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William F. Adkinson, Jr.
Attorney Advisor, Office of Policy Planning
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Submitted via regulations.gov

Re: Federal Trade Commission Hearing #8: Competition and Consumer Protection in the 21st Century

Dear Mr. Adkinson:

State Street Global Advisors appreciates the opportunity to comment on the Federal Trade Commission's hearings initiative on Competition and Consumer Protection in the 21st Century, specifically the eighth session which focused on common ownership ("**Common Ownership Hearing**").

Recognized as an industry pioneer, State Street Corporation created the first United States listed exchange-traded fund ("**ETF**") in 1993 (SPDR S&P 500® - Ticker: SPY) and has remained on the forefront of responsible innovation as evidenced by the introduction of many ground-breaking products, including first-to-market launches with gold, international real estate, international fixed income, and sector ETFs. With over $2.8 trillion in assets under management as of September 30, 2018, State Street Global Advisors is the third-largest asset manager and the issuer of the SPDRs family of ETFs.

We believe that the arguments purporting that minority ownership by institutional investors has led to decreased competition among firms in concentrated industries misconstrue the role that asset managers play in the marketplace with respect to corporate governance. Furthermore, these arguments overstate the influence of asset managers in the corporate decision making process and fail to provide any evidence that institutional investors (as index fund managers) take any actions to promote anti-competitive behavior. Set forth below are a number of important ways that the academic theories misconstrue the activities of institutional investors and the role of index fund managers:

1. Institutional investors have no motive to encourage industry competitors to not compete

The underlying thesis in the recent academic papers discussing common ownership is that institutional investors benefit if the firms in which they invest do not compete aggressively for market share. The most well-known paper on this topic is by Jose Azar, Martin Schmalz and Isabel Tecu ("**Azar et al.**") on the alleged anti-competitive effects of common ownership in the airline industry. Azar et al. claim that institutional investors benefit from anti-competitive behavior because increased competition among firms in a concentrated industry would lead to price cuts, decreasing profits for both firms. They argue that institutional investors actively pushing for more aggressive competition is not only costly but also "against the incentive to maximize the value of the family's total portfolio".[1]

However, more recent academic studies by noted economists have called into question the economic effects on the airline industry described by Azar et al. For example, in their examination of the anti-competitive effects of common ownership, Daniel O'Brien and Keith Waehrer find the predictions found by Azar et al. rely on "misspecified models " and therefore lead to corresponding correlations which are "not unexpected given the model misspecification".[2] We generally agree with these commentators who note that there are numerous flaws in the underlying models used to support these theories. At best it appears that these theories identify potential correlations while utterly failing to prove any sort of causal effects. This viewpoint is echoed by O'Brien and Waehrer and other academics who note that the regression models used by Azar et al. are "likely to show a relationship even if common ownership has no actual causal effect on price".[3, 4]

Moreover this argument fails to recognize that as index fund managers, institutional investors do not just hold airline stocks in their portfolio; they hold the entire market. Thus, these managers are focusing their engagement on areas that will improve the long-term profitability of all of the companies within an index fund's portfolio. It would make little sense for managers to pursue a policy that might help raise profits in one area (e.g. airlines), but have deleterious effects on other firms or industries also included in the index, such as hotels, restaurants, retail firms etc. It is perfectly reasonable to expect that increased airline prices could lead consumers to spend less money at these types of firms, thus hurting their profits and the broader index fund which holds them. This is why institutional investors engage with companies on issues like effective and independent board leadership which impact the company's ability to generate long-term value. Because institutional investors cannot simply sell shares in their portfolio (e.g. "vote with their feet"), they need to pursue stewardship programs that reflect the fact that they are in effect permanent capital. Any engagement on short-term issues, such as short-term corporate strategy, would contradict the fund's focus on maximizing the probability of attractive long-term returns for their investors.

2. Institutional investors (as minority shareholders) lack both the desire, and control needed, to influence strategic decision making at the companies in which they invest

Some academic research has claimed that, in order to spur this anti-competitive behavior, index fund managers structure their engagement to ensure that firms

[1] Azar, Jose, Schmalz, Martin C., and Tecu, Isabel. "Anti-Competitive Effects of Common Ownership." March 15, 2017.
[2] O'Brien, Daniel P., and Waehrer, Keith. "The Competitive Effects of Common Ownership: We Know Less than We Think." *Antitrust Law Journal*. Vol. 81, 2017.
[3] O'Brien and Waehrer, pg. 1
[4] Rock, Edward B., and Rubinfeld, Daniel L. "Defusing the Antitrust Threat to Institutional Investor Involvement in Corporate Governance." NYU School of Law. Law & Economics Research Paper Series, Working Paper No. 17-05. March 2017.

don't compete. Azar et al. claim that this is done either passively (e.g. by doing nothing) or actively through institutional investors' engagement with companies as part of their asset stewardship programs. Both of these arguments represent a lack of understanding as to how institutional investors engage with companies, and the goals associated with those engagements. As noted earlier, institutional investors engage on issues that impact the long-term performance of the companies in the index in order to fulfill their fiduciary duty of maximizing returns for investors. Decisions about when and what issues to engage on are made within this context, and not on the basis of whether the engagement might increase or decrease competition.

The assertion by Azar et al. that there is a "scarcity of information" about these types of engagements is also false. State Street Global Advisors, for example, publishes an Annual Stewardship Report that outlines our stewardship philosophy and objectives, how our stewardship program works, and the impact of engagement with firms. As noted in this report, our stewardship program is focused on using "our voice and vote to influence companies on long-term governance and sustainability".[5] The guidelines for our engagement policy, approach and processes are published on our website and designed with the purpose of communicating the objectives of our engagement activities. Our annual report and these guidelines make it clear that because we are in effect permanent capital, we cannot simply "vote with our feet", and thus have a duty to engage with portfolio companies in the long-term interests of clients /investors.

There is also a lack of empirical evidence in all of these theories that institutional investors have the necessary "control" in order to influence the strategic decision making of firms. This was clearly pointed out by Daniel O'Brien in his testimony to the Organization for Economic Co-operation and Development (OECD), where he notes that "the economic literature has not produced a definitive, tested prediction as to how minority shareholdings translate into control when owners have divergent interests".[6] It is unclear how institutional investors, who often make up less than 10% of a firms' holdings, would have the ability to exert the necessary level of control to push management to pursue strategies that are directly in conflict with the interests of the vast majority of shareholders.

3. Institutional investors do not create incentives for management to discourage competition

In the absence of control, Einer Elhauge in his paper on *Horizontal Shareholding* argues that managers "know the identity of their shareholders and the fact that their shareholders also own shares in their rivals" which means that managers know that "taking away sales from rivals imposes a cost on their shareholders".[7] This statement is not only inaccurate but implausible on its face; there is no supporting evidence or reasoning as to why management would choose to make decisions based on what they believe the other holdings of institutional investors are. Such a decision would be a breach of management's fiduciary responsibility to

[5] State Street Global Advisors. Annual Stewardship Report 2017. https://www.ssga.com/investment-topics/environmental-social-governance/2018/07/annual-stewardship-report-2017.pdf
[6] O'Brien, Daniel P. "The Competitive Effects of Common Ownership: Ten Points on the Current State of Play." OECD Hearing on Common Ownership by institutional investors and its impact on competition. December 13, 2017. https://one.oecd.org/document/DAF/COMP/WD(2017)97/en/pdf
[7] Elhauge, Einer. "Horizontal Shareholding." *Harvard Law Review*, Vol. 129, 2016

the company, and the board of directors' fiduciary responsibility to all of its shareholders. Azar et al. make a similar argument, stating that institutional investors seek to structure management compensation packages which discourage them from pursuing competitive strategies. However, this claim again inaccurately portrays how compensation decisions are developed and ultimately approved by the firm's board of directors. It further completely ignores the role and influence of executive compensation consultants that help company boards determine executive compensation packages. Institutional investors do not have the opportunity to structure executive compensation packages in this manner --- such packages are developed by firm management and approved or disapproved by shareholders. Given that "say on pay" proposals are approved by shareholders an overwhelming majority of the time, it is unclear at all how institutional investors would have the leverage and power to fine-tune compensation packages, making Azar et al.'s arguments naïve at best.

Conclusion

While we appreciate the FTC's ongoing efforts to examine and investigate potential anti-competitive activities in the marketplace, we believe that the current theories surrounding common ownership are far too underdeveloped and misguided to warrant further examination. The basic structure of index funds contradicts the theory that institutional investors would be using their role in the marketplace to encourage anti-competitive behaviors; because these funds are required to hold the entire marketplace, it would be difficult to understand why institutional investors, who have exposures to companies throughout the market, would take actions that might benefit some but hurt others. Furthermore, it is important to note that the public policy changes being suggested to "remedy" this situation, such as limiting an index fund to holding stock in only one competitor in a market segment, would eliminate index funds as we know them, increasing the cost of investing and depriving millions of Americans of what has become a key component of their retirement and other savings.

Once again State Street Global Advisors appreciates the opportunity to comment on the FTC's Common Ownership Hearing. Should you have any questions or need any additional information, please don't hesitate to contact me.

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Phillip S. Gillespie, General Counsel and Executive Vice President
State Street Global Advisors, a division of State Street Bank and Trust Company