MSCI

January 14, 2019

To Whom It May Concern:

We are grateful for the opportunity to respond to the U.S. Federal Trade Commission's request for public comments related to issues discussed at the recent eighth FTC hearing on *Competition and Consumer Protection in the 21st Century* which took place at New York University School of Law in New York City on December 6, 2018.

Some recent econometric studies have concluded that when institutional investors hold stock across competing firms, competition may be reduced among those commonly held and therefore may have anticompetitive effects. As a basis for our commentary, we wish to reference the paper, *Anticompetitive Effects of Common Ownership* by Jose Azar, Martin Schmaltz, and Isabelle Tecu, first published May 25, 2018.

The intent of the paper was to study the effect of common ownership on product market outcomes by examining the levels of common of ownership across companies and the impact of market concentration measures. The paper posits that many natural competitors in an industry are commonly held by a small set of large institutional investors. The paper claims to have found evidence of anticompetitive incentives due to common ownership at the market level, and of a causal link between common ownership concentration and higher product prices. The industry in focus for the examination was the US domestic airline industry.

Azar, et al., look to illustrate their assertions with a measure called MHHI, representing total market concentration which is then further divided into two parts: one noted as *HHI,* which represents industry concentration and the *MHHI delta* which captures the extent to which those competitors are connected by common ownership and control links.

The paper notes the role of institutional ownership across differing investment strategies, especially given that several large asset management companies, many of whom employ a 'passive' investment management style, can often be the largest beneficial owners of several firms in a given industry.

The point we wish to comment on references the examination of passive asset managers' holdings and control during bankruptcy periods of a given company. Here, the authors have noted that "Holdings are not observed during bankruptcy periods. During the bankruptcies of American Airlines, Delta Airlines, Northwest Airlines, United Airlines, and US Airways, we repeat the last observed value for percentage of shares owned" and go on to say that "Bankruptcies may confound the results because shareholders have no de jure control rights during such times, and this feature is not captured in our computation of *MHHI delta*." To summarize, Azar et al state that the results (of their study) are generally weaker in

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markets and at times affected by bankruptcies, consistent with shareholders not being in control at times.

It is important to understand the context of how asset managers with a passive investment strategy specifically behave with regards to management of their portfolios in the context of a bankruptcy. For those asset managers who passively track an index, their investing behavior is primarily related to changes in the composition of the index which the asset managers choose to reflect in their portfolios.

As a preface, when a company declares bankruptcy, it is generally delisted from stock exchanges. In terms of specific methodological treatment relative to a company's bankruptcy filing, MSCI removes companies which file for bankruptcy or protection from their creditors from our indexes as soon as possible, post confirmation of filing.

Therefore, asset managers that passively replicate an 'affected' index within their portfolios under management, would of course be forced to sell these positions. Given such, it would make sense that index manager holdings during bankruptcy periods are often not observed. Further, and as expected, these managers would no longer vote the companies' proxies.

If a company eventually emerges from bankruptcy and subsequently resumes trading, consideration of that security to potentially be reinstated within the MSCI indexes would fall under Initial Public Offering (IPO)/new listing categorization and be subject to the MSCI equity index methodological rules that pertain to those situations.

For example, AMR Group, the parent company of American Airlines, declared bankruptcy and was deleted from the MSCI equity indexes on November 30, 2011. The company went through a restructuring, ultimately resumed trading in December 9, 2013 and was added back to our indexes on December 10, 2013 after a 24-month period of non-inclusion in our indexes.

To give a sense of the frequency of occurrence of these events within our global indexes, since July 2008, there have been 82 bankruptcies and subsequent deletions across the MSCI IMI equity index constituents. This covers the Large, Mid, and Small Cap size segments within our Developed, Emerging and Frontier Market classifications.

Of those 82 companies, 16 companies (approximately 20%) were subsequently added back to the index after resumption of trading. The average number of months that passed before index reinstatement of those securities was 29 months.

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In summary, while the Azar, et al., study does a good job of examining some important facets related to common ownership and its extended impact on product prices, the paper does have some central flaws in its assumptions. As we have noted above, these are specifically related to the ownership and control observations made during bankruptcy periods. It would seem prudent that further extensions of this examination and other additional studies should be undertaken, so that any basis of a proposal for new regulation which potentially put forth these as a reference, would not be deemed premature, or more notably, incomplete in their conclusions.

Sincerely,

The MSCI Equity Index Committee

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