tax undermines the Proposed Rule. According to the Memorandum, the excise tax will "compound" the Rule's effect of reducing total share repurchases, "including potentially efficient, shareholder value-

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[4] As the Commission's Inspector General has noted, Commission managers have expressed "concerns" that "shortened public comment periods" have caused a decrease in "feedback during the rulemaking process," and the Commission's "aggressive [rulemaking] agenda" has "limit[ed] the time available for staff research and analysis." The Inspector General's Statement on the SEC's Management and Performance Challenges 3 (Oct. 26, 2022), https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.

[5] Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80,362 (Dec. 29, 2022).

[6] Mark T. Uyeda, Comm'r, SEC, *Statement on Reopening of Comment Period for Share Repurchase Disclosure Modernization* (Dec. 7, 2022), https://www.sec.gov/news/statement/uyeda-statement-share-repurchase-disclosure-modernization-120722.

maximizing repurchases." Staff Mem. 10. Because the excise tax will make repurchases less frequent, repurchase disclosures will be less frequent and thus less useful for estimating the total value of the issuer. *Id.* As the Memorandum acknowledges, the excise tax will reduce "the level of … inefficient repurchase activity" caused by "agency conflicts," making the "information benefits of learning about such agency conflicts" through the Rule's disclosure requirements "lower." *Id.* at 11.[7] And even though the excise tax will lead to fewer repurchases overall—reducing the benefits of the Rule—there will not be a proportionate decrease in costs because a specific "component" of the costs the Rule imposes on companies are "fixed" and will have to be paid regardless. *Id.* at 12. It follows from these findings in the Memorandum that the net benefits of the Proposed Rule—if they were ever above zero—are now even lower.

Although the Staff Memorandum acknowledges these deleterious effects, it does not attempt to measure them or adequately account for them in the Commission's cost-benefit analysis. The Memorandum expressly does not try "to estimate the quantitative economic effects of the new tax." *Id.* at 4. And it repeatedly emphasizes that—given the informational limitations facing the staff—it is "difficult" to assess with any certainty the size of the effects of the tax that it identifies. *Id.* at 2, 3, 4, 8, 10. Unsurprisingly, then, the Memorandum does not even try to explain why the Rule is still justified relative to the baseline, relative to any of the alternative policies the Commission has identified, *see* Proposed Rule, 87 Fed. Reg. at 8460–61, or relative to any other alternative approach. That is not reasoned decision making. And it is certainly not consistent with the Commission's "unique obligation" to assess the economic effect of its rules in a rigorous, empirical way. *Bus. Roundtable*, 647 F.3d at 1148.

In addition, the Staff Memorandum does not adequately take into account the effect of regulations and guidance from the Department of the Treasury. Treasury is authorized—indeed required—to issue guidance and implementing regulations for the excise tax. 26 U.S.C. § 4501(f). Before such guidance issues, it is not possible to determine with precision which companies and transactions will be subject to the tax. The Staff Memorandum recognizes as much, such as in acknowledging that the number of issuers subject to the tax will depend on which repurchases are "taxed as dividends" and which "foreign issuers … may be subject to the tax." Staff Mem. at 3. These are subjects on which the Act requires Treasury to issue regulations and guidance,[8] and yet the Staff Memorandum fails to consider the effect they will likely have. This "fail[ure] to consider an important aspect of the problem" is not consistent with reasoned decision making. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto.*

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[7] This, of course, assumes that there is a significant number of opportunistic share repurchases undertaken to benefit management rather than the shareholders, a claim the Commission has failed to substantiate. *See* Quaadman Comment of April 1, 2022, *supra* note 1, at 5–7.

[8] For dividends, see 26 U.S.C. § 4501(f)(1) (requiring regulations "to prevent the abuse of the exceptions provided by subsection (e)"); *id.* § 4501(e)(6) (providing the tax shall not apply "to the extent that the repurchase is treated as a dividend for purposes of this title"). For foreign issuers, see 26 U.S.C. § 4501(f)(3) (requiring regulations "for the applications of rules under subsection (d)"); *id.* § 4501(d) ("Special rules for the acquisition of stock of certain foreign corporations.").

Ins. Co., 463 U.S. 29, 43 (1983). What is more, just days after the publication of the Staff Memorandum, the IRS released a notice announcing that Treasury will soon issue proposed regulations concerning the excise tax.[9] And the "impending" promulgation of "undeniably related" regulations "clearly ... must be considered" in the course of issuing a rule. *Portland Cement Ass'n v. EPA*, 665 F.3d 177, 187 (D.C. Cir. 2011).[10]

The Commission could substantially mitigate these problems by simply proceeding with care rather than haste. The Staff Memorandum acknowledges that a quantitative estimate would be possible if "post-implementation data on how the new tax has affected repurchases" were available. Staff. Mem. at 4. That will be the case in twelve to twenty-four months. After the tax has been in effect for one to two years, it will be possible to compare companies' repurchase activity in that period with their activity in the years before the tax went into effect and draw quantitative inferences from the difference. Treasury's soon-to-be-proposed regulations will likely have come into effect by that point as well, allowing the Commission to better understand how the tax actually operates.

At least one full year is necessary because the tax operates on an annual basis. The tax is imposed on the value of stock repurchased *minus* the value of stock issued over the course of the taxable year, 26 U.S.C. § 4501(c)(3), and is imposed only when that figure exceeds $1 million for the taxable year, *id.* § 4501(e)(3). So it is not possible to know whether and to what extent a company will be taxed until the end of the year. A shorter period also may not give Treasury enough time to promulgate the tax's implementing regulations. And at least a full year's perspective is essential because repurchase activity is both seasonal and cyclical, even without a tax.[11] Indeed, given the "strong influence of cyclicality on share repurchases and issuances" and the likelihood of a recession in 2023, at least *two* years will likely be necessary to obtain adequate data on the effect of the tax on the typical functioning of the market.[12]

One to two years is also a reasonable period of time to wait and gather this critical data. An excise tax is an entirely unprecedented approach to regulating stock buybacks. *See* Staff Mem. at 4 (noting "a lack of a directly comparable prior regulatory intervention"). And in

[9] Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock under Section 4501 of the Internal Revenue Code, IRS Notice 2023-2 § 1 (Dec. 27, 2022).

[10] To be sure, the IRS notice also contains "interim guidance" concerning "transactions ... prior to the issuance of the forthcoming proposed regulations." IRS Notice 2023-2 § 3.01. But this temporary guidance is not a reliable basis for determining how the tax will ultimately operate. The guidance will become obsolete as soon as Treasury issues final, binding rules. The final rules could vary greatly from this interim guidance because—unlike the interim guidance—the final rules will be issued only after Treasury has had the opportunity to incorporate public feedback through the notice-and-comment process. And in any event, even if it were possible to make reliable inferences about the tax's long-term effects from the interim guidance, the Staff Memorandum does not attempt to do so.

[11] C.M. Lewis & J.T. White *Addendum to Corporate Liquidity Provisions and Share Repurchase Programs* (January 11, 2023) (attached below).

[12] Lewis & White, *supra* note 11, at 4.

addition to the excise tax, the Commission has adopted amendments to Rule 10b5-1, including adding a cooling-off period before corporate insiders can trade under a Rule 10b5-1 plan.[13] Those amendments are aimed at stopping the same opportunistic trades that the Proposed Rule seeks to prevent. Rather than immediately adopt a *third* major policy initiative—one that is also entirely unprecedented in the content and quantity of the disclosures required—the Commission should take stock of these other major policy shifts and obtain a clear understanding of their effects.

The Commission may not base a rule on conjecture where "empirical evidence" is "readily available." *Bus. Roundtable*, 647 F.3d at 1150. Empirical evidence will be readily available in just a year or two, and the Commission has not identified any exigency requiring it to act sooner. There is simply no good reason to forgo a deliberative approach that predicates the Rule on real-world data rather than speculation.

In sum, as we have previously explained, the Commission should not adopt the Proposed Rule. But if it insists on moving forward, it should wait one to two years so it can gather data on and quantify the effects of the excise tax created by the Inflation Reduction Act. The Commission should then issue a revised analysis incorporating that data and, in line with its historic practice, allow the public at least 60 days to comment on it before making a final decision. Anything less would be inconsistent with the APA and the Securities Exchange Act.

The Chamber again appreciates the Commission's decision recognizing the importance of the novel excise tax and reopening the comment window. The Chamber and its members remain ready to assist the Commission on this important issue.

Sincerely,

[13] Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. at 80,366–72.

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Addendum to
Corporate Liquidity Provision & Share Repurchase Programs
By: Craig M. Lewis & Joshua T. White
January 11, 2023

On December 7, 2022, the U.S. Securities and Exchange Commission ("Commission") submitted a memorandum entitled, "Supplemental Analysis of the Potential Implications of the Recently Enacted Excise Tax on Share Repurchases for the Economic Effects of Share Repurchase Disclosure Modernization Amendments," to the public comment file on the Proposed Rule on Share Repurchase Disclosure Modernization.[1]

The United States Chamber of Commerce commissioned us to describe the *cyclicality* and *seasonality* of share repurchases and related activity by issuers that might be influenced by the recently enacted excise tax on share repurchases under the Inflation Reduction Act of 2022.

Seasonality in issuer activities is the pattern of regular fluctuations that occur at certain times of the year. Such fluctuations can occur for various reasons, such as variation in customer demand and the knock-on effects to the supply chain and production, the cash flow impacts of holidays, and other industry-specific factors. For example, tourism might increase during summer, while demand for consumer electronics fluctuates around the holiday season. Because seasonality can significantly influence an issuer's cash flows, it is an important consideration when deciding whether and when to repurchase shares and issue stock. Seasonality can also impact the issuer's stock price and, by extension, affect employees' decisions to sell stock grants or exercise stock options. All these considerations impact the amount of time needed to gather accurate data on the effect of the novel share repurchase excise tax due to the netting provision of share issuances.

Cyclicality in issuer activities is the tendency for an issuer's performance or that of its industry to follow persistent patterns of increases and decreases. While seasonal fluctuations occur during a year, cyclicality can last multiple years and is typically driven by macroeconomic factors such as inflation, changes in interest rates, variation in gross domestic product, or other systematic factors that influence the overall economy. Thus, cyclicality can impact an issuer's profitability and cash available for payouts such as share repurchases and other corporate financial policy decisions. Academic research has

[1] Memorandum from Div. of Econ. & Risk Analysis to Comm'n File No. S7-21-21 regarding Supplemental Analysis of the Potential Implications of the Recently Enacted Excise Tax on Share Repurchases for the Economic Effects of Share Repurchase Disclosure Modernization Amendments (Dec. 7, 2022). Available at https://www.sec.gov/comments/s7-21-21/s72121-20152424-320317.pdf.

documented "hot" and "cold" periods in share repurchases and equity issuances, which we discuss below.

Several studies document the relation between seasonality, cyclicality, and issuer activity as it pertains to share repurchases and share issuances. These studies find that issuer activities tend to be more common at certain times of the year or during certain periods of a business cycle.[2] Dittmar and Dittmar (2008) find cyclicality-driven patterns in stock issuances and repurchases. They note that stock issuances and share repurchase activities are 90% correlated, which they attribute to fluctuations in the business cycle. They find that expansions in the economy increase cash flow and lead issuers to increase both share issuances and repurchases. This study argues that cyclicality in the business cycle drives waves of stock issuance and repurchase activity.[3]

Bolton et al. (2013) attribute cyclical issuer behavior to the precautionary demand for cash to fund issuer activities.[4] They argue that, when the economy is expanding, financing conditions increase stock prices and lower the need to hold precautionary levels of higher cash designed to buffer and fund activities. This behavior results in more stock repurchases by cash-rich firms. Therefore, when economic conditions deteriorate, issuers engage in fewer share repurchases as they increase their level of precautionary cash savings.

Cyclicality in share repurchases is also demonstrated in our study, "Corporate Liquidity Provision and Share Repurchase Programs."[5] For example, Figure 1 of this study (replicated below) shows substantial variation in share repurchase activity, with the largest downturn in the year following the Great Recession of 2008:

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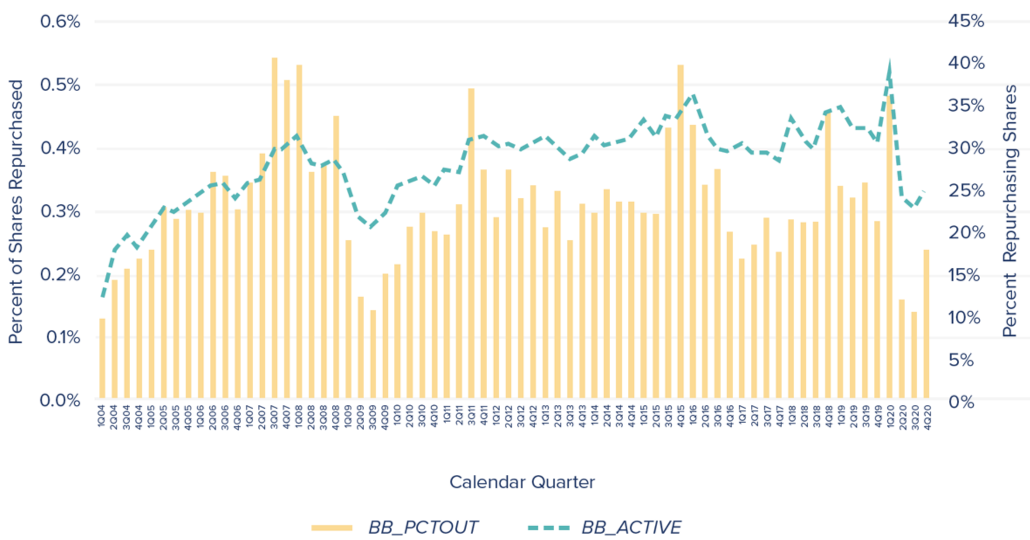
[2] Prior research documents seasonal patterns in several other market-related events, such as excess investor returns (DeBondt and Thaler, 1987), short interest (Brent et al., 1990), and stock-trading volume and volatility. See De Bondt, W. F., Thaler, R. H. (1987). Further evidence on investor overreaction and stock market seasonality. *Journal of Finance*, 42(3), 557-581. (noting that excess returns are higher in January); Brent, A., Morse, D., Stice, E. K. (1990). Short interest: Explanations and tests. *Journal of Financial and Quantitative Analysis*, 25(2), 273-289. (noting that short interest follows a seasonal pattern); Heston, S. L., Sadka, R. (2008). Seasonality in the cross-section of stock returns. Journal of Financial Economics, 87(2), 418-445. (noting persistent seasonal patterns in stock trading volume, returns, return volatility).

[3] See Dittmar, A. K., Dittmar, R. F. (2008). The timing of financing decisions: An examination of the correlation in financing waves. *Journal of Financial Economics*, 90(1), 59-83. Other studies note that repurchases are not smooth like dividends and tend to occur when stock prices are higher. See Bonaimé, A. A., Hankins, K. W., Jordan, B. D. (2016). The cost of financial flexibility: Evidence from share repurchases. *Journal of Corporate Finance*, 38, 345-362.

[4] See Bolton, P., Chen, H., Wang, N. (2013). Market timing, investment, and risk management. *Journal of Financial Economics*, 109(1), 40-62.

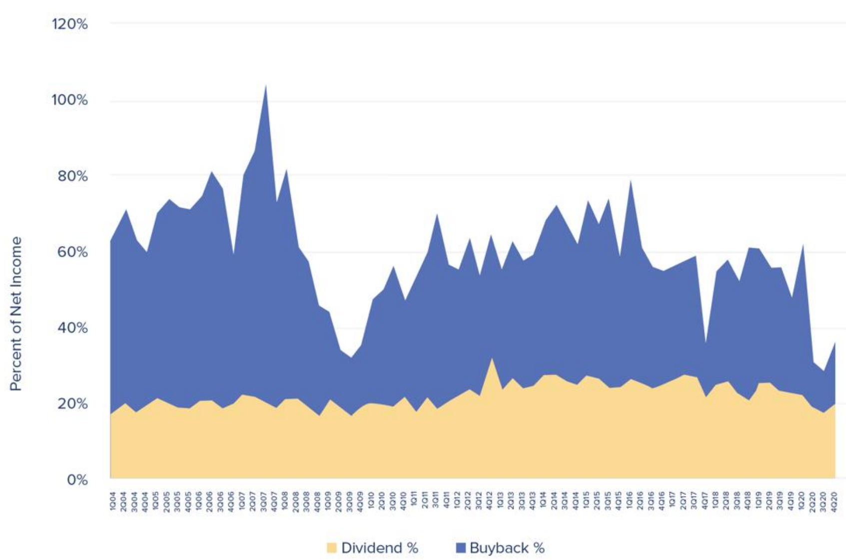
[5] See Lewis, C. M., White, J. T., (2021). Corporate liquidity provision and share repurchase programs. *US Chamber of Commerce: Center for Capital Markets Competitiveness*, Available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/09/4-01-22-CCMC_StockBuybacks2022-9.pdf.

Figure 1. Buybacks Over Time



We observe this cyclical pattern in share repurchase but not cash dividends, which we attribute to the popularity and flexibility of open-market repurchases relative to the inflexibility of commitments to pay dividend in Figure 4 of this study (reproduced below):

Figure 4. Payouts Over Time



Share repurchases and stock issuances also display patterns of *seasonality*. For example, one study finds that share repurchase activity tends to be higher at certain times of the year or based on variation in prior quarterly profits.[6] Another shows a direct connection

[6] See, e.g., Stephens, C. P., Weisbach, M. S. (1998). Actual share reacquisitions in open-market repurchase programs. Journal of Finance, 53(1), 313-333.

between employee stock options and share repurchases. Specifically, Kahle (2002), finds a strong correlation between employee stock options—both options outstanding and those that are exercisable—and the decisions of whether to repurchase shares and the number of shares to repurchase.[7] Further, research shows stock issuance displays seasonality. For example, a study by Lowry (2003) shows there are fewer equity offerings in the first quarter of the year, which the author associates with the practice of investment banks allowing their employees to take extended breaks during the holiday season.[8]

Given the seasonality in stock repurchases and issuances documented in academic literature, the true impact of the excise tax will likely be unknown for at least a year after it becomes effective. Additionally, several analysts forecast an economic downturn and potentially a severe global recession during 2023.[9] Based on the academic evidence that demonstrates a strong influence of cyclicality on share repurchase and issuances, it is likely that a period of at least two years is necessary to properly gather data and quantify the impact of the excise tax on share repurchase activity.

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[7] See Kahle, K. M. (2002). When a buyback isn't a buyback: Open market repurchases and employee options. *Journal of Financial Economics*, 63(2), 235-261.

[8] See Lowry, M. (2003). Why does IPO volume fluctuate so much? *Journal of Financial Economics*, 67(1), 3-40. Other studies confirm that there are fewer equity offerings in the first calendar quarter and summer periods, likely due to Wall Street vacation periods. See, e.g., Pástor, Ľ., Veronesi, P. (2005). Rational IPO waves. *Journal of Finance*, 60(4), 1713-1757; and Hong, H., Yu, J. (2009). Gone fishin': Seasonality in trading activity and asset prices. *Journal of Financial Markets*, 12(4), 672-702. We note that numerous other factors that could influence seasonality in stock issuances. For example, issuers may conduct equity offerings during certain parts of the year reduce their cost of capital during "windows of opportunity." For example, new investors might be more receptive to new stock issuances in the latter part of the year due tax year-end considerations. Issuers might also conduct equity offerings during periods of the year where financing needs are higher. Thus, issuers in highly seasonal industries such as retail might conduct more equity offerings to purchase inventory in anticipation of busy holiday seasons.

[9] See, e.g, Domm, P. (2022, December 23). Why everyone thinks a recession is coming in 2023. CNBC, https://www.cnbc.com/2022/12/23/why-everyone-thinks-a-recession-is-coming-in-2023.html (noting that most economists and many CEOs predict a recession in their 2023 forecasts); Potter, S. (2023, January 2). Here's (Almost) Everything Wall Street Expects in 2023. Bloomberg News, https://www.bloomberg.com/graphics/2023-investment-outlooks (noting that more than 500 Wall Street analysts forecast a recession in 2023); and Rabouin, D. (2023, January 2). Big Banks Predict Recession, Fed Pivot in 2023. Wall Street Journal, https://www.wsj.com/articles/big-banks-predict-recession-fed-pivot-in-2023-11672618563 (stating that, "More than two-thirds of the economists at 23 large financial institutions that do business directly with the Federal Reserve are betting the U.S. will have a recession in 2023. Two others are predicting a recession in 2024.").