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Office of the Secretary
Federal Trade Commission
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex C)
Washington, DC 20580

Re: FTC Hearing #8: Competition and Consumer Protection: Holdings of Non-Controlling Ownership Interests in Competing Companies

Dear Mr. Secretary:

S&P Global is a leading provider of ratings, benchmarks, analytics, and data to the capital and commodities markets worldwide. Our company's insights and commitment to transparency, integrity, and superior analytics have been at the forefront of U.S. economic growth since the company's founding over 150 years ago. Two of our flagship products, the S&P 500® and the Dow Jones Industrial Average®, are widely accepted as leading measures of U.S. equity market's performance. We appreciate the opportunity to provide comments on this important topic.

Notes on Indexation, Corporate Governance, and Common Ownership

Fifty years ago, there were no index funds; all institutional (and retail) asset management was conducted on an active basis. Today, we estimate that between 20 to 25 percent of the U.S. stock market is held by index funds.[1] This growth has resulted in tremendous cost savings for investors.[2] Not surprisingly, some questions have been raised about what impact this growth of index funds could have. One of these concerns is around the common ownership by index funds in the U.S. stock market.

Suppose that index funds own approximately 25% of every large company in the U.S. Is this a problem? Critics claim that ownership of a substantial fraction of most or all of the competitors in an industry could lead to "softer competition among product rivals" and higher consumer prices.[3]

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[1] See Ganti, Anu R. and Craig J. Lazzara, "Shooting the Messenger," S&P Dow Jones Indices, December 2017. Note that this estimate does not include so-called "smart beta" or factor indices, which can be viewed as a hybrid of purely passive and active strategies.

[2] We estimate that investor savings exceed $20 billion *annually*. Ganti and Lazzara, *op. cit.*, pp. 11-12.

[3] Posner, Eric A., Fiona Scott Morton, and E. Glen Weyl, "A Proposal to Limit the Anti-Competitive Power of Institutional Investors," Yale School of Management, Nov. 29, 2016.

The most often-cited example of this putative problem is the claim that U.S. airline ticket prices are "3-7% higher because of common ownership."[4] Other academics claim to find similar anti-competitive effects in the banking industry. Therefore, it is argued, public policy should require that "investors in firms in well-defined oligopolistic industries…choose either to limit their holdings of an industry to a small stake…or to hold the shares of only a single 'effective firm' per industry."[5]

In response, we offer four observations:

- There is by no means an academic consensus that common ownership has raised the price of airline tickets.[6] Moreover, the critics' statistics are, like any statistical analysis, indicative of *correlation* rather than *causation*.[7] The data on airline ticket prices span 2001-2014. Ticket prices may have risen, and the importance of index funds has certainly increased, but without a clearly identified causal mechanism, we should be extremely cautious in attributing the first effect to the second.[8]

- This is especially true because of the limited scope of the critics' evidence. Even if we accept their claims about airlines and banks, where are all the other industries? There are 71 industries in the Global Industry Classification Standard taxonomy, and all of them are equally subject to the effects of common ownership by index funds. If only two industries show adverse effects, it suggests that the effect being detected is random or coincidental rather than a systematic implication of common ownership. Perhaps, e.g., the result arises from factors unique to airlines and banks, both of which are relatively heavily regulated.

- One company's revenue is often another company's expense. Airlines accounted for 0.5% of the float-adjusted market capitalization of the S&P 500 as of year-end 2018. Even if index funds could cause airline executives to raise prices, why would they do so? Why increase the profits of 0.5% of your portfolio and raise the expenses of the other 99.5%?

- Price fixing and collusion are proscribed under applicable anti-trust laws. If such behaviors were suspected, appropriate legal remedies are presumably near at hand.

If common ownership is a problem, the problem presumably arises because corporate managers know that their shareholder base is highly diversified. Therefore, it's argued, they don't compete aggressively and are motivated to raise the aggregate profits of their industry rather than focusing on their own company's income. The critical assumption is that shareholders, for the most part, hold

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[4] Azar, Jose, Martin C. Schmalz, and Isabel Tecu, "Anti-Competitive Effects of Common Ownership," *Journal of Finance*, 2018.

[5] Posner et al., *op. cit.*, p. 1.

[6] See Dennis, Patrick J., Kristopher Gerardi, and Carola Schenone, "Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry," Feb. 5, 2018, SSRN; and Kennedy, Pauline, Daniel P. O'Brien, Minjae Song, and Keith Waehrer, "The Competitive Effects of Common Ownership: Economic Foundations and Empirical Evidence," July 24, 2017, SSRN. A particularly useful summary can be found in Committee on Capital Markets Regulation, "Common Ownership and Antitrust Concerns," November 2017.

[7] See CCMR, *op. cit.*, p. 10.

[8] For a cautionary tale about the dangers of the *post hoc* fallacy, see Leinweber, David J., "Stupid Data Miner Tricks: Overfitting the S&P 500," *Journal of Investing*, January 2007. The article was initially written in 1995.

diversified portfolios, and this is not a function of indexation. An active portfolio manager who is bullish on the oil industry, e.g., might own both Exxon and Chevron. The common ownership stems from the desire of portfolio managers and investors to be diversified, not from the fact that they diversify with index funds.

Finally, even if we accept the critics' view that indexers' common ownership of competitors is a problem for the economy, their proposed solution may be a cure worse than the disease. We've estimated that the passive management industry, at its current scale, saves investors better than $20 billion annually in management fees alone. Handicapping an industry that delivers benefits of this magnitude, on weak evidence of an ill-defined problem, strikes us as a bridge too far.

Thank you for the chance to provide thoughts, and I am happy to discuss further.

Very truly yours,

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