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Testimony
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For
The House Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets

Hearing:
Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers

May 15, 2019

Chair Maloney, Ranking Member Huizenga, and members of the subcommittee: On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following comments regarding the legislative proposals advanced at this hearing that would promote economic growth through the protection of workers. Rachel Curley, also of Public Citizen's Congress Watch division, contributed to this testimony.

Our economy currently enjoys a period of prolonged growth, with rising GNP, relatively low unemployment, modest wage growth, and a strong stock market. Unfortunately, as has been the case for several decades, the fruits of labor have not been shared equitably. The fortunes of those in the senior ranks of corporations, especially the financial sector, pierce the ceiling of embarrassment; the financial fate of the too many Americans has bordered on the bleak. The charts below developed by Thomas Piketty and the Federal Reserve document this disparity.[1]

We believe Congress must adopt bold reforms to address this yawning income gap. That must include governance changes to the way corporations concentrate revenues generated by their workforce into senior executive pay, which is the purview of this subcommittee. First, we review the proposals now before the committee; second, we outline some of these additional needed reforms.

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[1] Bricker et al, *Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009 (PDF).* FEDERAL RESERVE BOARD, (2011) https://www.federalreserve.gov/pubs/feds/2011/201117/201117pap.pdf , also, Thomas Piketty, Capital in the 21st Century.

Proposed Legislation

This hearing addresses some important first steps towards rectifying this maldistribution of income.

1. The Outsourcing Accountability Act

Sponsored by Rep. Cynthia Axne (D-Iowa), this measure requires publicly traded companies to disclose the total number of workers they employee in each state and in each foreign country. This will help inform policymakers and investors about the geographic strategies of the nation's larger corporations. This information is already known to these companies, making disclosure simple.

2. A bill to amend the Securities Exchange Act of 1934 to require issuers to disclose information about human capital management in annual report

Also sponsored by Rep. Axne, this legislation would expand reporting of a firm's investment in its workforce and certain intangible assets. Increasingly, the value of a firm consists not in its factories or inventory but the quality of its workforce. An investor may wish to know more about such firms where most of the assets essentially disappear at the end of a work day. According to one study, "about 3/4 of the value of public companies, as perceived by investors, reflects nonphysical and nonfinancial assets. Much of this huge value constitutes intangibles that are absent from the balance sheet."[2] Firms with superior human capital management (HCM) enhance company performance and share value.[3]
Two portfolios of large-capitalization companies launched in 2001 and 2003 using criteria related to training and employee development outperformed the S&P 500 on an annualized basis by 3.1% and 4.4%, respectively, through May 25, 2010.[4]

To date, however, the Securities and Exchange Commission (SEC) requires minimal information regarding employees. Specifically, under Regulation S-K, only one item addresses the issue, and mandates the disclosure of the "number of persons employed." The only other item is the median pay of workers.

Public Citizen supports the Human Capital Management Petition filed with the SEC by the Human Capital Management Coalition on July 6, 2017.[5] This change would enhance disclosure. And we thereby support this Rep. Axne legislation that calls upon the SEC to implement the petition for rulemaking.

In addition, Public Citizen supports comprehensive disclosure rules around all corporate environmental, social, and governance (ESG) risk from climate change, political spending, tax, human rights, to gender

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[2] Baruch Lev "*Intangible Assets: Concepts & Measurements*" NYU ENCYCLOPEDIA OF SOCIAL MEASUREMENT, VOL 2 (2005) p 299. Available at: http://raw.rutgers.edu/docs/intangibles/Papers/Intangible%20Assets%20Concepts%20and%20Measurements.pdf.

[3] See, for example, Beeferman, Bernstein "*The Materiality of Human Capital to Corporate Financial Performance*" IRRC AND THE KENNEDY SCHOOL (April 2015) http://www.law.harvard.edu/programs/lwp/pensions/publications/FINAL%20Human%20Capital%20Materiality%20April%2023%202015.pdf.

[4] Laurie Bassi & Dan McMurrer, *Human Capital Management Predicts Stock Prices*, AMERICAN SOCIETY FOR TRAINING AND DEVELOPMENT, (June 2010) (http://mcbassi.com/wp/resources/documents/HCMPredictsStockPrices.pdf)

[5] *Letter to SEC from Public Citizen re Human Capital Management Petition*, SECURITIES AND EXCHANGE COMMISSION (Sept. 27, 2017) https://www.citizen.org/wp-content/uploads/migration/case_documents/public_citizen_comment_on_hcm_petiton.pdf

pay ratios. To that end, we supported a new petition for a rulemaking[6] at the SEC from securities law experts and investors representing more than $5 trillion in assets under management that would create a standard disclosure framework on all ESG issues for public companies.

Public Citizen urges the SEC to begin work on this rulemaking and would support legislation from Congress that mandates such a rule.

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

This measure takes a welcome step to address the glut of stock buybacks that have accelerated since the SEC relaxed anti-manipulation rules in 1982. On the surface, a stock buyback represents a declaration of management indolence. Firms issue stock to raise capital for growth, for the expansion of existing production, for the research and development of new products. When managers repurchase stock, they are confessing they have no new promising ideas. In fact, this apparent humility may mask a darker motive: stock buybacks raise stock prices, and when senior executive pay is paid in stock options, this can generate an unjustified bonus.

President Trump and congressional Republicans sold the recent tax giveaway law as a stimulus for corporate investment in higher worker wages and enlarged production facilities. In fact, the single largest use of corporations' tax savings has been stock buybacks.[7] When a corporation buys stock, it should be governed by the maxim that applies to any investor: buy low, sell high. Yet the stock market has been at a record high level during this frenzy of corporate stock buybacks, contradicting any claim that these are sound business decisions. Commissioner Robert Jackson of the SEC found that corporate insiders were inexplicably active sellers following a buyback announcement,[8] buttressing the concern about manipulation. Clearly, the motives behind these stock buybacks must be examined. This bill aims to clarify those motives and we therefore support it.

Public Citizen also endorses several other affirmative efforts to reform stock buyback abuse. Congress should begin by repealing the 1982 Rule 10b-18, which relaxed anti-manipulation safeguards. We additionally support the Reward Work Act, sponsored by Sen. Tammy Baldwin (D-Wisc.), which does reform 10b-18. It would also empower workers to elect a third of a company's board of directors.[9] Public Citizen also supports a bill authored by Sen. Bernie Sanders (I-Vt.) and Rep. Ro Khanna (D-Calif.) that would prohibit buybacks where CEO pay exceeds 150 times that of the company's median pay. We also support a rule from the SEC that would require that shareholders approve buybacks, rather than directors. Finally, Congress should simply ban executive stock sales during buybacks altogether.

4. Greater Accountability in Pay (GAP) Act of 2019

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[6] *Request for rulemaking on environmental, social, and governance (ESG) disclosure*, SECURITIES AND EXCHANGE COMMISSION, (website viewed on March 28, 2019). https://bit.ly/2Pg52qz

[7] *Wage Growth Tracker*, FEDERAL RESERVE BANK OF ATLANTA (April. 15, 2019) https://www.frbatlanta.org/chcs/wage -growth-tracker.aspx

[8] Comm. Robert Jackson, *Speech at the Center for American Progress*, SECURITIES AND EXCHANGE COMMISSION (Jun. 11, 2018), https://www.sec.gov/files/speech-jackson-061118-data-appendix.pdf.

[9] *Reward Work Act*, press release, OFFICE OF SEN. TAMMY BALDWIN (website visited May 13, 2019) https://www.baldwin.senate.gov/press-releases/reward-work-act-2019

Sponsored by Rep. Dean Phillips (D-Minn.), this measure requires publicly traded firms to show the change in their median pay each year, compared with the change in CEO compensation. Public Citizen has actively supported the underlying disclosure provided in Section 953b of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act that this bill expands.[10] This modest disclosure of the pay gap helps investors better understand how a firm invests in its most critical driver of revenue—employees.[11]

We encourage the committee to consider additional disclosures and rules. We support disclosure of pay by gender and race to help policymakers shape appropriate incentives. Policymakers should use the power of the public purse to incentivize narrower pay gaps—for example, by banning contracts to corporations with extreme gaps or giving preferential treatment to firms with narrow gaps, as proposed in Rhode Island.[12] Similarly, all forms of corporate welfare should be required to incorporate pay ratio guidelines in their qualification standards. As a member of Congress, Mick Mulvaney authored legislation designed to prevent the U.S. Export-Import Bank from subsidizing any U.S. company with CEO pay greater than 100 times median worker pay. [13]

Needed Reforms

In addition to these measures, we urge the committee to consider additional steps. We believe that unbridled escalation of CEO pay both reflects and causes serious economic injury. High executive pay drains income from lower wage workers. Excessive pay led to the 2008 Wall Street crash, where the CEOs of failed Lehman Brothers and Bear Stearns earned hundreds of millions. Exorbitant pay is corrupting medicine.[14] And as noted, high stock-based pay leads to buybacks instead of investment in factories and human capital. These serious problems demand stern answers.

Many reforms involve shareholder governance. Shareholders legally decide how senior managers are paid, but current rules don't allow for true shareholder control.

Say-on-Pay Director Accountability

By law (Dodd-Frank Section 951), corporations must seek a shareholder vote on the compensation package for the CEO. Unfortunately, the current vote is non-binding, meaning that even if a majority disapprove, no changes are required. Say-on pay votes should be binding. In addition, there should be an

[10] Letter to SEC, Public Citizen (March 29, 2018) https://www.citizen.org/wp-content/uploads/migration/public_citizen_on_sec_pay_ratio_data_integrity.pdf

[11] *Letter to SEC*, Public Citizen, SECURITIES AND EXCHANGE COMMISSION (July 6, 2015) https://www.sec.gov/comments/s7-07-15/s70715-44.pdf

[12] Sarah Anderson, How Taxpayers Subsidize Giant Corporate Pay Gaps, Institute for Policy Studies (August 29, 2018) https://ips-dc.org/wp-content/uploads/2018/08/EE18-embargoed-until-aug-29.pdf

[13] Robert Schroeder, *Republican Aims To Block Ex-Im Aid To Companies With Hefty CEO Pay*, MARKETWATCH (Nov. 3, 2015) https://www.marketwatch.com/story/republican-aims-to-block-export-import-aid-to-companies-with-hefty-ceo-pay-2015-11-03

[14] Martin Shkreli quadrupled drug prices to fund his high pay. See Brendan Pierson, *Martin Shkreli, Who Raised Drug Prices 5,000 percent, Heads into Fraud Trail*, SCIENTIFIC AMERICAN (website visited May 14, 2019) https://www.scientificamerican.com/article/martin-shkreli-who-raised-drug-prices-5-000-percent-heads-into-fraud-trial/

additional incentive to ensure good packages. Where shareholders oppose the package, the pay should revert to 20 times the median pay at the company, and director compensation should be cut in half.[15]

Proxy Access

Directors set executive pay, yet these directors don't necessarily reflect shareholder interests since there is no true election; shareholders only vote on one set of candidates. We propose a ballot that shows multiple candidates for each position, a policy endorsed by the Council of Institutional Investors.[16]

Worker boards of directors

We support worker representation on boards, and endorse the Accountable Capitalism Act, sponsored by Sen. Elizabeth Warren (D-Mass.). In a recent poll of likely U.S. voters, 52 percent were supportive of putting workers on boards of large corporations and only 23 percent were opposed.[17] In at least a dozen European countries, workers have the right to representation in their company's top administrative and management bodies.[18] This has had a moderating effect on CEO pay levels. In Germany, average CEO pay levels, while hardly stingy, were less than half the U.S. average in 2016.[19]

Defer banker pay for penalties

Following the 2008 financial crash, the Justice Department found widespread fraud at financial institutions. However, prosecutors brought no charges against any senior individuals. Some officials cited the complication of identifying culpable individuals. That left shareholders to shoulder the fines. To improve compliance, we call for the system advocated for by Willian Dudley, then president of the New York Federal Reserve, which says that senior bankers (such as the 2,000 most senior at JP Morgan) must defer a substantial portion of pay.[20] If the bank must pay a penalty, this pool is used to pay the fine instead of shareholder funds. This will motivate managers to police one another.

No stock options for bankers

Structuring pay to motivate executives to take risks may be healthy for some firms, but it can lead to disaster at banks. Bankers should not be paid in stock options. The EU rules introduced in 2014 limit banker bonuses to no more than annual salary, or up to 200 percent of annual salary with shareholder approval. The cap applies to bankers in non-EU banks located in the EU, as well as senior staff (including Americans) working for EU-based banks anywhere in the world. This reform aims to help counter the "bonus culture" that encourages high-risk investing.

Banker stock options should be banned, but short of that, they should at least be kept (and not cashed in) until at least two years after they leave the firm. This deters banking that yields short term profits at the expense of long-term problems.

CEO pay limit for firms in bankruptcy

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[15] Dean Baker, *High CEO Pay*, CENTER FOR ECONOMIC POLICY RESEARCH, (March 26, 2018) http://cepr.net/publications/op-eds-columns/high-ceo-pay-it-s-what-friends-are-for
[16] Proxy Access, Council of Institutional Investors, (website visited May 13, 2019) https://www.cii.org/proxy_access
[17] *The New Progressive Agenda Project*, DATA FOR PROGRESS (website visited May 13, 2019) https://www.dataforprogress.org/the-new-progressive-agenda-project/
[18] *Co-Determination in Germany*, HANS BOEKLER (June 2009) https://www.boeckler.de/pdf/p_arbp_033.pdf
[19] Anders Melin, *Executive Pay*, BLOOMBERG (Jan 23, 2018) https://www.bloomberg.com/quicktake/executive-pay
[20] Bartlett Naylor, *Decimate Wall Street*, HUFFINGTONPOST (Dec. 22, 2014) https://www.huffpost.com/entry/decimate-wall-street_b_6029372?guccounter=1

Executives should not be able to pocket huge bonuses after declaring bankruptcy and cutting jobs and pensions for workers. Policymakers should eliminate loopholes in existing law and prohibit companies in bankruptcy from awarding "retention" bonuses.

Private equity executives should not bankrupt companies and therein terminate employee pension benefits as a means of increasing their own profits. These executives should be barred from receiving any pension or pension-like benefits unless pensions and severance funds for operating companies are fully funded.

Again, we thank the subcommittee for beginning to address the needs of workers as it refashions securities laws. We look forward to a continuing dialogue about needed progress.

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