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The Honorable Tammy Baldwin
United States Senate
717 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Baldwin,

Thank you for your letter regarding the Securities and Exchange Commission's (SEC's) oversight of activist hedge funds, stock buybacks, and executive pay. It is my honor to be nominated to the SEC—and to have the opportunity to answer these important questions about the Commission's work, which affect the futures of millions of American families.

I am deeply grateful to have had the opportunity to learn about these matters from you and your staff during our conversations in your office, and I have provided responses to your questions below. Should you have any further questions, or if I can be helpful to you or your staff in any way, please do not hesitate to let me know.

ACTIVIST HEDGE FUNDS AND THE BROKAW ACT

1. In 2011, you co-authored a paper, *The Law and Economics of Blockholder Disclosure.*[1] In that paper, you argue that shortening the 13(d) 10-day window would discourage active shareholders from buying large blocks of stock and "investing in monitoring and disciplining management" of the stock issuing company. The paper argues that fewer actively participating large blockholders would harm public investors who share in the value created by actions of the large blockholder. Do you still hold this view?

I absolutely share your concern about the effects hedge funds can have on American companies, workers, and families, and if confirmed I will be a strong advocate for those communities' voices at the SEC. Since 2011, our knowledge about hedge-fund tactics, the frequency of hedge-fund interventions, and their effects has deepened considerably, and as a Commissioner I would be open to any and all evidence that helps the SEC understand how best to protect American companies, communities, and investors.

For example, recent academic work shows that hedge-fund activism is now at an all-time high—underscoring the importance of this issue for communities across the Nation.[2] But let's be clear:

[1] Lucian Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39 (2012).

[2] John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance* 41 J. CORP. L. 545, 564 (2016) (documenting that "[h]edge fund activism has increased almost hyperbolically" over the last decade).

those costs are hardly academic, a point that you have so ably highlighted in your advocacy on this critical issue. When hedge funds gain influence over American companies, their decisions have very real effects on the American workers, investors, and communities that rely on those companies for jobs and a safe place to save for their retirements. You, along with other Senators, have personally conveyed these real-life stories to me, and if confirmed those families will be on my mind every day I go to work at the SEC.

That's not to say, of course, that blockholders cannot play an important role in holding corporate managers' feet to the fire.[3] Capturing the benefits of blockholders, while also protecting American families, communities, and investors, is the task that now faces the SEC. If confirmed, I would look forward to working with your Office, my fellow Commissioners, and the SEC Staff in achieving that critical goal.

2. In the 2011 paper, you wrote that "[t]here is a substantial body of empirical evidence that is consistent with the view that outside blockholders improve corporate governance and benefit public investors." Do you still believe that the current body of empirical evidence makes this conclusion clear?

As noted above, since 2011 our knowledge about hedge funds has grown considerably. Delaware's Chief Justice, Leo Strine, recently summarized the evidence in this area, writing that "[s]tudies of the impact of activist hedge fund investing are emerging monthly."[4] We are still learning, for example, about the effects of hedge fund activism on public companies' research and development activities.[5] And, while it is difficult for me to know as an outsider whether and how the SEC Staff is studying these issues, the Commission's Division of Economic and Risk Analysis has at its disposal a wealth of data that could help us better understand the effects hedge funds are having on American companies and communities—and, if I am confirmed, I will urge the Division to pursue those questions.

As I noted at my confirmation hearing, in both academia and government, my work has always been motivated by what the evidence can tell us about the real-world effects of the choices we face. Since the paper mentioned in your question was published, the evidence about the effects of hedge-fund activism on American companies and communities has grown much deeper. When deciding how to modernize its rules on hedge-fund activism, the SEC should consider all of this evidence. If confirmed, I will do just that.

3. I am concerned that the influence of aggressive short-term oriented shareholders, along with the rise of stock-based pay, have made corporate executives focus myopically on their share price at the expense of long-term growth and serving other stakeholders such as workers and taxpayers. Do you believe large blockholders contribute to this problem, and if so, how would you combat it?

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[3] *See, e.g.*, Lucian Bebchuk et al., *The Long-Term Effects of Hedge-Fund Activism*, 115 COLUM. L. REV. 1085 (2015).

[4] Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1888 (2017).

[5] *See* Alon Brav, Wei Jiang, Song Ma & Xuan Tian, *How Does Hedge Fund Activism Reshape Corporation Innovation* (forthcoming, J. FIN. ECON.) (concluding, "[c]onsistent with previous findings, . . . that R&D spending drops significantly in absolute amount during the five-year window subsequent to hedge fund activism," but simultaneously finding that patent filings rise at firms targeted by hedge-fund activism).

I am deeply concerned that corporate executives are too focused on short-term share prices instead of sustainable value creation. In my view, the SEC should be thinking holistically about all of the market participants who may be contributing to this problem—blockholders, executives, corporate boards, and others—when considering how to fix it.

There are at least three areas in which the SEC should consider immediate steps to encourage companies to focus on the long term. The first is executive pay. Most public companies require executives to hold stock-based pay for only three years, making it unsurprising that executives so often pursue short-term stock increases. As I mentioned at my confirmation hearing and during our meeting, it's time for corporate executives worried about short-termism to put their money where their mouths are. SEC rules could encourage these executives to hold their stock for far longer periods. That would give executives real incentives to invest for the long term—and truly align their interests with the investors, employees, and communities that these companies serve.

The SEC should also consider allowing companies and investors to choose voting arrangements that reward shareholders who commit to hold shares for the long term. Other jurisdictions have long permitted the use of these arrangements, and academics have advanced powerful arguments in favor of them.[6] The SEC should consider whether and how to enable public companies to choose these arrangements. That could help ensure that companies favor the interest of their longer-term investors—despite any pressures they may face from short-term speculators.

Finally, as I mentioned at my hearing, the SEC should consider whether the rules governing stock buybacks need to be modernized. Those rules have not been updated for years—at a very different time for our markets and our country.[7] Given the importance of this issue to making sure that public companies invest for the long term, these rules now deserve another look.

4. Do you believe activist hedge funds encourage public companies to cut their investments in favor of buying back their own stock?

Yes: the empirical evidence makes clear that, among other strategies, certain activist hedge funds often encourage public companies to engage in stock buybacks. Nearly one-fifth of activist hedge-fund engagements explicitly involve a request to pursue recapitalizations—and that fraction excludes the hedge funds that do so behind the scenes.[8]

Moreover, as noted above, it is also clear that research and development investments, on average, fall following hedge-fund interventions.[9] While the longer-term implications of this evidence are still being debated, most researchers agree that activist hedge funds often encourage stock buybacks and reduce aggregate research and development investments.

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[6] *See, e.g.*, Patrick Bolton & Frederic Samama, *L-Shares: Rewarding Long-Term Investors* (ECGI Finance Working Paper) (2012).

[7] *See* Securities and Exchange Commission, Purchases of Certain Equity Securities by the Issuer and Others, Release Nos. 33-8335; 34-48766; IC-26252, 17 C.F.R. § 228 (2003) (providing a safe harbor from certain securities-law liability for stock buybacks affected in a particular manner).

[8] *See* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1742 tbl. 1 (2008) (noting that nearly 200 of the activist events studied in that paper involved a hedge fund with stated goals including recapitalization).

[9] *See* Coffee & Palia, *supra* note 2, at 575 (citing Brav et al., *supra* note 5 ("Consistent with previous findings . . . we find that R&D spending drops significantly in absolute amount during the five-year window subsequent to hedge fund activism.")).

5. Do you believe the definition of "person or group" should be updated to capture groups of investors coordinating their actions to remain under the five percent threshold?

I very much share your concern that investors are coordinating their activities behind the scenes while avoiding disclosure—to the detriment of the investors, employees, and communities that depend on American companies to deliver long-term economic growth. Without commenting on any particular matter that may come before me as a Commissioner if I am confirmed, I can say without reservation that making sure that these rules give investors the transparency they need to evaluate the activities of these investors will motivate my work at the SEC in this area.

In particular, the Commission's review of these rules should take account of two areas in which the law may no longer reflect the realities of today's markets. First, the courts have over time narrowed the definition of a "group," potentially encouraging hedge funds to pursue tactics like those described in your question.[10] Second, insider-trading law today is unclear whether and how coordinated buying in a wolfpack is prohibited by the securities laws.[11] If confirmed, I look forward to working with your Office, my fellow Commissioners, and the Staff to ensure that these rules are modernized as necessary to protect American investors.

6. What do you believe is the purpose of the 10-day 13(d) disclosure window?

The ten-day disclosure window, established by a law named for Senator Harrison A. Williams, reflected Congress's judgment in 1968 regarding the appropriate balance between the need to provide prompt information to investors and the benefits large shareholders can provide by holding corporate management's feet to the fire. Although the ten-day window, at the time of its enactment, reflected extensive debate in Congress about that balance,[12] I share the concern that the window may no longer reflect the speed at which capital markets operate today.[13]

Importantly, when Congress considered the appropriate length of the ten-day disclosure window, it also considered the percentage of ownership that would trigger disclosure by large investors. For example, although the Williams Act, as originally enacted, required disclosure only when investors crossed the 10% ownership threshold, it was amended two years later to require—as current law does—disclosure when investors reached 5%.[14] Consideration of the appropriate

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[10] *See id.* at 568-570 (citing *Hallwood Realty Partners, L.P.* v. *Gotham Partners, L.P.*, 286 F.3d 613, 615 (2d Cir. 2002) (concluding that two Schedule 13D filers and a 13G filer were not, together, a "group" for purposes of Section 13(d), "even though one was a well-known raider and all three discussed among themselves how to improve the value of the target company")).

[11] *See id.* at 566 ("Under existing law, such tipping [by a hedge fund to other investors in connection with a wolf-pack attack] would be unlawful only if a tender offer for the target is planned by the wolf pack leader.").

[12] *Compare* A Bill Providing for Fuller Disclosure of Corporate Equity Ownership of Securities Under the Securities Exchange Act of 1934, S. 2731, 89th Cong. § 2 (Oct. 22, 1965) (Sen. Williams's original proposal, which would have made it unlawful for a blockholder to cross the 5% threshold without prior public disclosure) *with* S. 510, § 2, 90th Cong. (amended Aug. 31, 1967) (the proposal that eventually became the Williams Act, providing a ten-day window for disclosure). *See also* Statement of Sen. Williams, 113 Cong. Rec. 24,664 (1967) (noting that, in introducing the final legislation, Senator Williams and his colleagues in the Senate had "carefully weighed both the advantages and disadvantages to the public" of the ten-day window and "took extreme care to avoid tipping the scales either in favor of management or in favor of" large investors).

[13] *See, e.g.*, Coffee & Palia, *supra* note 2, at 598 (arguing that "closing" the 13D window would address some activist hedge funds' counterproductive tactics).

[14] *See* Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968); Act of December 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (1970).

balance between providing rapid information to investors and holding corporate management accountable would ideally include both the disclosure threshold and the ten-day window. Although Congress has granted the SEC clear authority to shorten the ten-day window, it has not yet addressed what, if anything, the SEC might do about the threshold that triggers disclosure.[15]

At bottom, however, the purpose of the Williams Act—like the purpose of all of the securities laws—is to protect investors. If confirmed, I would look forward to working with your Office, my fellow Commissioners, and the SEC's Staff to ensure that the SEC's rules under the Williams Act serve that critical purpose in today's fast-moving capital markets.

7. Do you believe the current 13(d) disclosure rules adequately provide issuers, investors, and the marketplace with sufficient information about large shareholders?

As noted above, and again without commenting on any particular matter that may come before me if I am confirmed, I share the concern that the SEC's current rules under Section 13(d) may need to be updated to reflect the reality of today's markets. Importantly, with respect to the ten-day window, the SEC is empowered to take that action even if Congress takes no further action.

Another area where the SEC can move forward under existing law is addressing the failure of current SEC rules to capture transactions in derivatives that allow activists to accumulate economic and voting influence beyond the 5% threshold without disclosing that fact to the public. There has been concern about those transactions for many years, and in 2011 a widely respected federal judge in New York noted that the SEC's rules in this area were "murk[y]".[16] In response, Congress in the Dodd-Frank Act empowered the SEC to clarify the law, and if necessary to require disclosure of derivatives used by activists to accumulate hidden positions in public-company stocks.[17] The SEC, however, chose simply to repromulgate its previous rules—though the Commission promised in 2011 that the Staff was "engaged in a separate project to develop proposals to modernize reporting under [Sections] 13(d) and 13(g)."[18]

More than six years later, the SEC has taken no action—while our markets are changing every day. In my view, the SEC should provide guidance in this area. That guidance should make sure that investors have the information they need to understand the role that large shareholders are playing in the future of American corporations—whether those shareholders do so through common shares or clever contracts. If confirmed, I look forward to working with your Office, my fellow Commissioners, and the SEC's Staff on achieving that goal.

8. If investors are found to be intentionally skirting the 13(d) disclosure rules (for example, by forming a "wolf pack" or using a derivative to avoid filing a 13D) do you support updating the SEC's rules to restore the spirit of the law?

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[15] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929R(a), 124 Stat. 1376 (2010).

[16] CSX v. Children's Inv. Fund Mgmt., 562 F. Supp. 2d 511 (S.D.N.Y. 2011) (Kaplan, J.).

[17] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929R(a), 124 Stat. 1376 (2010).

[18] *See* SEC, Beneficial Ownership Reporting Requirements and Security Based Swaps, Release No. 34-64,087 (June 8, 2011).

Without commenting on any particular matter that may come before me if I am confirmed, I very much share the concern the SEC's rules in this area may need to be updated to reflect the reality American businesses, workers, and communities face today. As noted above, whether those rules involve the threshold for disclosure of hedge funds' stakes, the ten-day window for such disclosure, or transparency about activists' use of derivatives, they should be updated as necessary to achieve the fundamental purpose of the securities laws: protecting investors.

It is worth noting that, in addition to updating its rules, the SEC should also consider enhancing its enforcement of existing law in this area. My research has previously shown, for example, that more than 10% of hedge fund activists fail to disclose their stakes even within the current ten-day window.[19] I was gratified when, soon after the release of that research, the SEC announced enforcement actions against ten hedge funds for failing to disclose to the public on time.[20] In addition to making sure that SEC rules are keeping up with today's fast-moving markets, vigilant enforcement will be critical to protecting our companies and communities—especially with hedge-fund activism at an all-time high.

The SEC has a broad set of tools at its disposal to make sure that hedge fund activists play by the rules—and that those rules protect American investors and the companies they rely upon to create sustainable jobs and long-term value. If confirmed, I look forward to working with you and your Office to ensure that the SEC is up to that challenge.

STOCK BUYBACKS

1. The SEC's mission is to facilitate capital formation. However, in recent decades, through stock repurchases and mergers, public corporations actually send money to the stock market, rather than vice versa.

Over the last decade, *net* equity issuances (stock issuances minus buybacks) averaged negative $412 *billion* per year (money flowing out of companies to shareholders).[21] Are you at all concerned about the rate of buybacks and what, if anything, do you believe the SEC should do to reverse the extraction phenomenon in our public markets?

Yes: I absolutely share the concern that the volume and scale of stock buybacks have increased dramatically. As explained in more detail below, it is not at all clear that the SEC's rules in this area, which have not been updated for over a decade, are adequate to ensure that investors understand exactly how and when corporate cash will be used for buybacks instead of job creation. If I am confirmed, I would look forward to working with your Office, my fellow Commissioners and the SEC's Staff to make sure our securities laws give investors the information they need about stock buybacks.

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[19] Lucian A. Bebchuk, Alon Brav, Robert J. Jackson, Jr. & Wei Jiang, *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 10 tbl. 2 (2013).

[20] Securities and Exchange Commission, *SEC Announces Charges Against Corporate Insiders for Violating Laws Requiring Prompt Reporting of Transactions and Holdings* (Sept. 10, 2014), *at* https://www.sec.gov/news/press-release/2014-190.

[21] William Lazonick, *The Functions of the Stock Market and the Fallacies of Shareholder Value* (Working Paper June 2017).

2. Stock buybacks have famously increased in frequency since the 1982 10b-18 rule that provides safe harbor from insider trading charges to executives buying back their company's stock.[22] Do you believe that 10b-18 should be reconsidered in light of the explosion of stock buybacks?

Yes. As I indicated at my confirmation hearing, in my view these rules deserve another look. As your question points out, these rules were adopted decades ago, and have not been substantially updated since 2003—a very different time for our markets and our country.[23]

When the SEC last considered these rules, the scale and frequency of stock buybacks—and their importance to our economy as a whole—were far smaller than they are today. Given the importance of this issue to American companies, employees, and investors, I believe these rules should be reexamined to ensure that they are keeping pace with changes to our markets.

3. Buybacks have been observed to coincide with declines in R&D spending, and possible investment overall.[24] Are you concerned that the amount of corporate capital flowing to stock buybacks could undermine American global competitiveness?

Yes. If stock buybacks are occurring because corporate executives are failing to make important and productive investments, this is an issue that concerns me—and should concern all SEC Commissioners. The ability of the American securities markets to unite willing capital with worthy projects has been the envy of the world for generations, and a core part of the SEC's statutory mission is to facilitate capital formation. If corporate management is declining to make productive investments in research and development in order to satisfy short-term demands for stock buybacks, that is a concern that goes directly to the heart of the SEC's mission.

As noted above, the SEC has many tools at its disposal to ensure that long-term value creation, rather than short-termism, drives corporate decisionmaking. As I mentioned at my confirmation hearing, those tools include developing new rules that encourage corporate executives to commit to hold their shares for the longer term. Such rules would have the benefit of ensuring that corporate executives who claim that buybacks are the best strategy for the company's long-term future would be required to put their own money at risk on that proposition—rather than benefit from the short-term price increases that so often come with stock buybacks.

4. What impact do you believe increased stock buybacks have had on wages and jobs?

It is notoriously difficult to isolate the causes or effects of a particular change to our economy—such as the significant recent increase in buyback activity you described in your letter—on our labor markets. What is clear, however, is that the increasingly rapid cycling of capital among firms and industries has imposed real costs on American workers and families.

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[22] William Lazonick, *Profits Without Prosperity*, HARV. BUS. REV. (Sept. 2014).

[23] *See* Securities and Exchange Commission, Purchases of Certain Equity Securities by the Issuer and Others, Release Nos. 33-8335; 34-48766; IC-26252, 17 C.F.R. § 228 (2003).

[24] J.W. Mason, *Disgorge the Cash: The Disconnect Between Corporate Borrowing and Investment*, ROOSEVELT INSTITUTE (February 25, 2015), *at* http://rooseveltinstitute.org/disgorge-cash-disconnect-between-corporate-borrowing-and-investment-1/.

These Americans depend on our companies to focus on creating stable jobs and long-term value—not trading in their own company's stock. That is why, if I am confirmed, I will work tirelessly to make sure that corporate executives' interests are aligned with the long-term needs of the company—not shortsighted demands for buybacks.

5. Do you support requiring public companies to disclose their repurchases and issuances more frequently, and include more granular data about the transactions?

Without commenting on any particular matter that may come before me as a Commissioner if I am confirmed, I can say that the SEC should consider requiring better disclosure of stock buybacks for companies that wish to take advantage of the "safe harbor" that Rule 10b-18 provides from securities-fraud liability. As noted above, that Rule—and the conditions for the safe harbor—has not been substantially revised for over a decade, and it is critical that the SEC's rules be updated to reflect the increasing scale and importance of buyback activity.

In particular, modernized disclosure in this area should require managers to explain the basis for the buyback decision to their investors and to the public. This improved transparency would allow markets more accurately to price the value of the buyback into the company's shares—and put investors on notice as to when, and how, the buyback will occur. In light of the increasing importance of buybacks to American companies and investors, a close look at rules that would improve the transparency of these transactions is warranted. That is especially true if changes to our tax laws are likely to make these transactions even more important in the years to come.

EXECUTIVE PAY RULES

1. As a Commissioner, will you commit to supporting proposing and finalizing the mandatory Dodd-Frank rules as required by Sections 956 and 954?

Yes. As I mentioned at my confirmation hearing, my view on these rules is simple: Dodd-Frank is the law of the land—and it has been for seven years. It is long past time that the SEC and public companies give legal effect to the investor protections that Congress chose to enact.

It is especially troubling that the rules under Section 956, which requires the SEC to work together with other agencies to develop rules prohibiting the kinds of banker bonuses that helped fuel the devastating 2008 financial crisis, have not yet been finalized. After the agencies first proposed those rules in 2011, I and others testified before the Senate Subcommittee on Financial Institutions and Consumer Protection, arguing that the proposed rules could and should be strengthened to make sure that bonus practices at our largest banks never again endanger financial stability.[25] The agencies long ago proposed new rules addressing many of these concerns.[26] The fact that these proposals have not yet been acted upon reflects a troubling failure

[25] *Pay for Performance: Incentive Compensation at Large Financial Institutions, Hearing Before the Subcomm. on Fin. Insts. and Consumer Protection of the S. Comm. on Banking, Housing, and Urban Affairs,* 112TH CONG. 477 (2012) (testimony of Robert J. Jackson, Jr., Associate Professor of Law, Columbia Law School).

[26] *See* SEC, *Agencies Invite Comment on Proposed Rule to Prohibit Incentive-Based Pay that Encourages Inappropriate Risk Taking by Financial Institutions* (joint release of SEC, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Federal Reserve Board of Governors, National Credit Union Administration, and Office of the Comptroller of the Currency), *at* https://www.sec.gov/news/pressrelease/2016-89.html.

to follow the law at the Commission that I hope will be quickly rectified by Chairman Clayton and, if I am confirmed, my fellow Commissioners.

Similarly, it is hard to understand why rules under Section 954, which requires public companies to adopt policies addressing the clawback of erroneously awarded executive pay, have not been adopted. Proposed rules have been awaiting Commission action for years—which is unacceptable if the SEC wants its commitment to the rule of law to be taken seriously.

The Commission's failure to complete these mandated rules has been harmful to investors, companies, and the SEC. For seven years, neither public companies nor investors have had any ability to know if these rulemakings will actually become law. The result is that both parties spend significant amounts of shareholder money to predict whether and when they might have to comply with these rules. That's good for lobbyists and lawyers, but hardly anyone else, and especially not investors. As I mentioned at my hearing, ordinary investors are still waiting for basic, common-sense protections like rules requiring clawback of erroneously awarded executive pay to take effect. Without these rules, executives continue to have the incentives they had before the financial crisis to take excessive risk, and I cannot see why these rules have not yet been implemented some seven years after Dodd-Frank's passage.

2. Do you believe that stock-based pay has distorted priorities for public-company executives?

Yes. While stock-based pay can have the beneficial effect of aligning managers' incentives with those of shareholders, in my view the structure of much stock-based compensation—especially top executives' freedom to unload shares in the short term—has led corporate managers to pursue short-term profits rather than long-term value creation.

Much of my research has focused on understanding how, and why, public-company managers are given the freedom to sell shares they earn from stock-based pay so quickly. One explanation, I have argued, is that public-company directors have failed to bargain hard enough with top managers to restrict whether, and when, executives can sell company stock they receive as compensation.[27] Another is that the SEC's rules do not emphasize executives' stock holdings as the critical determinant of their incentives.[28] As a result, most public company executives are free at any time to sell the overwhelming majority of stock they hold in the firm, leading many to focus on short-term stock prices rather than long-term value.

This structural problem has had devastating consequences for millions of Americans, whether or not they ever received a single dollar of stock-based pay. Some executives yielded to the temptation to pursue short-term share-price spikes rather than investments in employees. And in the run-up to the financial crisis, bankers reaped millions—sometimes even billions—in stock-

[27] In one paper, for example, I compared public-company executive-pay packages to those in private firms overseen by private-equity investors known for driving a hard bargain over managers' pay. *See* Robert J. Jackson, Jr., *Private Equity and Executive Compensation*, 60 U.C.L.A. L. Rev. 638, 663 (2013) ("The evidence from companies owned by private equity suggests that public company directors should drive a far harder bargain over the CEO's ownership of the company's equity.").

[28] *See id.* at 666-667 (noting this problem with SEC disclosure rules in this area).

based pay before their firms collapsed, nearly taking the American economy along with them.[29] If I am confirmed, the consequences of these incentives for our economy—and for the millions of American families our markets truly serve—will never be far from my mind.

3. Do you believe stock-based pay has encouraged executives to buy back their company's stock?

Yes. As noted above, executives' freedom to sell shares earned from stock-based pay gives them strong incentives to increase short-term stock prices, and researchers have consistently found strong associations between the use of stock-based pay and stock buybacks.[30]

This research supports the common-sense conclusion that, when executives are paid on the basis of increases in share prices, they are more likely to favor tactics that increase share prices—such as buybacks. What this research does not reveal, however, is the effects of these incentives on the companies and communities affected by stock buybacks: the employees and factories that could no longer be supported, research that was never conducted, opportunities lost. For me, those are the truly troubling implications of stock-based pay that rewards short-term stock increases. If confirmed, those are the concerns that will motivate my work at the SEC.

4. Do you support the pay ratio disclosure rule and will you commit to finalizing and enforcing the mandatory rule as Commissioner?

Yes. As noted above, I have long shared the concern that the Commission took much too long to implement the rules required by Dodd-Frank, including Section 953(b), the provision requiring disclosure of the ratio between the CEO's compensation and that of the median employee. I was delighted by the SEC's recent announcement that this rule, which is now final, will be effective for the coming proxy season.[31] And, along with millions of American investors and employees across thousands of public companies, I look forward to learning from the first disclosures of these ratios when companies file their proxy statements this Spring.

As companies prepare their disclosures over the coming weeks—and for every year going forward—the Division of Corporation Finance must carefully monitor compliance with the rule and direct companies to give the clear and candid information that the law requires. If confirmed, I will be a strong voice at the Commission to make sure investors get that kind of information.

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[29] Lucian A. Bebchuk, Alma Cohen & Holger Spamann, *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008*, 27 YALE J. REG. 257 (2010) ("Overall, we estimate that the top executive teams of Bear Stearns and Lehman Brothers derived cash flows of $1.4 billion and $1 billion respectively from cash bonuses and equity sales during 2000-2008.").

[30] *See, e.g.*, Christine Jolls, *Stock Repurchases and Incentive Compensation* (NBER Working Paper 1998) ("firms which rely heavily on stock-option-based compensation are significantly more likely to repurchase their stock than firms which rely less heavily on stock options to compensate their top executives"); *see also* Kathleen M. Kahnle, *When a Buyback Isn't a Buyback: Open Market Repurchases and Employee Options*, 63 J. FIN. ECON. 235 (2002) ("the decision to [engage in a stock buyback] is positively related to the number of executive options outstanding, even after controlling" for other relevant factors, including the number of non-executive employee options outstanding).

[31] Securities and Exchange Commission, *SEC Adopts Interpretive Guidance on Pay Ratio Rule* (Sept. 21, 2017) ("Under the Commission's rule implementing the pay ratio requirement, companies are required to begin making pay ratio disclosures in early 2018."), *at* https://www.sec.gov/news/press-release/2017-172.

5. Do you believe reducing the ratio of CEO to median worker pay is a worthy goal?

I share your concern about the growing pay divide between hard-working Americans who have struggled to see a rise in their wages and the skyrocketing pay packages of those who occupy the executive suite. Sunlight, Justice Brandeis famously pointed out, is "the best of disinfectants."[32] That's why I believe that the Dodd-Frank Act took an important step forward by requiring public companies to disclose this information to their investors.

Because of Dodd-Frank, for the first time this Spring, American investors and the broader public will be provided with a financial metric that can give them a snapshot of each company's compensation philosophy. I think that the disclosure of company-by-company numbers will spur corporate directors, top executives, investors and employees alike to ask themselves hard questions about how their firm's ratio reflects upon the company—a much-needed conversation that has, in my view, been too long in coming.

As a researcher, I have been astonished by the unrelenting increase in the ratio of Chief Executive Officers' pay to their workers' compensation over the last generation. According to one study, that ratio has risen from about 25 times to more than 400 times since 1970—while workers' wages have been stubbornly stagnant.[33]

While the ratio itself reflects important information about the company, even more important is what is behind those numbers: the real-life stories of American workers seeing an ever-growing gap between their pay and top executives' compensation. I am grateful to have had the chance to hear about so many of those workers from you during our conversation in your office, and if I am confirmed those stories will be on my mind each day I report to work at the SEC.

6. Do you believe that "actual realized gains" is a more accurate representation of an executive's pay than "estimated fair value"?

As a researcher who has focused on the study of executive pay, I very much appreciate the concern that "estimated fair value" measures of executive compensation may fail to reflect the true amounts that top executives are paid. That's especially true when it comes to stock-based pay, which over time has come to reflect the majority of value that executives, and particularly CEOs, receive in their compensation packages.

The purpose of SEC rules requiring disclosure of executive pay is to provide transparency on the realities of managers' compensation, and I am open to any changes to those rules that would help investors and the public better understand how, and how much, top executives are paid. As your letter points out, the SEC's current approach under the pay-ratio rule calls for the ratio to be calculated on the basis of fair-value estimates, which have the disadvantages you described in your letter to the Commission on this subject in March.

As noted above, however, public companies will soon be required to provide their first-ever disclosures under those rules, giving the Commission a valuable opportunity to evaluate whether an alternative measure of CEO pay would give investors a clearer view on the ratio between

[32] LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY—AND HOW BANKERS USE IT 92 (1914).

[33] Brian J. Hall & Kevin J. Murphy, *The Trouble With Stock Options*, 17 J. ECON. PERSP. 49, 51 & fig. 2 (2003).

CEO and worker pay. In particular, the Divisions of Corporation Finance and Economic and Risk Analysis will be able to assess whether using another measure, such as actual realized gains, would have significantly changed particular companies' ratios—and, if so, how. If confirmed, I will urge the Divisions to conduct that analysis, so that we can use these new data to understand how this information should be presented to the public in the future.

Thank you again, Senator, for the opportunity to hear about these critical issues from you and your staff during our conversations in your office over these past weeks. I am very grateful to have had the chance to learn more about the importance of the SEC's work for American companies, families, and employees.

If I have the honor of being confirmed, I will do all I can to make sure that our securities laws protect those communities—and encourage the kind of long-term value creation that so many Americans rely upon for a safe place to invest their hard-earned savings. Should you have any further questions at all, please do not hesitate to contact me at your convenience.

Very truly yours,

Robert J. Jackson, Jr.