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CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
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Washington, D.C. 20515

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RANKING MEMBER

May 10, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: May 15, 2019, "Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers."

On Wednesday, May 15, 2019 at 10:00 a.m., the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets will hold a hearing entitled, "Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers." Witnesses for the hearing are:

- **Steve Clifford**, Author and former CEO of King Broadcasting Company
- **Heather Slavkin Corzo, J.D.**, Director of Capital Markets Policy, AFL-CIO
- **Abigail E. Disney, Ph.D.**, President of Fork Films, and Chair & Co-founder of Level Forward
- **Nili Gilbert,** Co-founder & Portfolio Manager, Matarin Capital Management
- **James R. Copland**, Senior Fellow and Director, Legal Policy, Manhattan Institute for Policy Research

This hearing will examine four legislative proposals that are designed to provide more information to help investors make decisions based on long-term economic growth.

1. H.R. ____: Outsourcing Accountability Act (Axne)

The Securities Exchange Act of 1934 requires public companies to file annual reports with the Securities and Exchange Commission (SEC) to publicly disclose company information that investors would find pertinent in making investment decisions.[1] This reporting requirement mandates the disclosure of information related to risk exposure, material financial data, and an analysis performed by management on the company's financial condition.[2]

Although public companies are currently required to disclose their total number of employees, there is no requirement that they disclose where those employees are geographically based. This

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[1] *See* 15 U.S.C. § 78m(a).
[2] SEC, Form 10-K, General Instructions, *available at* https://www.sec.gov/about/forms/form10-k.pdf.

makes it difficult for investors and consumers to know if the companies they are investing in are creating and protecting American jobs.

The Outsourcing Accountability Act of 2019, sponsored by Rep. Cindy Axne (IA-03), is a draft bill that would require public companies to annually disclose the total number of employees they employ in each state and foreign country, as well as the percentage change from the previous year. The draft bill exempts smaller and newly-public companies from this requirement.

The bill is supported by AFL-CIO.

2. H.R. ____: A bill to amend the Securities Exchange Act of 1934 to require issuers to disclose information about human capital management in annual reports (Axne)

For the last four decades, the United States economy has been shifting from a manufacturing-based economy to a service-based economy. As a result, intangible assets, such as technological innovation and services, are playing a larger role in corporate balance sheets and stock market value. According to one 2015 study, intangible assets made up less than 20% of the market value of the S&P 500 in 1975 but accounted for more than 80% of its value in 2015.[3] These intangible assets can include brand value and intellectual property, as well as, the human capital of a company's workforce.

How a company invests in its workforce can affect the long-term value of the company and, ultimately, the future value of the company's return. For example, if a company consistently fails to train its employees in the latest industry developments or if the company has a high rate of workforce turnover, it may struggle to compete long-term. In a hearing before the House Appropriations Committee in April 2018, SEC Chairman Jay Clayton emphasized the importance of this information and stated that he "would like to see more disclosure from public companies on how they think about human capital."[4]

Since 1998, firms in the European Union have been required to report total human capital investments in relation to salaries, bonuses, and other benefits,[5] but because similar disclosures are not required and are thus only voluntary in the US, only 15% of S&P 500 firms do so.[6] However, according to research from the Embankment Project for Inclusive Capitalism (EPIC), a project bringing together businesses with more than $1.5 trillion in market capitalization and asset managers managing more than $30 trillion, those U.S. companies that voluntarily disclose this information outperform those that do not and receive better returns on their investment in human capital.[7]

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[3] Geoff Colvin, *How to Build the Perfect Workplace*, Fortune (Mar. 5, 2015).
[4] F*Y 2019 Budget-U.S. Securities and Exchange Commission, Hearing Before the H. Comm on Appropriations*, 115th Cong. (2018) (statement of Jay Clayton, Chairman, Securities and Exchange Commission).
[5] *International Accounting Standards Rule 19*, Employee Benefits.
[6] Letter from Dr. Anthony Hesketh, Professor, Lancaster University, to Anne Sheehan, Chairwoman, Investor Advisory Committee, U.S. Securities and Exchange Commission (Mar. 21, 2019), *available at* https://www.sec.gov/comments/265-28/26528-5180428-183533.pdf.
[7] *Id.*

26 institutional investors representing over $3 trillion in assets, including public pension plans, have petitioned the SEC to implement a rulemaking that would require public companies to disclose more information about human capital management. [8] The petition also includes many of the recommendations the SEC's Investor Advisory Committee adopted on March 28, 2019.[9]

This draft bill would require the SEC to implement this petitioned rulemaking.

3. H.R. ____: A bill to require the SEC to study stock buybacks under rule 10b-18

SEC Rule 10b-18, adopted in 1982, creates a safe harbor that allows companies to repurchase their own shares, provided that they follow certain criteria regarding trading volume, timing, and price. In the years since, use of that safe harbor has grown dramatically with companies announcing more than $1 trillion of share buybacks in 2018 alone.[10] Rule 10b-18 has not been updated since 2003 when total repurchases were less than 20% of the current level.[11]

Traditionally, stock buybacks have been viewed as a capital allocation decision where a company repurchases its own stock when it feels it is undervalued, or as a way for a company to return excess capital to its shareholders.[12] Because stock buybacks, by their very nature, require a company to release excess cash, the practice has been criticized as coming at the expense of increasing worker wages.[13] Critics of the practice have become more vocal in the wake of the Tax Cuts and Jobs Act, where an estimated 40-60% of corporate tax savings have been spent on buybacks while average median wage growth for workers has remained stagnant.[14] In fact, in 2018, the same year the Trump tax cuts went into effect, total S&P buybacks increased by 60%,,[15] yet

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[8] Petition for Rulemaking from Meredith Miller, Chief Corporate Governance Officer, Human Capital Management Coalition, to William Hinman, Director, Division of Corporate Finance, U.S. Securities and Exchange Commission (Jul. 6, 2017), *available at* https://www.sec.gov/rules/petitions/2017/petn4-711.pdf.

[9] *Recommendation from the Investor-as-Owner Subcommittee on Human Capital Management*, Investor Advisory Committee, U.S. Securities and Exchange Commission (Mar. 19, 2019), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac032819-investor-as-owner-subcommittee-recommendation.pdf.

[10] Bob Pisani, Stock Buybacks Hit a Record $1.1 trillion, and the Year's Not Over, CNBC (Dec. 18, 2018), *available at* https://www.cnbc.com/2018/12/18/stock-buybacks-hit-a-record-1point1-trillion-and-the-years-not-over.html.

[11] Purchases of Certain Equity Securities by the Issuer and Others, 45 Fed (proposed Jan. 25, 2010) (to be codified at 17 C.F.R. pt. 240), *available at* https://www.sec.gov/rules/proposed/2010/34-61414.pdf.

[12] Gabriel T. Rubin and Michael Wursthorn, Record Stock Buybacks Draw Fire from Democratic Presidential Hopefuls, The Wall Street Journal (Feb. 4, 2019), available at https://www.wsj.com/articles/record-stock-buybacks-draw-fire-from-democratic-presidential-hopefuls-11549321288.

[13] *Senator Chuck Schumer and Senator Bernie Sanders, Schumer and Sanders: Limit Corporate Stock Buybacks, The New York Times (Feb. 3., 2019), available at* https://www.nytimes.com/2019/02/03/opinion/chuck-schumer-bernie-sanders.html?mod=article_inline.

[14] Wage Growth Tracker, Federal Reserve Bank of Atlanta (last updated Apr. 15, 2019), *available at* https://www.frbatlanta.org/chcs/wage-growth-tracker.aspx.

[15] Dr. Edward Yardeni et al., Stock Market Indicators: S&P 500 Buybacks & Dividends, Yardeni Research, Inc. (Apr. 29, 2019), *available at* https://www.yardeni.com/pub/buybackdiv.pdf.

companies simultaneously reduced their spending on capital expenditures, debt reduction, and research and development.[16]

In addition to the criticisms surrounding the connection between stock buybacks and employee wages, there are also concerns related to a lack of transparency around company share repurchases. Companies are not required to carry out the repurchase programs they announce, nor are they required to immediately disclose the transactions to the SEC, which makes it difficult for the SEC to supervise these programs and invites potential abuse.[17] A study conducted by SEC Commissioner Robert Jackson found that corporate insiders sold up to five times as much stock as usual immediately following a buyback announcement, suggesting that corporate insiders may be abusing this practice for personal gain.[18]

This draft bill would require the SEC to study existing stock buyback practices, including incidents where the practice may be misused to enhance executives' stock options, and the impact of buybacks on workers' wages. The draft bill would also require the SEC to report the results of its study to Congress and, within one-year of such report, to amend its rules to address the results of the report.

4. H.R. ____: the "Greater Accountability in Pay (GAP) Act of 2019" (Phillips)

Income inequality is a growing concern both worldwide and in the United States. Federal Reserve Chairman Jerome Powell has described the problem of income inequality as one of the biggest challenges facing the United States, stating that "the US lags now in [economic] mobility."[19] While CEO compensation has continued to rise, median worker wages have remained stagnant. In fact, a recent Pew Research Center study shows that today's real average wage has about the same purchasing power as it did 40 years ago.[20] However, compensation for CEOs now dwarfs that of employees. In 1965, the average CEO was paid 20 times their median worker, rising to 58-to-1 in 1989. In 2017, this ratio reached 312-to-1.[21] This trend is the result, in part, of workers' wages not keeping pace with inflation, while executives have received yearly salary

[16] Lynnley Browning, *Share Buybacks Could Hurt Corporate Cash Flows, Moody's Says*, Bloomberg (May 1, 2019), available at https://www.bloomberg.com/news/articles/2019-05-01/share-buybacks-could-hurt-corporate-cash-flows-moody-s-says

[17] Jesse M. Fried and Charles C.Y. Wang, The Real Problem With Stock Buybacks, The Wall Street Journal (Jul. 6, 2018), available at https://www.wsj.com/articles/the-real-problem-with-stock-buybacks-1530903118.

[18] Commissioner Robert Jackson, Securities and Exchange Commission, Speech at the Center for American Progress (Jun. 11, 2018), *available at* https://www.sec.gov/files/speech-jackson-061118-data-appendix.pdf.

[19] Transcript of Teach Town Hall, Federal Reserve Board of Governors (Feb. 6, 2019), *available at* https://www.federalreserve.gov/mediacenter/files/teacher-town-hall-transcript-20190206.pdf.

[20] Drew Desilver, For Most U.S. Workers, Real Wages Have Barely Budged in Decades, Pew Research Center (Aug. 7, 2018), *available at* https://www.pewresearch.org/fact-tank/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades/

[21] Lawrence Mishel and Jessica Schieder, *CEO Compensation Surged in 2017*, Economic Policy Institute (Aug. 16, 2018), *available at* https://www.epi.org/publication/ceo-compensation-surged-in-2017/ .

raises. For example, according to data from the Economic Policy Institute, the average CEO from one of the 350 largest firms received a 17.6% raise in 2017, while the typical worker in those same firms received just a 0.3% raise.[22]

This draft bill would require public companies to disclose the pay raise percentage of its executives and the pay raise percentage of its median employee over the past year and compare each to the rate of inflation. The bill would also require public companies to disclose the ratio between the two pay raise percentages.

[22] *Id.*