Dechert LLP

1900 K Street, NW
Washington, DC 20006-1110
+1 202 261 3300 Main
+1 202 261 3333 Fax
www.dechert.com

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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:

The Financial Services Group of Dechert LLP appreciates the opportunity to comment on the principle suggested by some that the acquisition of non-controlling interests in competing companies by asset managers, for the benefit of their clients, may cause anticompetitive effects ("common ownership theory").

Dechert is an international law firm with a wide-ranging financial services practice that serves clients in the United States and abroad. In the United States, we represent a substantial number of asset managers, including mutual funds, closed-end funds, exchange-traded funds, business development companies, fund boards, fund independent directors, and fund service providers. In developing these comments, we have drawn on our experience in the financial services industry generally. Although we have discussed certain matters related to the common ownership theory with some of our clients, the comments that follow reflect only the views of a group of attorneys in our Financial Services Group, and do not necessarily reflect the view of our clients, other members of our Financial Services Group or the firm generally.

U.S. government officials, academics, and asset management industry professionals recently gathered in New York to discuss "concerns that acquisitions and holdings of non-controlling ownership interests in competing companies, for example by institutional investors, may have anticompetitive effects."[1] The day-long hearing focused on the common ownership theory, a novel

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1 "FTC Announces Agenda for the Eighth Session of its Hearings on Competition and Consumer Protection in the 21st Century; Session at New York University to Focus on 'Common Ownership,'" *available at* https://www.ftc.gov/news-events/press-releases/2018/11/ftc-announces-agenda-eighth-session-its-hearings-competition.

and unproven area of antitrust research with major implications for investors. Several academic papers have hypothesized that common ownership harms competition, and that this harm occurs when an asset manager invests client assets in competing companies.[2]

The common ownership theory has generated some academic debate and policy proposals designed to address the conjectural harms the theory supposes. The hearing provided an opportunity for attendees to weigh the arguments on both sides and evaluate the theory. When we do this, five points emerge:

- Proponents of the common ownership theory are not able to explain how common ownership causes the anticompetitive effects that they allege.
- Proponents may not be fully familiar with fundamental asset management realities and, as a result, they may overstate the extent of common ownership, misunderstand the manner in which asset managers engage with portfolio companies on behalf of clients, and make incorrect assumptions about the incentives of asset managers and their clients.
- Proponents fail to recognize and account for the fact that decreased competition among portfolio companies would not benefit all investors.
- There is no credible evidence to support the theory that common ownership of companies by asset management clients harms competition.
- Policy proposals based on the common ownership theory are "solutions in search of a problem" that would harm investors and the economy.

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[2] *See, e.g.*, José Azar, Martin C. Schmalz, and Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513 (2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2427345 (last revised May 10, 2018) (concluding that, in the airline industry, ticket prices are 3-7% higher on the average U.S. airline route than they would be under separate ownership); José Azar, Sahil Raina, and Martin Schmalz, *Ultimate Ownership and Bank Competition* (2016), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2710252 (claiming that increased common ownership of banks causes higher consumer fees).

I. Proponents of the Common Ownership Theory Fail to Explain *How* Common Ownership Causes Anticompetitive Effects

Proponents of the common ownership theory assert that investors with stakes across multiple competitors in an industry benefit from reduced competition in the industry, and that those common holdings actually result in decreased competition. Often citing flawed empirical data and analyses, they argue that simultaneously holding stock issued by competing firms results in less competition and higher consumer prices.

Importantly, the theory's proponents do not explain *how* common ownership by asset management clients results in decreased competition. Instead, they posit that asset managers may actively engage with companies to discourage competition,[3] or may simply do nothing to encourage competition.[4] They speculate, without evidence, that asset managers might take direct actions to discourage competition, such as through supporting executive compensation structures that reward management for competing less aggressively,[5] or by voting against management recommendations if management competes too aggressively.[6] Moreover, proponents do not provide any evidence that asset managers actually advocate for anticompetitive behavior in meetings with portfolio companies, but simply presume such advocacy has occurred because the meetings have occurred. This presumption is inconsistent with certain regulatory incentives asset managers have to avoid the appearance of changing or influencing control of an issuer. For example, in order to benefit from favorable filing deadlines and limited disclosure of certain information regarding beneficial ownership of portfolio securities on Schedule 13G under the Securities Exchange Act of 1934, asset managers avoid acting in a manner that would be deemed to have the purpose or the effect of changing or influencing control of the issuer.[7]

Furthermore, the proponents have not offered actual evidence that asset managers consider competition factors when making decisions on executive compensation or when voting on management proposals. And they ignore the many obvious alternative corporate-governance reasons why an asset manager may decide to support or oppose a particular proposal.

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3 *E.g.*, Azar, Schmalz and Tecu, *supra* note 2, at 45-52.

4 *E.g.*, *id.* at 43-44 ("In sum, large diversified mutual fund families doing nothing, that is, not pushing portfolio firms to compete aggressively against each other, can implement the outcomes we document.").

5 *See e.g.*, *id.* at 49-51; Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1278-1281 (2016).

6 *E.g.*, Azar, Schmalz and Tecu, *supra* note 2, at 51-52.

7 17 C.F.R. § 240.13d-1(b)(1) (2018).

Nor have the proponents offered evidence that company management is either actively or passively influenced by common-ownership considerations when setting their company's competitive strategy. The FTC has reviewed strategic plans of many companies through its Hart-Scott-Rodino Act and other investigative powers. If common-ownership considerations were influencing competitive strategy of company management, the FTC would have seen evidence of this in company documents for years prior to the very recent academic papers of the proponents. The absence of such evidence historically should counsel against imposing the burdens of an FTC 6(b) study to satisfy the curiosity of the academics promoting the theory. In practice, proxy voting generally occurs with respect to resolutions that have broad goals and that are not narrow enough to specifically induce anticompetitive behavior.

In addition to the lack of substantiation, the sheer diversity of the proponents' causation theories demonstrates that they do not know *how* common ownership allegedly causes the harms that the theory purports to identify. In fact, certain of these theories of causation are fundamentally at odds with each other. For example, as noted above, certain proponents have argued that anticompetitive effects may be caused by asset managers doing nothing, while others (and even the same proponents) have argued that perhaps asset managers actively discourage competition by affirmatively engaging with the companies in a variety of ways. This scattershot, "damned if you do, damned if you don't" approach makes clear that proponents of the theory are not able to explain causation and are instead assuming it.

II. Proponents of the Common Ownership Theory Misunderstand Fundamental Asset Management Realities

Proponents of the common ownership theory overstate the degree of common ownership and make incorrect assumptions about the incentives of asset managers when they claim that several large asset managers "own" significant stakes in competing companies. This claim is not accurate. Asset managers are in the business of offering investment solutions to investors. They manage assets owned by their clients, with the largest asset managers having many thousands of separate client relationships. The profiles of these investors vary dramatically and may include individuals, funds, corporations, retirement plans, charitable organizations, other asset managers or government entities. Furthermore, many investors that utilize the investment products offered by asset managers are separately advised by third-party financial advisors — broker-dealers, financial planners and representatives of smaller investment advisory firms.

Clients of asset managers have a variety of investment goals. Some clients will invest with the goal of achieving capital appreciation; others will seek to realize the returns of a benchmark index or maximize current income. Importantly, it is the client that determines its investment goal, and the asset manager has a fiduciary duty to invest the client's assets in accordance with those objectives. The client's investment goals therefore constrain the investment adviser's discretion with respect to investing the client's assets. Accordingly, while the "record owners" of a company's shares may appear to be a small group of asset managers, the actual (beneficial) shareholders are thousands of separate investors with diverse investment goals.

Asset managers generally offer multiple products to their clients, each with a different (and sometimes, even contradictory) strategy. For example, a fund's manager may invest the fund's assets to track a specific index, which is very different from a fund with an active investment strategy where the portfolio manager has flexibility to determine the securities in which he or she will invest the fund's assets. In practice, an asset manager may have different incentives with respect to the performance of the same stock on behalf of different clients because of the clients' varying objectives, strategies or instructions, or even because of differing views among portfolio managers within a firm. It is therefore incorrect to assume that an asset manager will always have the same incentives with respect to a particular stock or industry on behalf of its clients.

Even if a manager invests the assets of two separate clients in the same stock, it may do so for different reasons and may have different relative interests with respect to that stock. For example, let's assume an adviser acquires shares of a bank (Bank A) for two funds — an index fund that is also invested in the stocks of several other banking companies, and an actively managed fund that does not own shares of stock of any other banks. While the index fund may benefit from the maximization of profits across all banking companies in which it holds stock (even if that means Bank A's individual profits are not maximized), the actively managed fund would benefit from the maximization solely of Bank A's profits. Heterogeneity of common-owner incentives is a critical factor that undermines the common-ownership theory of harm, and the proponents of the theory erroneously assume away this heterogeneity by incorrectly aggregating ownership and incentives at the level of the asset manager instead of at the level of their clients.

Relatedly, proponents of the common ownership theory do not accurately represent how asset managers act on behalf of clients when voting proxies. Literature supporting the common ownership theory generally assumes that an asset manager will vote proxies for all shares of a given company in a uniform manner. The literature does not cite any specific votes by asset managers that have created an anticompetitive effect. However, this assumption does not reflect how proxy voting occurs in practice. Shareholders typically have the right to vote proxies on certain matters, and this right belongs to clients, not their asset managers. In practice, clients may retain their proxy voting rights or delegate those rights to an asset manager or other third party.

It is simply incorrect to assume that an asset manager will vote on behalf of all of its clients, let alone that all clients will vote the same way. Asset managers with proxy voting authority must adopt and implement proxy voting policies and procedures that are designed to ensure that proxies are voted in the best interest of the applicable client and that address how conflicts of interest between the adviser and its clients will be handled.[8] Furthermore, a registered investment company must describe its proxy voting policies and procedures in its registration statement and publicly file a record with the SEC of how it voted proxies relating to portfolio holdings.[9] An asset manager's fiduciary duty (discussed below) compels the manager to vote proxies in its clients' best interests.[10] Because clients may have different investment strategies and interests, asset managers with voting discretion sometimes vote the same proxies differently for different clients.

The literature also assumes that asset managers put their financial interests ahead of their clients' interests when making investment decisions. This assumption lacks merit. Asset managers are not just agents for their clients, but they are fiduciaries, with a legal duty to act in the best interest of each client, including acting in a manner that is consistent with a client's agreed-upon investment objectives, strategies and policies.[11] Under well-established legal doctrines, asset managers owe their clients a duty of loyalty and a duty of care. Asset managers that breach either of these duties face significant legal and reputational risks.

III. Decreased Competition Among Portfolio Companies Would Not Necessarily Benefit Investors

The proponents of the common ownership theory assume that minority investors in competing firms would prefer those companies not to compete aggressively. As noted above, however, asset managers have many clients with widely varying interests and investment strategies, and they manage those clients' assets according to agreed-upon guidelines and restrictions and in a manner that is consistent with their fiduciary duties.

It would seem incorrect to assume that "common ownership" investors would prefer less competition in concentrated industries for another reason — the same investors often *also* hold shares in upstream or downstream companies that would be harmed by reduced competition in a particular industry. Consider, for example, an index fund that tracks the performance of a major,

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8 17 C.F.R. § 275.206(4)-6 (2018).

9 *See* Form N-1A at Item 17(f), *available at* https://www.sec.gov/files/formn-1a.pdf; Form N-PX, *available at* https://www.sec.gov/about/forms/formn-px.pdf.

10 *Proxy Voting by Investment Advisers*, 63 Fed. Reg. 6585, 6586 (Feb. 7, 2003) (stating that "an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting"). Managers subject to the Employee Retirement Income Security Act of 1974, as amended, may be operating under even additionally heightened standards. See, e.g., 29 C.F.R. § 2509.2016-01 (2018).

11 *See SEC v. Capital Gains Research Bureau, Inc.*, 365 U.S. 180, 191 (1963) (recognizing the fiduciary nature of an investment advisory relationship).

broadly diversified index, of which airline stocks make up a small percentage. If airline ticket prices increase, this might benefit airline stocks, but it may well hurt the stocks of other companies included in the index by increasing the price they pay for business air travel. Further, if airline ticket prices do increase, this could result in fewer airline customers, which results in declining stock performance for companies in the index that provide services to the airlines (e.g., fuel, food, or maintenance companies). Therefore, the gains that might be realized by the index fund as a result of the rising airline stocks could be more than offset by the resulting decreases in the prices of other stocks in the index. Academic papers advancing the common ownership theory do not adequately account for this effect or explain how asset managers could even begin to account for this effect in their investment decisions. Nor do the academic papers address how company management could identify and act to maximize their many common owners' optimal portfolio returns given these complexities.

IV. Common Ownership Theory Has Drawn Significant Academic and Industry Criticism and Debate

Recent academic, industry and U.S. government papers have cast doubt on the common ownership theory. Some researchers have presented alternative empirical models with which to study the effects of common ownership on the airline and banking industries. Two studies examined the airline industry — one of the more concentrated industries in the transportation sector and the subject of a seminal paper advancing the theory — and found no evidence that common ownership has had any anticompetitive effects.[12] A recent study by staff members of the Federal Reserve took issue with the findings of one of the theory's proponents, concluding that the effect of common ownership on competition in the banking sector was minimal.[13] These papers illustrate that there is ongoing debate surrounding the preliminary research on common ownership in the airline and banking industries, on which much of the work supporting the common ownership theory has been based.

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12 Patrick J. Dennis, Kristopher Gerardi, and Carola Schenone, *Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry* (last revised Feb. 5, 2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3063465; Pauline Kennedy, Daniel P. O'Brien, Minjae Song, and Keith Waehrer, *The Competitive Effects of Common Ownership: Economic Foundations and Empirical Evidence* (July 24, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3008331.

13 Jacob Gramlich and Serafin Grundl, *Testing for Competitive Effects of Common Ownership*, Finance and Economics Discussion Series 2017-029, Washington: Board of Governors of the Federal Reserve System (2017), *available at* https://www.federalreserve.gov/econres/feds/files/2017029pap.pdf.

Several observers have also challenged the assumptions underlying the common ownership theory. For example, they note that asset managers may engage with a company in which its clients own stock differently based on different client interests.[14] They also study how asset managers vote company proxies, noting that advisers often vote proxies based on client instructions or preferences, with no uniform approach for determining whether to vote with or against management.[15] These observers found no evidence that asset managers vote proxies based on a company's approach to industrywide competition. In regards to executive compensation structures, these observers cite evidence directly contradicting the assumption that asset managers support executive compensation structures that reward outperformance of an industry, as opposed to outperformance of a company within the industry.[16]

The papers described in this section provide evidence that overwhelmingly refutes the common ownership theory. These papers highlight why the theory's proponents have been unable to establish a mechanism by which common ownership actually causes decreased competition and increased consumer prices.

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14 *See* Thomas A. Lambert and Michael E. Sykuta, *The Case for Doing Nothing About Institutional Investors' Common Ownership of Small Stakes in Competing Firms*, University of Missouri School of Law Research Paper No. 2018-21 (May 4, 2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3173787. In particular, these authors studied the holdings of various Vanguard funds in the airline industry and found that, as a result of the funds' varying holdings in airline stocks, different Vanguard funds would be benefitted by different competitive outcomes in the industry. *Id.* at 24-26.

15 *See* Douglas H. Ginsburg and Keith Klovers, *Common Sense About Common Ownership*, George Mason Law & Economics Research Paper No. 18-09 (April 27, 2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3169847 (stating that "[c]onsistent with its fiduciary duty, each fund votes the shares it manages in the best interests of their underlying economic owners" and noting that, "of the shares an investment manager can vote, it does not necessarily vote all of them the same way").

16 *See, e.g.*, Barbara Novick, *et. al*, *Index Investing and Common Ownership Theories*, *BlackRock View Point* (March 2017), available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-index-investing-and-common-ownership-theories-eng-march.pdf (citing Heung Jin Kwon, *Executive Compensation Under Common Ownership* (Jan. 30, 2017)); Edward B. Rock and Daniel L. Rubinfeld, *Antitrust for Institutional Investors,* New York University School of Law and Economic Research Paper Series, Working Paper No. 17-23 (July 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2998296##.

V. Policy Measures Suggested by Proponents of the Common Ownership Theory Would Be Inappropriate and Harmful

Proponents of the common ownership theory have proposed measures to address the alleged harms of common ownership, including: (i) reducing the ability of asset managers to acquire or hold shares in competing firms on behalf of their clients; and (ii) compelling clients of asset managers to forfeit rights, such as voting rights, if common ownership exceeds a certain threshold. Policy measures of this type could be implemented by statutory or regulatory means.[17]

Alternatively, proponents have urged federal antitrust enforcers, state attorneys general and private plaintiffs to bring cases under antitrust laws to require investors to divest any common holdings that cause anticompetitive effects.[18] There is disagreement among proponents of the theory about the usefulness of litigation as a means to address the alleged harms of common ownership. One paper has argued that litigation would not be an optimal approach to address the alleged harms of common ownership, arguing that courts might use different standards to determine liability.[19] Other observers have noted that it would be difficult to challenge the acquisition of a small stake in multiple competitors under existing U.S. antitrust law.[20]

The claimed effects of common ownership are far from proven, but even if the proponents' results are assumed to be true, any assessment of the harms and proposed regulatory measures must also consider the widespread benefits that investing through asset managers has on individual investors and the economy. Asset managers provide investors with professional portfolio management services and diversified investment exposure at a relatively low cost. Retail investors may not have the time, inclination, assets or expertise to invest directly in a diversified portfolio of stocks, so they rely on investments in regulated funds to fill this need. Investment in large funds allows the risks of investing to be shared effectively by many investors, and without such funds, retail investors may be subject to greater risks and costs in order to achieve their financial goals. These funds also benefit the economy as a whole by supplying capital to companies, which allows them to expand their operations, including by hiring additional employees and developing new business ideas.

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17 *E.g.*, Eric A. Posner, Fiona Scott Morton, and E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors* (March 22, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2872754.

18 *See* Elhauge, *supra* note 5, at 1302-1304.

19 Posner, Morton, and Weyl, *supra* note 17, at 20.

20 *See* Ginsburg and Klovers, *supra* note 15, at 5.

The policy measures that have been proposed to remedy the unproven harms of common ownership would themselves cause significant harm to investors and the asset management industry. Measures proposing to reduce the ability of asset managers to acquire or hold shares in competing firms would fundamentally change the way in which the asset management industry operates and would, as a result, harm investors by increasing costs and making investing more complicated. Such measures would also harm companies in which asset managers invest, as it may be more difficult for those companies to raise capital through outside investments. As a result, the proposed measures could lead to a suboptimal allocation of capital in the economy. Measures proposing to limit or take away voting rights could prevent an asset manager from properly monitoring and engaging with portfolio companies on behalf of its clients. Such measures could therefore interfere with the asset manager's fiduciary duties to its clients and decrease the effectiveness of corporate governance among portfolio companies. The U.S. government's recent submission to the Organization for Economic Co-operation and Development puts it best, by concluding that "[c]reating across-the-board limitations on common ownership without sufficient evidence of anticompetitive effects could impose unintended real-world costs on businesses and consumers by making it more difficult to diversify risk."[21] It would be highly inappropriate for regulators to adopt such disruptive measures based on an unproven theory.

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We appreciate the opportunity to comment on this issue. Please feel free to contact Tom Bogle at (202) 261-3360, Megan Johnson at (202) 261-3351 or Craig Falls at (202) 261-3373 with any questions about this submission.

Very truly yours,

/s/ Dechert LLP

Dechert LLP

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[21] Hearing on Common Ownership by institutional investors and its impact on competition – Note by the United States. Submitted to the Organization for Economic Co-operation and Development, Directorate for Financial and Enterprise Affairs Competition Committee. DAF/COMP/WD(2017)86 (Nov. 28, 2017), *available at* https://www.ftc.gov/system/files/attachments/us-submissions-oecd-other-international-competition-fora/common_ownership_united_states.pdf.