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WELCOME

MR. HEMPHILL: Hi, everyone. Why don’t we get started. Welcome to the New York University School of Law. My name is Scott Hemphill and I'm a professor here at the law school. NYU, joined by our Engelberg Center on Innovation Law, is delighted to be hosting this eighth session in the hearings initiative.

Today's hearing focuses on the question of common ownership by investors in competing firms and related issues at the intersection of antitrust and corporate governance. My first order of business today is to invite our dean, Trevor Morrison to offer a welcome. Trevor?

(Applause.)

MR. MORRISON: Thank you, Scott, and good morning. Let me be the second to welcome you all here to NYU Law. We really are thrilled to be hosting this hearing of the FTC. Thanks to the FTC for joining us in this. We certainly think that if the hearing is going to be held in New York, it's absolutely fitting that it be here at NYU Law.

We have a great many people in our community, on our faculty engaged in the issues that the FTC is engaged in, and many of them will be
speaking today, including Scott Hemphill, Dan Rubinfeld, and Ed Rock, and of course our colleague, Marcel Kahan works closely on these issues and with Scott as well. So with that cohort of faculty working on these issues, we're certainly glad to be able to bring and host the FTC here today. And I wish you very well for this hearing. Again, welcome and thank you.

MR. HEMPHILL: Thanks, Trevor. So next, I have a couple of housekeeping items. FTC staff has asked me to remind everyone that this is a public event and is being webcast, photographed, and recorded. By participating in this event, you're agreeing that your image and anything you say or submit may be posted indefinitely at FTC.gov --

(Laughter.)

MR. HEMPHILL: -- or on one of the Commission's publicly available social media sites. A transcript of today's proceedings will be posted as well. Question cards will be available throughout the day. Please use them to write down questions for panelists. Staff will collect them and pass them to the moderators who may pose selected questions if time permits. Finally, if you have your mobile phone with you, please silence it.
So let me also echo Trevor's welcome. It's particularly fitting that the session is held at NYU Law for two reasons. The first Trevor already gave, this school's deep engagement with some of these questions and more generally the role that financial services play as the lifeblood of New York City.

The second reason that I just wanted to emphasize for a minute comes back to the late Bob Pitofsky, Former Chair of the Federal Trade Commission and a dear friend to many of us. Today's hearing, and the FTC's series of hearings more generally, were inspired by Bob's desire to keep the FTC abreast of cutting-edge issues in antitrust and consumer protection. Chairman Pitofsky held a series of public hearings in order to advance that aim, and this is very much in that tradition.

Now, as some of you know, Bob Pitofsky and NYU have a deep connection. Before Bob was a public servant, he was a professor of law here at NYU. Bob joined our faculty in 1964 at the urging of our late colleague, the great Norman Dorsen. Such was their friendship that Bob led the school’s Hays Program on civil liberties while Norman was on sabbatical. And the favor was returned. Norman Dorsen filled in one year to teach Bob's antitrust class. So all of us at
NYU are particularly pleased to reconnect in this way with Bob's legacy as a scholar and as a public servant.

So as you guys have seen, we have a full agenda today. Our first session features two sitting Commissioners, one from the Federal Trade Commission and one from the Securities and Exchange Commission, who will be giving some remarks. So first up is Noah Phillips. Commissioner Phillips was confirmed by the Senate in April. Prior to the Commission, he served as Chief Counsel to Senator John Cornyn on the Senate Judiciary Committee and a variety of other roles advising the Senator.

Prior to his Senate service, Commissioner Phillips worked at Wasserstein Perella, an investment bank, and as a litigator at Cravath Swain & Moore.

So Commissioner Phillips, the floor is yours.

(Applause.)
OPENING REMARKS AND DISCUSSION

COMMISSIONER PHILLIPS: Thank you for the kind introduction and also the privacy warning. This is not our privacy hearing, but it's important that everyone think about that all the time.

I'm really, really thrilled to be here to open today's excellent hearing and to welcome the distinguished group of scholars and market participants from whom we'll hear today. I'm also very thankful to NYU for hosting this event. I do think it is appropriate that we are here in New York to talk about this.

I don't know whether Commissioner Jackson is here yet. I'm very pleased that he is joining us. He has spoken publicly about the need to bring competition economics to the Securities and Exchange Commission and, of course, is joining us today. My only hope is that doesn't bog your some sort of, like, interjurisdictional power grab on the part of the SEC. We are older, but we're scrappy, and we don't shy from a fight, so he should just know that.

I want to start with the traditional FTC caveat, and that is the remarks that I give today are my own thoughts and don't necessarily represent the views of the Commission as a whole or my fellow
Commissioners.

Common ownership is an issue of particular interest to me, but it probably helps to just start with a little bit of a definition. Last year in front of the OECD, the U.S. antitrust agencies defined common ownership as "the simultaneous ownership of stock in competing companies by a single investor where none of the stock holdings is large enough to give the owner control of any of these companies."

And I want to draw an important distinction. Common ownership is distinct from cross ownership wherein a company holds an interest in one of its competitors or other joint venture or copartner scenarios that have long been a focus of U.S. antitrust law.

The most important thing for purposes of today about common ownership is that it is a reality of our modern economy and that it is ubiquitous. Americans are increasingly utilizing the many and diversified investment options that large institutional asset managers offer, and the advent of indexing funds has opened important avenues through which average Americans can invest their retirement savings, sometimes at a low or even zero price. They can also have pretty good returns.
As a result of the growing demand for this popular product, trillions of dollars that these companies now manage are increasingly including shares of competing companies. That's a reality. In the last few years, economists and law professors have raised the question whether common ownership is negatively affecting competition.

We have a number of them here today. I see Martin Schmalz sitting over here. His work with José Azar and Isabel Tecu kicked off such a bevy of research and commentary that it is often simply referred to as “the airlines paper.” I know that's not the only work, but it's sort of set the ships to sea.

Some are concerned that common ownership remedies proposed are quite dramatic. According to one group of scholars who are proponents of these remedies, addressing the threat of common ownership would upend “the basic structure of the financial sector,” for example, by limiting asset managers to holding no more than 1 percent of a given industry unless they do so in a purely passive manner.

And this debate is not just academic. Antitrust enforcers around the world are watching its development, as we are today, and incorporating common
ownership into their analyses. For instance, last year, as I mentioned, the OECD held hearings on common ownership, and we've seen that European antitrust enforcers began citing these theories in their decisions.

I find this debate particularly interesting because it takes us to the intersection of antitrust, corporate and securities law and policy. And in a sense, historically, this is very fitting because in a way the FTC grew out of the Bureau of Corporations at the Department of Commerce.

When I spoke about this issue last in June, I noted an important way in which the intuition behind the antitrust theory of harm from common ownership runs counter to the longstanding concerns of those other bodies of law. Specifically, corporate law in particular preoccupies itself with the principal agent problem, the issue of how you get the management to work on behalf of the owners of the corporation, the shareholders.

Management neglect of shareholders -- and in particular of minority shareholders -- is a particular concern. And the common ownership theory -- or at least one version of it -- and I'll talk about that a little bit later -- is a concern that managers show
too much attention to shareholders and, in particular, to certain minority shareholders.

In June, I identified several areas of research that I, as an antitrust enforcer, would like to see developed before shifting policy on common ownership. They were, first, how common ownership affects a broad group of industries; second, whether a clear mechanism of harm can be identified; third, a rationale why managers would put the interests of one set of shareholders, in particular a minority set, above the others; and, finally, a rigorous weighing of the harms -- of the allegedly anticompetitive harms -- against all the benefits of institutional shareholding.

So the first question stems from the fact that common ownership is so ubiquitous. Is it also ubiquitously causing anticompetitive harm? And if so, how? Professor Menesh Patel, from whom we'll also hear today, writes about the sensitivity of the harm theories to various factors, including the structure of a given industry.

We've seen some additional research since June. One recent working paper examines common ownership and competition in the ready-to-eat cereal industry; and another looks at pay-for-delay
settlements in the pharmaceutical industry.

I understand that economists are continuing to analyze the impact of common ownership in other industries. These studies are critical to understanding whether, and if so how, common ownership might dampen competition between rivals. The better the research behind our enforcement, the better our enforcement will be.

So the second thing I asked about was to identify a clear mechanism of harm. Identifying the mechanism of harm, that is, how common shareholding actually causes a lessening of competition, remains a matter of robust debate. Some proponents of predicing antitrust liability on common ownership acknowledge that "the theory literature to date does not identify what mechanisms funds may use to soften competition." That's Fiona Scott Morton and Herbert Hovenkamp.

Understanding the mechanism is, however, critical to developing a coherent legal theory of antitrust harm and ultimately to crafting an appropriate remedy. To my mind, there are, in fact, two competing theories of common ownership and how it might lead to anticompetitive harm. And for purposes of this discussion, I want to call them active and
passive.

The active theory involves managers affirmatively foregoing competition. Professor Einer Elhauge argues that the harm mechanism is less opaque than critics claim, noting that it would include “all the ordinary mechanisms by which managers are incentivized to act in the interest of their shareholders -- voting, executive compensation, the market for corporate control, the stock market, and the labor market.” That's his quote.

He cites examples of when common ownership might impact how the common owners encourage the commonly owned firms to behave. Professors Ed Rock and Daniel Rubinfeld, from whom we'll also hear, who disagree with Professor Elhauge about the remedies, offer a hypothetical of a portfolio manager who cautions airline companies not to expand capacity as they're coming out of an economic downturn.

These types of active mechanisms may look like classic collusion with which antitrust law is well familiar. And certainly where they involve active communication, the anticompetitive conduct and harm should be more easily observable. In the case of a portfolio manager on a call, literally public, they entail real-world affirmative action to which one can
point and, as such, should be covered within existing antitrust jurisprudence.

While presumably not intended to deal with competition, we have seen some asset managers themselves work together to effectuate what they view as social responsibility as exemplified in recent reporting about principles for firearms dealers.

The second theory of harm is what one might call the passive theory. Professor Schmalz and others posit that because they “own” shares -- putting “own” in quotation marks, and we’ll talk about that later -- because they “own” shares in competing firms that would all benefit from a lessening of competition, common owners do not have incentives to push their commonly owned firms to compete.

Collusion of the sort contemplated in the active theory can exacerbate anticompetitive effects, but it is not required for this theory of harm to operate. This passive harm theory asserts that the common ownership harm derives from the absence of incentives from shareholders to encourage the firms in which they hold the shares to compete.

In a sense, the anticompetitive harm asserted here is only a species of an incentive problem endemic to the economy, to the nature of the
public corporation itself. As Berle and Means long
ago recognized and I discussed in June, dispersing
ownership among numerous shareholders reduces the
ability and the incentive of any given shareholder to
attempt to exert control, such as by pressuring a firm
to compete more aggressively.

This means not only common shareholders but
any dispersed shareholder may have reduced incentives
to encourage the firm to compete. Professor Elhauge
notes that the benefits from softened competition may
also be shared more broadly among shareholders as a
firm increases profits, for example in an
oligopolistic market. So while dispersed shareholders
may lack an incentive to encourage competition in
general, that may especially be the case if we can
assume that they are affirmatively benefitting from
oligopolistic pricing and profits.

This passive theory raises a number of
interesting issues in my mind. First, it appears to
be in tension with some of the remedies proposed to
address common ownership, which offer up, for
instance, “pure passivity” -- not my words -- as a
solution. If passivity itself is the problem, it can
hardly be the solution as well.

Second, at a time of concern about a lack of
competition in the economy generally, is chilling shareholder input the right move? Should we not be considering mechanisms that would encourage companies to compete? The Hart-Scott-Rodino Act explicitly exempts from filing requirements acquisitions made “solely for the purpose of investment,” which the antitrust agencies have interpreted to mean as applying to purely passive shareholders. If we don't get enough encouragement to compete, is that the right approach?

Years ago, Henry Manne explained that the market for corporate control helps to rectify the disparate power and incentives of firm managers and shareholders and affords "to these shareholders both power and protection commensurate with their interests in corporate affairs." Actions that undermine the effective operation of the market for corporate control, including antitrust policy that fails to consider this market, may prove harmful to investors but also to consumers.

Third, how can we identify the marginal and purportedly negative effects of common ownership where shareholders already have little incentive to encourage firms to compete more aggressively and maybe even less than that given the structure of a
particular market, as I mentioned earlier, say an oligopolistic market.

Consider liability under Section 7 of the Clayton Act, a theory propounded in the common ownership literature, where acquisitions are only unlawful if they are likely substantially to lessen competition. At what point do the effects of a share acquisition meet that substantiality threshold?

Whichever theory you subscribe to or scares you, I look forward to today's discussion of the evidence. I'd be remiss not to mention two of our hosts, Professor Hemphill and Professor Marcel Kahan, who conclude thusly with regard to the mechanisms of harm -- this is a quote and it's long, so forgive me -- "first, several mechanisms in the literature are not, in fact, empirically tested. Second, some mechanisms are ineffective in raising portfolio value or would pose major implementation problems for CCOs [common concentrated owners]. Third, because most institutional CCOs have only weak incentives to increase portfolio value, they are likely not to benefit from pursuing mechanisms that carry significant reputational costs or legal liability."

Third, my third question from June, was
asking for a rationale regarding managers' responsiveness to certain shareholders, and apparently certain shareholders over others. This is another context where the assumptions underlying common ownership run up against assumptions underlying other legal regimes, specifically corporate and securities law.

If the principal-agent problem concerns you and you think about shareholder neglect, or put a little differently, maybe too little competition, understanding how shareholders and managers behave is critical to ensuring that we have coherent legal regimes that accurately capture harmful behavior and encourage beneficial behavior. Common ownership presumes that managers are very particularly attuned to the desires of a minority of their shareholders and act to maximize value to them, whereas corporate law assumes that managers, unless forced to behave otherwise, will act to maximize their own interests over that of shareholders generally and of minority shareholders specifically.

So in a real sense, corporate law tends to worry very much that managers will not be responsive enough to their shareholders while common ownership theories presume loyalty to select a few, often
passive, investors.

Professors Azar and Elhauge point to modeling demonstrating that if managers seek to maximize expected shares of votes or likelihood of being reelected, then they will seek to maximize the weighted average of their shareholders' profits from all their shareholdings. This model also demonstrates that shareholder variation in levels of common ownership will “alter the precise weight managers put on each shareholder.”

But skeptics have raised questions as to the practical application and real-world predictability of such models. Are managers so acutely attuned to the shareholding levels and desires of their various shareholders? Do they respond in a precise fashion to those changing shareholder levels and desires? Do boards and senior managers of major companies even get involved in deciding issues like pricing?

As noted earlier, common ownership theory proponents have responded in part that noncommon shareholders might likewise benefit from softer competition, and so managers are not actually acting against the interests of most holders. But, again, if all or most shareholders benefit from soft competition, such that none have incentives to
actively encourage a firm to be more aggressive in
competition, what additional impact does common
ownership make?

        Much of this comes down to what shareholder
and manager incentives actually are. There are
reasons why shareholders might prefer softer
competition in certain circumstances, but there are
also reasons why they might not. For instance, if
they are diversified across industries as investors
and customers to those setting oligopoly prices, they
might not always benefit from oligopoly pricing in
discrete industries. The answer can only be complex,
measuring those harms against the gains to those
shareholders from softening competition.

        What's an asset manager to do? To the
extent the answers are, in fact, nuanced, different
shareholders with different perspectives, different
preferences, different incentives changing over time,
to the corporate manager isn't competition the safest
and most legal bet?

        Another issue. In my remarks thus far, I've
been a little bit irresponsible about using words like
"own." Some investment advisers or investment
managers are beneficial owners but are not the
economic owners of the shares. Professors Hemphill
and Kahan criticized “the empirical literature to date
[as paying] insufficient attention to the systematic
differences in the incentives of different investor
types.”

They find that “the empirical literature
fails to take account of the possibility that investor
types likely to be CCOs [common concentrated owners],
have systematically lower incentives to get involved
than investor types likely to be nonconcentrated
owners. They explain that while the literature
assumes the common owners' objective is to raise
portfolio value, the “archetypal CCO, the investment
advisor, has incentives quite unlike those of an
individual who holds the ownership stakes” and has
only weak incentives to increase portfolio value.

Consider an index fund where your goal is to
sort of track the index and lower fees. You're not
necessarily looking for higher returns than that. How
do these facts factor in?

Finally, in June, I asked for a rigorous
weighing of the procompetitive effects of
institutional shareholding. Several scholars debating
common ownership have acknowledged that various
proposals would alter "the basic structure of the
financial sector" and "transform the landscape of
institutional investing.”

Such tectonic policy shifts should not be undertaken lightly. Large institutional investors have, in many ways, made investing affordable for the average American. Index funds, for instance, as I said earlier, sometimes have nominal to no fees, and the returns are nothing at which to laugh. Such investing opportunities were unheard of before the second half of the 20th Century.

When considering policies that could find index funds as they exist today are fundamentally incompatible with the antitrust laws, we need to keep these very real benefits in mind. Many Americans simply do not have the funds available to buy into more expensive investment options. Scholars have also historically placed great hope in large sophisticated institutional investors to have the incentives to make corporate governance better. Are they doing so?

I look forward to hearing about stewardship practices today and how their development should be considered in this context. John Bogle, the inventor of the index fund, wrote last week about his concern that too few people control corporate governance in America. Are those concerns valid? And how should they factor in at all to what we're talking about
This common ownership discussion has remained vigorous since I last had the opportunity to speak about it in June. And I am really heartened to see the serious scholarship continue to examine the theories and empirics at play and very pleased that the FTC has included this topic in our hearings. Our panelists today will grapple with a number of very intriguing questions, and I'm excited to hear from them all. Thank you.

(Applause.)

MR. HEMPHILL: Thank you, Commissioner Phillips.

Our next speaker is my good friend and colleague, Robert Jackson, who was sworn in in January as Commissioner of the Securities and Exchange Commission. He comes to the Commission from right here at NYU Law, where he's a professor of law on leave.

I can't resist noting here the deep connection between the SEC and these FTC hearings. As Bob Pitofsky, who I mentioned before, liked to explain, it was a series of FTC hearings like these that led to the creation of the SEC.

Previously, Commissioner Jackson served as a
senior policy adviser to the Department of Treasury. Earlier in his career, Commissioner Jackson practiced law at Wachtel Lipton & Katz. Commissioner Jackson.

(Applause.)

COMMISSIONER JACKSON: Well, thank you so much to my friend and colleague Professor Hemphill and to all my friends here at NYU and at the Federal Trade Commission for hosting these very important conversations. It's really a privilege to be back here at NYU and speaking before the FTC, and I share the commitment that everybody brings here this morning to make sure our markets are competitive and fair for all Americans.

Now, when I give a speech like this, I'm supposed to give a caveat, which is that these are my views, not the views of anybody else at the SEC, but I don't even work at the FTC, so I should give the further caveat of the total irrelevance of my views; however, I want to point out that it's been my experience that just given enough time and wisdom, all my colleagues at the SEC figure out I was right all along. That never happens.

So one of the things that's important to begin here is with some history, which as Professor Hemphill alluded to, back in 1933 at the adoption of
the '33 and '34 acts -- the '33 act used to be
enforced by this agency -- famously, the Securities
Division at the FTC first implemented the securities
laws before the creation of my agency in 1934. And
that's why the FTC is in a very real way and an
important way, both historically and intellectually,
the birthplace of the SEC. So it's good to be home.

I remarked in a recent speech about the
fundamental analytical mistake we've been making in
American securities markets to assume that we at the
SEC can regulate our capital markets without thinking
through the effects of those choices on competition.
I said there and I believe this morning that the FTC
and SEC should be working more closely together so we
can better oversee these markets and the exact kind of
issues we're discussing today.

In fact, the subject of today's hearing, in
my judgment, which is really competition and consumer
protection in the 21st Century, highlights the
compelling need for this close collaboration, and I
hope my appearance today marks the beginning of that
partnership.

Now, the subject of today's hearing, and
you'll hear about evidence all morning, is whether
institutional investors and primarily passive index
funds that hold large stakes in American public
comppanies can decrease competition and raise prices
for consumers. It's a critical debate on which I'll
explain my views shortly, but I've come here today to
urge all of you to think about common ownership and
the subject we'll discuss today and identify it for
what it is, which is an investor protection problem, a
corporate governance problem.

In my judgment, we're at a pivotal moment in
American financial history when corporate elections
are increasingly decided by a handful of exceptionally
powerful index fund managers. What's clear to me is
that the SEC’s current rules leave investors largely
in the dark about how institutional investors are
wielding that considerable authority. And I'm here
today to call on my colleagues at the SEC to pursue
rules that will take advantage of existing data on
institutional voting to empower investors with more
and better information on how their money is voted in
American corporate elections.

More on that in a moment, but let me begin
with the common ownership debate. First of all, for
anybody who believes, as I do, that all good research
scholars have an obligation to seek policy impact in
their work, today's hearing is an enormous victory,
because we're here, of course, because of exceptionally important and thoughtful scholarship by my friends in the academy who have done work that has taught me a great deal that I didn't know about the relationship between common ownership and competition.

Of course, the seminal piece is by José Azar, Martin Schmalz, and Isabel Tecu -- an extraordinary recent paper in the *Journal of Finance* that demonstrates a relationship between measures of common ownership and price increases in the airline industry. And of course, Professor Elhauge has incredibly thoughtfully moved the debate forward, examining the ways in which we should be thinking about those data for the enforcement of the antitrust laws.

I commend that work to all of you, and as a researcher, I can only admire the enormous scholarly and policy impact that that research has had. My own reaction to the work is that it presents us with a puzzle and that we're at the beginning, not the end, of our conversation about common ownership and what to do about it. And let me say why.

First of all, my NYU colleagues, Professors Hemphill and Kahan, in a recent paper explained the difficulty with using the measures set forth in that
scholarship for evaluating the questions we're
discussing today and in particular the MHHI measure
and the MHHI delta measure employed in those papers.
And there's two things that I want to highlight in the
Hemphill/Kahan paper that I commend to all of you
that, to me, sets the agenda for moving forward with
scholarly work on common ownership.

First, as Professors Hemphill and Kahan
explain, there are a number of different strategies
that one -- that an institutional investor might
pursue in connection with the reduction of competition
in their portfolio companies. One is to eliminate
competition within a particular -- or reduce
competition within a particular firm in an industry,
permitting rent extraction for other firms and the
total value of the portfolio to rise.

Another is restrict production across the
industry, permitting rent extraction across all firms
of the industry. And the crucial thing to see that
Professors Hemphill and Kahan point out is that these
are two very, very different strategies from the point
of view of an undiversified investor. That is, one
will meet with approval from that undiversified
investor and another will be resisted.

To the degree that those two strategies
reflect completely different ways of thinking about
the impact of common ownership on competition, or I
should say the potential impact, we need new
scholarship that studies the difference between those
strategies, in particular that looks for cases where
an undiversified owner of the firm will resist the
purported anticompetitive instincts of the diversified
owners.

As Professors Hemphill and Kahan point out,
we don't yet have that paper. We don't yet have
scholarship that tackles that, and indeed as they
point out, I think, very importantly, the MHHI measure
itself is not designed to test that hypothesis. No,
instead, we need new scholarship with new measures
that test that particular difference in those two
strategies to see whether or not we actually have hard
evidence of this kind of activity in American
industry.

But much more importantly for my purposes,
as Professors Kahan and Hemphill point out, and as my
colleagues, Dan Rubinfeld and Ed Rock, have also
pointed out in an important paper this year in the
Antitrust Law Journal, there's very little evidence so
far about the precise mechanism by which such activity
might take place. There's a great deal of speculation
about how this might occur. And I find the
preliminary evidence on that subject extremely
interesting.

In particular, Professor Schmalz, along with
a group of coauthors, has a recent paper on the use of
relative performance measures, relative performance
compensation-based incentives that may or may not
contribute to competition in an industry. Now, as
someone who has studied executive compensation for
many years, I would love to think that it's that
important to competition in American industry.
Indeed, I'm biased to believe that a change in
managers' relative incentives could affect price
setting across American industries, because otherwise,
I've been wasting my life.

But I'm unpersuaded by the evidence we have
so far and here's why. Changes in incentives at the
top of the house in an American public company can
have many, many effects. I'm inclined to believe it
can work throughout the organization to have an effect
on price setting, but we don't yet have hard evidence
that it does so. And I would want to understand the
organizational design and the differences from
industry to industry in the price-setting authority
throughout a firm to better comprehend how changes in
relative performance incentives could have an effect on prices.

Now, whatever you think of this evidence, as I said earlier, in my view, we are at the beginning, not the end, of the debate on concentrated common ownership. And I took with great interest a careful look at the work of Eric Posner, Fiona Scott Morton, and Glen Weyl with respect to potential proposals to limit diversification or to regulate institutional investors in order to address the issues in this literature.

And I must tell you, as somebody who's sworn to protect investors, my sense is that the literature we have today does not carry the heavy burden that a commissioner sworn to protect investors should demand in order to impose limitations on diversified investment in American public companies. I say that for many reasons, but most importantly because diversified holdings have delivered an enormously important product to American families who are saving for retirement and education. These are the savings I'm sworn to protect, and to restrict their diversification would impose costs upon them that are potentially enormous.

Also, as Professors Rock and Rubinfeld
pointed out, we wouldn't have even begun to
contemplate the effects of such a rule on other
industries that common ownerships might own -- that
concentrated common owners might own. For example, if
we think about the airline industry, we'd need to
begin to think about limits on diversification on
their suppliers, in others who play a role in the
distribution or consumption of airline activity. And
all of these knock-on effects, to my mind, have not
yet been sufficiently considered for me to be
supportive of a rule that would restrict
diversification in American investment.

But my concern about those proposals is not
so much that their burden has not been met. I don't
think it has. I think we're at the beginning of a
conversation that might someday lead to sufficient
evidence in that respect. But we're not yet at a
place where I would be comfortable with such a
resolution.

Whatever you think about that, my concern is
that it's distracting us from the actual issue we
should discuss today. To me, the particular -- the
issue that deserves and demands more attention than
it's received, both at the FTC and my agency, is the
fact that today institutional investors cast votes in
corporate elections on behalf of more than 100 million American families. They wield enormous influence on the future of our companies and our communities, but we're not giving investors nearly enough information about how their money is being voted, and because of that, American investors can't make choices among index funds about the way that they carry out those duties. And it's time for that to change.

Now, the shareholder vote, we all understand well, is a critical tool in setting governance policies of companies and holding management accountable for their actions. And that's why another series of recent papers that I believe you'll hear about later today, in my view, deserve as much attention as the common concentrated ownership scholarship you'll also be talking about.

In particular, Professor John Coates, my corporate law professor, a fact for which he will never fully be forgiven, has a recent paper identifying what he calls the problem of 12. It's an extraordinary paper in that it makes a very simple point. Actually, it's the rare empirical paper that confesses that it just picked a number out of thin air.

Coates' point is not that there's actually
12 people who control Corporate America. It's that number is a realistic, reasonable ballpark of the number of people who make decisions about the future of American corporations, and he worries about the credibility of any securities market, any product market where that much power is wielded by that few people, and so do I.

Professor Coates identifies a number of particular -- potential resolutions of that problem. I'll discuss them in a moment. But what he knows because he's been thinking about agency problems for a very long time is that the -- what's happened here is, in a search for holding corporate management accountable, we have transferred the potential for agency problems from corporate management to institutional investors who now wield the extraordinary authority that Coates described in his paper.

Indeed, with all respect to Professor Coates, his insight is not new. My friends at Columbia, Ron Gilson and Jeff Gordon, years ago, published a paper, "The Agency Cost of Agency Capitalism," that pointed out increasingly the role of institutional investors in deciding about the agenda items that are set by other less diversified, more
activist investors. And since the publication of that article in the Columbia Law Review a few years ago, that problem has grown more, not less, relevant to policy debates in corporate law.

Now, the question is, what should we do about it? And for me, the clearest path forward is set by another recent paper that I commend for all of you. I'm giving you a lot of homework, I realize. Another recent paper by my friends, Ryan Bubb and Emiliano Catan of NYU. This is an extraordinary piece that takes years of data disclosed at Form N-PX, over more than a decade since that form became effective at the SEC, and shows the party structure of mutual fund voting. What Bubb and Catan demonstrate is that we can use standard models of political decision-making to understand the various ways that institutional investors vote.

They offer a model that distributes those votes across three different parties of institutional investors -- the managerialist party, the shareholder intervention party, and the shareholder veto party. Now, one thing about the Bubb and Catan paper that is so striking is that we didn't know it before, that is for years institutional investors had been putting billions of dollars of American families' savings to
work in pursuit of those choices, and we just now have
learned the way that they're making them.

And that's why today I'm calling on my
colleagues at the SEC to put forth new rules that
would require better disclosure of information just
like that. Now, you might say to me, oh, Rob, we
don't need new rules, it's already in Form N-PX. And
I would invite you to read one and try to do the
difficult work an investor must do in the United
States today to try to understand both at the fund
level and at the portfolio family level the way that
votes are cast.

My sense is that Ryan and Emiliano can tell
you stories of many late nights spent trying to
decipher this form. Whatever you think about that,
what I'd say is it's our job at the SEC to make more
clear the ways that institutional investors are
discharging their obligations to the people that
they're voting for.

And I'm happy to say it's my impression that
most large institutions agree. After all, Larry Fink
each year publishes a clear view about what he plans
to do in discharging that responsibility. You can go
to Vanguard or Fidelity’s website. They’ll tell you
all about what they plan to do.
And my call today is for us to put that information in front of American retail investors when they put their money down. In my view, at the moment when a retail investor makes the decision to be in a particular mutual fund family, to use a particular index product, they should have an understanding of how their money will be voted.

You might be inclined to say they won't care. First of all, that is -- I love to say this since it gives me papers to write -- an empirical question. But even if it weren't, I ask all of you to keep in mind the enormously powerful ex ante effects of a disclosure regime of this kind. The notion that someday a retail investor at the point of sale will be given salient, relevant information of the kind in the Bubb/Catan paper might get institutional investors thinking a little more about which party they belong to and why.

The ex ante benefits of this kind of disclosure were the basis for the '33 and '34 acts. And the notion that American retail investors won't read all this so it doesn’t matter, in my view is, with all respect, mistaken. What I'm interested in is providing institutional investors with the knowledge before they cast those votes that they're
going to have to tell people, in salient and clear
terms, how they are voting Americans’ money.

For me, that is a path to real
accountability for those institutional investors and a
beginning of an answer to Professor Coates’ challenge
about what to do about the concentrated power that
institutional investors wield in the United States.

Let me conclude by saying how important I
think today’s conversation is, and I feel very
fortunate to be here because this is exactly the way
policy should be made in the United States. We should
have researchers, like Professor Schmalz and Professor
Elhauge, put on the table important new questions that
we haven’t thought enough about, offer policy
solutions. We should debate whether they’re right or
wrong for the people of the United States. We should
demand better evidence when we need it, and we should
be willing to act when we have it.

And in my view, what we know now about
institutional investors in the United States is that
they wield a tremendous amount of influence over the
future of the economy in this country, and as a
result, we need to do better about the ways in which
we hold them accountable for those decisions.

So thanks so much to my colleagues at NYU
and at the FTC for holding these important hearings,
and I look forward to the conversation. Thank you
very much.

(Applause.)

MR. HEMPHILL: I've got to give them a
chance to finish their colloquy here.

Commissioner Phillips, any reactions to
Professor Jackson's remarks that you want to address?

COMMISSIONER PHILLIPS: I think my most
important reaction is he should send me the Catan
paper, which I haven't yet read.

COMMISSIONER JACKSON: I think we can
arrange that. Professor Catan is here. Actually, we
should just in the interest of full disclosure tell
them, actually, Noah leaned over and said I knew you
were going to try and grab power from the FTC. He's
right.

COMMISSIONER PHILLIPS: Things were good in
1933.

(Laughter.)

COMMISSIONER PHILLIPS: They ruined
everything in '34. No, I thought it was a fascinating
speech. I think I was struck that Commissioner
Jackson and I, in many respects, with respect to
common ownership, see things somewhat similarly. I
think we see similar kinds of tensions in the
literature -- similar kinds of questions to ask. Both
of us agree that we need to see more research. We're
both very grateful for everyone being here and for
this debate going on.

I absolutely agree that this is a better way
to make policy in the United States. At the very end
of my remarks, I alluded to the column that followed
on the Coates paper by John Bogle. I think those are
very interesting questions as well.

MR. HEMPHILL: Professor Jackson, any
reaction to Professor Phillips or to the Wall Street
Journal commentary from a few days ago? I’ll throw
that in, too.

COMMISSIONER JACKSON: So I thought Bogle
was exactly right. And it's really striking from an
historical point of view to see this from the inventor
of the index fund. My own view is that the problem
that we have, which is that index investing has become
so popular as to raise this debate, is what one might
think of as a first-class problem.

I mean, we have delivered an enormously
valuable product to American investors that has paid
for untold millions of retirements, educations,
incredibly important. This is the way that the
American people access the growth in our economy, so it's an enormously important product. It's become so powerful, so popular, so ubiquitous that we need to talk about the ways in which those who vote with that money are abiding that responsibility. That seems to me to be the right place for the conversation.

I think we also need to be very wary of the emerging evidence that there might be an anticompetitive effect here. Because, to the degree that that case gets fully proved, I think we do need to have a conversation about making sure that American industries are sufficiently competitive. So I continue to watch with interest as that literature evolves. But my own judgment is that we're at the beginning rather than the end of that conversation as a matter of optimal policy.

MR. HEMPHILL: Well, I think with that, I'm going to thank both of our -- do you want to take questions?

COMMISSIONER JACKSON: Sure.

(Laughter.)

COMMISSIONER JACKSON: I'm happy to take questions from people.

MR. HEMPHILL: Yes, I guess we’ll need a microphone.
UNIDENTIFIED MALE: Well, if you have questions, you should set them out on question cards, and we’ll bring them up you.

MR. HEMPHILL: And I can repeat it, depending.

(Audience question posed off microphone.)

AUDIENCE MEMBER: The question is simply that I agree with you. You were telling us about where the focus should be (inaudible) concentration is clear, the other is (inaudible). But in terms of disclosure, which seems to be where you’re heading with respect to institutional ownership, is there any thought about disclosure of conflicts of interest, compensation, the time horizons that are guiding institutional investors, or investor votes in general?

COMMISSIONER JACKSON: You want me to take it?

COMMISSIONER PHILLIPS: Seems more your lane than mine.

MR. HEMPHILL: This is a question posed to Commissioner Jackson?

AUDIENCE MEMBER: Yes.

COMMISSIONER JACKSON: So it's a good question. So let me say a few things about this.

First of all, because I was diving into the Bubb/Catan
paper, I spent some time in Form N-PX. First of all, just as a matter of, like, human advice, don't. Like, don't do that with your time. But what I found is that it already contains some of the information. Like, this is why I think the policy shift here is one that makes sense. It's a very rich set of detail. You can get a lot out of it. It's just incomprehensible.

And, so, a lot of the things you're talking about -- for example, incentive structure, portfolio family structure, the way people are voting across the organization -- if you work hard enough, it's there. So my answer to your question is yes. I think those things can and should be more summarily disclosed. And my case for this -- for moving forward with such a rule -- is that the information is already being produced in the largest institutional investors. My guess would be that the marginal cost of producing it in a summary, more digestible fashion, in the way that the Bubb/Catan paper presents, it would not be costly.

Now, we can have a debate over the benefits of that, whether or not it would move the needle. I'm happy to have that conversation. But my question to your question is yes, and moreover, I don't think it would be marginally as costly as everyone might
imagine to make that information more accessible to American investors.

COMMISSIONER PHILLIPS: Can I just add one thing to that? To me -- and I have not -- I haven't read the Bubb/Catan paper. I haven't looked at any one of these forms in my life.

COMMISSIONER JACKSON: How dare you?

COMMISSIONER PHILLIPS: I have read 10-Ks and 10-Qs. This is a species of a longstanding, ongoing discussion about how the provision of information, the mandatory provision of information, the amount of information, the medium of its communication, and, critically for purposes of Commissioner Jackson's remarks, the timing of the disclosure information empowers shareholders but also consumers to make decisions in the market.

Where you have information out there, there are times where it can very easily be reflected in, let's say, a liquid capital market. This is something we are grappling with now with Congress in the context of privacy, right? Everyone is familiar with the fact that you get little popup notices that tell you how the website you're visiting is going to use your information. Raise your hand if you've read one.

Okay. And this is a very well-educated
group of people. So we all believe in markets, and we all believe in the capacity of markets to help allocate resources efficiently. Markets require information. And, so, some of the most vexing questions that we face is how best to feed that information into those markets. It's a question of how shares are voted in elections. It's a question of the financials of companies. Right? That's the '33 act and the '34 act -- I think it was the '33 act.

It's a question in privacy. It's a broader issue. And, you know, it's good to look at these questions and keep up-to-date on how consumers (whether they be consumers of investments or consumers elsewhere in the market) assimilate information.

MR. HEMPHILL: So one question from the audience. Could each of you say a little bit more? This is a question about passive versus active. Could you all say a little more about the kind of fundamental differences between passive investors and active investors for -- I think both of these sets of issues that are on the table? Maybe we'll start with you, Professor Phillips.

COMMISSIONER PHILLIPS: Sure, since -- that was my nomenclature, so I guess I'm responsible for it.
MR. HEMPHILL: It shows up in the literature, too, to some degree.

COMMISSIONER PHILLIPS: So to me, the critical distinction or one critical distinction has to do with, if you believe that common ownership may present a competition problem, or even if you simply believe that it's a problem for purposes of competition that all sorts of folks, whether they be common owners or otherwise, don't have adequate incentive to spur for management to compete, to me, you need to think about what are the mechanisms for spurring that competition, who are the right people to do it.

I think as I mentioned, we need to look at the various ways in which we approach -- I'm going to stick in the competition policy lane -- the ways we approach competition policy and always be thinking about, will this chill that kind of input from shareholders, or will it help shareholders encourage firms to compete.

That is a really important dynamic in the market. It's important for purposes of large asset managers. It's important for purposes of smaller activist investors. It's important across the board. So I think to me the remedy question is really, really
important.

And also, as I said before, to me, there is a big distinction if you subscribe to the active theory, you support one kind of remedy. If you subscribe to the passive theory, the stay passive doesn't really look very attractive as a remedy.

MR. HEMPHILL: Rob?

COMMISSIONER JACKSON: So I'll take the question in a slightly different direction and talk about the distinction more broadly in the capital markets between what we're calling activist and passive investors as opposed to a particular theory about the behavior of concentrated common owners.

You know, for me, it's been fascinating to watch over the last decade the increasingly blurred lines between what someone calls an active and passive investor. And I'm quite sure that of all the people who could decide what the difference is, I'm least qualified to dictate to the marketplace what it means to be truly active. Let me say why.

You hear a lot about activist investors and the things we might do or not do. I'm not sure who people mean when they focus on activists in particular. But if what they mean is people who are thoughtfully engaged in the governance of public
companies, you could very well include index fund
managers who are voting their shares.

And, indeed, I think the point that Gordon
and Gilson paper made years ago is that there's this
important interaction we don't fully understand
between these two types of investors. Activists play
an important role in agenda-setting in a way that
passive investors might not. But the crucial decision
about who wins is often left to those institutional
investors because they carry such sway with respect to
votes at large public companies.

In fact, if you talk to any activist,
they'll tell you, and the data are beginning to make
this clear, that what dictates the success of their
strategy (and I suspect increasingly the targets that
they choose) is the degree to which they feel they can
persuade those institutions, those passive
institutions, that they are right.

And, so, for me, the interaction between
these two types of investors is one that hasn't been
studied as thoroughly as it could, especially
empirically. I think the Gordon/Gilson paper gives us
a good set of testable propositions. I think it's
time to test them because my own sense is that we call
one group activist, we call another group passivist,
but -- and I understand fundamentally the difference
is that for passive investors, the sort of components
of the index are dictated to them by the index
provider, but I think it's not -- it's a distinction
increasingly without a difference when we think about
who's really wielding power in American corporate
elections.

MR. HEMPHILL: Could I take a step back just
for a minute? Both of you all in your remarks have
kind of identified an ambitious agenda -- partly an
ambitious agenda for research, for further work,
especially by empiricists, to try to make sense of
some of these issues. Is there anything that you all
see the agencies doing to play a role?

I mean, both the SEC and the FTC have fact-
finding capabilities and also strong internal research
teams. I just wonder if either of you could reflect a
little bit on whether it's more data, whether it's
more analytical work, internal to you all? I mean,
setting the agenda for the rest of us is awesome. I'm
just wondering, you know, what about you all?

COMMISSIONER PHILLIPS: It's efficient, too.

MR. HEMPHILL: Yeah, right. It's efficient,
too. Right, right. Is there -- you know, how much of
a role is there to play? What might that look like?
I mean -- do you have thoughts about that?

COMMISSIONER PHILLIPS: I'm going to take this as the softball that you didn't intend. To me, this is the start of it, right? So today we're going to sit here and we're going to listen to the best minds in America on a variety of different, but interrelated topics talk about the state-of-the-art of research, what are the questions that are unanswered, and where is there agreement.

You know, Commissioner Jackson's call for sort of other metrics would be a great example of that. This is a good way of highlighting those areas and aiming those resources. There are certain authorities at our disposal. I will tell you there are many people who think we should use authorities to study a great many of topics. And, you know, we have to be somewhat measured. But I think this, convening folks, bringing it to the public, inviting in the conversation, and inviting criticism back and forth, which I hope is what we see today, is precisely the way to start.

MR. HEMPHILL: I think we will see some of that today.

COMMISSIONER JACKSON: Yeah, man, you're going to get that for sure. So here's what I would
say. I think one thing that I have suggested in past remarks, and the Chairman at the SEC and I have talked about it and I hope we'll continue the conversation about it, is joint research work between our two agencies, not only because of the historical mandate that we share, but because fundamentally these questions can't be tackled with the data that one or both -- and increasingly, frankly, when I talk to the research economists at the FTC and in our house, they have sort of very different data and perspectives on these questions. And, so, I would like very much for us to be considering joint work in the area.

I think putting together a task force of researchers at both agencies is something worth considering because you're not wrong, Scott, that we gave you guys a lot of homework today -- by the way, I should confess my conflict. I might be one day a guy who will do that homework so it's like, yeah, providing supply for my own -- it's complicated.

Anyway, I guess my view is that you're right to push us and say, there's got to be something that the agencies can do in terms of setting out agenda, roundtables, et cetera, where we can do some in-house work ourselves, and I think that's something we ought to give a lot of thought to.
MR. HEMPHILL: So a question from the audience. It’s a question about how to get a more active aggressive corporate governance, I think. So are there regulatory -- what are the kind of most important regulatory or legal barriers? I mean, I think the premise of the question is that a more active corporate governance would be attractive. What are the regulatory or legal barriers to that?

COMMISSIONER PHILLIPS: Well, you know, I talked a little bit in my speech about an issue at which I'm beginning to look, which is the impact of Hart-Scott-Rodino. Hart-Scott-Rodino is a mechanism to deal with antitrust issues. It doesn't go beyond that. I think we need to look at mechanisms that exist in the market that are either intended to or have the effect of chilling shareholder input.

I think that's a really important principle of which we can't lose sight. That, as I've said in the past and I sort of reiterated today, this to me has to be part of the weighing of the common ownership issue, which is -- I mean antitrust liability is a very powerful thing. It’s, you know, in civil lawsuits, treble damages. The remedies from antitrust actions can be severe. And some of the remedies that are proposed for common ownership, by some of the
proponents of the theory, are admittedly -- would have
a drastic impact.

And I think once you -- you know, if you're
talking about antitrust, you're going to chill the
conduct that you're looking at. And that needs to be
part of that weighing that I mentioned. That's why I
called for a rigorous weighing.

COMMISSIONER JACKSON: Yes, so ways to have
more active corporate governance, how much time do you
have? I have ideas about that. So a few things. So
first of all, it's important to begin by understanding
the fundamental economics that an institutional
investor faces when they think about engaging. And
Lucian Bebchuk and Scott Hirst have a terrific pair of
papers where they walk through the incentives that
institutional investors have or don't have.

And the short version that we've understood
for some time now is that making those investments and
engagement is expensive. It's very hard to cover the
scope of companies that they must when they have the
kind of portfolio that they do. They're making those
investments. You can see that in the corporate
governance teams of the very large institutions.

I've spent time with those teams. They're
doing good work, but it's an enormous task that they
face. And for me, my goal as a regulator is always to reduce the marginal cost of them doing that work. So I want to make sure that we give them the disclosure that they need, to get the information that they want to cast those votes.

That's why, for example, I've pushed so hard to finish the disclosure rules on executive compensation of corporate governance under Dodd-Frank. Those -- that statute's eight years old. We haven't finalized the majority of those rules. That's information that institutional investors have to go out on their own to get. It costs them money on the margin to do that. It makes them less likely to be actively engaged in corporate governance. It's just a fact.

Also, I think we should be looking at other ways to reward institutional investors and make it possible for them to access channels of engaging with the company. So just to give an example, there's increasingly proxy access proposals that have been adopted at public companies that provide some realistic path for institutional investors to actually have a contested election at a public company.

I really feel like the case for the universal proxy proposal that was put forth at the SEC
before the new administration took place is very powerful. And like Commissioner Phillips, to me, these things are all related, because he's right, to the degree you say that we're worried about antitrust, not only do the basic economics of institutional investing make it difficult for these folks to engage in the margin, but it raises the specter of too much engagement producing liability under the antitrust laws, which I worry deters very beneficial oversight of corporate management.

MR. HEMPHILL: So does the homework that you all have given us potentially do that a little bit? Right? I mean, should we be worried about institutional investors turning tail because, look, we're talking through the possibility that we've had this walking antitrust violation for some time, the cure to which is to do less governance?

COMMISSIONER JACKSON: Oh, for -- so, that's --

MR. HEMPHILL: I mean, how strongly should we take that?

COMMISSIONER JACKSON: I think that's a very real cost. I think those who have advanced those proposals have acknowledged that cost, that there is some downside to raising the specter of antitrust
liability because to the degree you get too much
engagement from an institutional investor, it provides
evidence of that kind of influence that might raise
questions from an antitrust point of view.

And as a scholar of corporate governance, I
worry about -- here's what I want to say. I don't
want to go too far down the road of a false choice,
because we can empower institutional investors to
engage and act and still be mindful of and pay close
attention to the degrees to which they use those
channels, or don't use those channels, to reduce
competition.

I don't think we have to choose between
effective corporate governance and reduced competition
in the United States, but I do worry -- and here's my
real frustration. There are already tools at our
business disposal to provide better disclosure on
executive pay, finish the rules that we’ve got, do
universal proxy. There are already tools that would
allow us to do that, and I think it's time for us at
the SEC to start taking that seriously.

MR. HEMPHILL: So another question from the
audience, and I might need a little bit of help just
clarifying it. I think the question is essentially
about who are these people that are voting the shares?

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Just trying to get educated on -- how many people are actually voting these institutional investors' shares? Who are they within the organization? I think to just get a little more educated about that.

COMMISSIONER PHILLIPS: So not to step on what Commissioner Jackson was saying, I think part of what he was pointing out is this is an area where we are beginning to learn a little bit more. We're beginning to learn about the dynamic. I expect that we are going to hear today some description of, like, at-large institutional asset managers, how stewardship works, like what that process actually is.

COMMISSIONER JACKSON: Yeah, I think that's right. And actually just to point out a really interesting and important dynamic, even in the empirical literature, I mentioned the Bubb/Catan paper, there's a debate about the right unit of measurement for casting votes. Should it occur at the fund family at the portfolio level, the fund family level? There's another paper that takes a different approach for all kinds of interesting reasons.

Just to give you a sense, these are brand-new, cutting-edge emerging papers that are debating at what level are these votes cast. So that's why I say we're sort of at the beginning of the conversation.
Also, by the way, Scott, I would predict heterogeneity among institutions with respect to the kind of group that they put together, who actually wields power in that group. Is it the portfolio manager? Is it someone just above them in the organizational hierarchy? You know, I think my understanding, when I talk to people, is that there's heterogeneity even with respect to that authority. And that's something that the literature's just now beginning to understand.

COMMISSIONER PHILLIPS: And just to add one thing, and this was alluded to earlier. There are also players outside of the institutional asset managers themselves. Right? There are other investors who may communicate with them. There are proxy advisers. There is a broader universe of folks involved in that kind of decision-making.

COMMISSIONER JACKSON: Man, I just want to point out, we got down to six minutes left and almost made it without mentioning ISS.

(Laughter.)

COMMISSIONER JACKSON: I was like so -- I'm still waiting for the day where I do something on -- and -- yeah, that's right. There are other players in this ecosystem. It's worth thinking and talking
about. And we're having -- actually at the SEC, to
the Chairman's great credit, we had a really
interesting roundtable discussion of those issues a
couple of weeks ago. And I really think my colleagues
on the Commission are thinking hard about these
questions, which is why it's such a good moment for a
conversation like today's.

MR. HEMPHILL: So one other question from
the audience I think is picking up the theme of
heterogeneity that you guys were just talking about
and wanting to focus attention for a minute on index
fund managers, right? Diversified portfolio, not just
within an industry, public companies in an industry,
but across industries, in some sense approximating the
whole economy.

So the question is whether we should really
worry about index funds to the extent that they own
not just the competitors but also the suppliers and
also to some degree depending -- you know, the
customers. How does that change how we think if it
does? How does it change how we think about that kind
of institutional investor?

COMMISSIONER PHILLIPS: Well, to me,
especially for purposes of the antitrust discussion,
this is part of the nuance into which we have to get.
You know, I think -- take a hostile merger, right? If you worry about too much power invested in an institution generally for purposes along the line of Coates and Bogle's argument, if you worry about antitrust liability, part of what you may have in mind is the notion that the asset manager just thinks generally or about itself broadly.

Take a contest where the shares are held in companies that don't have a shared interest. How are they being voted? Right? Are they being voted the same way? Because if they're voting against themselves, they may not be operating in the way that we might think of someone who just owns a lot of shares voting unilaterally.

I think those dynamics and those nuances are critical to understand. The leveling of the sort of supply chain that you not only have an interest in one company but in the companies from which that company buys and the companies to which that company sells, that is another level of nuance in terms of understanding what the sort of broad asset manager interest might be.

COMMISSIONER JACKSON: Yeah, I think that's right. I mean, one of the -- I mean, look, this is why the Azar and the Elhauge papers are so interesting
and important because when I begin to try to think through, if you're an institutional investor and you want to reduce competition, how do you think about that across your entire portfolio, not just in an industry? How do you think about the suppliers, customers, et cetera?

It's an enormously complicated calculus. It's not -- one of the things that the literature has done for me is clarified what the objective function might be in that situation, what they might be trying to do. So what we could meaningfully put on the left-hand side in terms of what the institutions might be trying to achieve.

Look, I think he's right that it's a good thing to start with understanding the various calculus that one might do if they exercise that influence. And then I think, as your paper points out, what we really want is to make sure we have a measure that tests that strategy. And I think that's where the literature, I hope, is going.

And the more recent paper on relative performance incentives, I think, takes a big step in that direction, really has given me a lot of food for thought about, okay, now, that helps me understand what the thesis might be, right, because these guys
are paid for exceptional within-industry performance, so maybe that's a mechanism we can think through. So understanding the basic economics of what a concentrated common owner strategy might be is I think where we need to go in terms of understanding this literature better.

MR. HEMPHILL: Any closing thoughts? Can I give a minute to each of you all if there's anything you want to close with?

COMMISSIONER PHILLIPS: I just want to close with my real enthusiasm. I have booked my train late enough to stay for as much of today as I can. I think this is going to be one of the most interesting debates. I think we are, like, literally and physically at the intersection of two very interesting areas of law, both of which focus on markets and their optimal functioning. So I just want to thank really everyone for being here with us.

COMMISSIONER JACKSON: Yeah, I certainly agree. I think this is the case for research. This is why research is so important to me. I mean, we're here because Martin and Einer and others sort of put this issue front and center for us and are making us think hard about it. And, so, as someone who was a researcher, now a policymaker, it's rewarding for me
to see the payoff of that research.

And when I say we're at the beginning of the conversation, I mean, I'm not only trying to give you guys more papers to write, I'm also learning in a very real way about the ways that I should think about doing my job well. So I'm very grateful to all of you for that, and I very much look forward to the conversation.

MR. HEMPHILL: Great. With that, please join me in thanking Commissioner Phillips and Commissioner Jackson.

(Applause.)

(Recess.)

INSTITUTIONAL INVESTORS, DIVERSIFICATION, AND CORPORATE GOVERNANCE

MR. ROCK: Welcome back. I'm Edward Rock.
I teach here at the law school. And it is really terrific to have this session here. The common ownership issue is one that folks here have been thinking about deeply for quite a while, so it's fun to have the session here.

I want to say a word about how this panel fits into the overall structure of the program today. Commissioner Phillips and Commissioner Jackson have introduced us to the issue and the tension, to the tension between antitrust liability and corporate governance, to the intersection between antitrust and corporate governance. And it's really a -- part of what is so interesting about this set of issues is looking at the intersection of antitrust and corporate governance. Something that is not often done but is extremely important.

The claim, as you heard this morning, as you'll hear more this afternoon, the claim that Martin Schmalz and coauthors have made is that the structure of common ownership through some mechanism has had competitive effects. Einer has argued that it's currently -- it's currently illegal under Section 7 of the Clayton Act, and Eric Posner and Fiona Scott Morton and Glen Weyl have argued that the appropriate solution is to either force firms to choose one firm
in a concentrated industry or limit them to 1 percent
or force them to commit to complete governance
passivity.

This then sets up the framework for this
panel, which is what would be lost if either through
antitrust risk, antitrust exposure firms opted for
governance passivity? What would be lost if the
Posner/Scott Morton/Weyl proposal were adopted in
firms in order to maintain their business model, opted
for governance passivity, opted to put their shares in
the drawer and to return to the kind of lack of
shareholder engagement in corporate governance that
characterized the '50s, the 60s, and really well into
the '70s and '80s?

So a big part of what we're trying to do
today is to provide a snapshot of what shareholder
involvement in corporate governance looks like in
2018. What the ordinary sort of engagement is, how it
works, who initiates it, so that we can see what would
be lost if common owners returned to passivity.

Another issue you heard in both Commissioner
Phillips' talk and Commissioner Jackson's talk is this
question of what are the mechanisms by which this
anticompetitive effect could happen, could come about?
And, again, this panel, by talking about what is the
nature of shareholder engagement in corporate
governance in 2018, can cast light on how plausible
different proposed mechanisms are, how plausible the
lobbying mechanism is, how plausible is it that the
large institutional investors in meeting with
corporate management are urging them to adopt the soft
competition approach?

How plausible is it that the mechanism of
reducing the amount of relative performance evaluation
compensation or having, to put it more positively, to
having greater emphasis on industry profits, industry
performance compensation? Is it a plausible channel
by which competition could be restrained?

In preparing for the panel, I've asked folks
to address a variety of issues, including how do asset
managers initiate the engagement? Just how does it
work? What are the topics of engagement? To what
degree is it firm-specific? To what degree is it
market-wide? In engagements, what are the -- what do
asset managers raise or touch on? Do they touch on
the sort of issues that are proposed to be the
mechanism by which the views in favor of soft
competition that are attributed to the common owners
get translated into corporate policy?

Let me briefly introduce the panel in order
of presentation. You have the biographies that tell you much more about their distinguished backgrounds. Our first presenter will be Barbara Novick, who is a cofounder of BlackRock, is a Vice Chair and now oversees -- among her varieties of duties, oversees investment stewardship.

We'll then turn to Allison Bennington, who is a partner at ValueAct but I should emphasize is not here in that capacity. She's also a member of the SEC Advisory Committee, a member of the Steering Committee at the Investor Stewardship Group and a member of the Advisory Board of NYU's Institute for Corporate Governance and Finance. And in those capacities, Allison sees and interacts with a wide variety of different kinds of investors and is very much involved in understanding and in crafting the approach that different kinds of investors take to corporate governance.

We'll then turn to Ken Bertsch, who is the Executive Director of the Council of Institutional Investors, which is the organization of which many of the largest institutional investors gather.

Our next speaker will be Heather Slavkin Corzo, who is the Director of Capital Markets Policy for the AFL-CIO. The AFL-CIO has been very involved
in corporate governance for decades now.

Following Heather, we'll have Holly Gregory, who's Co-Chair of Sidley Austin’s Corporate Governance Practice and is an experienced board counselor and can take us inside the boardroom to see how shareholder engagement looks from the perspective of the directors.

We'll then turn to David Hirschmann, who's Executive Vice President of U.S. Chamber of Commerce. And we will close our first round with Scott Hirst, Associate Professor of Law at BU and the author with Lucian Bebchuk of a very important recent paper that gathers data that looks at how much involvement in corporate governance institutional investors have. The takeaway -- Scott and Lucian's takeaway -- is much too little. They should do much more, which immediately sets up the tension that characterizes today.

It used to be that corporate law scholars divided between those who thought that institutional investors didn't do anything and those who thought that institutional investors did a little bit. With Martin and his coauthors' work, we now get all three positions -- potential positions on the spectrum. There are those who think that institutional investors
do too little, like Scott and Lucian. There are those
like Martin who think they do too much. And there are
those like Marcel Kahan and myself who think it's sort
of about right.

With that, let me turn it over to Barbara.

Here's the clicker.

MS. NOVICK: Good morning. I'd like to talk
about investment stewardship. This is the critical
element of the corporate accountability chain that
empowers shareholders to engage, to vote on issues
that are relevant to the long-term success of the
companies that we own on behalf of our clients. It's
the very essence of how shareholders can exercise
their rights.

It clearly matters to asset owners, who are
the economic owners of the shares, as they participate
directly in the fortunes of the company. It also
matters to the asset managers who are fiduciary agents
on behalf of those clients, earning a small basis
point fee on the total portfolio.

Voting in proxies is one of the primary ways
that shareholders can express those views. Many asset
owners choose to vote themselves. This includes both
asset owners who manage assets in-house and asset
owners who outsource to asset managers. When the
asset manager has the authority to vote, stewardship
codes and regulation not only encourage but very often
require that they do so on behalf of the clients.
And, of course, as you heard earlier, many asset
owners and asset managers use proxy advisers to assist
them.

The common ownership debate is not about
active versus passive. If the theory has any value at
all, it would logically apply to any investment
strategy in which an investor holds more than one
company. Investment strategies are best thought of as
a continuum from the most actively managed to the most
indexed-oriented, all of which may include multiple
companies in a given sector.

Stock indexes are a crucial component to the
underlying both index and active strategies. Index
strategies are designed to closely track the
performance of the index by tracking the composition
of the index. These strategies have grown
significantly as they provide the average investor
with low-cost access to market returns. Active
strategies by contrast are intended to outperform the
index by deviating from its competition.

One of the suggested remedies for common
ownership is to limit portfolios to one company per
sector. In that case, virtually all diversified portfolios would no longer be viable. Index providers are a key participant in the ecosystem. Companies such as S&P and MSCI create indexes that represent broad markets as well as specific sectors and geographies using a variety of methodologies.

Understanding stock inclusion rules and index rebalancings is essential to managing portfolios. The often-cited airlines paper assumes that managers continue to hold airlines during periods of bankruptcy, but the reality is quite different. When a company declares bankruptcy, its stock is delisted from the Exchange, and index providers promptly remove that stock from the index.

In contrast, when a company exits bankruptcy, there could be a significant lag before the stock is returned to the index. In the case of U.S. Airways, the stock was excluded from the index for over four years. As a rule, index managers sell and buy the stocks close to the timing of these deletions and additions. In the case of the airline paper, 29 of the 56 quarters -- that's half -- of the study period are impacted by this incorrect assumption.

Investment stewardship includes both
engagement and voting. Keeping in mind that a company's board represents its shareholders, the primary focus of engagement is on governance issues as the quality involvement of the board is paramount to representing shareholders' interests. In addition to board governance, we have engaged with companies to understand their long-term strategy, to assess the alignment of executive compensation with shareholders, to encourage climate risk disclosure, and to understand how a company is addressing human capital management.

You'll notice it was never about product pricing. And while we like to think our opinion matters, we represent a minority of the shares outstanding, generally in the single digits, so there is a limit to how much our opinion matters.

Let me touch briefly on compensation. When our stewardship team evaluates executive compensation, we start from the premise that boards and their compensation committees should set policies that are aligned with the company long-term strategy. Compensation consultants play a key role in designing these plans, and these plans are based on own firm performance as measured by metrics like pre-tax income, margin improvement, shareholder returns, and,
frankly, outperforming their competitors.

Proponents of common ownership believe that the presence of common owners incentivizes company executives to reduce competition. This would mean that CEOs are willing to place the minority interests of common owners above their own personal financial interests since many are paid in company stock.

There's a broad consensus amongst policymakers and asset owners that traditional asset managers should take a serious approach to investment stewardship of client assets. Stewardship codes and other regulations encourage engagement and often require the asset manager to vote in proxies. Over the past two decades, a series of codes have been issued from the U.K. to Australia to Japan and more. We count close to 20 stewardship codes globally today.

In the U.S., both the SEC and the DOL issued guidance 15 to 20 years ago stating that, as fiduciaries, fund managers must vote proxies when doing so is in the best interest of clients. Calls by some commentators to restrict engagement or eliminate proxy voting rights directly contradict the stewardship codes and regulations. Restricting voting would disenfranchise our clients, the asset owners.

The result could be an entrenchment of management or
empowering short-term actors, both at the expense of the long-term owners.

At BlackRock, we evaluate each ballot item on its merits in the context of materiality to the company's long-term financial performance. We believe voting is the ultimate expression of investment stewardship, and a vote against management reflects a failure to make progress in engagement.

In 2017, 98 percent of the 28,000 ballot items from companies in the Russell 3000 Index were management proposals, things like election of directors or reappointment of auditors, which are generally considered routine items and receive more than 95 percent in favor. The exception are say-on-pay votes, which often get lower support, especially if the proxy advisory firms have recommended against.

The remaining 2 percent of the ballot items are shareholder proposals. Roughly half of these are for environmental and social issues. As you can see, the voting on these items has no particular pattern across managers. ISS uses over 380 management agenda codes to categorize voting items for their proxy reports. Not even one agenda code relates to product pricing. The chart also highlights the proxy advisers and their recommendations. Various studies estimate
that proxy advisers influence between 10 and 25 percent of the vote. This far exceeds the influence of any individual or even multiple asset managers. Given their influence in voting, any study on shareholder voting must incorporate this effect. However, it is completely ignored in the common ownership papers.

So let me wrap up. The stewardship ecosystem, as you've seen, is complex, many different participants. Asset managers are there to provide investors with diversified portfolios to meet their investment needs. And we engage with portfolio companies not to influence pricing but rather to protect and enhance the retirement outcomes of our clients. This engagement plays an important role in the corporate accountability chain, which has value, not just for shareholders, but for society as a whole. Thank you.

MR. ROCK: Thank you, Barbara.

Allison?

MS. BENNINGTON: Thank you, Ed. Good morning, Commissioner Phillips and Commissioner Jackson. The lights are bright. I don't know where you are, but thank you. And thank you to NYU and the FTC for inviting me to participate in this panel today.
on such an important topic with such an August group
of fellow panelists.

So let me start with that same disclaimer
that my remarks today are entirely my own opinion and
not that of ValueAct Capital.

So, today, what I'd like to discuss is the
recent history of engagement between corporations and
their shareholders -- what we call corporate
governance -- what corporate governance achieves and
what would be lost to the savers, retirees, and
investors of this country if the approaches suggested
by some in the academic community were to be adopted
by the FTC.

So first a history. The recent history of
corporate governance starts with the financial crisis
beginning in 2008. Before the financial crisis,
shareholders as a group tended to be more passive, and
management and boards were dominant. The balance of
power was firmly on the side of corporations.
Shareholders trusted that management would do the
right thing and ceded long-term corporate strategy and
direction to management and the board.

Effectively, it was as if shareholders put
their shares in the drawer and only took them out when
it was time to sell. But then the whole world
changed. In 2008, the financial crisis struck, and over the next few years, trillions of dollars were erased from the savings and retirement accounts of American workers and savers. People who had saved for a lifetime for retirement lost huge portions of their savings or had to work for many more years before they could retire on much less than they had planned.

Parents could no longer afford college tuition; and household net worth was slashed. Almost every American was negatively impacted by the financial crisis, none more than retirees, workers, savers, and investors. A lot of these savings and retirement funds were invested through mutual funds or index funds, which I’m loosely calling asset managers. I know I don’t have these precisely right, but just to give an overall sense, which in turn invested in the shares of U.S. corporations.

Many union and public pension funds, what I’m calling asset owners, managed the pension contributions of their workers and also invested in U.S. corporations. The financial crash was an enormous wake-up call for these asset managers and asset owners. Workers and savers and retirees thought their savings were safe and that someone was looking out for them. But asset owners and asset managers
thought their investments in U.S. companies were safe and that managers and boards were not taking excessive risks.

At that point, asset owners and asset managers, which I’m going to call collectively institutional investors, realized that in order to fulfill their fiduciary obligations they had to take a role in corporate risk management and keep an eye on the long-term health of U.S. public corporations that they were investing in. They invested time and effort in establishing a set of protocols to engage with company management and boards of directors. And this is when the balance of power began to shift.

Shareholders insisted that their voices be heard, and a new wave of engagement between corporations and these institutional shareholders began, which, for lack of a better term, we loosely call corporate governance.

Then in 2010, the Dodd-Frank Act was enacted. Dodd-Frank had multiple provisions, encouraging shareholder corporate engagement and provided an important congressional endorsement of the role of shareholders in corporate governance.

I’d like to just take a little detour to the SEC, and thanks to Commissioner Jackson, I feel it’s
okay to do so. The SEC is the regulator of both the financial markets and also the U.S. corporations. So when the SEC speaks, the entire U.S. capital and corporate ecosystem listens. And when the SEC encouraged and continues to encourage shareholder engagement with public companies -- I’ll just give you a few quotes from Commissioner Kara Stein: I would posit that the entire corporate ecosystem success actually rests on effective communication and collaboration between corporations and their shareholders. When a company, its management, its shareholders, and its employees work together, companies tend to be more resilient and prosperous. In turn, this benefits companies, their corporate stakeholders, and the economy as a whole.

Ex-Chairman Mary Schapiro: As a general rule, interested, aware, and active shareholders are good for public companies, and I believe that more shareholder engagement is better.

And, finally, Commissioner Luis Aguilar: In the end, I firmly believe that companies with corporate governance processes that enhance how they engage with their owners will be more successful than those that keep the door shut.

So what does this all boil down to? It
boils down to accountability through corporate
governance. Any system without accountability
eventually fails. Some argue that the financial
crisis was caused in part by a cascade of failures in
accountability at multiple points in the greater
financial ecosystem, and public corporations certainly
played their part.

In the new world of corporate governance,
the very clean and clear system of accountability has
established itself, a system where everybody is
accountable, everyone has a boss. Here’s how it
works. Employees are accountable to management.
Management is accountable to the board. The board
is elected by, and therefore accountable to, its
shareholders. There are many different types of
shareholders, but when we’re talking about
institutional shareholders, institutional shareholders
are accounted to those whose financial assets they
look after.

So who’s at the end of that chain? The
retirees, savers, workers, union members, investors.
The chain of accountability between management and
boards and their shareholders is facilitated by
corporate governance, and it's the institutional
shareholders that have taken the lead in the corporate
governance engagement process.

If we adopt the suggestions of some in the academic community, institutional shareholder engagement will be choked off. The chain of accountability will be broken between the board and the vast majority of their shareholders. Boards will no longer have a boss, and the rest of the chain will be decoupled. And it's the retirees, savers, workers, and investors who are at the end of that chain who will suffer the consequences.

I'm sure that many of my fellow panelists will go into more detail about the topics of engagement between shareholders and management, but the overarching theme is that institutional shareholders want to see their companies run in a way that allows them to assess long-term goals. No shareholder wants to see a company they are invested in on the front page of the Wall Street Journal because of irresponsible corporate conduct that results in the destruction of shareholder value.

So where does this leave us, and what would be lost if shareholders were blocked from engagement? We’ve seen what happens when the chain of accountability is broken. I would posit that the healthiest ecosystems are the ones where everyone is
accountable. Ultimately, this chain of accountability protects the very people who the academic community is concerned about hurting. Consumers by one name are also workers, union members, retirees, and savers by another.

Muzzling shareholders and swinging the pendulum back in the direction of management creates a worrying scenario. As a country, we have been there before. Our financial system’s regulators and congressional leaders have led us in the right direction of developing an open shareholder/management relationship. In my opinion, we should very seriously consider the implications or unintended consequences of a shift in antitrust policy that could have major, far-reaching implications for established capital markets policies and practices that have served us all well. Thank you.

MR. ROCK: Thank you, Allison.

Ken.

MR. BERTSCH: Thanks, Ed. Thank you for inviting me to participate. Thank you, Commissioner Phillips and the FTC. I think it's a very interesting day, and it's already gotten an interesting start.

So my name is Ken Bertsch. I’m Executive Director of the Council of Institutional Investors.
We are a membership organization of organizations. Our core membership, are asset owners, institutional asset owners, particularly public pension funds. We were set up by public funds in the mid-1980s actually to try to fix what was wrong with corporate governance, which was lack of engagement by long-term shareholders with the companies that they owned, and I’ll come back around to that.

I do want to make a few comments on the dialogue earlier with Commissioners Phillips and Jackson, which I thought -- pretty much would identify myself with all of their comments. I did learn ever more that NYU is the center of the world, although probably the business school as well as law, I’d have to say.

And I remembered that I worked at TI -- what was then called TIAA-CREF in the late 1990s and early 2000s, and we had a corporate engagement program that I think was somewhat groundbreaking. I had a staff of two retired CEOs, which was kind of a unique perspective. We had a pretty vigorous program, and we had Chancellor Bill Allen, who by that time was working with NYU to come in and evaluate what we were doing and particularly to look for agency problems, and were we actually doing activities that were
worthwhile for the beneficiaries. And he did quite a thorough review. He was largely positive. He had some criticisms, but it occurs to me -- it only occurred to me this morning that might be some kind of exercise that’s worth doing based on Commissioner Jackson's comments.

I would also say that some of the comments were really about getting information to retail holders on stewardship programs in a way that they would understand. I would say that the institutional asset members, many of them, have had a lot of interactions with their asset managers about stewardship for a while. And, so, there are models out there. There are folks who are pushing the envelope. I’d cite in particular the GPIF, the largest pension fund in the world in Japan, which has in the last couple of years really further developed how to interact with asset managers on the subject.

Third, I want to identify myself with Commissioner Phillips’ remarks about chilling effects and worrying about chilling effects. I worry about chilling effects from actually the common ownership debate itself to some extent, but also would say the current HSR rules are -- the too narrow investment-only exemption and too ill-defined investment-only
exemption, I think actually is right now chilling some of the engagement that needs to take place, is on the liability side from the standpoint of law departments and asset managers that weigh whether -- whether there should be engagement or not.

I also want to associate myself with both Commissioners on the heterogeneity of the participants in this on the investor side. So on the asset manager level, I really see all kinds of different variety of interactions. Big indexers have varying levels of fundamental active investment that they're doing at TIAA. We involved our portfolio managers where they had -- at some companies where they had positive weightings, but we were largely indexed, and so we worked mostly in a similar way that BlackRock did.

Active managers have different combinations of involving corporate governance staff and portfolio management staff, and it’s changed rapidly in recent years. The corporate governance discussions tend to be on process, with investors trying to understand do we have faith in this board, are they awake at the switch, do they understand how the executive compensation works. And there are discussions about risk management and so on.

Those are the topics that are at the
 forefront. For active managers -- and strategies discussed, but it’s more does this board, does this board member understand the strategy, can they articulate it to us, and how does it connect to executive compensation, for example.

For more active owners, I think there’s more dialogue, no doubt, about strategy, particularly where companies are misfiring. But the measure of whether they're misfiring has been are they doing poorly relative to peers. Are they missing the boat on strategic change? And those discussions, and I have been in some of those as well, including at Morgan Stanley Investment Management, where I worked.

To the extent they get into execution, it's really about running faster, jumping higher, competing more -- better, becoming better competitors. So in that sense, some of the common ownership debate doesn’t ring true to me in terms of what these discussions actually are about.

I also would say there’s a little bit of tone deafness, I think, in some of the articles about what goes in asset management firms. Ed, your paper, just a trivial example, that picks up the commentary that some investors admitted to engaging with companies, using the word sort of an "admission
against interest,” that is not an admission against interest. It's probably exaggerated, actually.

The admission against interest would be that we're not engaging because --

MR. ROCK: That was a quote -- that was a quote from a different paper. That wasn’t --

MR. BERTSCH: No, no, I know, but you found it.

MR. ROCK: We found it.

MR. BERTSCH: It was not Ed's paper.

(Laughter.)

MR. BERTSCH: It was a paper he was critiquing. In any case, so engagement is expected at this point in time. Just to go back to our findings, Allison, I would take the history back quite a bit further. And you could really probably go back to the 1930s, but in the 1980s, the public pension funds felt like they were being squeezed between certain activist holders, particularly those that did greenmail, that basically held up companies and got paid off privately, and then corporations that decided to defend themselves by entrenching management through poison pills, through staggering election of directors and other means, and that there needed to be a voice for long-term investors to advocate for their asset
managers and through their own programs to engage constructively with companies.

And increasingly that became focused on the board of directors and trying to make sure that there was good engagement with the board and an opportunity for the investors really to understand the strength of the board. I’ll stop there.

MR. ROCK: Thank you, Ken.

Heather.

MS. CORZO: Thanks. Thank you, guys. Thank you all for being here and for the opportunity to speak to you today. My name is Heather Slavkin Corzo. As Edward mentioned, I’m here on behalf of the AFL-CIO. We represent 12 and a half million union members with more than $7 trillion invested in the financial markets in the form of retirement savings.

In addition to that, I am the Head of U.S. Policy for the UN Principles for Responsible Investment. We are the world's leading proponent of responsible investment, with over 2,100 signatories globally investing $82 trillion. Of that, around 400 of our signatories are in the U.S., with $45 trillion in assets under management.

And, finally, I am a Senior Fellow at Americans for Financial Reform, a coalition of more
than 2,000 civil rights, consumer, labor, business, and other organizations formed in the wake of the financial crisis to lay the foundation for a strong, stable, and ethical financial system. Whoo, so I got through that. You guys, if you think that took a while, imagine what it’s going to be like come tax time.

But as for the topic of today's panel, we’ve been asked to discuss what shareholder engagement and corporate governance looks like today. The AFL-CIO has a long history of engaging in corporate governance initiatives. The initiatives that most people who participate in the corporate governance space are most familiar with are the engagements on behalf of the AFL-CIO reserve fund, where we file dozens of proposals every year on topics ranging from executive compensation to human rights issues in the supply chain to political spending disclosure. We change the subjects periodically. And, you know, the engagement goes back more than 20 years.

In addition to that, there is an AFL-CIO equity index fund. It has about $8.4 billion in assets under management, large for, you know, the regular person, but compared to what Barbara’s managing, it’s a pittance. And what the AFL-CIO
equity index fund does is we are a large cap equity index fund. We file shareholder proposals periodically, and there’s AFL-CIO proxy voting guidelines, and so all of the votes are cast in adherence to the guidelines.

So when discussing engagement by large institutional investors, I think it's important to distinguish between the activities undertaken by large money managers versus including those who manage pension funds versus large pension funds that may engage more directly in corporate governance matters through the shareholder proposal process.

Large pension funds have managed to push the agenda on specific issues to get a say on issues like executive compensation, board diversity, proxy access, et cetera. In the U.S. context, however, the large money managers have not been as active in my experience on direct shareholder proposals through the SEC process.

As Barbara spoke about, the rise of stewardship codes around the world, however, has led to an increased focus on how large money managers approach governance and expectations that large institutional investors will show a commitment to transparency and drive good corporate governance
practices through engagement and voting.

So the ability of investors to engage with companies and the types of issues that may be raised through formal proceedings is limited. The SEC has an extensive body of regulation, guidance, staff legal bulletins, and nonprecedential but informative, no-action responses that guide investors on acceptable topics for engagement on ESG issues through the proxy process. At a very high level, the SEC will grant -- issues no-action requests to allow for the exclusion of a shareholder proposal if it seeks to micromanage the company or if it's considered ordinary business.

If a topic is considered a significant social policy issue, the shareholder proponent may nonetheless overcome a request for exclusion. There may be investors who are engaging with companies through informal means. That's not typically how the AFL-CIO engages. So the subjects that we are engaging in with companies are really limited to the ones that the SEC has determined are acceptable topics.

These tend to be -- I'm hard-pressed to think of an example that's not an environmental, social, or governance issue, or an ESG issue. I can't think of a single instance where we've talked to a company about product pricing.
And, in fact, as I think about it, it's hard for me to imagine that it would even be legal. I think one thing that we have to think about is the reality that insider trading laws prohibit companies from sharing material, nonpublic information, from any -- with any investor. So it's interesting for me to hear the topics that are under discussion, the conversations around whether there may be some anticompetitive impact that arises from investor engagement on governance issues. It's hard for me to imagine how it would actually happen. And I think to the extent it was, it would already be illegal and cause for serious concern.

So I think it's important to look at the questions being raised today about whether investors' engagement on corporate governance matters lead to anticompetitive activities in the context of the larger debate that’s happening in Washington that is really aimed at silencing investors when we attempt to engage with companies on ESG issues.

There is a hearing under way as we speak in the Senate Banking Committee right now to consider proxy voting and proxy advisers. And the SEC has taken a number of actions to scale back investors’ rights, to raise topics of concern with a company
through the shareholder proposal process, just in the last few months.

This is actually the opposite of the direction we should be headed. Individual investors are increasingly concerned about the impact the companies we own are having on the environment, income inequality, and other ESG matters. That is why large money managers are increasingly developing responsible investment options, and we should be encouraging that activity.

So I just -- I want to take one second to respond. We’ve heard other panelists respond to this notion that the way to respond to the concerns that are being raised about potential anticompetitive activity is to remove the rights of large institutional investors to participate in proxy voting. That is a serious concern to me. I think that would remove a tremendous opportunity for accountability.

And as Allison discussed, there is a -- there’s a balance that exists right now in the corporate governance system that provides accountability along the line. It would be very disruptive to interfere with that.

So with that, I’ll conclude my comments and...
Thank you all for the opportunity to speak today.

MR. ROCK: Thank you, Heather.

Holly, you spend a lot of time in boardrooms.

MS. GREGORY: Yes. Thank you. Thank you for inviting me to share a corporate governance lawyer’s perspective on the issues that you’re talking around common ownership. I cochair Sidley Austin’s Corporate Governance Practice. It’s a global practice. I advise corporate boards on the whole range of corporate governance issues, including engagement with institutional investors and shareholders.

Now for the disclaimers. I have not advised anyone on the common ownership subject matter of this hearing. I have not been retained by anyone to participate in this panel. And the views I express are my own and not for attribution to Sidley Austin or any of our clients.

I’m going to make four observations. First, while the institutional investor influence on publicly traded corporations has increased considerably in the past 20 years, the subjects of this influence, as evidenced by the topics on which they vote and the topics on which they engage, and as Heather mentioned,
do not appear to extend to ordinary-course business
decisions.

Outside of their very limited decision
rights as shareholders, shareholders cannot dictate
the actions of the corporation’s board or its
officers. Directors and officers are fiduciaries, and
as such they’re required to make their own judgments
in managing the business and affairs of the
corporation.

Now, shareholder influence, which I
mentioned is fairly powerful, comes in large measure
from their ability under federal law and regulation to
bring nonbinding shareholder proposals and company
proxy materials, and also to have advisory vote on
executive compensation and on the golden parachute
compensation.

Companies face significant pressure to
address, say-on-pay issues where the management
proposal does not achieve a significant majority of
support, and also to implement majority-supported
shareholder proposals. And failure to do so can lead
proxy advisory firms to recommend against the
reelection of directors.

Now, ordinary business operations are not a
proper subject of shareholder proposals. Absent an
overreaching policy issue, generally what products to
offer, what prices to charge, what areas to compete in
are ordinary business operations and they’re excluded
from shareholder proposals. And, similarly, in
engagement efforts, institutional investors focus on
the broader issues concerning shareholder rights,
board accountability and governance, executive
compensation structure, and corporate, social, and
environmental responsibility.

And according to the stewardship reports
from the large institutional investors and surveys of
corporate directors and members of management, the
most common topics for engagement in 2018 and 2017
were around board quality and composition and
accountability, climate-related risk, and board
oversight of sustainability issues, executive
compensation, including alignment of compensation with
corporate performance, and shareholder rights. And
there are more, but that’s really it. They’re not
about these ordinary business issues.

My second observation. Both institutional
investors and their proxy advisers heavily emphasize,
as reflected in their proxy voting policies, that
executive compensation should be aligned with company
performance and not with industry performance. The
voting policies of institutional investors provide
that misalignment between pay and company performance
is grounds for a negative say-on-pay vote, and in
certain circumstances, grounds for a negative vote on
the reelection of compensation committee members. And
that's pretty powerful stuff to a board of directors
in thinking about compensation structure.

Similarly, the proxy advisers both
incorporate relative performance evaluation into their
analysis and will issue negative vote recommendations,
for say on pay, if executive pay and company
performance are not aligned. Indeed, a misalignment
of pay and company performance relative to peers is
the most common reason for proxy advisers to recommend
a negative vote on compensation, and it is the most
common reason for a failed say-on-pay vote.

My third point. The topics on which
corporations and their institutional investors engage
is heavily influenced by legal concerns, including the
need to strictly comply with federal securities and
antitrust laws and regulations. Focused attention by
corporate counsel in line with written guidance on
engagement activity undermines the notion that
engagement is a means through which investors
encourage companies to soften their competition or
through which companies communicate confidential information about their competitive plans.

It is common practice in my experience for counsel to provide corporate directors and members of the management team with strict instructions about the rules of engagement, including parameters of topics for engagement. In line with SEC staff guidance, discussion topics are typically precleared with the shareholder and company counsel, either participates in the meeting or briefs the company’s participants in advance.

Through engagement policies and direct instruction from counsel, participants are reminded that they must not selectively disclose material nonpublic information in violation of Reg FD. They're reminded about tipping and insider trading liability that could result from someone else misusing material nonpublic information.

If engagement is encouraged during proxy season, special care is given to abide by the proxy solicitation rules, which only permit attempts to influence shareholder votes based on what has been disclosed in filed proxy-soliciting material.

Directors and officers are also reminded not to discuss competitive information, customer-specific
information, or details about the company’s pricing or production capacity.

My fourth point. Institutional investor engagement with portfolio companies has contributed to decisions by corporate boards to change corporate governance practices and to provide greater transparency into their decision-making. For example, in response to a combination of engagement and nonbinding shareholder proposals. A majority of S&P 500 boards now require annual election of all directors, majority voting in the election of directors, and shareholder access to the company's proxy to nominate directors.

This influence has a multiplier effect as other corporate boards take heed of these developments as evolving best practices and reflection of broad shareholder expectations. They are implementing these kinds of changes without direct shareholder engagement. The focus is now shifting to the social responsibility and environmental issues and corporate sustainability that Heather mentioned, and, so, we expect to see changes and greater transparency there as well.

In conclusion, if a decline in competition in concentrated industries is, in fact, associated
with common ownership, and I understand that that is also a point at issue, policymakers will face very difficult tradeoffs, given consumer interests in diversified investment vehicles for investment and college savings, and the benefits institutional engagement brings to corporate governance. Thank you.

MR. ROCK: Thank you, Holly.

We now turn to David Hirschmann from the United States Chamber of Commerce. Is this an issue in which the AFL-CIO and the Chamber of Commerce are shoulder to shoulder on?

MR. HIRSCHMANN: Actually, a few years ago, I testified at the Senate Judiciary, and that morning, I lost my voice. And I had to explain to Senator Leahy who was chairing the hearing that on this issue the AFL-CIO could speak for us. That issue happened to be the protection of intellectual property.

Unfortunately, for all of you, today I have my voice, so you’ll have to hear me actually agree with Heather and Ken.

MS. CORZO: Well, I’ll enjoy it.

MR. HIRSCHMAN: So thank you, Ed. And thanks to Commissioner Phillips, Commissioner Jackson, the FTC, and NYU for holding this important forum.

The Chamber represents 3 million businesses of
virtually every size and shape in this country, public and private. And we tend to come at these issues from the perspective of what will better enable capital formation. And that’s where we’ve long encouraged companies to engage more with their shareholders -- public companies -- and we’ve engaged and encouraged our asset manager members to engage with companies as well. And both have responded. In fact, certainly, we participate in countless conferences and other forums to discuss how shareholders should engage more and how to do that constructively.

Where we have disagreed, when we have, is on proposals that we view as giving one or another group of investors more favorable rules of the road in a way that makes it hard for boards to exercise their fiduciary duty to all shareholders. This has, for example, driven our concern about the lack of proxy advisory firms, which I’ll talk a little more about in a moment.

So while we don't always agree with the AFL-CIO and CI, I think we begin from a -- and what strikes me about this issue that the common premise that constructive engagement is better is something that I hear widespread agreement on today. Shareholder engagement does not drive down
competition. In fact, it can encourage and sustain, and it's important for healthy capital markets.

Engagement allows management to communicate with their shareholder base as they implement strategies to generate long-term growth.

Our most recent proxy survey showed, for example, that 80 percent of companies report that they engage year-round in a regular communication program with their institutional investors. And I’d be the first to say that we should get that number closer to 100 percent.

With that in mind, I’d like to make a couple of points. First, the subject in which companies engage with their institutional investors; some of the concerns public companies have when it comes to the current practices related to corporate governance; and finally the role of proxy advisory firms.

First, how do investors engage?

Institutional investors often communicate directly with the company, and companies reach out to their investors, either through their investor relations department, through management, through the board, in a number of means. And we are fortunate to live in an era where there is accelerating innovation and transformation larger than we’ve seen since certainly...
the Industrial Revolution.

Frankly, I can't recall meeting with a single business leader who isn't laser-focused on how to drive that change in a positive way for their business. In fact, because we understand that virtually every business model can be disrupted today, the Chamber is actively focused on removing barriers to innovation and growth. In that environment, companies must be able to communicate their strategy with all types of investors and stakeholders. This is the kind of constructive engagement that is happening more and more and that most investors are seeking.

Second, what are some of the concerns we have with the way public companies -- that public companies have with the current state of play. While we think constructive investor engagement is beneficial, there are ways in which a minority of some special interest investors can use outdated rules to promote their agendas at the expense of other investors. For example, rules governing shareholder proposals have allowed proposals dealing with social/political matters to proliferate, even when they fail to gain significant support.

We are pleased that the SEC is now looking at zombie proposals and other areas where the proxy
rules might need to be modernized so all investors -- both retail and institutional -- have a level playing field.

Third, the role of proxy advisory firms. Proxy advisory firms, as many of us know, have a demonstrated influence in the manner in which large public companies -- a large number of public company shares are voted. In some companies, it depends on the shareholder base, but it ranges, according to most research, between 50 and 30 percent. Way too much time is spent today in boardrooms to try to anticipate what ISS or Glass Lewis think and how that might impact how they vote in the next proxy season.

In fact, many companies feel the need to hire the ISS’s consulting arm to help guide them on the nontransparent and uneven way in which they apply their corporate standards. To be clear, we are not seeking to federalize or eliminate proxy advisory firms. We simply have pointed out that they play an important role and have supported sensible reforms that will enable them to better serve all stakeholders in the capital formation system.

Reforms in this area are long overdue, but that’s a topic best left to the SEC. My point in raising this issue today is not to labor into the
merits or relative merits of proxy advisers but point out that much of the academic research in this space has failed to even consider the role of proxy advisers and certainly has not considered how the solutions identified might influence the world that proxy advisers play.

Finally, I’d like to end with one final word about how the potential -- about the potential impact of limiting common ownership could have on capital formation, which as I said, is agenda one for the Chamber. Index investors play a key role in generating economic growth and job creation in a way that’s good for companies, it’s good for retail investors, and it’s good for retirees.

Being part of an index is an important tool to drive liquidity for all companies but especially so for smaller public companies. If the government places undue restrictions on investments in public companies, it would further discourage companies from going public and staying public. We have seen a sharp decline in the number of public companies over the past two decades, and liquidity concerns for smaller issuers is an important reason. While this is harmful for companies in our capital markets, it's also harmful for retail investors who might not be able to
participate in some of the fastest growing and most
dynamic companies.

So thank you for including me today. We
welcome the FTC taking an evidence-based look at
common ownership at this hearing and what I'm sure
will follow in discussions as an important
contribution to that. And I’d urge us all to continue
to challenge the science behind some of the things
that have been supported and to think about the
consequences of some of the solutions being identified
to date.

MR. ROCK: Thank you, David.

We now turn to Scott Hirst. I hope the
clicker has made it down. Scott and Lucien Bebchuk
have been working on trying to document how much
engagement there is between firms and shareholders.

Scott.

MR. HIRST: Thank you, Ed. And, so, this
work builds on work together with Lucian Bebchuk,
including a paper last year in The Journal of Economic
Perspectives with Alma Cohen, a work that’s currently
available on SSRN, and ongoing work that looks in more
detail at the implications of our analysis for the
common ownership debate. And the focus of our work is
on the stewardship decisions of index fund managers.
So by stewardship, we mean how they monitor, vote, and engage with their portfolio companies.

And our work aims to provide a systematic, theoretical, empirical, and policy analysis of these stewardship decisions of investment fund managers. And we identify the promise of institutional investor stewardship to combat the problem of agency costs between corporate managers and their shareholders. And, so, the increasing size of institutional investors over time and the greater monitoring and engagement that this allows is a positive development that can combat these agency problems within corporations.

And we show in our work that institutional investor stewardship has this promise to increasing corporate performance. So because of this, we argue that public policy should seek to encourage and to facilitate stewardship and engagement by institutions and not to limit it.

So we turn now to the common ownership literature. And, so, common ownership alarmists have argued that regulators should pay attention not only to the decisions of these managers of corporations but also to the ownership of those corporations by institutional investors and in particular whether
these shares are held across competitive companies.

But in our analysis, we show that the understanding of how these institutional investors act requires taking into account their own ownership structure, which common ownership alarmists fail to do. And, so, we turn to the missing mechanism, the link between common ownership and anticompetitive effects, and we make two points.

First of all, common ownership -- the question of whether common ownership can have anticompetitive effects because of the big three or other investment managers might actively encourage anticompetitive behavior. And on this, our work provides a detailed, empirical account of the stewardship activities of large investment managers, and we show that such active intervention in business strategy decisions by institutional investors is both implausible and inconsistent with the empirical evidence.

Second, on the question of the purported link by -- through passive means, could institutional investors have anticompetitive effects by inducing investment managers to do nothing and, therefore, tolerate anticompetitive behavior. And our ongoing work suggests that this mechanism is also implausible.
and unsupported by the empirical evidence.

In our paper, we make the point that the claims of -- not only are the claims of common ownership unwarranted, but paying regulatory attention to common ownership isn't merely unnecessary, but it's also costly, and counterproductive. Because it's corporate managers and not institutional investors that play the key role in shaping strategic decisions that determine competitiveness, it's these decisions of corporate managers that should be the central focus of regulatory attention and not the actions of institutional investors.

And given the constraints on the attention and the resources of regulators diverting attention to institutional investors and away from the decisions of corporate managers is counterproductive. The measures that those highlighting common ownership have put forward, intended to make the big three investment managers and other large investment managers less engaged and more passive.

And the very fact that we're having this discussion about the possibility of anticompetitive effects of engagement by institutional investors might itself chill engagement by investment managers. And while common ownership alarmists view these measures
positively, we argue that the effects on investment
stewardship would be counterproductive. We claim --
we make the point that modern corporations do not
suffer from too much shareholder intervention but
rather from too little, and that pushing investment
managers away from engaging would be a step backwards
and would exacerbate agency problems and, therefore,
harm, rather than benefit, the economy.

To conclude, the rise in investor engagement
is a positive development that contributes to a
reduction in agency problems and, therefore,
contributes to economic performance. The incentives
of investment managers make them insufficiently active
and excessively deferential to corporate managers.
And the measures that common ownership alarmists
advocate would be counterproductive in all of these
respects. Thank you, very much.

MR. ROCK: Thank you. Thank you Scott.
We’re now going to turn to a discussion among the
panelists, but, please, if you have questions, please
fill out one of the question cards that will then be
brought up to pose to the panelists.

Also, especially for those who are watching
online or will watch online, the FTC welcomes written
submissions on these issues and finds them very
helpful in terms of filling out their understanding of what’s going on in the corporate governance universe, so please send in written submissions as well.

I want to drill down on this notion of engagement. Engagement has -- there are at least three different types of engagement that are interestingly different. One is the engagement over high-profile contests. So Trian runs a contest to elect Nelson Peltz to the board of Procter & Gamble. These are high-stakes contests with real potential effect on firm value. There may be 10 to 20 of those a year, and that’s one sort of engagement.

We know that to a large degree in those sorts of engagements, BlackRock, Vanguard, and State Street, the big three, often collectively, though they don’t act together, collectively hold the decisive votes. And we’ll often hear from folks who are contemplating bringing proxy contests that you need to win two of the three in order to prevail.

There’s a second sort of engagement, which I think of as market-wide governance issues, things like is it appropriate to have annual voting on directors, or is a staggered board okay. Is it okay to have a poison pill or not? Should there be majority voting?

That’s a different sort of engagement; it’s
a different set of issues. And the third sort of --
but it's market-wide. The third sort of engagement is
on firm-specific performance, firm-specific pay. And
that’s yet a different sort of engagement, and I think
it's useful to think about these three categories of
engagement differently and address them separately.
What I’d like to now is turn to -- first to Barbara
and then to Holly and Heather to take us inside the
room, if you will, right?

When we’re talking about engagement, what
are we talking about? How many meetings a year does
BlackRock have with portfolio companies? They own
everything, and there are a lot of companies out
there, both here and abroad. How often, how often can
BlackRock meet with individual companies? Once a
year? Once every three years? Once every five years?
How does that differ with respect to high-profile
contests, like Procter & Gamble’s proxy contest,
versus the ordinary, day-to-day kind of engagement?

And, finally, what are the topics of these
different forms of engagement? How much -- Holly
pointed out the directors having instructions about
what they can talk about and what they can’t talk
about and encouraging directors to reach out to the
shareholders before meetings so that there’s an
agreed-upon set of issues.

So if you can take us into that world.

MS. NOVICK: Okay, so, first, let me make very clear, BlackRock does not collude with any other firms on our voting on any topics. That’s a very important thing because the idea that there are a big three and they all vote as one is a misnomer. When you look at the data, in fact, our voting is quite different from each other, and there is no concept of aggregation because we don't compare notes beforehand.

Okay, so now, I want to share some both numbers and some anecdotes I think will help in explaining Ed's question. The first thing is we think about engaging with companies on a few key areas. One is we vote at lots of shareholder meetings. I’ll give you some numbers on that. And sometimes we need to clarify something that’s in the disclosure's simple questions.

Second is there might be an event at the company. I don't want to pick on Trian, but since you brought them up, maybe they're doing something or some other activist is doing something, and we want to engage with all of the parties so that we can hear everybody's story and understand how we want to vote in the best interest of our clients as shareholders.
Another area is what I’ll call thematic governance. So what would be examples this year? We announce our engagement priorities. In fact, we’re quite transparent. We put them on the web. We talk about them in Larry’s letter. We do lots of things to make sure people know what issues are we concerned about. One of the issues we identified was board composition and diversity.

And I’m happy to say, when you look back at the end of the proxy season this year, there was a noticeable increase of women on boards. It actually moved two percentage points in the last year. Now, for the women in the room, hurrah, right? I mean, we’ve been talking about this forever, but you barely see the needle move year after year after year.

Now, the more we focus on it, the more we talk about it, we find boards do say let me think about that, let me really rethink how I'm approaching the next search.

Other more industry-specific topics. Things like opioids. So there’s a whole chain of what goes on from manufacturing to distribution. We want to understand how companies in that business are managing their risks, are enforcing current laws, and are making sure that we are protecting the value of the
companies, again, that we engage in on behalf of our clients.

How often do we meet with individual companies? It very much depends on are there any of those issues on the table. We also meet with companies when they request a meeting. And, generally, we encourage that off-season, so not during the proxy season, but just to get to know management better, to get to understand the company better.

I mentioned in my prepared remarks, it's never about product pricing. It's about the board. It's about governance. It’s about risk management. It's about much higher level things. In the 2018 proxy season, to put some numbers on it, we had 2,049 company engagements. We voted in 17,151 meetings. We voted on 158,942 proposals, and that included voting in 89 countries.

Now, where would I get stats from that?

Once a year --

MR. ROCK: How big is your engagement group?

MS. NOVICK: We have 40 people. Once a year, we publish an annual report where we detail what were engagement priorities and topics, give examples of engagements that actually occurred, talk about the voting statistics and things like this, how much do we
vote. That's the engagement part.

In the U.S. alone, there were 3,904 meetings with 31,265 proposals. So you kind of get a sense of the magnitude. Are we going to have the resources to do some deep dive and try and manage a company? No, and it's not legal, as you've heard from the other panelists.

So let me just refer back to some of what Rob Jackson said -- Commissioner Jackson -- and other people about disclosure. If you read the editorial, the op-ed that was submitted by Jack Bogle, both of them have a commonality. They go through and they talk about the different potential remedies, and they actually reject all of them except disclosure. Why? Because disclosure, sunshine, it's a good thing; it is self-correcting.

We already do all of this. We publish the engagement priorities, we publish the voting guidelines, we publish the actual voting, we put out quarterly reports by region, we put out an annual report that is global. We are incredibly transparent, and, frankly, we encourage a raising of the bar industry-wide to have similar transparency from all managers.

MR. ROCK: Holly, take us into the
boardroom.

MS. GREGORY: Yes, indeed. Look, I think there are all kinds of different situations that give rise to engagement, but engagement often, at least in large S&P 500 companies, has started to follow sort of a pattern throughout the year. Immediately after the annual meeting, the company, the board, the company management, are trying to understand how shareholders voted.

And there will be, in the fall usually, some outreach to large institutional investors. Some of it’s through surveys -- written surveys -- to get to a bigger group of shareholders, but also through meetings to find out what’s on their minds, what was on their minds when they voted, what drove some of the votes, if there were any problematic votes, and, also, what do they think the big issues are going to be in the proxy season going forward, just to start to get a temperature so that helps the board sort of get ahead of the game if there are kinds of corporate governance issues that they think they should be looking at.

I want to -- and then as you get into proxy season, it changes. It depends on the kinds of shareholder proposals you’re getting, the kinds of pressure for engagement that may be coming from
investors, but really it’s important to understand that engagement happens in really two directions. And often we’re counseling boards and management members to be in listening mode when they meet with their investors, to really use it as an opportunity to hear what’s on their minds. And in other situations, the company has a viewpoint that they want to help get across and emphasize.

I do think a real positive development in engagement efforts generally is that it’s becoming far more common for an independent director to participate. Investors often ask for an independent director to participate, and because they want to get that sense of how engaged is the board, how knowledgeable is the board around some of the kinds of issues that are on their mind.

There are a couple things that including that independent director do. Certainly, it helps in that discussion with the shareholder to let them know how engaged the board is. But it really adds a level of rigor into the company’s preparation for those discussions, including rigor around the kinds of legal issues, what will be the topics discussed, and the level of preparation.

And I also think --
MR. ROCK: Can I follow up on that just for a second?

MS. GREGORY: Sure.

MR. ROCK: In preparing directors and managers for those meetings, does the issue of talking about future pricing strategy come up?

MS. GREGORY: We have a standard memo that we provide to teams that are going to go into engagement that talks about antitrust concerns, absolutely. So it's definitely there in the kind of counsel, the legal counsel at least in my experience are giving, and that's based on what I do.

Having an independent director, though, in addition to enhancing the rigor and being a real way for the shareholder to get a sense of how involved the board is, it also means that the board now has a real window into the engagement, and so it adds a level of scrutiny that I think is also very helpful. Boards are very interested in those engagement efforts, and when a comp committee chair or a lead director, chair of a non-gov committee, chair of an audit committee, goes in to an engagement meeting, the expectation is that they're going to report out on that discussion to the board.

MR. ROCK: And, Heather, when you're meeting
with issuers, with companies about various shareholder proposals that the AFL-CIO is presenting, tell us about -- tell us about those meetings.

MS. CORZO: So as you suggested, typically when we’re having meetings with issuers, they come about because we filed a shareholder proposal at the company and they’re reaching out to us then to have a conversation about it. And, you know, the nature of the conversation depends on, on what the issue is. We would -- I can’t say never. We would never talk about product pricing, but typically, the topic of the conversation is within the scope of the shareholder proposal that we have submitted that’s limited as a result of the SEC regulations that limit the subject matter of the proposals we're permitted to submit.

Now, the conversation that happens depends on where the company stands with regard to the proposal. So sometimes the company will come to us and say, you know, you raised this issue with us about our political spending disclosure, and it was something that we hadn’t really thought that much about until you filed the proposal, and thank you for doing that. We're going to do X, Y, and Z in response to the proposal. If we do this, will you withdraw the proposal, and we’ll negotiate. And oftentimes we end
up withdrawing the proposal in response to the interaction.

You know, sometimes the company will come to us and say we think you got it wrong, we think your analysis is incorrect. You know, the justification for this proposal is not based on, is based on an understanding that differs from our understanding. And, so, then we have a conversation again confined to the bounds of the subject matter that we raised with the company through the shareholder proposal process. And then, of course, sometimes we don't have a conversation with the company and we receive no action letter from the SEC, and then there's a very time-consuming process that involves our on-staff attorneys, you know, responding to the submission the company has filed with the Securities and Exchange Commission asking for permission to exclude our proposal. It could be on any number of grounds, and we go back and forth and ultimately get a determination from the Securities and Exchange Commission as to whether they're granting the company's no-action request and then know whether our proposal will go to a vote at the annual meeting.

We have an open-door policy, so we've had a number of meetings similar to what Holly suggested.
that are not -- you know, inside the shareholder proposal schedule. And we have conversations, but, again, it's very clear when we’re engaging with these companies we have a handful of proposals that we file each year. It's broadly recognized what the subjects are that we’re going to be discussing, the issues that we care about, and we stick to the boundaries of those topics.

MS. BENNINGTON: Do you mind if I just jump in her for a sec?

MR. ROCK: Please.

MS. BENNINGTON: So when I was preparing for this panel today, I thought a lot about what is it that these interactions can be and sort of from the top level like Barbara mentioned, board composition, issues of engagement that Heather was talking about. And I looked and looked, and I found the most detailed type of engagement questions I could possibly find. And, actually, I will read those to you.

I’ve never seen anything this detailed, so I’m going to read it to you as far detailed as I think it goes. And this is from SASB, which is the Sustainability Accounting Standards Board. And what SASB does is they divide into 79 sectors, so very specific into sectors. And what they do is they
provide a set of guidelines for owners if they want to think about risk management and consider questions to potentially ask managers -- corporate managers -- in connection. And, so I’m going to read this to you because I think it maybe provides kind of the -- I don't know if it’s the ceiling or the floor. It's one or the other.

Okay, so for the wireless telecommunications industry, which I’ve tried to find the most concentrated industry I could find, which is my understanding is the top four are 93 percent of the market. Okay, so I’m going to read you a couple of the things SASB says, maybe things that owners want to engage with managers to understand corporate risk.

Okay. What internal processes does the company employ to protect and defend against cyber attacks? How does the company identify and address data security risks across its product lines? What is the level of capital investment the company has made into improving the reliability and quality of the service network? How does the company manage leveraging customer personal data for revenue opportunities with maintaining customer privacy?

So those are some of the most detailed business-orientated sort of questions or potential
engagement I’ve seen. And I just point out that what are those topics and what are they not? So that's just a little bit of food for thought, and people might want to take a look at the SASB guides.

MR. ROCK: So let me follow up on that with a question from the audience, which I’ll interpret slightly to bring within this. So, Barbara, you were very proud of the effect that your initiatives on gender diversity on the board had. And Larry Fink has talked in his letter about ESG initiatives. You’ve talked about guns, policies and so forth, where you’ve brought about real change in companies.

The question is how is it possible to promote those goals but not also -- and here, I'm interpreting, but now it also has the power to promote anticompetitive goals. So is the reason that you think BlackRock doesn't promote anticompetitive goals is you don't have the power, maybe because to do so you would have to drill down much more specifically than the kind of level of questions that Allison was pointing out? Is it because you don’t view it in your interest? Where does the -- the question is being asked is if you can succeed in bringing about change in gender diversity, then why can’t you succeed in forcing companies to adopt a soft competition.
approach.

MS. NOVICK: So the first thing is keep in mind we have -- let's call it 5 percent ownership. So even on gender diversity, if we were the only voice out there saying that we thought diversity of thought, diversity on various dimensions was important, it would fall on deaf ears. No one would care. But when there is a chorus of voices across the spectrum of different asset owners, it then resonates with a company, gee, this is something important I should be thinking about.

If you look over the long term, the ideas of overboarding, the ideas of active CEOs sitting on multiple outside boards, all of these governance issues have shifted over very long periods of time because more owners have spoken up. We heard about the PRI today, we heard about the SASB. You know, there are many different groups that are weighing in on corporate governance issues. None of them are weighing in on competition issues. I mean, it’s as simple as that.

If we somehow in some weird scenario decided to ignore all antitrust and competition law, which we're not going to do, we would be the only one because everybody is subject to certain rules. So the
idea that any one actor can have that influence, if anything, and I think we’ve heard this today, the sole actor that has the most influence is the proxy advisory firms, right? Fifteen to 25 percent, on say on pay. So if you're a public company and you’re concerned about a vote coming, the first place you look is those firms because they influence such a high percentage of the voting individually. And that’s the part that’s completely missing from any of the common ownership analytics they just completely ignored.

MR. ROCK: Holly, I want to turn a question to you. Let's take this scenario in which -- the so-called conflictual scenario that was mentioned this morning. That is to say a proposal that one firm in the oligopoly should take a hit because it's better that it loses sales because it benefits this purported common owners’ portfolio-wide interest.

And I’m now thinking, in the boardroom, the question -- one of the questions from the audience was do interventions by activist investors -- Carl Icahn, et cetera -- impose sufficient market discipline where management is lagging to prevent anticompetitive behavior. Tell us a little bit about what I now hear from lots of people, which is this notion of thinking like an activist before the activist shows up and how
that is shaping boardroom discussion.

    MS. GREGORY: Well, look, there is clearly
great interest in boardrooms across America in how
activist investors think for a couple of purposes.
One, to think about how to be prepared to defend
against an activist incursion, but also because
there’s a sense of it’s a way to challenge the
management team to really think about opportunities
that they might otherwise miss. So it provides a -- I
could argue a healthy disciplining to know that that
group is out there.

    I think when boards are thinking about those
activists, they’re trying to think about what -- what
their weaknesses are from a corporate governance
perspective that could be attacked. What kinds of
strategies an activist might come forward to and
recommend, and are those legitimate strategies and
things that should be undertaken.

    But I don't think that their strategies,
again around the anticompetitive kinds of issues that
the common ownership debate is concerned with -- they
tend to be kind of bigger picture. Sometimes they're
structural. I don't know if I’m getting to your
question, but that’s my experience with how boards
really look at those issues and the kind of influence
that activists have when they’re not yet at the gates.

MR. ROCK: Barbara.

MS. NOVICK: So I wanted to just add one little thing here. We heard earlier that, you know, somehow activists are cultivating the index voter’s vote. So, again, stats are helpful. In 2017-18, the proxy year in the U.S., there were 19 contests that had dissident nominees to the board. To put in perspective, we voted in favor about 20 percent, and we voted against 80 percent.

Now, if you look again at the other firms -- I don’t have the data here -- but I think what you’ll find is they voted differently, contest by contest, because stewardship and engagement is about hearing the perspectives of all the people who are putting up a slate and making a decision in your best judgment as a fiduciary what do you think is in the best long-term interest of these shareholders. So it’s not voting all one way or all another way or voting collectively. It just doesn’t exist.

MR. ROCK: Let me move on to another topic, which is there are different ways in which investors communicate with firms. We’ve been talking about these engagement meetings, but another way in which investors and others communicate with firms is
earnings calls. And often quarterly managers --
typically the CEO, CFO, occasionally a director --
will get on a conference call with whoever wants to be
on it. And it will typically be shareholders and
others who follow the company.

That would be another potential channel by
which -- it's a potential channel by which
shareholders can influence company strategy. Is it
the same people who are on these calls as are doing
the stewardship? Are they different people? Are
these different kinds of relationships? Let's talk
now a bit about the earnings call.

Holly, you deal with folks who are having to
go on these earnings calls, and then I’ll turn to
others on the panel who want to jump in.

MS. GREGORY: The same kind of preparation
goes into earnings calls. Directors tend to be a
little less engaged in that, but there’s a lot of
preparation and there’s a clear understanding around
the team of the rules of the game. But the thing
about earning calls that’s so interesting to me is
they’re public. So if something happens on an earning
call, the regulators have every ability in the world
to be scrutinizing that and taking action.

So I don't see earning calls as the issue,
if you will. Now, I can't promise that analysts don't ever say things that are probably not appropriate topics for earnings calls, but I don't know that that's actionable either. I think it would be interesting to know what kind of guidance analysts get when they go on earning calls, and that would be interesting to hear from the investor perspective.

MR. ROCK: Barbara, who from BlackRock is on the earnings calls?

MS. NOVICK: So you have to look at our business, and every asset manager's going to have a different mix. In our business, our equities are 90 percent index and 10 percent active. So in the index, it would be probably no one's on the earnings call, or if they are, they're in listen-only mode because they're curious to learn more about the company, and that would be the stewardship team, and that's where I'm involved.

On the 10 percent that is active, it would be a portfolio manager or an equity research person who has a much stronger interest in that company. But as you heard, those calls are public. I think people have a pretty good idea what the rules of the road are and would not stray into that territory.

MR. ROCK: And when they're --
MR. BERTSCH: Ed, can I just add? I’ve been in a lot of not public/private conversations with portfolio managers and analysts, with management and sometimes directors. And in all the conversations that I’ve had, I can think of only two where there were inappropriate comments from a regulatory standpoint, both really FD. One actually involved antitrust, but it was antitrust strategy, and one of our analysts trying to push the company to disclose privately what wasn't private. And in that case, the company said we can’t talk about that.

In the other case, a director started to talk about the next quarter and what he expected for the earnings. Totally inappropriate. We stopped that conversation because we were going to have to have a trading freeze.

So you’ve got two parties, and they're both sort of steeped in the rules, and there are slips occasionally, but I think in my experience one or the other will stop that conversation.

MR. ROCK: And in terms of -- so you have analysts -- you have portfolio managers who know a lot about the company because they -- they’re picking and choosing stocks. They have to decide whether to sell, to hold, to buy more. You’ve got proxy stewardship
groups that have this broad -- this broad
responsibility to make sure that you vote on all the
things you have to vote on. Tell us a little bit
about the intersection and the interaction between
those two groups and how that informs the work that
the proxy voting group does.

MS. NOVICK: So in many cases, we have
holdings that are only in an index portfolio and
figure we manage against so many different industries,
we have sort of every company in some way in an index
portfolio. And the percentage is based on which
indices do clients choose to put their money in.

Where there is a overlap with an active
holding, we encourage the stewardship analyst and the
active equity analyst to have a conversation to
compare notes. We actually allow, at BlackRock, that
there can be a split vote. So when you look at our
actual voting, you will find cases where we did not
vote a hundred percent of the shares the same way.
And that’s a conscious decision we’ve made that an
active portfolio may have a different perspective, and
while they compared notes beforehand, they may have
different reasons.

I’ll give one easy example. Let’s say an
active portfolio manager just established a position
at a company. It would seem that they’re confident, they’re coming in at a good price, they’re confident in that management going forward. But let’s say the stewardship team has engaged over time and feels that some things haven’t been done that they want to see done.

So the stewardship team may say, you know, it's time. You know, we have patience, but patience is up, it's time for us to vote against some specific director, call it the audit committee, the compensation -- whatever. Whereas the active manager who just bought that company, just entered, might say, well, I entered on the premise that I understand what’s going on and I think there’s going to be change over time, and I'm okay being patient now. So you see those kinds of splits, and there can be splits on other things.

But it is an open dialogue internally and then an independent decision for the vote itself.

MR. ROCK: Do others on the panel want to jump in on this before I move on to a related topic?

Go ahead, David.

MR. HIRSCHMANN: I think -- two points quickly. One is from our experience asset managers and investors take their fiduciary responsibility to
represent the underlying interests they represent pretty seriously, and I think you heard that today from Barbara. And management takes its fiduciary responsibility to shareholders pretty seriously.

We can't lose sight of the fact, though, that the way to influence corporate behavior goes well beyond that relationship to the court of public opinion in a way that consumers are increasingly participating in, employees, investors, right, and it’s that -- we have to be careful not to confuse both of those.

Now, companies respond to both. They care a lot about their reputation, but that doesn't mean every debate belongs on the proxy.

MR. BERTSCH: One other miss here, thinking of Barbara's comments on split votes and so on, many of our members retain vote authority, so BlackRock may be managing their money, but BlackRock’s not voting their shares, and I don't think that's reflected in some of the literature.

MS. NOVICK: We estimate 25 percent of our equity separate accounts clients retain the votes, so large public plans who have their own stewardship teams. And, so, whereas we have to report the voting under the various forms -- 13(f) is the one that’s
applicable to these studies.

MR. ROCK: Because you have investment authority.

MS. NOVICK: Because we have investment authority, we’re required to report these as, you know, shares that we have investment authority over, but a huge percentage of them we actually don't vote. There’s a slug that is voted by the clients themselves. There’s another whole slug that we have to outsource for regulatory reasons or conflict reasons.

And, so, you’ve got a data set on what theoretically is voting data that doesn't actually reflect the manager’s voting authority.

MR. ROCK: If you look at the antitrust enforcer’s approach historically to both common ownership and cross ownership, the threshold is much higher than we’re talking about here. This is much lower level. But in addition, one of the factors that the antitrust enforcers look at is whether you -- whether the investor has or the cross owner or common owner has board representation.

And this brings me to one of the questions from the audience. Section 8 of the Clayton Act bars interlocking directorates. Does the panel accept the
antitrust concerns underlying this law? If not, why? If yes, would these concerns extend beyond -- as the question puts it -- formal board membership? But what I would -- I interpret that as saying to the extent that there are large shareholders who have influence, should the same antitrust -- and I think this is a fair interpretation of the question, should the same antitrust concerns that motivate Section 8 of the Clayton Act and the bar on interlocking directorates also bar common ownership.

MS. GREGORY: So my answer is no. I didn't give the lawyerly “it depends.” It's a different nature of control and influence. A board has control. A board has fiduciary obligations. And, so, you want to make sure that the boards of competitors are indeed separate groups of people for the most part.

The influence that we’re talking about investors is -- it’s an important influence. I think it's brought great benefits, but it's not the same. It's not control. Even when it's strong influence, there are all of the -- there are other investors who have -- who are trying to exert influence in great -- in different ways. The amount of ownership by any individual investor in a company is still not nearly at the levels that we consider to be problematic. So
I just think -- I think it's apples and oranges.

MR. ROCK: Heather, does the AFL-CIO nominate directors?

MS. CORZO: No. You know, there have been a couple of times I can think of -- I’ve been with the AFL-CIO for almost 12 years. There have been a couple of times where we have supported "vote no" campaigns, but I can't think of any examples where we’ve actually nominated. It's a very onerous and expensive process. And, so, I don't think even the threat of that or the ability to do that would create the implication of some sort of control, you know, or influence over the firm.

And, you know, I agree with Holly. Investors -- we talk about ourselves as owners of a firm, but I think that really does overstate the level of control we have over the operations. A director is extremely different in the terms of the ability to influence decision-making within a company.

MS. GREGORY: Can I say something along those lines?

MR. ROCK: Sure.

MS. GREGORY: So I know in the economic literature and also in the legal literature there’s a lot of discussion about principals and agents and
about the shareholders being the principal and the directors being an agent. It's an interesting construct, but from a legal perspective, it's not a true construct. So a principal can direct the activities of its agent. Shareholders cannot direct the activities of the board because the board is charged with managing and directing the affairs of the corporation under state law, and that's a power of the board that doesn't belong to the shareholders, even if all the shareholders come together as one. They can vote out the board, but the board is a separate entity and has that obligation.

MS. NOVICK: So if I could also jump in. So this idea of nominating directors, I’ll go even further then that. The traditional asset managers, so I’m talking long only, whether it's active or it's indexed, and there could be some exceptions, but the traditional asset manager does not nominate directors and does not put shareholder proposals even on a ballot.

So the AFL-CIO is taking a very active decision to be active in shareholder proposals, but most of the managers don't even put a proposal on, never mind, you know, get into a proxy fight on directors. We’ve never done either of those.
MR. ROCK:  Ken?  Your members, do you sense from your members any desire to nominate candidates?

MR. BERTSCH:  Well, so members have won the proxy access tool and I expect it will be used sometime in the next few years. It's a very difficult tool. And it's -- you know, I think realistically it's the hedge fund activist or the activist holders who are running real contests that are holding management accountable and hopefully getting noticed by other boards who want to be competitive and stay on the top of their game so that they're not targeted by those activists.

So, yes, there is some interest, but it's really for the extraordinary situation. It will be used in some situation where a company has extended poor performance, where it has ignored its shareholders repeatedly. And Holly is right, the board manages the company, but a poorly performing company that doesn't listen ever to shareholders, I mean, that's kind of a tenuous position. And it's probably going to be a company that actually an activist -- a hedge fund activist is going to have some questions whether they can make money in the company or not, but the pension funds have run out of patience, and -- but it’s going to take a lot of work.
MS. BENNINGTON: I’d just jump in there for one second. I talk about accountability, and just to be really clear what that is, really what it means is you can fire the board by not voting for them, but that's really it. I mean, that is the ultimate tool you have as a shareholder is you fire the board.

MR. BERTSCH: And it's not easy to do that.

MS. BENNINGTON: And it's really, really hard. Something that I have seen, though, in the corporate governance work that I do is the desire for -- particularly on issues around policy issues and diversity on the board, different thinking, shareholders having the desire to potentially offer up some ideas to the nominating governance committee on people who might be good, but these are not proxy fights. These are well-intentioned shareholders who think that they may know somebody who might be somebody that the company might want to consider. But that's about as far as I’ve ever seen it go for asset owners and asset managers that are not literally activist investors who do run proxy fights.

MR. BERTSCH: Yeah, and I think most of them actually don’t even want to suggest names.

MS. BENNINGTON: Yeah, a lot of them don’t.

MR. ROCK: Much less put one of their
employees on board.

Scott, a question from the audience. Scott says that the common ownership debate itself may have a chilling effect on engagement and increase deference to managers. Does he or others on the panel have thoughts on the remedies proposed by the common ownership proponents?

MR. HIRST: I mean, I think that point is that the fear of these remedies and the fear of increasing regulation of the clients being proposed is going to limit the extent to which managers -- sorry, investment managers might engage.

You know, what kind of remedies do we think would be appropriate? We think that the remedies that are being put forward to -- that would have the effect of limiting engagement are misguided and that none of those are appropriate because the problem doesn't exist because of the incentives of the investment managers don't lead them to take this anticompetitive behavior. So I don't -- we don't believe that there’s a need for a remedy because the incentives of the investment managers aren’t such that created this problem.

MR. BERTSCH: Yeah, so we -- our members don't want to take away the proxy vote from the large
index investors. We believe it's -- that's the opposite of the direction that we've tried to push in for the last 30-plus years. So that's not -- in our mind would be a very damaging solution. The idea of essentially banning the largest indexes from doing index investing, which is what -- when you’re saying invest in one company per industry, that is not indexing. That is some kind of active strategy, and I don't even understand how it would work.

With the government assigning who can be in which company and even defining the industries is actually a huge problem anyway. I think that what that means is breaking up BlackRock, State Street, and Vanguard. And I think it’s going to lead to chaos, more costs. You know, there may be legitimate antitrust concerns at some point, but the case really has to be made that it's worth the cost and disruption. It would be expensive for our members.

MS. CORZO: I just want to weigh in to associate myself with the issues that Scott and Ken have raised about concerns with the policy proposals that are put forward and, in fact, say -- repeat what I said earlier, that I think it's extremely important, in fact, that large institutional investors get more engaged on ESG issues as opposed to less.
And to the extent we're looking for positive ways, I think the best way to do that is to make it easier for analysts to access more information about environmental, social, and governance issues of the companies that we’re investing in by improving those disclosures.

MR. ROCK: Did you want to jump in on that?

MS. NOVICK: So I would say to date this has not chilled our enthusiasm for engagement or voting. There are laws on the books that -- again, not just encourage us but actually require us to vote, and we think informed voting, which requires engagement, is a sensible way to do it.

Now, that said, if the laws change, the SEC or the FTC changes the law, we’ll reevaluate and follow the new laws. I will say that while a lot of time is spent on the remedies, we have some fundamental questions about the underlying models and econometrics. I think as people get a chance to test these models -- they’ve only been made publicly available quite recently -- I think they will see that this is much ado about nothing and, in fact, we don't need these remedies because there isn't a problem.

MR. BERTSCH: Can I just add, so BlackRock is very active and it has really taken a leadership
position. There are pretty large folks who are on the
fence and are not out there as much as some of our
members would like them to be. And I would point in
particular to some larger quant firms that are
inhibited by both the SEC and FTC regulation. And it
just is too much hassle, just -- so let's just back
off.

MR. ROCK: On the fence about what, about
going involved --

MR. BERTSCH: About engaging.

MR. ROCK: In engaging.

MR. BERTSCH: I mean, everybody votes.

Everybody votes, you have to vote, but some people
vote down the line with ISS, which David doesn't like.
You know, some people are just checking the box and
not doing the job.

MR. ROCK: Let me follow up on that because
the universe of asset managers is heterogeneous. And
for -- let's take, just as an example, a high-
frequency trading house that has a huge position for
maybe a minute or so, and it happens that one of those
minutes falls on the record date, so they have to
close.

MR. BERTSCH: Yeah, I wouldn't expect --

MR. ROCK: What sort of engagement, if any,
do you want from that shareholder?

MR. BERTSCH: Yeah, I don't want engagement from frequently traded, and they don't want to do it, so that's fine. I'm really talking about other kinds of firms that are not high-frequency traders that -- particularly that use quant models and so they don't have the analysts to really understand.

MR. ROCK: What kind of engagement do you want from them?

MR. BERTSCH: So, actually, ideally, some thoughtful proxy voting, that they actually do the job. And I recognize there’s a scale problem here, but many of them are quite large and I think could do a more careful job around that and occasionally communicate with companies where they see something that they're concerned about.

MR. ROCK: Holly?

MS. GREGORY: So it's an interesting theory of how the world should work, but every investor, as you note, they're not monolithic, and they have their own strategies on how to best extract value and where to spend their resources. I'm concerned that too much pressure on investors to thoughtfully vote leads them to higher proxy advisers and vote as proxy advisers tell them to and say that that's our thoughtful
voting.

So I just think it's a little bit misguided to sort of insist that everybody engage because engagement is expensive. Companies are struggling to find the time for engagement. They can't engage with every shareholder. Shareholders -- the large institutional investors are also finding it difficult to accommodate corporate requests to engage. If you're in the Russell 3000 and not the S&P 500, it is damn hard to get a meeting with an institutional investor. It's hard to get a phone call.

MR. BERTSCH: Yeah, I guess I'd just say I think there are some that should be engaging that are not. Clearly, you have a whole range of styles. I do know that the legal departments at asset management firms are very cautious, having dealt with them at two different large asset managers.

MR. ROCK: So we have a bit more than ten minutes to go, so I want to give each of you a chance to make a final -- make final comments, and I’ll do it in reverse order that we went, and so I’ll start with Scott.

MR. HIRST: Thank you, Ed. I think now my point is that it's imperative that the debate take into account the incentives of the investment
managers. And doing that makes it clear that
incentive managers, investment managers have
incentives to engage not too much but too little, and
so the remedies should not be focused on the
possibility of them overengaging and possibly
resulting in anticompetitive conduct, that we should
be thinking about the problem as how do we have these
investment managers that control large parts of public
companies engaging with them in thoughtful ways and
not being constrained from doing so.

MR. HIRSCHMANN: I was thinking here, maybe
I’ve changed my mind. Maybe if I was king for a day,
I’d decide which investors to give more power and
which investors to take less power, but in a moment of
calm reasoning, I think I’d have to be humble enough
that I probably couldn’t pick the right ones and that
whatever scheme I came up with probably would backfire
over time.

And I think that’s the point here. We need
to follow the physician’s oath and first do no harm.
The answer is not to pick winners and losers among
investors but really to make sure that the system is
allowing everybody to have a seat at the table and to
remember that it’s not just the way standards are set
on corporate governance. It’s really also in the
court of public opinion. And this is a much more complicated issue than -- which will merit much more conversation, and I’m glad that we’re having it today.

MS. GREGORY: So the rise of concentrated ownership in the hands of institutional investors has coincided with much more focus by corporate boards on issues around governance processes, oversight of strategy and risk, accountability to shareholders, and transparency. And I think that there is a causative link there that I would be concerned about interfering with.

MS. CORZO: You know, I'm excited to see the Federal Trade Commission getting more active in engaging a lot more on antitrust issues. I've been in Washington a long time and have interacted more with the FTC in the last month than I did in the ten years before that. And from my perspective, that's a good thing.

On this particular topic, I find the analysis a little bit perplexing, and it's hard for me to understand both the mechanism that institutional investors would use to influence corporate boards in an anticompetitive way and also the motivation to do it, and so that's where I would close.

MR. BERTSCH: I’ll just make one general
point and one specific point. General point, our
members are often called universal owners. So they're
owning the whole economy certainly, the whole publicly
listed company economy and actually for the bigger
funds, private companies as well. And their interest
is in the vitality of the economy, the prospering of
the economy broadly, which means that antitrust is
actually important.

So I think it's very good that the FTC is
looking at I think a variety of new thoughts about,
you know, where there may be problems, and that's all
to the good.

That said, in my more narrow -- I'm going to
go to my more narrow point. I just don't see it in
the common ownership. It doesn't seem compelling to
me. And just one thing that Holly said -- mentioned,
whatever criticism of ISS and Glass Lewis, the proxy
advisory services, is they attempt to reflect their
clients, and they heavily reflect the institutional
investor community in the United States.

ISS in particular, its number one issue
could be pay for performance on an industry-relative
basis. That's what they’re really pushing. Those are
the most salient issues for shareholders and
companies. And that seems to me entirely
contradictory to the notion that there's not only --
not a push for market restraint, but actually there's
a voice coming -- the voice coming from the
institutional investor community, to the extent that
it is, is saying you got to do better against your
peers.

MS. BENNINGTON: Everybody has said great
stuff and I agree with it all. That's all I have to
say. No. I've read most of the papers. I read them,
and I obviously have my own experience of being
involved one way or another with the capital markets
for over 25 years, and I don't see it. I read them,
but I don't see what the papers are pointing to with
the actual results that they're coming out with.

My main concern is that the sorts of
tweaks that are being proposed are maybe small for
antitrust law but they're absolutely enormous -- just
enormous -- for the capital markets and for asset
management. We have the most robust and competitive
capital market system for investors in the world here.
And I do worry that this sort of a theory, that if
these are put in place, they could do tremendous
damage to that system.

MS. NOVICK: So a couple of things I wanted
to touch on because you’re going to hear about these,
I'm sure, in presentations this afternoon and I want you to have some perspective. So one of the things that gets said a lot is diversification across industries is enough diversification, why do you need it within the industry? And, so, I'll give you just some examples.

In 2017, J.P. Morgan was up 24 percent; Wells Fargo was up 10. In the aerospace industry in 2018, Lockheed-Martin was down 10 percent; Boeing was up 17. I don't think I need to say more on the importance of idiosyncratic risk within a sector.

The second thing you’re going to hear is only rich people invest in mutual funds and so it's not fair that consumer prices for little guys are benefitting the wealthy. So the actual numbers are the median household income of a mutual fund investor is $100,000. That means that half of the investors earned less than that. So I'm not sure what we want to count as wealthy versus not wealthy, but clearly many of them investing in their retirement accounts.

So I'm going to dub this whole conversation the Goldilocks problem. You heard from Scott, we do too little. You'll hear this afternoon, we do too much. You'll hear from some in the middle that we seem to do just about the right amount. I actually
believe corporate governance, stewardship is a net positive, being active, being involved in these conversations. I don't think it goes anywhere near the topics that are of concern.

And, then, lastly, I did want to thank Ed, as well as Martin and Einer, for bringing together the Chamber, the CII, and AFL-CIO to agree on something even in this very political climate today.

MR. ROCK: Thank you, Barbara. John Bogle's opinion piece is a really interesting one because he does raise the prospect of if 50 percent -- if we continue at the current rate, if we continue at the current rate, then in not too many years, 50 percent of all assets will be held by the big three and wouldn't that be a cause for concern.

One thing to think about in that regard and very much is I think present in this discussion is that the asset manager world is a very heterogeneous world. And there is a natural balance that emerges between actively managed strategies and passively managed strategies. And the more money that goes into the passive strategies, the more profits there are going to be in the active strategies.

And, so, the idea that we will get to a point where the big three own 50 percent of all assets.
equities and 50 percent of all companies is extremely unlikely, and, of course, there’s always the possibility of new entrants both into the index, the passive strategies as well as into the active strategies. But it is something that, you know, is worth thinking about as we think about the appropriate relationship between shareholders and firms. It's not just one kind of shareholder. There are all sorts of shareholders, and they have different relationships with firms.

And Delaware law, for what it's worth, doesn't draw any distinctions among the different kind of shareholders. They let shareholders more or less do what they want to do.

We're going to break for lunch until 1:00. And if you will please join me in thanking our panel.

(Applause.)

(Lunch recess.)

REMARKS

MR. ADKINSON: Good afternoon. My name is
Bill Adkinson, and I’m an attorney adviser in the Office of Policy Planning at the FTC. Welcome to the afternoon portion of our proceedings.

Before we begin, I’d like to reiterate the instructions that Scott mentioned this morning. I’d like to say that this event is being webcast, photographed, and recorded. By participating in this event, you are agreeing that your image and anything you say or submit may be posted indefinitely at FTC.gov or one of the Commission’s publicly available social media sites. A transcript of today’s proceeding will be posted as well.

Question cards will be available throughout the day. Please use them to write down questions for panelists. Staff will collect them and pass them to the moderators, who may pose selected questions if time permits. Finally, if you have your mobile phone with you, please silence it.

Thank you. It is my pleasure to start this afternoon's proceeding by introducing Commissioner Rohit Chopra, who was sworn in as a Federal Trade Commissioner on May 2nd, 2018. He was previously a Senior Fellow at the Consumer Federation of America, a Visiting Fellow at the Roosevelt Institute, Special Adviser to the Secretary of Education and Assistant
Director of the Consumer Financial Protection Bureau.

Commissioner Chopra.

(Applause.)

COMMISSIONER CHOPRA: Good. It's great to be here, and thank you all for attending the FTC's hearings on consumer protection and competition as we assess how the agency can be more effective in tackling today's problems in the economy. Today, large corporations increasingly dominate the economy. In the past 25 years, Fortune 500 corporate revenue has substantially increased their share of GDP, and the Fortune 100 firms have grown even faster.

These corporations are complex, sprawling, with significant power to exert over the economy and democracy. Compared to main-street businesses, these firms are more integrated with Wall Street and global financial markets, and, in my view, these companies frequently do not make decisions in ways that our economics textbooks predict.

I want to discuss how Wall Street incentives and corporate governance concerns can distort firm behavior. The FTC should not and cannot ignore these incentives, since they may be the root cause of decisions that break the law. Now, originally, corporations were specifically chartered by state
legislatures to help facilitate capital raising and activities that would benefit the public. Unlike charters in Britain that were bestowed by the Crown, states sought to ensure that corporations acted like mini-republics by outlining how elections for directors would take place with the hope that board members would balance interests among shareholders, but that original vision has faded.

In today’s hearing, many of you have been focusing on the implications of a specific market trend, the increasing dominance of passive equity index funds. But there are many other corporate governance trends that we need to be thinking about. I want to briefly discuss two of these: one, the explosion of corporate debt; and, two, the distorted incentives in executive compensation packages.

First, despite earning record levels of profits, the U.S. corporate sector is deeply in debt. From 2007 to 2017, outstanding bonds for nonfinancial corporations in the United States more than doubled from $2.3 trillion to $4.8 trillion. Overall, American companies now owe more than $9 trillion in debt, and the ratio of cash on hand to debt has fallen to one of its lowest points ever.

A decade ago, the economy unraveled and
highly leveraged Wall Street banks, and homeowners
with toxic mortgages were at the center of the storm.
And while debt levels went down for both banks and
households, debt for nonfinancial corporations has
surged. At the time of the crisis, we heard a lot
about families who were irresponsible for taking on so
much debt, but we didn't hear so much about all of the
big companies who did and are doing exactly the same
thing.

Don't get me wrong. Debt can be useful.
Debt can help a shop buy inventory or a manufacturer
open up a plant to meet demand. This kind of debt
makes economic sense because the investment has real-
world cash flows to service that debt, but sometimes
debt is used for other purposes that are disconnected
from real investment and competition. Playing tax
games, buying back stock or snapping up a competitor
who might pose a threat are just a few of these
d samples. And that's where enforcers need to be more
wary.

But there's other cause for concern with
heavy debt loads. When companies borrow too much,
they take on more risk. Heavily indebted companies
can get desperate and will go to great lengths to keep
creditors happy since those lenders control their fate
when companies are walking on a tightrope. And that's a situation ripe for illegal behavior. A company in dire debt would have more incentive to save money by taking illegal shortcuts or make money by beating out competitors using illegal practices.

One firm that I have closely studied and investigated is called ITT Educational Services, a very large, publicly traded, for-profit college chain that is now defunct. The company started off as a small number of trade schools preparing students for jobs in demand. But as it became hungry to attract Wall Street investment, it took on more debt and engaged in riskier practices.

To stay afloat, the company believed it had no choice but to aggressively sign up students for tens of thousands of dollars in loans to enroll in programs of questionable value. Due to its own financial position, investing the time and money to create high-quality programs would have put the company in peril since it didn't have the room to take any short-term losses.

Instead, this debt-driven deception has destroyed the lives of so many students and their families who have been crushed by financial ruin. Now, law enforcement eventually took action. The
Consumer Financial Protection Bureau, the Securities and Exchange Commission and others sued ITT. The Department of Education sanctioned the company for financial mismanagement, but for the students defrauded by the company, it was too late for any legal action or settlement to fix the damage that was done.

In the merger context, heavy debt loads can also cause trouble. And as you know, a common way that antitrust enforcers solve the anticompetitive concerns in a deal is to require divestitures. Now, parties will tell a great story about how a divestiture buyer will become a hard-charging player that will innovate or push down prices. But when the new competitor is loaded up with debt, it can make it much harder or even impossible to compete.

In one matter involving discount dollar stores, a private equity group purchased several hundred stores that were required to be divested as part of a merger. But instead of proving to be an upstart challenger, the private equity fund that bought those stores ended up selling them to another large industry competitor after telling the FTC it could no longer operate as a viable standalone business.
In these deals, that debt doesn't stick with the private equity buyer. It typically remains a burden on the business until the debt is paid or until the business dissolves, raising even more questions about when competition will be restored.

In a recent matter that came before the Commission recently, two massive industrial gas corporations, Praxair and Linde sought to merge to become even bigger, raising a host of anticompetitive concerns. While these may not be household names, industrial gases are the inputs to an extremely wide range of goods produced in our economy.

Due to some nuances with this deal, the FTC was in an unusual position to negotiate a remedy or to block the deal outright. To address certain overlaps, the parties sought to divest assets. Now, I expressed concerns about the divestiture buyer’s debt level and whether this would jeopardize their ability to grow and compete vigorously. The whole reason to divest assets is to create a meaningful competitor in a market where a merger puts competition in jeopardy, but that hope for competition will not exist for very long or at all if the would-be competitor goes bankrupt or runs the divested assets into the ground by selling off their most valuable pieces to service...
their debt.

While I hope these concerns do not materialize, the significant chance that they could says to me that we need a new approach to evaluating financial condition of divestiture buyers. We could start by taking a page from the business playbook. Sophisticated lenders go to great lengths to protect themselves when extending credit. They include provisions that require corporate borrowers to keep enough cash on hand; they accelerate repayment when a firm is sanctioned by regulators; they even forbid questionable payouts to investors and management. And when things go wrong, these lenders make sure they get paid way before any government fine comes due.

If Wall Street creditors can protect themselves from getting burned in these situations, enforcers should consider using similar provisions to protect the public. And if those provisions are impossible, I would argue that we are better off seeking to block a deal than allowing one through that includes divesting to a high-risk buyer.

Second, excessive executive compensation is a virus in the economy that is distorting incentives. Consumer protection and competition regulators and enforcers cannot ignore this. CEO pay in particular
has risen dramatically. Now, many might believe that CEOs are increasingly more important to corporate performance than an average worker, but are top executives in many industries really ten times on an inflation-adjusted basis more valuable than their predecessors from a generation ago? Many long-term shareholders are saying no.

As many of you know in 1993, Congress and President Clinton discussed capping the deductibility of executive pay at $1 million. There was a big exception for performance-based pay. This policy change created momentum for compensating executives with stock options and stock grants. With stock options, executives are paid for any gains the company's stock makes over a certain price for a particular period of time. With stock grants, executives receive actual shares of the company, but they're often required to hold on to them for a certain amount of time.

These compensation vehicles are intended to align the interests of executives with those of long-term shareholders, and sometimes they can. But according to some evidence, these performance-based incentives may actually lead to unnecessary risk taking or even law breaking. Stock options, in
particular, have no value unless a stock price exceeds
the price at which the option can be exercised or the
strike price.

In other words, if there's no stock
appreciation before that expiration date, it's
worthless. This can lead to executives taking risks
by operating on the margins of the law to create those
short-term gains that make options valuable.

According to a 2016 paper, a stock-option-
heavy executive compensation package drastically
increased the likelihood of a corporation breaking
environmental laws or engaging in financial
misconduct. But even stock grants come with risks for
executives reluctant to see their net worth decline.

Take the pharmaceutical industry.
Executives with stock grants may not see big short-
term payoffs from doing what they're supposed to do --
curing disease by making life-saving drugs. Inventing
new drugs takes time and money, and that's why the
public grants them patents and exclusivity periods
that can often result in a monopoly. But many firms
do not want to fully embrace capitalism by competing.
They look to preserve their company's stock price and
their personal wealth. So, instead, they focus quite
a bit of energy on blocking generic competition to
drugs that have long been on the market.

Indeed, by shifting the focus from making medicine to making themselves rich, I worry that some pharma companies and their executives seem to be acting like patent trolls. Filing frivolous patents, making minor or cosmetic modifications to drugs, and playing other patent games allows them to keep raking in government-granted monopoly profits. The longer they maintain their monopoly rents, sometimes through breaking the antitrust laws, as we’ve seen at the FTC, the lower the chances these executives will see their company stock price and their personal net worth decline.

But even if their company is caught, it might be too late because they might have already cashed out. The decision to cheat consumers or rig the market or otherwise break the law can provide big payouts to executives sometimes. But when it comes to paying fines, the ones who call the shots rarely face accountability. Executives tell shareholders that this is the cost of doing business.

Now, it is critical that we understand how these executive compensation incentives might drive misconduct or when a defendant is keen on settling, whether we need to address those distorted incentives.
directly. There have been instances where enforcers have required significant changes to executive compensation policies. For example, in the civil and criminal settlements with GlaxoSmithKlein and Johnson & Johnson, the corporations were required to amend their policies to ensure adequate clawback provisions from executives when law breaking occurred.

The role of heavy debt and executive compensation in both consumer protection and competition matters raises many questions about our approach to settlement remedies. When we find that heavy corporate debt poses risk, how should we safeguard against it? Should enforcers, like creditors, seek bans on stock buy-backs and dividend payouts until debt levels and risk levels get under control? Should enforcers require recapitalizations, including raising equity capital when companies claim they cannot afford to make victims whole?

Should we require the company to sell off assets to pay back victims when wrongdoing is found? Should we require clawback provisions to stop executives from getting a windfall if consumers are cheated again? Should we seek compensation arraignments where executives guarantee payments to victims if companies go belly up? Should we require
more attestations signed by executives or board members that they have no personal knowledge of any wrongdoing?

There are many questions that we need to be asking about corporate governance and corporate governance remedies if we want to be taken seriously by potential bad actors in the boardroom.

So thank you for taking part in our examination of our approach to consumer protection and competition with today's focus on capital markets and corporate governance. While we are just scratching the surface today, this must be a start of changing our approach to face the realities of an economy dominated by large firms. Thank you.

(Applause.)

MR. ADKINSON: Thank you, Commissioner Chopra.
MR. ADKINSON: We will now have two 20-minute framing presentations. First will be Dan O’Brien, an Executive Vice President at Compass Lexecon. Dan was Deputy Director of the FTC’s Bureau of Economics, and prior to that was Chief of the Economic Regulatory Section at the DOJ Antitrust Division.

Dan coauthored some of the main theoretical work underlying the analysis of competitive impacts of cross ownership and common ownership in competing firms.

Dan?

MR. O’BRIEN: Thank you, Bill. I’m pleased to be here today with such a distinguished group to discuss common ownership, which I think is a very important topic for the FTC and other competition authorities around the world.

Last week, my good friend, Martin Schmalz, tweeted that it was bad form for the FTC to include me on the program without my disclosing past consulting work that I’ve done relating to common ownership.

So, Martin, I think you know better than that. I’ve been an academic. I’ve been a government policy wonk, and I’ve been a consultant. And in each
of those positions, I've been fortunate enough to
publish articles in the top peer-reviewed journals in
my field. And, frankly, I find it a little bit
insulting that you would insinuate in public through a
tweet that my remarks today are somehow tainted by
some consulting work that I did for the industry.

I think you'll find that my analysis today
is just that, it's analysis. But since you raised
the question, I'm not being compensated for my
participation or my remarks today, and I have not been
paid by a third party for work on common ownership for
over a year.

That said, I agree with you, Martin, that
there is value in knowing what drives research
forward. And with that in mind, I'm going to tee up
my discussion today in a way that fully discloses my
research and my consulting work on common ownership.

Okay. So in the mid '90s, I coauthored a
paper titled "The Competitive Effects of Partial
Ownership, Financial Interest, and Corporate Control."
At the time, I was consulting with cable TV companies
about transactions that involved changes in partial
ownership interest. And we needed a way to analyze
the problem. So the result was this academic paper,
motivating consulting work. And I've published a
number of papers motivated by consulting work in the
same way.

The paper develops a very general theory
that explains how partial common ownership can have
anticompetitive effects. And it shows how one can
quantify those effects. Eighteen years later, Martin
and coauthors published a very important paper
examining common ownership in the airline industry
that by all appearances draws heavily on the
theoretical framework that I helped develop in
conjunction with my colleague at the time, Steve
Salop.

Our framework was really the only rigorous
type of how common ownership could harm competition
at the time. And, in fact, newer theories that are
coming out tend to build on the earlier framework. So
in particular, Azar, Schmalz, and Tecu, they drew on
our paper for the key explanatory variable in their
analysis, the modified Herfindahl-Hirschman index, or
MHHI.

I became aware of Azar, Schmalz, and Tecu’s
paper in 2015 while I was at the FTC. It's always
gratifying when your own research is used by others,
but I had several concerns about how they applied the
theory of partial ownership to the common ownership question. I published a critical review in the ABA's Transportation, Energy, and Antitrust newsletter that same year. And in my review, which was not funded by any third party, I touched on many of the issues that I'll discuss in a few moments.

That same year, while at the FTC, I began working on a technical paper that dissects some well-known and some less well-known problems with price concentration regressions, which was the methodology used in Azar, Schmalz, and Tecu. That paper also received no third-party funding, by the way.

Then in 2017, I wrote a note for the OECD on common ownership raising many of the same issues. That paper also received no funding. Finally, also in 2017, I coauthored two papers, one that's now published, critical of the application of the theory that I helped develop to the issue of common ownership by institutional investors. Okay, those papers did receive funding from ICI, as is fully disclosed on those papers. And they make the same points essentially that I am going to make today and that I had made previously, before I even knew who ICI was.

So that brings us to today. And as I said earlier, I'm here really on my own dime, but it seems
more like a quarter because New York is very expensive.

Okay. So this short history of my involvement in research and consulting on common ownership kind of tees up my topic for the session, which is the application of the theory of partial ownership to questions about common ownership by institutional investors. This is a narrow focus, but I think it's an important one because I think it's important for the theory that motivates empirical analysis to be appropriate to the question at hand.

I think it's fair to say that we're here today in large part because of the empirical findings in Martin's important papers. I find that when the level of policy interest in new research reaches a certain decibel level, it often makes sense to pause, take a 40,000-foot view of the landscape, and make a reasoned assessment. And that's what I hope to do in the next 15 minutes.

First, what is partial ownership and why do we need a theory about it? So most economic theory and most applications of economics to policy assume that the firm is a monolithic decision-maker whose objective is to maximize profits. The economics we see in textbooks is built on this assumption.
Of course, this assumption is an abstraction. With the exception of a sole proprietorship, firms typically have more than one owner, and each owner partially owns the firm. If the owners agree that the firm's objective should be to maximize the profits of the firm, then the assumption that the firm behaves as a monolith is fine. But if different firm owners want the firm to pursue different objectives, for whatever reason, how will the firm behave?

Okay, the theory of partial ownership that Steve and I worked out was developed to answer this question. The theory provides a way to model how firms behave when a firm's owners have divergent interests. The theory then analyzes how markets function when firms pursue this objective, which could be quite different from the standard objective of maximizing own firm profits.

Okay. So I've been using the term “partial ownership.” Where does common ownership fit in? Common ownership occurs when one or more owners of a company also owns one or more other companies. The FTC discussed a more nuanced definition earlier today, but I'm sticking with the analytical definition that works for economists when we think about this, okay?
The companies are said to be commonly owned in this case because they have some owners in common. A pure horizontal merger, for example, is a special case of common ownership technically, where the merging firms become commonly owned. That may be inconsistent with discussions of common ownership policy and legal discussions, but analytically, that's true.

Interesting questions arise, though, when common ownership also involves partial ownership. When different partial owners have different common ownership interests in firms whose profits are interrelated in some way, different owners are apt to have divergent interests. For example, a noncommon owner that holds share in Company A wants Company A managers to pursue strategies that maximize the profits of Company A, but a common owner that owns shares of Company A and Company B wants the manager of Company A to compete less aggressively to increase its returns from its partial ownership of Company B.

This shows how different degrees of partial common ownership by different owners create divergent interests among the owners. The theory of partial ownership was built to address this situation, as I said.
So how does the theory do this? How does the theory -- what does the theory assume about what a firm's managers do when owners have divergent interests? Well, the theory assumes, naturally enough, that managers pursue strategies that are in the interest of the firm's owners. In particular -- and this is the key assumption of the theory on which the empirical work was based -- each manager maximizes a weighted average of the returns to the firm's owners from their shareholdings in the relevant common ownership group. That's a lot, okay?

There's a lot in that statement, so I want to take it apart because the usefulness of the theory for understanding specific cases of common ownership depends on the accuracy of the assumptions that relate to the three elements that I underlined -- the control weights, returns as an objective, and the relative common ownership group.

Before carving into these assumptions, I want to just stop and say, you know, what about this theory, is this theory goofy, or do we think it's okay? So what are the scholarly views of the theory? I think generally positive. And I say that based on two observations. First, much of the literature on the subject uses the theory either as a starting point...
for extending it or to motivate empirical work. And, second, my experience on the kind of presentation trail of work related to common ownership is that folks don't find the theory itself objectionable. Okay. But that said, like any theory, it comes with warning labels, and they relate to the three elements that I had underlined on the preceding slide, which I now want to go through.

So the first warning is that serious side effects may occur with improper control weights, and I'll explain what I mean by that in a minute. The second warning is that you should consult your doctor before using this model if your relevant common ownership group includes antitrust markets beyond the market at issue. And a third warning label is consult your doctor before using this model if owners' objectives differ from investment returns. Those are three warning labels I want to discuss in the rest of my talk.

These three warning labels raise troubling issues for using the theory of partial ownership to assess the competitive effects of common ownership by institutional investors. Okay, so the first warning label relates to control weights. Remember that the theory assumes that managers care about the returns to
their owners, but because the owners typically have
different ownership interests, the manager has to
decide how much weight to give each owner in deciding
what to do, okay? The weight given to a particular
owner is the owner's control weight.

In the theory, this is just a number between
zero and one such that the control weights sum to one
for a given firm. The manager is maximizing a
weighted average of the interests of the owners. In
practice, the value of these weights that lie between
zero and one is really critical. If common owners’
control weights are zero, for example, common
ownership has no effect. And if the control weights
are positive, it can have anticompetitive effects, the
size of which depends in a somewhat complex way on
financial interests and control weights.

Here's a bit of economic humility.
Economists do not have robust tested theories about
how common ownership -- about how ownership shares
translate into control weights. José Azar, one of the
coauthors of the airline paper that brought us here
today, I think it's fair to say, has a nice paper from
his dissertation that provides one motivation of what
Salop and I called proportional control, which occurs
when managers give their owners weights equal to their
ownership shares.

I think José’s paper is interesting. It was alluded to in an earlier discussion today, and I recommend reading it, but it's one motivation for proportional control. It's not especially compelling for many reasons. It's a long discussion. And it's not been tested.

Other approaches to control use cooperative voting models, such as the Banzhaf power index, Shapley's voting model and so on. These approaches are also not well tested.

So the question is what are the appropriate control weights. The assumptions about control in the empirical literature also raise additional puzzles, okay? Suppose a company is owned by a set of common owners and a set of noncommon owners that have very small shares. The noncommon owners have very small shares, so the noncommon ownership is diffused.

Under proportional control, okay, which is the assumption in -- Azar, Schmalz, and Tecu used to create the modified Herfindahl-Hirschman index -- they also considered Banzhaf control -- if the number of noncommon owners is large, those owners have essentially no say, okay, in the direction of the firm. Their control weights are near zero.
On the other hand, a common owner that holds even 1 percent of the firm has almost complete control over the firm. Okay, so, is this assumption reasonable? That's a prediction of the theory that if ownership by noncommon owners is diffuse, they have no control. Is this assumption reasonable?

Well, experts in corporate finance -- corporate law, rather, they say no. In the U.S., a firm's directors have a fiduciary obligation to the firm and to the owners as to their interest in the firm. In other words, the law technically obligates directors to pursue objectives that are in the best interests of the firm, which means they should not place weight in their objective functions on the returns of shareholders from their ownership in rival firms.

Now, I won't stand here and say that common owners can never influence management to pursue strategies contrary to noncommon owners' interests, but I’ll note that compensation of managers in most major U.S. corporations is based on a firm’s stock, in part, and this gives the manager at least a short-run incentive to price in a way that maximizes the profits of the firm consistent with fiduciary obligation and inconsistent with anticompetitive effects from common
ownership.

In the interest of time, I'm going to skip ahead to Warning Label 2. This relates to what I've called the relevant common ownership group. Okay, this group consists of firms that are commonly owned and whose profits are interrelated. For example, airlines that are commonly owned and compete with each other are in the same relevant common ownership group.

In addition, if the airline suppliers and customers are also owned by the same common owners, they should also be included in the relevant common ownership group. Azar, Schmalz, and Tecu's paper assumes that the relevant common ownership group consists of the airlines and only the airlines. However, the same institutional investors that own the airlines also own airline suppliers and customers.

Okay, why is this important? Well, under AST's assumption, institutional investors ignore the impact of airline prices on airline suppliers and business travels. And an increase in airfares has a negative effect on both groups. Both impacts give common owners incentives to lower price rather than raise it.

Similarly, in the European Commission's use of the MHHI to analyze the Dow/DuPont merger, they
assumed that institutional investors would ignore the impact of agrochemical companies’ strategies on their suppliers and buyers, which institutional investors also partially own. These impacts can give common owners incentives to reduce price rather than raise it.

In the interest of time, I'm going to go on to Warning Label 3, which is that owners' objectives differ -- institutional investors' objectives differ significantly from the objectives of owners that are not institutions. Okay? Institutional investors make money by attracting retail investors. Is this accomplished by instructing Company A to pull its competitive punches against Company B to increase the value of the institution’s shareholdings in Company B? That is, should Vanguard instruct United Airlines to raise price to increase the value of its position in American Airlines?

What if Fidelity owns a larger share of American than Vanguard? Then Vanguard's strategy would increase the value of Fidelity's portfolio more than the value of its own portfolio. Is this something Vanguard wants to do? The point is that institutional investors that purchase shares for retail investors have vastly different incentives than
investors that purchase shares for themselves. The
theory of partial ownership was built to capture the
incentives of investors that purchase their own
shares. It was not built to capture the incentives of
institutional investors. And, in fact, I'm not sure
we have a real good idea at this point of what those
incentives are. We really need a theory of how
institutional investors compete with each other and
the implications of this competition for how they
behave to influence managers before we can apply the
theory to the question of common ownership by
institutional investors.

So I'm going to conclude by summarizing
circumstances where I think the theory of partial
ownership is properly and improperly applied. The
theory can be quite useful when three conditions are
satisfied. Control weights are reasonably clear or
can be bounded. The relevant common ownership group
is properly defined. And owners have the objective of
maximizing their returns across the relevant ownership
group.

These conditions often hold in transactions
that involve changes in partial ownership among a few
large companies or investors, but for common ownership
by institutional investors, control weights are not
clear; research has not properly identified relevant common ownership groups and there's a mismatch between the objectives of asset managers and the objectives assumed by the theory.

Thank you very much.

(Applause.)

MR. ADKINSON: Thanks, Dan.

Our second presenter is Martin Schmalz, an Assistant Professor of Finance at the University of Michigan's Ross School of Business. As mentioned by Dan and also this morning, Martin and his coauthors have written the seminal papers finding that common ownership in competing firms has anticompetitive effects.

He is a financial economist whose work examines how finance interacts with other fields of economics, including industrial organization, labor economics, monetary economics, and microeconomic theory.

Martin?

MR. SCHMALZ: Thank you very much for having me and for holding this hearing and to NYU for hosting it. So I’d like to state for the record that I do hold a portfolio of ETFs but have no other conflicts of interest to disclose.
So I want to take a much broader view on what the theoretical literature on this topic has shown and also speak about governance mechanisms and a few words on policy. So let me start with a benchmark model of competition that is really what we should think about, similar to what Adam Smith described in his Wealth of Nations.

So what he imagined is a baker that is completely self-interested and tries to, you know, innovate and work very hard to undercut the bakery on the other side of the street and thereby compete for market share for new customers. This self-interest leads to a maximization of social welfare.

Now, a key assumption here is that each firm wants to maximize its own value and that assumption is naturally satisfied when the firm’s owner-managed and the owner’s wealth is concentrated in one firm. Okay, so what's an example, though, of today's corporations where managers and owners might differ?

Here's one illustrative example. Virgin America used to be an airline. The largest shareholder is Richard Branson, not the CEO, and you ask yourself, how is it, by which mechanism is it that owners get firms to compete aggressively? They won't do it on themselves -- by themselves without

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incentives. And the media reports point to explicit
directions by the owner to use the cash from the IPO
for capacity expansions, buying new airlines, opening
new routes, just expanding market share, stealing
market share from Delta, United, and the other
shareholders.

Of course, he has the power to vote and can
design incentives to break up this voice channel.
Here’s a quick illustration of to which lengths such
an owner can go to attract market share. This is
Richard Branson, you know, trying to attract market
share from other players.

Now, I’m kind of serious about this because
a key question is, who takes that role? Who puts on
the lipstick at Delta and United and Southwest
Airlines? To find out, let's find out who the largest
owners are. Well, the largest shareholder of Delta
and Southwest and United is Berkshire Hathaway, and
that’s Warren Buffett's investment firm, who is also
the third largest in Berkshire Hathaway, and the other
owners are Vanguard, BlackRock, PrimeCap, State Street
in some proportion.

So who is supposed to put on the lipstick?
Warren Buffett? No? First at Delta and then at
United? Well, that seems absurd, no? And that’s the
point. The point is he has no economic incentives of
doing that. If you steal market share from Southwest
Airlines, you know, you call Delta and say steal
market share from Southwest; and you hang up and say
call Southwest and say now you steal market share from
Delta; hang up, then you call United. That's
completely absurd. It's against economic interests of
a common owner. And I use Scott’s words from this
morning, common owners simply have weak incentives to
engage in stewardship aimed at enhancing the value of
particular companies, but they do have incentives to
defer to the preferences of corporate managers.

The question is what happens then. You
know, what happens is the corporate manager has weak
incentives to cut costs, then the costs are going to
be higher, output is going to be lower and illustrate
equilibrium, and product price is higher. That's an
anticompetitive effect, okay?

So the key insight is nobody needs to soften
competition if there are no incentives to compete in
the first place. That's a key insight. Okay, let me
give a few more empirical facts. The thing is, common
owners are not in the minority as we’ve heard much in
this debate. There are almost no noncommon owners
left. If you look at the largest 100 shareholders of
United that own more than 91 percent of the shares, five of these shareholders are not common owners; 95 of them are. The largest of these noncommon owners is number 42. Okay, we have absolutely no power, according to any theory I'm aware of, in these firms. And that's similar for American, Delta, and Southwest.

There have been some claims in the literature suggesting otherwise, but if you read Einer's new paper he just posted, there's a correction to that record.

Okay, now, what happens in theory when you have few such investors left? There's three decades starting in the '70s of formal theories and informal writings, suggesting that compared to the text model, you'll get less competition if there are less incentives to do so. Okay, this is not a brand-new theory. And all of them have a similar logic that I just explained. Okay, so let me give some details.

It is true that the theory doesn't distinguish between asset owners or asset managers. You can either believe that asset owners have an incentive to maximize the total value of the shares in the management, or that they stick to the fiduciary duty by which they promise that they will do that for -- on behalf of its investors. But future work can
figure out if that's an empirically important
distinction, okay?

Another thing I should point out is I
totally agree with Dan that we have no empirical
evidence or established theory that explains how
different common owners or different shareholders
get the firm to have an objective function and how,
therefore, they behave. What we do have is a paper
by a Nobel Laureate, Oliver Hart, that says one
thing we know is they won't agree on own-firm profit
maximization, and that's a key assumption in all of
traditional antitrust.

So I agree with everybody that robustness is
needed in applications when it comes to the choice of
control weights. Once more, the theory is saying that
common ownership reduces incentives to compete. None
of these theories says if common owners do nefarious
things or incite collusion or do something like
intentionally elicit, and that is clear from page 1 of
the first formal theory on this topic, suppose no
collusion is possible.

Rotemberg says, note that this collusion
need not be enforced. Managers never need to meet
with each other. He also writes, you know, the
mechanism for the collusive outcomes is reduced,
incentives to compete simply as a result of managers looking out for their shareholders. So these responses we’ve heard by the investor community, we don't ask for them to collude. We don't collude with anybody. It has just little to do with what the claim is.

That’s a very important distinction because if you're waiting to find a collusive mechanism by which the investors or firms collude and you don’t find any, that’s the prediction of the theory, okay? So you’re likely to find false negatives, and everybody should be aware of that distinction.

Now, what corporate governance tools do common shareholders use? Well, as a first order, all those that are available to them. That's voting, designing incentives, or voice, speaking to portfolio firms. And I'll show you just some examples of apparent deliberate attempts to reduce competition with these firms.

Now, the important thing is academics are not going to produce much of this evidence because we don't have access to the data. That’s where the role of the regulators would come in. First is let's talk about incentives. Here's an empirical fact. If you measure which fraction of firm value goes to the CEO,
that's wealth performance sensitivity, and regress
that on some measure of common ownership concentration
-- and by the way, this is robust to using other
measures rather than MHHI -- you get a negative
correlation between those, and it’s robust, a very
robust finding.

So what does it mean? Well, it means that
the CEO has reduced incentives to cut costs, which
means costs are going to be higher, which means output
is lower, which means prices are higher. That's an
anticompetitive effect. So what you get is this
apparent paradox that it can be a weak principal in
corporate governance and at the same time the cause
for anticompetitive effects. Okay.

Now, there's been some debate in the
literature about the use of relative performance
evaluation. Now, whether or not a contract features
that is completely uninformative about its competitive
incentives because everything depends on how you
measure performance. Do you measure performance in
terms of value, in which case it can be
procompetitive, or in terms of margins? And to see
that, here's one equation. Margins are price minus
marginal cost, and usually prices fall when quantities
are higher, but then maximizing margins means
minimizing quantity.

And Rock and Rubinfeld in their paper point out that in American Airlines, the CEO’s incentives are actually 100 percent based relative income, margins relative to the competitor, so that’s actually an anticompetitive type of contract.

Now, how relevant is this not only in the data but, you know, anecdotal? If you read the Wall Street Journal, almost exactly a year ago, you find a group of investors meeting in New York, trying to figure out how they can change executive incentives to reduce the output the frackers produced. That seems to me like a discussion about common -- about product markets, let's talk about voting.

And it is true that many institutions don't put their own employees on the board, but, of course, they vote on everybody else, all the directors. Two years ago, Warren Buffett's deputy CIO, Todd Combs, was named to J.P. Morgan's board, the largest shareholders there are BlackRock, Vanguard, and State Street, Fidelity.

Now, Bloomberg also pointed out that Berkshire is the largest shareholder in Wells Fargo as well as in Bank of America and many other -- and holds large stakes in many other banks -- U.S. Bank
Corporation, Goldman Sachs, American Express, and so forth. So -- and, of course, you can kind of predict that Combs is not going to propose competitive strategies or a price war there.

One of the instances in which voting is most important might be activism. If you're a large investor or the largest investor in a firm, it doesn't matter whether you like it or not, but you'll be pivotal in many elections. And we just spoke about Trian this morning. They had in the proxy find at DuPont in which they explicitly asked for increased R&D spending, more relative performance evaluation as measured by value, and all with the explicit goal to increase market share.

Now, they were voted down by BlackRock, State Street, Fidelity, each of which was a pivotal decision. And it's not me who concluded alone but a prominent corporate law scholar said the most plausible hypothesis is that the large asset managers are concerned about the impact of activism on the broader portfolio.

And Commissioner Jackson this morning mentioned that if you talk to any person in this space they'll confirm that they call them index funds, control America, that they're pivotal in all these
proxy contests. We know in the established literature that hedge fund activism affects product markets. So if mutual funds affect hedge fund activism, we know there’s an effect on product markets.

I don't have time to go through the exploding literature on mutual funds’ pivotal role in proxy contests. I’ll just say as early as 2008 in the standard finance journals, we have established that funds vote not in the interest of the individual firm but in the interest of their portfolio, which is very much consistent with the assumptions of the literature.

Now, let's switch gears. Okay, let’s go to Southeast Asia and private equity. If you read The Economist, you’ll find claims that the Vision Fund by Softbank explicitly asked Uber and the ride-hailing firms to compete less feverishly and push up fares. It ended with Uber withdrawing from particular markets in exchange for cross ownership stakes, and competition authorities in Southeast Asia challenged these deals.

So do we see communication also about product markets in the U.S.? Well, so, this morning, we had a representative of ValueAct here. There was a U.S. lawsuit by the DOJ against ValueAct for a
violation of the Hart-Scott-Rodino Act, a filing

requirement.

Now, what Reuters reports is that this puts
-- rings alarm bells in the $16 trillion mutual fund
industry because the communications the mutual funds
have are very similar to those that were cited in this
lawsuit and that the case comes as active and passive
investors work more together to pressure management at
underperforming companies and that activist core
passive shareholders and passive investors recruit
activists, so I don’t think this distinction between
active and passive is all that important in that
debate, but, you know, empirically, we can figure this
out.

Okay. So one might think that this was a
warning shot. So the question arises, were topics
touching on product market competition discussed
since. Well, actually, this fracking case I mentioned
happened long after that, so, yes, it did. A few
weeks ago, we had an institutional investors meeting,
and perhaps we were all happy about this, to be clear,
about, you know, reforming how guns are made or how
easily they should be trackable and so forth.

Larry Fink is on the record saying we can
tell a company to fire 5,000 employees tomorrow, and
at the same time, we hear they insist no effect on product market outcomes. Now, in Germany, my translation of a headline is “Fund Giant BlackRock Lobbies for Mergers of European Banks.” Now, that is precisely what the Hart-Scott-Rodino Act was supposed to prevent. So, apparently, mechanisms exist for mergers, then I don't understand how mechanisms don't exist for affecting product market outcomes.

Okay, so there's more. Matt Levine pointed this out. In earnings calls, common shareholders saying I’d like Southwest to boost fares and also cut capacity, it’s mysterious to me how anybody could think that owners don't have the ability to engage on topics that affect product market outcomes.

Okay, so let me now move on and conclude. Given the theory we have and the magnitude of anticompetitive incentives documented -- we'll speak about this afternoon -- as well as a fiduciary duty of the asset managers to maximize the value of the portfolios of assets, as well as the abundance of mechanisms that at least potentially yield ability to affect product markets, we need overwhelming empirical evidence that anticompetitive incentives from common ownership never in any markets cause anticompetitive outcomes.
And I don't think we have any evidence to that effect. I'll mention about two dozen papers in the panel later on. Many of them published in top journals that document the facts on prices, outputs, product market conglomeration, innovation, and many other outcome variables we care about here, so I don't think it is warranted to just focus on one particular paper.

So the question arises of what we should do about the issue. And, to me, two things stand out. First is collecting better data. It's a huge pain to deal with common ownership data. Chris Conlon will speak about this later on. But for private firms, we don't even know who owns them as researchers.

And I want to just make clear, if anybody uses an HHI screen, you are assuming that even if 100 percent of the shareholders of two firms completely overlap, 100 percent shareholder overlap, they should be treated as completely independent firms. You have six shareholders, each owning 15 percent, and the antitrust establishment goes completely independent firms, no impact, because they hold less than 15 percent. What they hold cumulatively we completely ignore.

This doesn't make sense in economic theory.
We have absolutely no evidence that supports that assumption, so, therefore, I think we should challenge it. Now, there are many open questions, and we’ll raise many of them. Dan has mentioned a few of them. You know, potential criticisms of what's being done in the literature. And academics will study those, I'm quite confident, but there are many questions academics can't study because we don't have the data for it. And I think that's where the regulators come in.

One is this morning we heard do engagement meetings, future topics touching on competition. All I know is from reading the newspaper, no? But how systematic is that? Well, academics won't deliver the answer. We heard, well, we want to know what the chain is from executive incentives to the price-setting within firms. I think that’s a fascinating question, and it is an open question, but academics are not going to answer that question. We don't have the data, okay? So the regulators need to think about how badly they want to know the answer to these questions.

Okay, so I’ve always held back with policy proposals or endorsing them, but I do want to speak about a few arguments that I think are not warranted
in this and just miss the mark. And one of them is
that any intervention would be all radical and new and
based on brand new theories. I don't think that’s
true.

Regulators understood long before this
literature started about this problem. In the 1934
Senate Securities Report -- again, Commissioner
Jackson mentioned it this morning -- it reads,
“Congress must ‘prevent the diversion of these trusts
from their normal channels of diversified investment
to the abnormal avenues of control of industry.’” In
the SEC’s -- that's a typo, ICA, Investment Company
Act, bill -- reads, “and the national public interest
is adversely affected when investment companies have
great size and excessive influence on the national
economy.”

And ICA as written, it applies to funds but
not the management companies, which pointed Jack Bogle
earlier this year to point out when and if our index
funds get to 10 percent, all we have to do is start a
second one and we’d be in technical compliance. We
need new limits. And we mentioned Jack Bogle’s piece
last September, that he thinks we can no longer ignore
the concentration of corporate power that is bundled
in the so-called index funds.
Okay, so one might ask, but what about the benefits of diversification? Well, that's been partially addressed, and I’ll address quickly. The common ownership problem, as presently documented, has very little to do with households’ ability to diversify. There might be this problem in the limit, but for the moment, that's not what the problem is. Berkshire Hathaway is not an index fund. ValueAct is not an index fund. So there are many things one can do before even starting to think about touching index funds. Although that might be the logical conclusion, I don't think I have time to talk about the more minutia down here.

Second is common ownership reduces incentives to compete and potentially welfare because of the reduced cost of diversification they enable. And this is an excerpt from Rotemberg, who says, “government interventions which reduce diversification ... are potentially beneficial since they promote competition.” So everybody is aware that mutual funds help reduce the cost of diversification, but that might be the fundamental problem behind it all.

So I'm very glad that the SEC and the FTC talk to each about this because they have different
missions here. And the investors currently are caught in between this conflict, which has been in the room the entire day, but that is what the conflict is. It’s not like, oh, but they help diversify investments and, therefore, we shouldn’t do anything about it. This is the basic problem, okay?

Now, I'll conclude by Rotemberg’s conclusion, who literally points to mutual funds and says by lowering the cost of diversification, they naturally induce more collusion -- he means collusive outcomes -- if managers follow the wishes of the ultimate recipients of the dividends. It may well be that the funds which concentrate on specific industries, and those whose portfolio is very broad, do the most harm.

Okay, so that is just opening a debate, indeed, as we’ve pointed out on where we want to draw the lines between do we want firms to act in the owners' interest and to which extent do we want the owners to be diversified in unrestricted ways. And I don’t want to chime on what correct tradeoff here is, but that's what the debate is and what it should be about. Thank you.

(Applause.)

MR. ADKINSON: Thank you, Martin.
And we're going to take a short, ten-minute break. Please be back quickly because we have a lot to do this afternoon.

(Recess.)
MR. ADKINSON: We’re now going to convene the second panel for this hearing. It’s Theories of Competitive Harm from Common Ownership. I’ll briefly introduce our distinguished panel. Starting from the far end, I believe it’s Bill Rooney down there, Co-Chair of the Antitrust and Competition Practice Group at Wilke Farr & Gallagher.

Then it’s Fiona Scott Morton, who is a Professor at the Yale University School of Management. And then Professor Einer Elhauge at the Harvard University Law School; Professor Menesh Patel, University of California, Davis, School of Law; Professor Scott Hemphill, New York University School of Law; and Professor Dan Rubinfeld is my comoderator at the New York University School of Law.

MR. RUBINFELD: Thanks, Bill. We're going to really get down in the weeds this afternoon and talk some serious economics and law at a different level than we did this morning. And my hope for the session is that the commentators we're going to hear from will help us to understand some of the possible if not plausible or perhaps likely mechanisms by which common ownership may create a competition problem. And those could range from what we in antitrust call...
unilateral effects; they could be coordinated effects; they could involve different kinds of communications, either through the board, through earnings calls, through private or public talk of other kinds.

They could involve forms of remuneration. They could involve proxy voting, and I'm sure I left out some other possible venues, but more importantly or equally importantly as Martin suggested in his talk, it could be that there is no form of communication of any kind, nothing that would amount to an agreement or nothing that would amount to necessarily a traditional competition problem, but the structure could create an effect which might warrant a policy intervention.

So what I'd like to do is we're going to have each of the commentators talk for at most a relatively short period of time outlining their views on this issue. And then we'll go back to the panelists and discuss two issues. One is to get some criticism or clarification as how they think -- if there is a competition problem, how they think it might arise.

And given what I just said, the final issue I want to talk about is whether antitrust is really the appropriate remedy because there are some
potential structural problems that might suggest policy intervention but would not necessarily invoke either Section 1 of the Sherman Act or Section 7 of the Clayton Act.

So with that overview, I'll warn everyone I'm going to jump in if you go beyond your allotted time and interrupt you at will. Otherwise, I look forward to a great conversation and maybe a little debate along the way.

So we'll start to my left with Scott Hemphill.

MR. HEMPHILL: Great. So thanks again for the opportunity to talk about this, I think, fascinating and important issue. And thanks again to the FTC for choosing to do this at NYU. So, today, I'd like to talk about some research I've been doing with Marcel Kahan, a colleague here at NYU. The title of our paper is "The Strategies of Anticompetitive Common Ownership."

Now, this is the same paper that you all heard about at some length this morning from Commissioner Phillips and also from Commissioner Jackson. The full paper is available on SSRN if you want even more after getting through today. The link is listed on the slide, but in any event, let me offer...
a few introductory thoughts about the project.

So the project is to identify and examine the causal mechanisms that might link common ownership to higher prices and then bring that thinking to the empirical evidence that's been developed thus far. We're particularly interested in empirical studies and theoretical work that use a particular measure, the MHHI, which you heard about a little while ago. This is the measure developed in O’Brien and Salop and also in some earlier work by Tim Bresnahan and Salop that's been used to measure common ownership and is quite prominent in the literature.

For each of these strategies, we try to answer two questions. First, to what extent is it tested by the empirical literature? Second, is it plausible? That is, would such a strategy be effective if attempted, feasible to implement, and in an investor’s interest, given the benefits and offsetting costs.

Our basic message is that some mechanisms are tested and some mechanisms are plausible and that the intersection between those two mechanisms that have both been tested by the existing literature and are plausible is relatively few. And then we describe some implications for assessing welfare, for reform,
and for further investigation.

Now, in thinking about any given mechanism, there are three basic questions we think we should answer. The first is conflict. Would a noncommon owner at the firm oppose the common owner strategy or is it happy to go along? The second question is about what I'm putting here as precision. Does the mechanism target a particular firm action such as capacity on a particular route in the airlines context, or does it instead alter incentives across the board, perhaps weakening overall a manager's incentive to compete or, indeed, to maximize profits?

Third is the distinction that Commissioner Phillips emphasized this morning between active and passive strategies. Does the common owner take affirmative actions to push the common owner to do something, or is it really about, you know, sitting tight, thereby permitting the firm to relax and compete less?

Now, there's a lot more in the paper than what I'm going to get across in what's left of my seven minutes, but we make three main points. First, the empirical program that's based on MHII -- not the entirety of the empirical evidence, mind you, but I think the most important part thus far depends on a
conflict of interest between the common owner and
other investors. So to take an example, if an owner
of just one airline is happy to go along with the
common owner strategy, right, when the owner owns just
one airline, they’re happy to go along, then this
strategy is not well tested by the MHHI approach.

Second, for strategies that are passive
across the board, you know, so and help the firm live
the quiet life, most of these are not tested and most
are not plausible.

And, then, finally, third, as to active
targeted strategies, right, imagine an investor
telling the firm, you better go, you know, reduce
capacity on a particular route, that these aren’t
plausible for institutional investors.

So let me just offer a few thoughts about
this first point about MHHI, right, as we’ve heard the
most important tool used thus far in investigating
common ownership, I would say both on the theory side,
right, the O’Brien/Salop story has MHHI at its
foundation, and also the airline study and other
empirical work.

The key thing to see here is that when
common ownership goes up, MHHI increases. Well, no
duh, right? That’s exactly what you would expect for
any reasonable manager of common ownership, but
importantly, MHHI decreases when there is an
additional noncommon investor. And to be clear, this
is not just a question of replacing or displacing an
existing common owner. What we're talking about here
is conditional on some level of common ownership, if
you added a noncommon owner, MHHI would go down.

Now, why did that make any sense as the
basis for a model? Well, it comes out of an
underlying story where there's conflict back and
forth, disagreement between the common owner and the
noncommon owner.

This is what Dan was talking about before as
divergent interests. This divergent interest point is
really important because not all mechanisms that we
talk about have this conflict. So take an example
where some common owner tells American and United, it
would really be in your interest to reduce capacity or
to increase price. Maybe you already knew this, maybe
not, but in any event, it’s in everybody's interest to
do this.

If you regard that mechanism as a plausible
one, I think it’s important to recognize it’s not an
MHHI kind of story. Now, could a common owner have a
special ability compared to other investors to promote
a strategy like that? Well, maybe, but the MHHI-based literature is not informative about this point.

Do I have another minute?

MR. RUBINFELD: Yes, you do.

MR. HEMPHILL: All right. So I thought I had about another minute. I just wanted to make sure.

MR. RUBINFELD: And we have not colluded on this, right?

MR. HEMPHILL: Okay. I see you’re pulling the one-minute hook. Yeah, there we go, one minute, great.

So one other comment about passive mechanisms, and that's that MHHI is not a great fit for studying passive mechanisms either. Well, why is that? Well, MHHI doesn't actually measure passivity. That wasn't the point, right? So, for example, if two index funds merge, right, imagine each of them is passive. Together, still passive, but not more passive, or at least not necessarily more passive, and your MHHI goes up in that circumstance.

Or take maybe the basic fact in this economy of, you know, dispersed retail investors being replaced by passive -- we might imagine -- passive index funds. Well, there, too, here we have a situation where dispersed retail investors were
passive and index funds on this story are passive, too, so there's no real change in passivity, and yet MHHI goes up. So MHHI is capturing or is failing to capture passivity, and so it's not the right measure for testing that kind of a theory.

MR. RUBINFELD: Thank you very much, Scott. Our next speaker, moving down the aisle, will be Menesh. Thank you.

MR. PATEL: Great. Thanks, Scott. I learned a lot from that talk and also from your paper with Marcel. My comments are also based on a paper that's in the Antitrust Law Journal, so I'll keep my comments at a fairly high level. The issue of common ownership is a complex one, but in many regards, it is not a complex issue. And the reason for that is that the common ownership issue relates to some of the very fundamental precepts of antitrust that we as antitrust scholars, practitioners, and regulators think about on a daily basis when we consider issues in antitrust, counsel our clients, litigate cases, and shape antitrust policy and enforce the antitrust laws.

And, so, what I explore in my work and the comments that I’d like to address briefly today postulate that when these core principles of antitrust are applied to the common ownership question, the
answer that is the outgrowth of that is an eminently antitrust answer. And the antitrust answer is that it depends. While common ownership may in certain instances give rise to substantial competitive effects, in other instances, it may not. And the answer to that question depends on things such as the structure of the market, the objectives, and incentives of the participants that are in those markets.

Just because the common ownership question is so factually dependent doesn't mean that we throw up our arms and go home or I suppose live the quiet life as we read in the literature. Instead, our objective is to critically evaluate and identify those salient features that cause common ownership to have a substantial competitive effect and see in a given market whether or not those factors are present or not present.

That mode of analysis should sound quite familiar because it indeed is the same analysis that we use when we evaluate whether or not a particular merger generates substantial competitive effects. And that is not by coincidence. The same competitive concerns that underlie mergers, underlie issues of common ownership. Indeed, as Dan has reminded us, a
merger is a very special case of a common ownership, and just like many mergers may raise no substantial competitive concerns. That, too, is the case for instances of common ownership.

That basic proposition that is that common ownership may be competitively benign in many circumstances is a very simple proposition that I think generates some modest yet important implications for the shape of antitrust policy.

Before getting into those factors that may not cause common ownership to have deleterious competitive effects, it’s worth it to explore circumstances in which they may. And we need not go too far. We can consider the workhorse model of common ownership that undergirds so much of the empirical work and theoretical work in this area, and that's the model by Dan and Steve Salop that Dan discussed earlier.

It is an economic model, and like all economic models, it is built upon a set of core precepts, assumptions that are intended to model a particular market environment. It’s worth marching through quickly some of those key economic assumptions.

First, the model assumes that the firms in
the market under consideration produce homogenous products and engage in Cournot competition. Second, the model postulates that owners of those firms simultaneously have ownership interests in other firms in the relevant market, i.e., common ownership.

Third, the model assumes that the managers of each of their firms set their output in order to maximize a weighted portfolio of each of the owners' portfolios, and keeping in mind that each shareholder has ownership interests across other firms in their relevant market.

And, fourth, the model assumes that there is no market entry or at least there's no entry at the equilibrium. And, finally, to keep the model tractable, it assumes that there are no other markets that are affected by the common ownership — upstream, downstream, complementary markets. Those are assumed away to make the model tractable.

It’s an elegant model that generates a very clean theoretical prediction that common ownership results in competitive harm. Why? Well, because managers in the model recognize that if they decrease the amount of competition, yes, that decreases the amount of profits that accrue to that firm and that firm's shareholders, but some of those profits are
regained by competing firms which are then returned back to the firm common owners.

In other words, the model creates a linkage between profits of firms across the industry, therefore providing incentives for firms to compete less. The O’Brien/Salop model does a lot more. It also through the model mathematically generates the two key concentration measures that are used in the empirical work and the theoretical work: the MHHI delta, which is a reflection of the amount of common ownership in the market, and the MHHI, which is the sum of the HHI and the MHHI delta, in other words, a modified concentration measure used when there is common ownership.

Furthermore, within the confines of the O’Brien/Salop model, and that proviso is important, the MHHI does something more than being just a measure of market concentration. Just like the HHI in certain markets becomes a reflection of competitive harm, in the O’Brien model, the MHHI also becomes a reflection of competitive harm.

O’Brien and Salop do not suggest or even intimate that their model applies in all circumstances. Instead, the model applies under those particular circumstances that are assumed in the
model. And the key point is many markets -- many, many markets -- may not exhibit those key attributes. And if those attributes are toggled, then common ownership may not result in competitive harm and, in fact, may result in competitive harm that is not very well captured by the modified concentration measures.

There are many of those characteristics, and I don't have time to march through all of those, but one can consider even the most fundamental precepts that are embedded in that market. And I'll come back to a few of those later in the time that I have.

Consider market entry, for instance. It is undeniably the case that markets differ with the extent of entry that is feasible, both by new entrants or the amount of expansion that current firms can undertake. In the presence of market entry, common ownership’s competitive effects will be substantially muted, if at all. And, in fact, the amount of competitive harm will not be reflected by the modified measures of concentration if there is market entry.

MR. RUBINFELD: And, actually, I’ve got to cut you off. Can you just finish up?

MR. PATEL: For sure, for sure. The point is quite simple, and the point is that common ownership depends on a myriad set of market
characteristics, some of which may be present and some of which may not be present. And our objective is to only target those instances where those salient characteristics may be present.

MR. RUBINFELD: Thank you very much.

Our next speaker, moving down the line is Einer Elhauge. Einer?

MR. ELHAUGE: Thank you all. Thanks for having me here. So I thought a lot of the discussion this morning proceeded on a mistaken premise, with the position of critics of horizontal shareholding like myself have as our position. The assumption was that we want institutional investors to do less. That is not at all the case. The idea is instead that if you eliminate anticompetitive uses of horizontal shareholding in concentrated markets, that institutional investors will use their influence then only to increase corporate performance rather than to have anticompetitive effects.

In fact, if you have less horizontal shareholding, the natural effect is that institutional investors will have more -- higher levels of shareholding in individual companies and thus have more incentive to exert influence over them in positive ways, so there is no necessary tradeoff
between having institutional investors exert positive
forms of influence and eliminating anticompetitive
effects.

The notion that horizontal shareholding
might have anticompetitive effects is not just
inferred from theory or models. It's a hypothesis
that's been empirically tested. And I want to give a
sense of the landscape because it’s a lot broader than
just the airline study we hear a lot about.

First, there is a very broad cross-industry
study that shows that the gap between corporate
investment and profits increases with horizontal
shareholding levels. That study has been undisputed.
There's another study that we did talk about earlier
that says that changes in executive wealth make --
sorry, that increased horizontal shareholding makes
changes in executive wealth less sensitive to
corporate performance. That study is also undisputed.

Now, critics often focus on an earlier
dispute about effects on executive annual pay, but
that was just 22 percent that the executive wealth
changes. There’s two other undisputed studies that
show that increased horizontal shareholding delays and
prevents pharmaceutical entry.

And, next, there’s a study that shows that
horizontal shareholding adversely impacts bank fees and rates. And this is, I think, sort of but not really a dispute. There is a supposedly contrary study that finds mixed results, but it itself says its results are preliminary because it has data problems that they haven’t investigated yet.

Last, we get to the airline study and one thing that seems to be underappreciated is that even the critics actually replicated the results of that study using their own construction of the data and their own definition of horizontal shareholding. They changed the results only by changing the regression in various ways that I would argue are incorrect, and I’m going to talk about one not here in the slide but this morning it was brought up that bankruptcy can affect airlines, and I think that's right. The trouble is that in bankruptcy you're not sure exactly how much weight to give the shareholders because after bankruptcy they generally retain some level of shareholding in the firm.

So what the study did, though, is it ran the study again, excluding periods of bankruptcy, and what it found is that removing that confounding effect actually increased the price effect.

All right, so what are the causal
mechanisms? I don't think they're either surprising
or mysterious. They are the same exact causal
mechanisms that law and economics for decades has been
citing as the explanation for how the separation of
ownership from control gets restrained and how agency
slack gets limited. And if you think those mechanisms
can change corporate operations in a way that
increases corporate performance in good ways, it
follows they can also change corporate operations in
ways that might increase corporate profits in
anticompetitive ways.

One obvious one is board elections. Now,
the arguments against it -- I think the best argument
against this is, oh, but a lot of elections are
uncontested. Well, we've got empirical evidence that
shows that the share of votes withheld, even in
uncontested elections, has a strong effect on whether
the directors keep their jobs and whether they lose
committee seats.

Then there's executive compensation, and we
just saw how that can be structured to reduce
competition. The big complaint about the causal
mechanism here has been, well, sometimes these votes
by shareholders are nonbinding. Well, okay, but the
empirical literature shows that even in nonbinding
votes, the votes that are withheld, have a very strong
effect on reducing CEO pay. There's a market for
corporate control, labor markets, direct
communication, other mechanisms as well. Now, one
distinction that Scott has drawn in his excellent
paper is between macro-mechanisms and micro-
mechanisms, and macro-mechanisms being one that
influences general corporate competitiveness, micro on
particular markets.

But I don’t think it’s the case that the
macro ones have not been tested. In fact, the airline
study itself separated out the airline-wide effect on
competitiveness from route effectiveness, and 90
percent of it was macro effect on general
competitiveness. And the cross-industry studies also
find the general effect.

In terms of micro effects, we have it proven
empirically in airlines, banking, two pharmaceutical
studies, and evidence by these earnings calls. Then
what about these contra-mechanisms people talk about?
One is, well, there’s nonhorizontal shareholders, and
they’ll have conflicting interests. Those are
actually already included in the formulas and the
models, but the key thing for them is they benefit
from horizontal shareholding because horizontal
shareholding does not reduce competition from that one firm unilaterally. Horizontal shareholding reduces competition from their firm and their rivals simultaneously.

So a nonhorizontal shareholder has no more incentive to object to horizontal shareholding than they would to object if the firm could enter into a legally permitted cartel. That’s different from saying we're going to restrict ourselves; we're going to instead enter into something that helps us produce competition across the board.

The other argument raised has to do with vertical shareholding. For example, the claim that the S&P 500 wouldn't allow anticompetitive effects because, after all, they own business travelers in the airlines as well. Well, if you look at the actual incidence, though, of these increased prices, you find that 95 percent of the price increase is inflicted on people outside the S&P 500 because there’s a lot of nonbusiness travelers and a lot of the business travelers aren't in the S&P 500.

Finally, there's been a claim that index funds lack incentives to increase portfolio value. In fact, I think they’ve got plenty of incentives, in part because the costs are either zero or negative.
You have to vote one way or the other on the board or on the executive compensation. And, in fact, it’s kind of negative because the less you annoy management, the better are they likely to treat you. They have incentives to get flow. And really all that matters is that they exert more effort than other shareholders.

But the key thing, I think, is there’s tons of empirical evidence that shows that index funds exert a lot of effort and are hugely influential, including in very positive ways that increase corporate value. So the notion that they are doing nothing is not consistent with the empirical evidence, even outside the horizontal shareholding area.

And there’s also, as Martin mentioned, there’s 24 studies now that show that common shareholding does have an effect on corporate operations. So at some point, you have to give up on the theory that, oh, it’s impossible, they could possibly have it, when we’ve seen it proven time and time again.

MR. RUBINFELD: Thank you, Einer.

Fiona Scott Morton is our next speaker.

MS. MORTON: Thank you. I wanted to begin with a concern about the design of these hearings. I
observed, I wasn't able to attend in person this morning, but I observed that there were many mutual fund industry members here, and it strikes me as a bit odd for the FTC to need to hear from so many people who are interested parties who make money from this industry and are going to say that they would like to keep on making money. I think that it's kind of clear that that would be the message, and I don't really see -- we can have employees of funds, we can have trade associations, we can have consultants, but it's going to be a little bit repetitive. So as a use of time, I'm not sure I understand it.

We then have a panel like this one with a bunch of academics on it, but there are three kinds of real research in this area -- economic theory, economic empirical work, and legal analysis. Einer wrote the first legal analysis paper that I know of in this area, and I have a policy paper, but there is nobody else on this panel who has written either a theory or an empirical paper in this area.

So if I were going to try to learn about this topic, I would try to find those people. Now, I know there are three of them in the afternoon, but as we've heard, there’s 24 papers. So, again, it's not a super efficient way to gather information.
But probably the most interesting omission is that 80 percent of stocks in America are held by the top 10 percent wealthiest people. So the bulk of the -- should this be a problem, okay, the bulk of the harmed people have no representative in these hearings at all, as far as I could tell.

So we have some fund industry people saying we'd like to keep our dollar; please don't make a regulation that would take it away. And we have academics saying whatever we think the truth is, but there's nobody on the other side saying, I want that dollar, also, I'm a regular person who buys Coke and Pepsi or airline tickets or whatever I buy, and I would rather have the dollar than have somebody else have the dollar. So I think the representation of the bottom end of the income distribution is a problem.

And I noticed this morning that it was represented that the median owner of stocks earns $130,000 a year or something like that. Now, you know, that's two and a half times the median family income. That's probably considered quite low income if you work in financial services, I understand that. But it's also misleading in the sense that if you take the owners of stocks and you line them up and you pick the middle guy, you get 130,000. But if you line the
stocks up from order of low wealth to high wealth,
since 80 percent of the stocks are held by the top 10
percent of the income distribution, the middle stock,
that guy is super rich. I mean, I have not done that
experiment. I don't know what that income is, but it
would be in the millions for sure.

So this problem is not one that is
afflicting people in a symmetric way. There's a big
difference between people -- the bottom 80 percent of
the income distribution who would like prices and the
top 20 percent of the income distribution that face a
tradeoff between diversification, as Martin clearly
said, and prices.

Okay. So let me turn to some substance.
The basic economics here has been covered very well by
others. There's incentive which is profits, money,
higher stock prices, higher returns, which I think is
a basic function of the asset management industry and
ability which is corporate governance, which, again,
if we don't have corporate governance we have a big
problem with capitalism. We need a way for owners to
influence managers to make sure they're working on
behalf of the shareholder.

But I would combine the incentive and the
ability, which is what we traditionally look for in
antitrust with size. Okay? This is a very large problem. If there's a problem, it's impacting all of public and private corporations in America because there are so many common owners. And it's a problem we don't understand very well. So if something is a problem you don't understand very well and it's enormous, I think that the conclusion we could all agree to is that we should be studying this quite vigorously.

Okay, academics are, in fact, studying this vigorously. The 24 papers, most of them have been written really recently. However, I need to second Martin in saying that academics cannot study private communications. It’s not possible. They’re secret. So if FTC were to do one useful thing from these hearings, it would be, I think, to open a study, a 6(b) study, and go out and get the kind of data that you would need to have to study this problem more seriously.

And I think if the financial services industry says we don't want you to study our communications, we don't want you to study this problem, then we have our answer. I mean, if there's something to hide, you don’t want a study. If there's nothing to hide, then you don't mind if there's a
study. So that will be informative to hear about.

Then the last thing I just wanted to touch on was the need for more corporate governance theory. As I said, that would be what I would be trying to get on a panel if I were organizing hearings because we really don't have good models of how it is that ownership translates into product market competition. So we have a bunch of -- Einer very eloquently put a list up, and that makes plenty of sense, and those things are all plausible, but actually if you go out and you look in the literature, those papers have not been written.

So I think it would be super helpful if we had some more engagement from the corporate finance community and the theorists to write these things down. I think we're all paying a lot of attention to MHHI, and that has also been said today, a product of a very specific model. And there are many other models out there. And, so, I think beating a dead horse over MHHI, there's no need to do that. There are plenty of other ways in which owners could affect product market competition, and it would be more helpful I think to study some of those.

So the one that I think is extremely important to touch on that both Einer and Scott said
in different ways and I'll try to meld that together, the distinction between taking my owners and worrying about whether one holds $2 of United and 8 of Delta, and the other one holds eight of Delta and 2 of United -- what did I just say? Two of one and eight of the other. Any way, the reverse. Those two owners are not indifferent to the location of a dollar of profit. The one that holds more Delta wants it to land on Delta, and the one that holds more United wants it to land on United.

So that's the sense in which people don't like MHHI. But the obvious alternative model, which Scott raised and Einer raised, is the idea that maybe we soften competition in a way that just leads to generally higher prices. Nobody is against generally higher prices. The owner who owns only Delta thinks it's great if Delta has higher prices because they're going to earn more money, their stock price is going to go up. There's no sense in which the management of Delta doesn't experience this as a good thing for its fiduciary duty. The stock price of Delta goes up.

So I think these directions are ones where we need to take the literature so that we can write them down, be rigorous about testing them, and figure out whether there are other routes besides the MHHI,
which seems to be a little overdiscussed relative to
the options. Thank you.

MR. RUBINFELD: Thanks, Fiona.

And, Bill Rooney, you've been relegated --
or not relegated, you’ve been added to the list of
academics on the panel by Fiona, so, Professor Rooney,
you're the last one.

MR. ROONEY: Thank you, Dan.

Good afternoon, Commissioners Chopra,
Phillips, and Jackson and my good colleagues. Thank
you to the FTC and NYU for inviting me to participate.
It is really a privilege and a pleasure. Like others,
I speak only in my personal capacity, not on behalf of
my firm or any client, and although I am a practicing
lawyer, I'm not giving legal advice this afternoon.

I will address common ownership from a
specifically legal standpoint, and I will assume that
Section 7 of the Clayton Act may apply. I do not
address the issues of long-held investor positions or
the statute of limitations.

I start with basic due process. We are
accountable only for our own actions. Liability is
personal. We are not accountable for the actions of
others whose conduct we have not caused and with whom
we have not joined in concert and for whom we are not
legally responsible. That proposition and Section 7 law present a steep hill for those wishing to hold a common investor liable, even if by awful assumption, managers choose to lessen competition.

My question: whether an investor stock acquisition of 10 percent or less of an issuer could violate Section 7 where the investor owns not more than 10 percent of a competing issue or stock and is not competitively related -- horizontally or vertically -- to either issuer.

A few more assumptions. The shareholding does not provide the investor with the rights to direct the affairs of either issuer, receive competitively sensitive information, appoint directors, or participate formally in governance. I do not speak today to the effect of altering any of those assumptions. They are meant to distill and engage the question of whether common ownership qua common ownership plausibly subjects the investor to Section 7 liability.

Finally, I assume that the share acquisition provides the investor with access to management of both issuers, though not the ability to control or coerce their decision-making.

I first note the relevance of Section 7's
investment-only exemption. The exemption states in
substance, Section 7 shall not apply to persons
purchasing stock solely for investment and not using
the same by voting or otherwise to bring about the
substantial lessening of competition. Many common
owners are institutional investors, and their share
purchases, on the parameters that I have set, would
likely be solely for investment and presumptively
exempt from the Clayton Act.

The plaintiff would then have to displace
the exemption by showing that the shareholder has
used its stock to cause a substantial lessening of
competition.

Three observations. First, displacing the
exemption requires the shareholder to have used, not
just held, the shares; to have caused, not just
threatened, an actual, not just probable, substantial
lessening of competition. Second, not all voting
takes the investor out of the exemption, just voting
that causes the substantial lessening of competition.
Third, the voting would have to relate proximately
to competition, not to governance or many other
noncompetitive issues. Although facts always matter,
most executive packages would seem insufficiently
related to competition to void the exemption.
Although I will not address here whether a shareholder's engaging with management is inconsistent with Section 7's exemption, the case of Tracinda held that it was not. The exemption thus provides common ownership with substantial protection. So does Section 7 jurisprudence. Section 7 requires the share acquisition to provide the shareholder with a mechanism to lessen competition substantially, and the substantial lessening must be probable, not possible. Not just possible. All elements, of course, are necessary.

If the shareholder acquires its common investment and does nothing, and even if the issuers, again by awful assumption, respond to the common ownership by reducing competition, the shareholder is not liable. Recall our due process starting points. Legal liability cannot obtain from a lawful act -- here are the acquisition of shares -- in response to which others, by assumption and by themselves, act unlawfully.

Nor does an assumed incentive constitute causation. Suppose Noncompetitor A, a known premium pricer, buys a Company B, a price cutter, and raises B's prices. Competitors C and D conclude the coast is now clear to raise their prices, and they do. Company
A is not liable under Section 7.

Cross ownership differs from common ownership. In cross ownership, Competitor A acquires an ownership interest, typically greater than 10 percent, in Competitor B, or perhaps in a customer or a supplier. Competitor A, by its own conduct, can lessen competition with Competitor B to protect its B shares. Competitor A can also favor the acquired supplier or buyer.

The cross owner, unlike the common owner, participates in and therefore can affect competition in the relevant market. But could the owners’ access to management provide the mechanism that establishes the necessary probability that the common owner will join the issuers in substantially lessening competition? The answer is no.

Access alone, or shareholder engagement, is competitively neutral, has been encouraged by the SEC in Congress, and has many confirmed benefits. One can speculate whether or when a common owner may try to lessen competition between or even among issuers, but that conduct would entail legal risk and, given the many lawful and beneficial uses of access, the prospect remains speculative, at most a possibility, not a probability, and cannot support Section 7
liability.

MR. RUBINFELD: Thanks, Bill.

To summarize briefly, I think what we've heard and what we're going to continue to talk about, we might think of the issues that are raised as consisting of three categories of issues. First of all, arguments based partly on the discussion of the MHHI, that there is a possibility, if not a probability, of adverse unilateral effects.

Second, the possibility through sharing of information or communications of one kind or another, there's a possibility of coordinated effects.

And third, just because the inherent structure of the industry and the extent to which there is common ownership, the implicit argument or explicit, in some cases, is that firms maximizing their profitability, their shareholders' interest, might act differently if there's extensive common ownership than if there's not.

Now, if I can just quickly advertise, Ed Rock and I have been working on this issue. Our first paper I saw as being primarily about unilateral effects with some commentary on the second or third alternatives that I mentioned. We have a new paper which we just put on SSRN yesterday which talks about
possible coordinated effects. And perhaps if we keep working on this issue, we'll think about the broader structural issues.

Now, the comments we've heard from the panel really cover that range, and I'd like, if possible, during this round to give each person a chance to respond to each others’ comments or to expand on what they’re saying, but I'm particularly interested in what your views are as to what the likely mechanism or plausible mechanism is.

For example, Einer, you've listed a whole list. I’d like to pin you down a bit on what your favorite is and, also, the issue which we'll talk about next will be whether we think there's really a competition problem that for which the FTC should be worried or whether there's more of a broad structural problem. But let's focus right now on the mechanism.

So, Scott, I'll just go down the line. Do you have any comments about what you’ve heard from the other commentators, or do you want to expand on your own views about the likely mechanism, if there is one?

MR. HEMPHILL: Yes. It's tempting to take the bait on the first option, but I think I'll go with the second and just plow ahead a little bit on a couple of things I was planning to try to get across
this time around.

I’d like to make two basic points. One, thinking about the incentives of fund managers, we’ve already talked about that to some degree -- it surfaced also in Dan O’Brien’s earlier comments -- and, then, you know, if there's time talk a little bit about a mechanism that I think hasn't gotten enough attention.

Now, I think this world, this debate, lots of debates can be sort of divided into folks who want to do a lot of lumping and folks who want to do a lot of splitting. And the way that I’ve conceived this, you can probably tell, at least in this project, we're very much in the splitters camp, right? We're firmly splitters here.

So, you know, I don't think -- you know, I learned a lot from Professor Schmalz's remarks. I don't think a Berkshire Hathaway board seat on a bank helps me that much to understand what's going on at Fidelity, that is, you know, there could be things going on at Berkshire, there could be things going on at Fidelity, but I would be hesitant before saying that what’s going on over here helped us necessarily understand what's happening over there.

And, so, I want just to dig in a little more
on a version of Dan's -- I think it was the third
warning label about owner objectives diverging from
investment returns. So just a couple of quick points
here. One, Fidelity, like Congress, is a “they,” not
an “it.” Individual fund managers are interested
typically in the returns of their fund, not those of
Fidelity as a whole. This, I think, is not a novel
point to express but worth putting across because I
think it makes it problematic to think about the
institutional investor as an undifferentiated whole.

Second, for an institutional investor,
you're increasing portfolio value, and I recognize
there's some difference of opinion on the panel about
this, only has a small effect on fees. This bears
principally on thinking about active mechanisms as
opposed to passive, right, where you're actually doing
something, you're doing something that might be
costly, you're doing something that might incur
liability or reputational harm.

And, you know, we got to keep our eye on the
ball here that, you know, asset-weighted average fees
for equity index funds, I have here it was, like, nine
basis points. And for actively managed funds, it’s,
like 82 basis points. So we got to think about, you
know, what the returns are, at least for the
strategies that we might regard as being costly --
costly in a legal sense, costly in, you know, its
appearance in the Wall Street Journal. Internal
discussions at Fidelity, you know, that were driving
decisions or omissions could be, in a reputational
sense, quite costly to the firm. So one message here
is that there’s a big difference between thinking
about an institutional investor on the one hand and
Warren Buffett on the other.

You know, there are some technical points
here that I'm not going to dwell on, but they’re in
the paper. You know, depending on the distribution of
holdings across funds earning different fees, an
increase in portfolio value can actually reduce fees.
So there are some extreme versions of that third
warning label to think about, again particularly with
active strategies.

Another point on incentives that I think is
worth making is with respect to passive strategies.
You know, let’s think about passive as a strategy for
a minute as opposed to just a kind of thing that
happens because big funds aren't paying attention,
let’s imagine. Right, if as a strategy, adopting a
passive stance could be really costly, right. You're
causing them to not compete in certain ways and
improve your portfolio, but that might, you know,
throw out the baby with the bath water. It might, at
the same time, cause a dampening of competitive
incentives that would be a cost viewed by the fund, by
the fund family more broadly.

Do I have a minute, or do I not?

MR. RUBINFELD: Go ahead.

MR. HEMPHILL: Okay, so, finally, just a
word about a mechanism that I think is worth paying
more attention to that we talk about in the paper
called -- that we call selective omission. So the
idea here is that an investor might pursue just a
subset of the possible available strategies, that is
pursue just those strategies that both increase firm
value and also increase portfolio value while staying
silent, omitting to act as to those actions that also
increase the invested-in firm's value, but at the
expense of portfolio value.

So that kind of selective activity, I think,
is one that would be consistent -- consistent with the
MHHI-based literature that I'm not willing to abandon
just yet. I mean, I think it still is a large part of
the most important empirical evidence that we have,
and our workhorse theory, and I think apart from its
testedness is also plausible.
MR. RUBINFELD: Thank you.

Menesh.

MR. PATEL: Thanks. I don't think that, at least any of us on this panel, maybe no one in the room, disputes the proposition that as a theoretical matter common ownership can impair competition. I think our differences relate to what extent we think that the postulates of that model we observe in various markets and to what extent we believe the empirical findings today show a causal connection between common ownership and adverse effects to competition.

But I want to sort of think about focusing on Dan's suggestion when we focus on the mechanism, go back to the workhorse model that guides our theory, our intuition, and the empirical findings and think about how likely we believe that those assumptions are going to hold. And the key assumption, again, is that manager, when the manager maximizes the profit of her firm, her objective function, she maximizes a weighted portfolio of all of the shareholders that are invested in the firm.

To what extent is that a reasonable assumption? For if that assumption doesn't hold, then common ownership has no effect on competition. One
way to think about that is to exploit an equivalency that is shown in the literature that holds that if the postulates of that model are true, then it is as if the manager is maximizing both the profits of her own firm and the profits of all other firms in the industry that are subject to common ownership. Meaning that if there is this linkage between portfolios, then -- and there are two firms, for instance, in the market -- the manager of Firm A is maximizing profits of her firm, Firm A, and some portion of the profits of the rival firm, Firm B.

To what extent is that an accurate assumption? We should think about that. First, fiduciary duties. Dan mentioned we’ve all thought about what seemingly constrain the manager from acting in that manner. To be sure, it is undisputed that the business judgment rule shields managerial decisions, particularly when they relate to core corporate decisions, such as pricing and output decisions. We do not dispute that.

However, if one frames the issue as a manager choosing to set her profits and the profits of a rival firm, that seemingly implicates issues not of duty of care, but duty of loyalty that would give a less robust shielding of the business judgment world.
MR. RUBINFELD: Thank you.

Einer.

MR. ELHAUGE: So you asked -- you wanted to pin me down on which is my favorite. So I think that's the wrong way to think about it. I think it is the combination of them. Some of them apply to some investors but not others. For example, the stock market effect where you might dump your stock to show your displeasure with management does not work for index funds. It works for other kinds of investors who are in and out of stock.

The market for corporate control, the proposition that managers might be influenced by the fact that they want the shareholder to be on their good side when there's the next control contest, that works better for index funds than for other investors because you know they’re going to be around because they have to hold the stock.

I also think to some extent that these ways of influencing a company are substitutes for each other in the sense if you clamp down on one, institutional investors would logically put more effort on the other. So, for example, if you try to just legislate the executive compensation and say from now on, we’re going to have all stock options with a
trigger price that’s based on how their industry does rather than just some set price, that might improve things, but then they might switch to other methods of influencing the company.

But I'll stress what I think is the most underappreciated, which is the labor market effect, the notion that you might want to please your horizontal shareholders because they are going to be there at the next job. And what's nice that I found in the empirical literature was that there’s actual evidence that the percentage of votes that are withheld in elections, even uncontested elections, affect how many directorships you get at other corporations. Right, so it's an influence that's quite direct in that way in terms of trying to please other sorts of companies. So I would say it's the combination.

And in terms of the plausibility, intuitively, I think a lot of people feel that the fact that Puerto Rico does not vote in presidential elections might influence the fact that the hurricane response in Puerto Rico was less effective than hurricane response in other states that do vote for the president.

Now, do we have a micro-mechanism where in
the election the voter said I want -- Mr. President, I want you to focus on this level of hurricane relief -- unless there's some operational decisions and communications from voters. No. I think what this shows is who your electorate is and what their interests are, are going to have an influence on operational decisions.

You know, so some of the work I do is in political science and law. There, it just seems to be everybody understands it's obvious. It seems to me even more likely to be true here because they have a much bigger share of the votes. Right, the big three vote about a quarter of the votes actually cast because other voters don't vote. Institutional investors vote about 90 percent of the votes cast because other private investors don't tend to vote very much. They get to vote on things besides the elections, they get to have direct communications. They have a lot of other avenues of influence than political voters do. So it seems implausible to me that we would think that they have less influence than political voters do.

MR. RUBINFELD: Thank you.

Fiona.

MS. MORTON: I wanted to respond to one
thing that Scott said, which is there's heterogeneity across funds, and that's undoubtedly true, but I do wonder which fund manager it is who is against higher profits. It seems to me that there might be unanimity of enthusiasm for that.

In terms of mechanism, I think rather than answer your question directly, Dan, I would say that the mechanism really, really matters for policy here. If it is the case that we were to do studies and find out that the mechanism causing anticompetitive effects was communications between fund managers and top executives, then a policy limiting those communications might be all that was necessary and no change in the way funds run or votes or anything else.

If it's voting, as Einer just said, then maybe the policy change needs to address voting. I think that it's super important to dig into this, and, again, I think an FTC study would be the right way to get at this question because without an understanding of the policy and the exact way it works, then if there's a problem, all we can do is use a very blunt instrument. And that seems to be much less ideal for savers and investors than if they’re a way of running a mutual fund that did not cause anticompetitive effects. And to do that, we'd have to know a lot more
than we know today.

So I think this is a really top priority of something to learn more about. I do think -- I do take the point that these methods might be substitutes, if you can't use one you try to use another. But I don't think it's obvious that they are super close substitutes. It might be a lot harder to achieve some kind of outcome with one tool than another. So I just think that's the place to go.

MR. RUBINFELD: Thank you.

And, Bill, you're last.

MR. ROONEY: So I'll stay on the legal side, and I will comment on the need for a mechanism by which a shareholder causes the harm for Section 7 liability. And I will focus my comments on two leading cases that seem to be cited in support of common ownership liability. The first case is called Dairy Farmers, U.S. v. Dairy Farmers. It's a 2005 Sixth Circuit case and is often cited with the following quote: “Even without control or influence an acquisition may still lessen competition. The key inquiry is the effect on competition regardless of the cause.”

And Dairy Farmers is often cited for the proposition that the shareholder need not cause the
relevant harm. I would say the context clarifies in
that holdings can't be divorced from their facts. In
Dairy Farmers, there were two agreements that were at
issue, an original and a revised. The relevant party
to both agreements was the Dairy Farmers of America.
DFA was the largest dairy farmer cooperative whose
purpose was to market the unprocessed milk of its
dairy farmer members to milk processors.

The parties whose stock DFA acquired were
milk processors. So DFA and the processors had a
vertical relationship that is not present in common
ownership cases. DFA owned 50 percent of one
processor called Flav-O-Rich, though did not
participate in its management.

DFA acquired 50 percent of the competing
processor called Southern Belle. Southern Belle and
Flav-O-Rich were the only two milk sellers to 42
school districts and two of three to 49 districts.
The District Court granted summary judgment against
the DOJ and the challenge of the acquisition of
shares. The Sixth Circuit reversed, remanded for
trial, and made no findings as to Section 7 liability.

The original agreement gave DFA the right to
some control over the business activities of Southern
Belle, and so it was a simple case of cross ownership,
which we distinguished before.

In the revised agreement, DFA exchanged its voting shares in Southern Belle for nonvoting shares but retained its 50 percent financial interests, and recall that the same DFA had a 50 percent financial interest in Flav-O-Rich. The court observed that even under the revised agreement there may be a mechanism that causes anticompetitive behavior other than control. The court found that mechanism in DFA's financial relationship to Southern Bell -- “The government presented evidence that DFA did, in fact, have control or influence over Southern Belle. DFA may leverage its position to Southern Belle's financier to control or influence Southern Belle's decisions. In addition, other business relationships between DFA and operators of Southern Belle and Flav-O-Rich raise the genuine issue of material fact, whether DFA, through its 50 percent interest in the two duopolists, its potential control or influence over one, and its business relationships with both may cause harm to competition.”

_Dairy Farmers_ provides no support in my view for finding a 10 percent common owner vicariously liable for the presumed acts of issuers in which the owner did not participate.
U.S. DuPont is the second case often cited. It’s a 1957 Supreme Court case. And in DuPont, the chemical company DuPont owned 23 percent of General Motors stock, was vertically related to GM, and had a close business relationship with GM for 30 years. DuPont supplied over 65 percent of GM's requirements of one relevant product and 35 to 50 percent of another.

The court found that DuPont’s share acquisition was designed to and did obtain a competitive advantage for DuPont in supplying GM. DuPont is a simple case of cross ownership, again at levels in excess of 10 percent.

MR. RUBINFELD: Thanks, Bill.

For the next round of discussion, we'll continue a bit more on the legal side. We clearly have a difference of opinion between Bill and Einer with respect to Section 7, but I want to broaden the discussion again.

It seems to me if we’re advising our colleagues at the Federal Trade Commission, particularly the two Commissioners who were here today, we want to distinguish the impact of our discussion as to whether it impacts the way the Commission ought to look at particular acquisitions.
under Clayton Section 7 or whether they think there should be investigation that might open a look at Clayton -- at Sherman Section 1, or perhaps they might conclude that there's a structural issue here but really no competition issue that requires FTC intervention and maybe they should just talk to their colleagues on the Hill about doing something constructive with respect to the structure and competition in the industry.

So I wonder whether -- just going down the line -- whether any of you has any views, just given the work you've done in this area and I would say where you think we ought to really focus on our emphasis as we delve more deeply into these issues.

And I was struck in that regard by Martin's comments today. Martin's comments to me seemed to suggest that he thought there was a strong argument for a structural problem but he wasn't making the claim that there's necessarily a violation of the Clayton Act or the Sherman Act.

So here's your chance to tell the Commission where they ought to be at least focusing at some of their attention. I'll start with Scott.

MR. HEMPHILL: All right. So on the broad question of what is to be done, a couple of thoughts.
In my welcome this morning, I invoked Bob Pitofsky as the animating spirit behind these hearings, and I'm reminded of something that Chairman Pitofsky said in thinking about the application of antitrust law to high-tech industries, right. Big issue then as now.

He said that as with any adjustment to new facts or proposed law, a cautious approach is called for but abandoning antitrust principles in this growing and increasingly important sector of the economy seems like the wrong direction to go. Now, I think that same kind of caution applies here. I think the right next step, just echoing what a few others have said, but I have maybe a slightly different take, for the antitrust agencies would be to collect more information.

This morning, you know, I sort of asked, sort of pled a little bit with Commissioner Phillips and Commissioner Jackson about what they might do to further illuminate this terrain. And I want to echo Martin’s comment from before that academics can't observe communications, and in that vein, this might be something that could be looked into.

I do want to just kind of note that I think the communications identified so far are a little on the thin side. You know, I’m struck, the example
that comes to mind is the airline paper which points
to a -- I think it's a Delta earnings call from 2014,
maybe it's third quarter, I wouldn't promise, where
they planted two analysts who pipe up and ask about
reduced -- well, how about some reduced capacity,
wouldn't that be good? I forget that they talked
about prices as well.

Well, one of the analysts was for J.P. Morgan. I'm not sure, though, that this was an
analyst for J.P. Morgan’s asset management business,
and I assume it was a sell-side analyst that worked
with the investment bank. The other analyst who’s
also quoted but not named in the study was from Morgan
Stanley. And, so, I don't think that communications
from sell-side analysts tell us much about the
capacity or likelihood of a Fidelity, let's say, to
engage in similar communication.

Now, partly, this is a point about, this is
something we should go run down. I do want to note at
the same time that the fact that -- just as we can't
observe communications, we also cannot easily observe
agency investigations of communications. So, you
know, I can't rule out that some of that investigatory
work, whether in the airline context or elsewhere,
might already have taken place.
There's one second area that I think looking into detail might be of some value, which is to think about responsive steps taken by firms. So communications are a no. If firms are implementing strategies, cognizance of who their institutional owners are and what those institutional owners' interests are, then we should observe firms working out that math, right.

I'm not saying they have to have an MHHI calculation written down. Oh, okay, I got 12 percent from BlackRock and 12 percent from Fidelity or something like that, but they ought to in some rough sense be thinking, okay, who are my owners, what is it that they want right now, and we should be able to observe, I would think, some of that cognition on the part of the firm. And that's something that could be excavated and either would be present or not, and that, I think, would provide some insight into the nature of the problem, if any, here.

MR. RUBINFELD: Thanks, Scott.

Menesh.

MR. PATEL: Thanks, Dan. I'll keep my comments brief. I suppose three things. First is I, too, would echo the calls for additional research, but I'd also add on the point that the fact that we're all
echoing those calls indicates that there is not yet seeming consensus among the community as to the import and the magnitude of this issue. It is not as if we are on the eve of the Leegin decision where economic consensus was clear that resale price maintenance can have procompetitive effects and, therefore, be adjudged by the rule of reason.

The second is we should be mindful and very careful about using -- in whatever policy prescriptions -- using the modified concentration metrics. Those only serve as guides for competitive harm in certain narrow circumstances. And just as if you are to rewrite the merger guidelines from a blank slate today, we may rely much less on the HHI for the reasons that we all know we want to rely less on the HHI than historically was the case. The same would be the case for that HHI is a noble construct but limited purposefully to its confines.

And the third and final piece is we need to be careful and be mindful that efficiencies that we may be butting up against. Our core objective is to make sure that we magnify and amplify the well-being of consumers generally in these markets. The common ownership issue is looking at consumers in the product market, but these very decisions have effects on
consumers in other markets with respect to corporate
governance changes and also diversification effects.
We should be mindful of its consumer interests across
the board.

MR. RUBINFELD: Thank you.

Einer, I was going to pin you down a little
bit if it's okay. I know you’re going to want to
debate Dairy Farmers with Bill, but I'm hoping your
comments will be a little broader than that because
you’ve thought broadly about a lot of topics. And I'm
particularly interested in you elaborating a bit on
how you view these solely for investment aspect of
Section 7.

MR. ELHAUGE: Sure, and I also want to
answer your question about -- what did you say? Oh,
how traditional merger analysis is going to be
affected. So the backdrop is that the Clayton Act
does ban any stock acquisition that may substantially
tend to lessen competition. And the cases hold that
continuing to hold stock itself is an acquisition.

So -- and another thing should be brought to
mind -- borne in mind is that although it's generally
selectively quoted, the statute actually has two
provisions. One provision is about commercial
enterprises owning stock in other commercial
enterprises, but there's a whole other separate provision that repeats it to say it also applies to acquisitions by any entity, commercial or otherwise, in commercial entities. That is -- the structure of the statute also supports the application of horizontal shareholding.

Now, the solely-for-investment exception is somewhat of a misnomer. It's really a provision that changes the standard of proof. It provides there's an exemption only if there's both, no influence on the corporation but also that the stock is not actually used to create any anticompetitive effects. So, in effect, all it does is change the standard from may substantially tend to lessen competition to actually doesn’t lessen competition.

The claim that you need control or influence is not only contrary to that text but there's six cases that interpret it that way. One is the Dairy Farmers case you mention, and another is the DuPont case. It is true that on the facts of those cases there seemed to be influence and control. But that doesn't alter the legal interpretation of that of the actual statute.

More to the point, though, the agency guidelines on cross shareholding specifically apply to
cases where there's no control or influence, where all
you've changed is the incentives of the company. So
unless the FTC is going to abandon its merger
guidelines on cross shareholdings that only have
incentive effects, then it is committed already to the
position that the statute is not limited to
transactions that create influence or control.

     Even if the Clayton Act doesn't apply,
there's the Sherman Antitrust Act, applies to any
agreement in restraint of trade. Stock acquisitions
are agreements. If they restrain trade, they apply.
In fact, when you look historically, the trusts
attacked by antitrust law were horizontal
shareholders.

     As to the proposition that due process
would be violated, let me mention three areas of
antitrust law that are inconsistent with the theory
that you can't possibly be held liable when your
anticompetitive effects turn, in part, on the actions
of others. One is the Leegin case just mentioned,
which explicitly stated that resale price maintenance
could be legal because it facilitates oligopolistic
coordination if others in the industry use the same
kind of resale price maintenance -- depending on the
actions of others.
Motion Pictures, for exclusive dealing says you could be liable for the cumulative foreclosure, it depends in part on exclusive dealing of others. And for that matter, mergers to oligopoly are all dependent upon the effects of you interacting with others.

Speaking of the traditional merger analysis, let me just say that if we're not going to tackle horizontal shareholding directly, it actually has enormous implications for traditional merger analysis. In particular, it means that we have to lower the concentration level we're willing to tolerate under a traditional merger analysis because we have to take into account that often horizontal shareholding is going to worsen that, in fact that post-merger horizontal shareholding could occur and would not be tackled.

I would submit that maybe this is why so many mergers have been allowed that turn out, in fact, to raise prices because the predictions were made assuming no effect. And that's an important feature of current merger analysis. The agency's practice today is not empirically neutral on the effects of horizontal shareholding. It is affirmatively assuming in all their models and HHI measures that horizontal
shareholding has zero effect.

There is no basis for that assumption. The empirical evidence, I would say, is strongly to the contrary. Certainly, there's no basis for the way the agency is doing its current merger analysis, ignoring horizontal shareholding.

Lastly, it actually -- horizontal shareholding also influences which mergers we regard as horizontal as all. Right now, a lot of mergers just fly through as conglomerate mergers, say, because you’re merging big, national chains in different geographical markets, not reducing the number of firms in the markets. But often in those transactions we basically moved from having two to five different firms in our local markets to having the same two or five firms in every market. They’re all big, national firms with much more horizontal shareholding.

So I would say horizontal shareholding actually also support people who are concerned about national concentration levels rising even if HHI levels, standing alone, are not rising in particular geographically defined markets.

MR. RUBINFELD: Einer, thank you very much.

Fiona.

MS. MORTON: Yeah, to follow up on that
point, if we were to tighten up merger standards in
order to keep markets fragmented, I think that could
potentially create significant losses to consumers due
to real efficiencies from those mergers. I mean, what
we would essentially be saying is we care more about
keeping car manufacturers or green bean manufacturing
plants inefficient and small so that we can have a
concentrated owner downstream for people to invest in,
so that tradeoff, seems to me, to be quite asymmetric.

I think the cautious approach mentioned
earlier is indeed very characteristic of government
and appropriate. And, therefore, the evidence that
will be required on this issue for the FTC to move
strikes me as being significantly more than that
required for a well-incentivized private plaintiff to
move. And, therefore, my concern is that we end up
with disorganized, random private litigation that is,
in fact, successful because if there starts to be an
evidence body that this, in fact, does cause
anticompetitive problems, those plaintiffs may well
succeed.

Then we have a problem of certain areas of
the country. Somebody can't hold Pepsi, and somewhere
else, a different fund can't hold Delta, and that
seems to me to be a really bad way to run a mutual
fund, not that I've ever run a mutual fund myself, but it seems like a bad idea.

And not only those different rulings might have ordinal implications. So what do I mean by that? Well, what if the implication on -- what if the evidence showed that to have an anticompetitive effect you have to be the largest shareholder in a company? Well, you might be the largest shareholder today, but another fund might purchase some shares tomorrow and then become the largest shareholder, and then you would perhaps no longer have the same anticompetitive effect you had yesterday. Well, how does that allow for a rational portfolio to be developed because it depends on what other people are doing?

So I think the way to solve this competition problem is what I wrote in a paper with Glen Weyl and Eric Posner, and that is to just say hold one of these competitors, and that would solve the competition problem. It would also improve corporate governance because then you would be very much invested in one firm.

And the impact, I've done some experiments that I have not published yet, but the impact on variance is small because stocks in the same industry co-move, so holding one does a lot of the job of
diversification. The fourth airline doesn't add very much. So I’ll stop there.

MR. RUBINFELD: Thank you.

Bill.

MR. ROONEY: So you might find it ironic that an antitrust lawyer would entitle his concluding remarks “The Cost of Antitrust,” but there it is. So Judge Easterbrook's influential 1984 article, “The Limits of Antitrust,” detail the distortive effects of overenforcement. I offer two quotes for your consideration.

“In most cases even a perfectly informed court will have trouble deciding what the optimal long-run structure of the industry is because there is no right balance between cooperation and competition. The judge has no benchmark. Small wonder the history of antitrust is filled with decisions that now seem like blunders.”

Second, “Donald Turner once described the inhospitality tradition of antitrust. The tradition is that judges view each business practice with suspicion, always wondering how firms are using it to harm consumers. If the defendant cannot convince the judge that its practices are an essential feature of competition, the judge forbids their use.”
The annals of antitrust law are indeed filled with blunders. Since 1975, all vertical, price, and nonprice restraints have been moved from per se illegality to rule of reason review by overturning Supreme Court precedents. Consider the extraordinary development in merger review and enforcement from the 1950s to the modern era. We've realized that private actors do not always or even frequently have anticompetitive malice in their hearts. Rather, they often favor consumers -- more innovation, lower prices and greater outputs.

In the present circumstances, institutional investors have their own consumers to serve. Millions of investing workers, union members, and, yes, main street residents. As I have noted, common owners are, by definition, not active in or adjacent to any relevant market in which a lessening of competition is feared. This is in stark contrast to every other Section 7 case of which I am aware in which an injunction or divestiture has been ordered.

The shareholder was either in the same or an adjacent relevant market to that of the issuer and/or sought to control the issuer. The legal basis of common ownership liability on the parameters that I have noted is not obvious.
In addition, the shareholdings of common owners involve no scrambling of eggs. If the common owner participates in unlawful collusion with its issuers, a share divestiture order along with other obvious remedies could easily be implemented.

Limitations on common ownership would distort experienced investment judgment. Proper diversification may not be achievable only across sectors. Investors would be trying to select only winners in each sector. Let the professionals decide if proper investment requires diversification within a single sector.

I close with another observation of Judge Easterbrook, and I trust is costly. We already have effective antitrust laws that protect markets from anticompetitive behavior. No new law or guideline limiting investment discretion is necessary and it would impose distortions that almost certainly would harm far more consumers than it would help.

MR. RUBINFELD: Thanks, Bill. I'm at a bit of a loss because I'm imagining the additional panel membership of Frank Easterbrook, my friend, sitting here. It's a looming presence, but I will get past that and say that we have a little time for some questions from the audience.
And the first question that was posed, which I’d like anyone to comment on, we'll go down the row, but if you have something that would be useful. And the question was we haven't talked at all about hedge funds or private equity funds. How should we think about how either of those entities -- types of entities enter into our analysis of common ownership?

Scott.

MR. HEMPHILL: I’m not going to insist on going first on that one if --

MR. RUBINFELD: Anyone else? We'll just play it by ear. Anyone want to respond to that question?

MS. MORTON: I mean, they seem a bit more like the traditional partial ownership rather than something that -- the relatively novel common ownership I think that we're more focused on.

MR. RUBINFELD: Anyone else still?

MR. ADKINSON: I guess if I extend the question to consider whether they might be investing only in one other competitor in the industry, and how they might offset some of the --

MS. MORTON: Oh, I think they don't. I think -- don't we know that? That it’s the strategy in Silicon Valley to invest in competitors and to --
well, I won’t say -- I don't really have a lot of data on this, but I think this is a common thing.

MR. PATEL: I think this does raise the point that was mentioned earlier, though. If we were going to take seriously the competitive dynamic that common owners are owning horizontal competitors and that is the driver of this, we need to buy into the whole theory, and the whole theory acknowledges that that large investor’s hedge funds, index funds have ownership interest across, up and down in complementarities and in substitute markets as well. If we buy -- if we are basing our policy prescriptions on horizontal ownership, we need to take into consideration all ownership of those common owners.

MR. HEMPHILL: To the extent that the question is about their strategy as a noncommon owner rather than strategy as a common owner, you know, this would be a special case of part of what I was trying to get across that there's circumstances in which you would expect a firm that's invested -- you know, an investor that has stakes in just one firm in an industry to be pushing back on whatever strategy is being cooked. I don't accept the idea that it is always the case that, you know, this rising tide will lift all boats, right?
The strategy -- there is a set of strategies. In fact, it's the set of strategies that's being tested by the MHHI literature that's premised on there being a disagreement, a conflict, between the common owners and the noncommon owners. And, so, to the extent you think that that's a plausible strategy, then you would expect firms that are invested in just one to be pushing back on that.

MR. ELHAUGE: So I would say sometimes the hedge funds are horizontal shareholders, but sometimes they're not. But the big issue when they're not is can they get the support of the other shareholders to the extent they are horizontal shareholders. And just empirically, there's research indicating that increased index fund ownership is associated with a statistically significant decline in hedge fund activism.

So that might suggest that hedge fund activism often is unable to succeed or disproportionately unable to succeed in cases where they're facing horizontal shareholders, and that would be consistent with their more procompetitive efforts to try to increase individual firm competition be more likely to be thwarted because they can't get the votes to win in the control contest.
MR. RUBINFELD: Okay, thank you all.

Another question that was posed by the audiences covers something we've kind of taken for granted. We've avoided talking about board membership because a number of the analyses we've been talking about looked to possible competitive harms that occur without any board membership. But let's consider for the moment a company like Berkshire Hathaway that might decide when it takes a significant position in an industry to expect to have board membership.

And my question is -- or the question from the audience is how would that board membership necessarily affect or not affect the kinds of issues we're talking about when, for example, Berkshire typically is not -- may or may not be active as a board member. What can we say, if anything, about how board membership might add to or subtract to -- subtract from the theories we've been talking about?

Anyone?

MR. ELHAUGE: Well, it’s going to be a pretty powerful direct mechanism, I guess, if you have a board representative, right? You don’t even have to have an indirect communication.

MR. RUBINFELD: Well, board membership, first of all, Berkshire Hathaway maybe not being an
example. Board membership may -- it may still involve someone, typically minority ownership, the minority owner may or may not have much impact on the outcome.

MR. ROONEY: Well, we can’t forget the presence of Section 8, so that there would be board membership on only one issuer or not on the competing issuer.

MR. HEMPHILL: I think there’s -- I mean, I don’t know if this is part of what’s contemplated by the question or not. I think the threat of board membership, right, I own a bunch of shares, and so maybe I could, you know, cause a board member to change or threaten to add somebody, subtract somebody from the board, you know, that’s a strategy that would play out, if at all, over a medium to long term. It would take a while to make that happen.

And, so, you’d want to, I think, consider how effective that is, given how long it would take, and also given what we know is a certain amount of churn in putting index funds to the side in the ownership, the different, you know, names held by active funds, whether they hold onto to them for long enough on average to actually render that threat credible and actuated, I think, is not obvious.

MR. RUBINFELD: Thanks. So another question
from the audience question puts -- Bill, you’re off
the hook on this one, but it puts the academics here
on the spot, which is have any of the academics on the
panel interviewed corporate CEOs or I think other top
corporate executives and actually asked them how, if
at all, they take common ownership into account in
terms of their pricing decisions and other strategic
decisions. So you're all on the spot, academics. Who
have you been speaking to and what have you asked
them?

  MS. MORTON: I have not interviewed a panel
of CEOs. That's pretty hard to do.

  MR. RUBINFELD: You mean your name is not on
their list, Fiona, okay.

  Anyone else?

  MR. PATEL: No, likewise. I haven't either.

One wonders the accuracy of that exercise, but I have
not interviewed them.

  MR. RUBINFELD: Well, I think Menesh's point
is that we usually like to get a substantial sample
size, and that would be pretty difficult.

  I have interviewed quite a few CEOs, but I
have not broached this question, but I’m the neutral
observer anyway.

  Scott, have you?
MR. HEMPHILL: I'm not for this -- in this context. I mean, I think absent a CID, I'm not sure that a negative answer -- I'm sorry, absent compulsory process, I'm not sure that a negative answer would be probative. I mean, I guess, maybe one side to test, if they said, yep, I've been waiting for you to stop by, I've been wanting to unburden myself.

MR. RUBINFELD: And I think it's true actually that academics, most of us, at least on the economics end, often try to draw inferences from decisions people make, not from what they tell us they're thinking.

So with that in mind, I think we have enough time to just go around the panel and give everyone a chance to make any final comments they want before we close this session. And I'm going to, following on the last session, I'm going to try to reverse the order here if it's okay.

So, Bill, we'll give you the first shot. Do you have anything else you'd like to add to the discussion.

MR. ROONEY: Just my thanks for being on the panel first of all and being able to interact with folks who spent so much time on this issue and published so deeply and broadly and impressively. And
I think that in a sense I'm bringing or I'm offering a perspective that is not fully engaging with the economics of the theory, and I just was trying and I'm trying to couch the dynamic debate that's happening, from an economic and theoretical and econometric standpoint in a legal context, and how that would transfer in a careful examination of whether the common owner really would -- has a serious plausible risk of Section 7 liability within the parameters we're talking about today.

MS. MORTON: I'd like to bring us back to what Martin said about the fundamental tradeoff here being between diversification and competition. And there is no escaping that tradeoff. And to encourage the FTC to be an agency for all citizens.

It's just remarkable how few citizens own any stocks. It's really the bottom two-thirds of the income distribution doesn't own stocks in America, and many, many stocks are held by the top 1 percent who are getting diversification from private equity, foreign stocks, real estate, and lots of things besides the fourth airline.

So who is it who's getting diversification that's meaningful from the fourth airline? Well, it's people like me, actually. I have enough money to be
saving, and I don't have enough money to have any private equity, so I'm in a mutual fund, index fund. But there just aren't that many of us.

And when you think about the tradeoff I get from the fourth airline, diversification versus how much I'm paying in higher prices, that's the thing that we need to work out through further research and so on, how big is that difference. But then we also have to remember that only 20 percent of the population cares about that tradeoff, that the other 81 -- 80 percent of them don't care at all about diversification, and the top 1 percent probably doesn't care very much either.

So the distributional consequences of this debate are really substantial.

MR. ELHAUGE: So a few points, one just picking up on the question about do managers say that this is what we're doing, our pricing based upon horizontal shareholding. I want to emphasize, I don't think anything in the theory depends upon managerial consciousness. Take the executive compensation, it could just be that they naturally follow their compensation incentives and thus compete less. For voting, it could just be that shareholders vote for the sort of managers who are less competitive. And it
could simply be the absence of shareholder pressure to compete. So nothing depends upon managerial consciousness of this.

Second, on MHHI levels, there’s a lot of critiques of them, but I want to emphasize that it’s not like the anticompetitive effects are being assumed from the MHHI measure. It's a hypothesis that's being tested. Now, I think it could be tweaked. And for that matter, HHI isn't that terribly accurate either. You need to tweak it for, you know, case-specific facts. I myself have a paper proposing one possible tweak to the MHHI measure, something different in the differentiated market. I think we could take into account perhaps better the different percentage fees that different funds have or the different flow incentives that they have.

But it seems pretty clear from empirical evidence that just assuming there's no aggregated voting and there's no effect at all is wrong because if you ignore that aggregation, then you don't find anything statistically significant because you're using a measure that's not related to anything, whereas the measure is validated by the fact that it does statistically relate with high level confidence to prices.
And, lastly, I want to emphasize something that Fiona mentioned, which is there's a tradeoff. I think, here between what we’re going to do in merger analysis, what we’re going to do in horizontal shareholding analysis. If we're going to allow horizontal shareholding, we are, it seems to me, going to have to lower the concentration levels we allow in mergers, and that does mean that we’d be prohibiting more mergers that would otherwise be more efficient.

It seems quite likely to be better off allowing efficient, relatively concentrated markets and giving up on some of this horizontal shareholding than having unfettered horizontal shareholding but having deconcentrated markets that are less efficient.

MR. RUBINFELD: Thank you.

Menesh.

MR. PATEL: Thank you. Yeah, the FTC is to be applauded for holding not just this hearing but this whole slate of hearings. It really demonstrates the vitality and robustness of our antitrust laws.

I'll close where I started, and that is that this is a new issue with many complexities. However, there are large aspects of it that relate to the issues that we, as antitrust scholars, practitioners, and regulators, have thought about for a very long
time. And those existing tools, when applied to this new manifestation of potentially anticompetitive behavior, can result in policy prescriptions that are consonant with antitrust, as it has been for the past decades.

MR. RUBINFELD: Scott.

MR. HEMPHILL: I guess the governing thought is that we ought to be splitters rather than lumpers. I mean that in two senses. First, I think we should really be working hard to nail down what we think is happening in each situation, to work out what we think the mechanism is at work in different empirical studies.

For example, take the two pharmaceutical studies that Einer mentioned. You know, one of them roughly is about common ownership increasing — I mentioned pharma competition because I think I’ve had conversations individually in other contexts with everybody else on this panel on this set of subjects. One is about common ownership potentially increasing the prevalence or likelihood of reverse payment settlements. That’s a strategy that’s presumably to the benefit of both the brand and the generic that’s in the nature of reverse payment settlements. That might be an example of the rising tide lifting, in
that case, both boats.

The other is about common ownership just making the generic less likely to enter vigorously. It just sort of discourages the generic from entering. If I’ve correctly characterized the study, that would be an example of the brand benefitting but the generic losing out, right? That's perfectly possible as an implication of common ownership, but it's not one that both of the firms are going to equally like, and it's not one that the noncommon owners of each are going to equally like, right?

If you're a hedge fund invested in the generic, you're likely to resist the common owner telling the generic that it needs to take one for the team -- to take one for the common owner’s team. So that’s one kind of splitting.

The second kind of splitting is simply to come back to where I started, that the analysis of common owners needs to really take account of these, I think, systemic important differences in the incentive and ability to pursue anticompetitive strategies. And I think there's a big difference between a Berkshire Hathaway in this respect and a BlackRock or a Fidelity.

MR. RUBINFELD: Thanks, Scott.
I want to thank everyone on the panel for their help in the minute and their comments, but I did want to make one final comment myself. When I teach my antitrust students about both law and economics, one of the things I tell my students is that there's about a ten-year lag between the kind of deep research that goes into thinking about the issues we're talking about.

Academics go back and forth. We debate, we push, we shove, we kick, whatever. And eventually, at least in many cases, some clear conclusions are reached, or we hope they are, and policy follows. So I think there's roughly a 10, sometimes 15-year lag between the analysis that the academics are doing and some of the important court decisions that follow.

Why do I say this? Because we're really -- even though it's true that Dan and Steve and others have done work in partial equity ownership issues for a long time, the work that Martin and his colleagues have done has moved us into a new area, and it's been very recent. We're talking about the last couple years that really focused work has gone on in this area.

My hope will be that we'll continue the work on this area and think about it deeply and be careful
about the policy conclusions we draw until we have
some really certain -- at least reasonably certain
results about where this is taking us.

So on that thought, I want to thank everyone
on the panel for an excellent discussion. Thank you
all very much.

(Applause.)

MR. ADKINSON: I would like to thank the
panel as well and mention we're going to have a 15-
minute break and then our final panel on econometrics,
so please come back sharp in 15 minutes.

(Recess.)
MR. WILSON: Good afternoon, everyone. My name is Nathan Wilson. I’m an antitrust economist at the FTC. Today, I’m going to be moderating the last but certainly, I think, not the least panel of the day, focusing on the Econometric Evidence of Competitive Harm from Common Ownership.

Thus far today, we have heard various speakers provide important background details, as well as discuss the core theoretical elements of common ownership. Now, we’re going to turn our attention to discussing the efforts that have gone into testing whether or not those theories seem to match what appears to be happening in the real world.

We are fortunate to have a panel composed of authors that have contributed to this subject from its very infancy. Now, two of our panelists should be familiar faces, having provided framing remarks earlier this afternoon. They are Dan O’Brien, now of Compass Lexecon, and Martin Schmalz of the University of Michigan’s Ross School of Business.

Joining Dan and Martin are Serafin Grundl, who is a Senior Economist in the Financial Structure Section of the Federal Reserve Board. His research...
focuses on industrial organization, and his policy
work is concerned with antitrust issues in the
financial sector.

Next to him is Christopher Conlon, Assistant
Professor of Economics at the New York University
Stern School of Business. His recent studies have
looked at interactions between taxes, regulations, and
competition among practitioners -- among firms, excuse
me. Separately, he has also developed a number of
tools for antitrust practitioners.

Our fifth and final new panelist is Nancy
Rose, Department Head and Charles P. Kindleberger
Professor of Applied Economics in the MIT Economics
Department. She has served as Deputy Assistant
Attorney General for Economic Analysis in the
Antitrust Division of the DOJ from 2014 to 2016, and
was the Director of the National Bureau of Economic
Research Program in Industrial Organization from 1991
through 2014.

Our panel will begin, as previous ones have,
with individual presentations. After these initial
remarks, there will be a moderated discussion, but
time will be reserved at the end for questions from
the audience, either from those here at NYU or
potentially from those watching remotely. Please note
that FTC staff will be circulating throughout the
panel with comment cards if you have a question you
would like me to ask.

Now, without further ado, I would like to
turn the floor over to Serafin.

MR. GRUNDL: Thanks, Nathan. So I would
like to thank the FTC and NYU for inviting me to this
panel and for hosting it. And like so many others
before me, I have to start with a disclaimer, and that
is that I’ll only present my own views, maybe the
views of my coauthor Jake Gramlich, but not the views
of the Fed Board or any of its staff.

And in my remarks, I will focus on
methodological issues. I will not comment on
potentially conflicting findings or conflicting
conclusions, you know, when different people look at
the same findings. And I hope to give a little bit of
an introduction and hopefully it kind of sets up the
rest of the panel.

So my copanelists and I, we have, I think
broadly speaking, used and advocated for three
different methodological approaches. Martin and José
Azar in their seminal studies have used an approach
where they relate MHHI, which is a concentration
measure that takes common ownership into account, to
price levels. And the idea is that without common
ownership, MHHI collapses to the HHI, so the gap
between the MHHI and the HHI is a measure of how much
common ownership affects concentration, and if that’s
related to prices, maybe there’s an impact of common
ownership on prices.

The second approach, which is, you know,
dear to the hearts of IO economists, is a structural
approach. So I’m also an IO economist, so I also like
that one, and Dan and Chris have papers advocating for
that one, so it’s similar to the kind of exercise we
do when we do a merger simulation, so we specify the
complete structural model of the industry, enhanced
for the fact that we also allow for the effects of
common ownership.

And I will be talking mostly about a third
approach that Jake Gramlich and I have used that I
call testing comparative statics, and I will talk
about what I perceive to be the strength and
weaknesses of this approach, especially compared to
the structural approach.

So what's our question? We have two
competing theories. The incumbent theory is -- Theory
1 is each firm maximizes its own profits, common
ownership or not. That’s what we usually assume. And
the challenger theory is Theory 2, which is that each firm maximizes a weighted average of its own profits but also of the profit of its commonly held rivals, and it assigns these weights -- WIJ -- to the profits of these rivals.

And we want to develop an econometric test that distinguishes Theories 1 and 2, so we need to find some testable predictions to do that. So that’s kind of a straightforward exercise in a sense because obviously Theory 1 predicts that changing the profit weights has no effect on anything that are part of the theory. And Theory 2 predicts that changing the profit weights changes everything, okay, every outcome of this particular action between firms -- prices, quantities, profits, whatever you can think of, exit/entry decisions, investment, advertising, everything should be affected by changes in these profit weights.

Now, the way I've explained it is slightly simplifying because you can't really base a test yet on this. Ideally, what you want to have is a monotone comparative statics result so you want to have a prediction of the theory that changing the profit weights changes one of the outcomes in a monotone way, and then you can design a test distinguishing Theories
And the last ingredient we need is we need obviously variation in the profit weights, and this is generated by changes in ownership, combined with theory that tells us how does ownership translate into these weights, for example, the one that Dan helped to create.

Now, what are the strengths and weaknesses of such an approach? So I think one of the important strengths is that relatively weak restrictions are sufficient to obtain monotone comparative static results. So under -- just placing some restriction on the competition between firms, we get predictions, for example, that if Firm I starts to care more about the profits of Firm J, it will respond by competing less aggressively, increase its price, and decrease its quantity.

In particular, we do not have to impose conditions that are sufficient for identification. We only have to impose conditions that are sufficient to generate testable predictions.

The second point that I’ve listed here is kind of a special case of the first point. We do not even have to specify a full model. So we do, for example, not have to specify a demand system. We will
just have to make high-level assumptions, such as
firms are competing in the sense that their goods are
substitutes.

And then a practical advantage of this
approach is it’s relatively easy to implement. By
that, I mean it’s easy compared to, say, estimating a
structural model, there’s no numerical optimization or
things of that kind. And if someone, say the FTC,
wanted to do a study where we look at many industries
and collect outcome variables for many industries and
ownership structures, then you could do this in a
fairly straightforward manner.

Now, there are also downsides of this
approach. And one that Dan has pointed out in his
work, which is that it’s not so easy to do the way I
just described it in practice. What you would like to
do is you would like to estimate how your outcome
variables at a price depends on the complete set of
these profit weights in a flexible way.

And because there are so many profit
weights, you cannot actually do that, so you will have
to define certain functions that you hope summarize
the effects of the different profit weights. So you
may want to control for how much does each of I’s
competitors care about the profits of Firm I, but in
practice, you can only control for how much do they
care about the profits of Firm I on average, and you
hope that this is good enough.

And the second downside is kind of the flip
side of the advantage that I mentioned earlier, which
is that we only test the direction of the effect. So
we impose fairly weak restrictions, those that give us
directional predictions of the theory, but not more
than that. And if you have a complete structural
model, you will, in effect, get predictions also about
the size of the effect.

So, for example, the structural model will
tell you if you get your demand system right and you
get the parameter estimates right, how close
substitutes are, you know, the products of Firm I and
J, and that will have implications for if Firm I cares
more about the profits of Firm J, will it respond a
lot or will it respond a little. And Firm I and J
don’t really compete because their products are not
close substitutes, maybe Firm I will not respond much.
And this kind of more specific prediction is something
that you get out of a structural model but not of our
approach.

And I’ll leave it at that. I’m curious to
hear what my copanelists have to say.
MR. WILSON: Thanks a lot, Serafin.
Now turning it over to Dan for the next remarks.

MR. O’BRIEN: Great, thank you. Earlier, I talked about the theory that grounds the empirical studies on common ownership, and now I want to turn to the empirical evidence. And in my discussion of theory earlier, I raised two issues that I will assume away for the purpose of discussing the empirical evidence. First, I assume that even though institutional investors purchase shares across a broad set of industries, I’m going to assume that it's reasonable to focus on one industry such as airlines, banking, breakfast cereals, or whatever.

Second, I'm going to pretend that it's reasonable to assume that the objective of individual investors is to maximize the value of their retailer investors’ shareholdings in the industry under analysis. So those were Warning Signs two and three in my previous presentation, and I'm going to basically assume those away. By making these assumptions, I don't mean to suggest that they're good ones but making them facilitates a coherent discussion of other critical empirical issues that arise in assessing common ownership.
So let me start with the empirical question. The heart of the question is whether common ownership causes firms to behave less competitively by raising price, reducing output, cutting capacity, investment, or what have you. The way this happens in theory is that firms’ managers take into account the effects of their decisions on the profits of rivals and thus pull their competitive punches.

The accounting for rivals’ profits that managers do is captured in what I call common ownership incentive terms, and these reflect a fraction of each rival’s profit that a manager accounts for in making strategic decisions for the firm. So in a five-firm market, for example, each firm faces four rivals, and there would be 20 common ownership incentive terms -- five times four. These terms are accounting for the profits of each rival, and each firm does that. So there are 20 common ownership incentive terms which Serafin alluded to a moment ago, which makes certain empirical analysis difficult.

Let me pause and observe that the common ownership incentive terms that I’m talking about, and these are discussed in the paper that I've written with some colleagues. The terms subsume the financial
interests and control weights of all of the owners that are part of the theory. Okay, that’s measuring the -- estimating the common ownership incentive terms amounts to measuring the impact of the control weights, which as I mentioned earlier are critical, that reflect the control or influence exerted by the owners.

Okay, so if it seems like we're a little bit deep into the weeds here, let me say that this is actually on purpose because there's quite a desperate need for a view from the weeds that I think this issue is now getting, which is good. Like all rigorous science, it makes sense to express the problem in a way that's as simple as it is but not simpler.

And I want to commend Serafin for going back to what we learned in IO 30 years ago about how to do empirics, which is do comparative statics, which is basically writing down a theory, seeing how things change when other things change, and seeing whether or not that holds true in the data.

Okay, so let's move out of the weeds just a bit and talk about how we measure these critical common ownership terms. There's basically two approaches. One approach is called the reduced form approach, to simplify. And that’s to estimate a
relationship between price and some measure of common
ownership, which should be the common ownership
incentive terms in some way since those are what
matters.

This is the approach that we see in the
empirical research, the airline paper and the banking
paper which got this whole thing started. And a
difficulty with this approach is that theory tells us
that prices depend on the full panoply of common
ownership incentive terms. The interaction of these
terms with each other, and the interaction between
these terms and cost and demand factors, this makes it
impractical to estimate a true reduced form because
there are just too many variables. The airline and
the banking papers address this problem by using an
index to summarize common ownership, and that was the
MHHI that we’ve been talking about. But this creates
problems that I’ll discuss in a moment.

The other empirical approach is to build an
oligopoly model and measure the common ownership
incentive terms as they appear in that model. The
advantage of this approach is that it's possible to
capture the full panoply of interactions in a rigorous
way. And this is the approach that I've pursued in my
own study of the effects of common ownership in the
The comparative statics approach that Serafin talked about I would classify as a variation on the reduced form approach because you don't specify the full structural model but you come up with relationships that you should see in the data if there's any competitive effects going on, and so I think I would put that in there, but maybe there's a nuanced difference as well.

So let's talk about the empirical approach in the airline and the banking papers that found that common ownership raises price. The airline paper uses two approaches -- a price regression that relates airfares to route-specific MHHI and quasi difference-in-differences analysis that exploits the BlackRock/Barclays merger to try to see whether or not the impact that that had on common ownership affects price.

The diff-in-diff analysis is really a variant of the reduced form approach that I mentioned, and both approaches are pursued in the banking and the airline papers have some shortcomings that make me quite skeptical. The problem with the price MHHI regression is that the MHHI is a measure of concentration, not a measure of common ownership.
So there are two issues here. One is that common ownership has multiple dimensions, all those common ownership terms I mentioned, okay? And the MHHI has only a single dimension. So it's generally not possible to capture the impact of common ownership that way.

The second problem is the MHHI depends on market shares, and market shares move up and down for a lot of reasons that have nothing to do with common ownership. So I’ll reserve -- I want to give you one example, and then I'll preserve the rest of my remarks for the Q&A, but it's not possible to determine the effects of common ownership by looking at the correlation between price and the MHHI. Okay, it's not possible.

So let me give you an example. It just snowed in Tahoe, it’s ski season, and the demand for air travel to Tahoe has risen. Okay, airfares rise, and an airline with very flexible capacity takes advantage and sees its share rise relative to less flexible airlines. So if the flexible airline is a big guy, price and the MHHI both rise. The reason is that an increase in the big guy's share increases the MHHI. If the flexible guy is a little guy, price goes up but the MHHI goes down, okay? The reason is that
an increase in the little guy's share reduces the
MHHI.

So this illustrates that price and the MHHI
can move in the same direction or in opposite
directions for reasons that have nothing to do with
common ownership. Thanks.

MR. WILSON: Many thanks, Dan.
And now we’re on to Martin.

MR. SCHMALZ: So thanks very much. Once
more, I unfortunately have to not speak about
particular empirical approaches or papers but about an
entire literature. And, so, let me start with the
baseline again. The baseline is that we have decades
of evidence of institutional ownership effects,
capital expenditures, payouts, merchant activity, and
so forth. More recently, we have evidence that common
ownership measure in various ways affects corporate
financial choices. That’s not surprising given that
the big institutional investors directly express views
on the level of payouts and CapEx firms should take.

Now, how's that related to competition?
Well, every dollar that’s paid out in the form of
payouts can’t be spent again on capital expenditures
in the same firm. So reduced capital expenditures
means lower capacity; lower capacity means lower
output, and there's a competitive effect, okay? So if there is an effect of common ownership on capital expenditures and payouts, how could there not be an effect on product markets?

Now, most of the studies, indeed, have been more recent, but let me give you an entire overview. First come studies that documented an economy-wide increase in common ownership, and that's been going on a long time, including in VCSS, a view hypothesized earlier. Let me just point out, one paper published in the JFE that concludes that by 2005 already most institutional investors in S&P 500 firms do not want corporate managers to narrowily maximize the value of their own firm, instead, investors would see their portfolio values maximized if managers internalized a large percentage of any externalities imposed on other firms. Okay, so this is just mainstream finance, and since then, this has been continued. We’ll hear from Chris later on.

Now, when does the literature on empirical evidence on anticompetitive effect start? So José, my coauthor and classmate, in his dissertation shows that a measure of common ownership density predicts industry margins. Okay, then come two authors here from NYU who showed ownership of firms by quasi-
indexers is causally related to an increased level of buybacks and reduced investment, which is precisely the mechanism proposed earlier relative to margins.

Now, the only reason apparently our study with José and Isabel made such a buzz is because we were the first to study market-level effects, indicating that common ownership is variable and is causally related in a reduced form way to higher prices, as well as reduced output. And that has been independently replicated, but the data and code is available on the JF website after they replicated this, so everybody can see how robust these findings are or not.

Now, a bit of detail on this. These results have been shown to only apply in particular markets, for example, only markets with relatively high levels of concentration to start with, substantially above 2,500 points. The second is that it's, of course, not just based on correlations as Dan just illustrated with this Lake Tahoe example. And, of course, it is true that MHHIs depend on market shares.

That’s why many of the tests are just literally fixed or even set to one over the number of players counterfactually, so we know that this is not what drives the results. Okay, that does not exempt
the study from any of the other criticisms, but they
have to be a little more complicated than what is
being levied here, okay?

So it hasn’t been mentioned so far today,
but in the discussion, there has been a paper claiming
that our results were driven by weighting the
regressions by the number of passengers in a route,
which you want to do because you're interested in the
average effect on a ticket price and not on, like, a
route as an outcome variable, as well as by the
largest 5 percent of markets. Now, these claims are
just factually incorrect, and again you can see this
on our websites. There are links to the paper that do
that.

What I'm showing here is the regression of
price on MHHI deltas that are not weighted by the
number of passengers and you see that in the first
column that the effect is there in a full sample in
the largest 5 percent of markets and the lowest 95
percent of markets, so the results are just not driven
by weighting regression.

So how is it that these authors come to the
conclusion that in so many markets they're not there?
Well, it appears that they made a data error. They
failed to aggregate 13(f) holdings, which is where we
get most of the ownership information from, to the
level of the institution that actually votes them.
When we do the same mistake, simply commented out of
our code, we also find that the effects appear to be
driven only by the largest 5 percent of markets and
are not present in the full sample or the bottom 95
percent but it’s just a data error. Okay, so that
turned out to be a nonissue.

Now, let me jump over this a little bit.
There is a thing called the structure conduct
performance critique, and I don’t think I have time to
cover both -- all of it, other than saying that, you
know, when you talk to an IO economist, you sometimes
come away with the impression that there’s only a
single way to conduct credible empirical analysis, but
some of the biggest minds in this field concluded that
this seems a very narrow and dogmatic approach to
empirical work, and credible analysis comes in many
guises and so forth.

So, you know, there's a difference between
identifying causal effects of one variable on the
other and the structural analysis. Now, that said,
there have been economic structural studies of common
ownership as early as the late '90s. One of the
studies of common ownership of telecom licenses finds
that it explains higher prices. Now, that’s between
two firms, okay, so this is just two firms, each
owning 50 percent. And they looked at the commonly
owned that explains price 5 percent higher than a
common ownership. Lundin looks at Swedish nuclear
power plants and finds that if they’re commonly owned,
that explains that prices are 5 percent higher than
they would be without common ownership.

And on the best work by far, most careful in
this literature, we’ll hear about by Chris, and they
find -- they don't estimate effects on prices of
common ownership. They rank models by whether a
common ownership model performs better than a Bertrand
model, and the answer is clearly no. So there’s one
market, one particular industry, rather, that where
that model is outranked, okay?

Now, obviously, that doesn’t reject that
there are positive effects of common ownership in any
other market, so I don’t think we should use that as
an argument that the literature needs to stop.
Rather, this can be applied in many, many other
industries and people should, of course, do that.

Now, in his paper that Dan referred to, we
wrote a reply to that as well a long time ago, more
than a year ago, I believe. The paper finds no
positive effects, but it also doesn’t reject positive
effects because the standard errors are so large as we
understand. Also, it finds a negative effect of the
length of a route on the cost of flying route. Now,
that seems counterintuitive to -- you know, based on
any economic logic, and all the estimates are based on
10 percent subsample of the data, and there’s no
justification we could make out for that.

We tried to replicate that with the full
sample and do not manage to replicate a nonpositive
effect, but to be honest, the incentives to an
academic of replicating industry studies are pretty
low. And, so, that’s one of the reasons why I
encourage regulators to take a look at that. That’s
their natural role of the competition authority.

But my broader comment is that the singular
focus on MHHI really misses the forest for the trees.
There are many, many papers in this literature -- at
this point roughly two dozen -- that estimate effects
on firm behavior and market structure, innovation,
entry, as we said, using alternative measures of
common ownership as well.

So, again, my point here is not we found,
like, the crystal ball and everybody should use this
particular measure, but the insistence that no matter
the level of common ownership, we shall just assume
that there are no effects. That has been clearly
rejected by the literature.

So one is an effect in venture capital
showing that common ownership fosters alliances among
the VC-backed firms, and there's a banking paper which
is subject to similar criticisms as the airline paper,
but one reason I want to mention it is because they
always split out -- we recently have split out the
passive investors -- the so-called passive investors
and the active investors and the effects seem to be
almost exclusively driven by the quasi-indexers, so
that goes to Scott Hemphill’s request to start looking
at different types of owners.

There are other papers that show that the
reduced competition from market share seems to be
effectuated via reduced advertisement expenses, many
other things. The two pharma studies came up.
Gerakos and Xie show that common ownership predicts
the probability of a settlement that includes pay-for-
delay where the brand keeps a generic drug out of the
market and independently that’s reduced, and the entry
result has been replicated by other authors with
slightly different methods.

There is a bunch of other studies I don’t
have time to talk about. And there are more than a handful of studies of the effect of common ownership on corporate innovation. Again, He and Huang, for example, has published in the *Journal of Financial Economics*, so those are top journals. The gist of it is that depending on if the common ownership is within industry or across industry and if it’s long-term owners and short-term owners and so forth, there can be a positive or a negative effect on corporate innovation.

But even if the effect was unambiguously positive, the welfare effects, of course, aren’t clear, right? So we know that the innovation effects would have to overpower any anticompetitive effects, and that only happens on the very restrictive conditions and theory. And we have no empirical evidence of welfare-enhancing effects.

There are also effects of vertical common ownership links. Ojeda is a Berkeley Ph.D. student, shows that if there's common ownership between a bank and a firm, that firm tends to get lower -- so loans with lower interest rates, and riskier loans whereas as the noncommonly owned ones pay higher interest rates. And there's a bunch more in the literature as well.
So the takeaway from that is, of course, it doesn't mean that horizontal effects exist or sign the net effect, so the argument that if we just had one giant index fund that owns all firms, all productive capital in the economy, there would be no problem, and it appears wrong to me because an index fund would not own the economy; it would own the productive capital. And maximizing social welfare is a different thing from maximizing producer rents.

Okay, now, I just ran over a list of 23, 24 papers in 12 minutes or so, that gives 30 seconds per paper. I'm afraid I could not do justice to the evidence in that amount of time, but I just want to encourage the FTC to hear some of these other 40 authors of the other papers as well if they want to get a reflective view on the state of the empirical literature. And to be clear, this is not meant as a criticism. This is meant just as a statement that this panel here does not reflect the state of the empirical literature.

Okay, so, to conclude, I've said before that I think the quality of this debate would benefit from better data access to researchers and independent analysis of product markets. Data access, we're being scolded here about using ownership data that's
incomplete or voting data that is uninformative.
Well, it’s very simple, then we should have better
disclosure of data to the regulators.

So it's not okay if the industry at the same
time scolds the academics for using faulty data and
lobbies the regulator at the same time for disclosing
this. That doesn’t make much sense. To the
regulator, I think it’s important to do studies
themselves for multiple reasons. One I mentioned
before. Why can’t we ask the academics to first
produce the results based on data that we cannot
possibly produce. That leads to a catch-22.

The second, with all due respect I have for
the substance of Dan’s work, I’m worried that if we
base this discussion on sponsored research we get
coverage similar to what the economists had last week
or last month, which I think can be damaging to the
agencies. And it doesn’t mean that I endorse the
coverage; it means that I take that seriously, and I
think we should avoid that. I think today’s hearings
are great for a step in that direction of doing work
themselves and getting informed. So thanks again for
holding it.

Third, I mentioned that academics in some
cases may have reduced incentives of running, say, the
work that Matt and Chris and others are doing on, like, 50 more industries. We don’t get published in a top journal for that. So that is another natural role, even if we had the work for the competition authorities to do.

Lastly, it seems that the industry is not interested in the Commission to focus its resources on this topic. And I think it’s worth thinking about why that could possibly be so. I would have expected that if transparency is in the interest of us all that then we should want the FTC to study this topic in all imaginable detail.

So, again, there are many open questions. We’ll hear about some of them. Dan raised a few others as well, which we can better answer with better data access. Serafin’s paper alludes to that as well. I don’t think focusing our attention on other topics is going to answer these open questions. So given the state of the literature, given the basic theory that we have, given the enormous levels of common ownership that have been documented for decades, and given the abundance of mechanisms, I don’t think it’s reasonable to just assume there’s no effect and continue with business as usual. But, instead, I think the competition authorities should study this topic.
Thank you.

MR. WILSON: Thanks, Martin.

And now Chris.

MR. CONLON: All right, thanks. I'm going to go fast here because people covered a lot of this stuff. So I'm going to mostly focus on sort of facts and what I'm going to call sort of positive results, and I'm going to leave my sort of opinions to the panel discussion at the end, with one caveat that I'll show you in a second.

So, yeah, as Martin sort of alluded to, the data on ownership are sort of unusually bad. We spent about a year going through and scraping all the SEC filings for the SEC database post 2000. We've gone through all the 13(f)s in the Thomson Reuters database, for all the firms in the S&P 500. You might wonder, like, why does Thomson Reuters only find that there's 400 or 450 firms in the S&P 500 in certain quarters. That's sort of a level of how bad the data can actually be, but we've cleaned this up as best we can, and we're going to try to make it available to other researchers, assuming that Thomson Reuters doesn't sue us.

Okay, so, yeah, so there's been some debate about what is the object of interest. The thing that
I’m going to call kappa here on the right is the thing that Serafin and Dan referred to as the profit weight. And what it is is it's just a measure that says how much -- how many shares do you earn in a particular firm as an investor and then how much does that firm actually pay attention to you as a particular investor.

And I think, kind of, there's a lot of debate, and I think there’s a little bit of a false choice here in that there’s this, like, well, we should either focus on profit weights or this MHHI delta and that these are like two very distinct, very different measures. And what I want to just tell you is that the profit -- the MHHI delta literally is that profit weight, but it's that profit weight multiplied by the market shares of the two firms and then summed up for all the firms in the market.

And what happens is we throw away kind of a lot of variation that we might have. We often see these asymmetries in these profit weights, where I might want to care a lot about your profits as a firm, and you might not want to care very much at all about my profits. And when we sort of summed it up into a market-level measure, we kind of lose a lot of the interesting variation, right? There's other issues
that people have referred to that this -- you know, if I'm going regress a price on something that looks like the quantity, you can say that it's a demand curve; I can tell you it's a supply curve; and we can sort of agree to disagree. And that's, I think, kind of where some of the disagreement is.

So I'm going to show you sort of large aggregates for what happens with these profit weights for the whole economy, and these are results I think people haven’t seen before. So imagine everybody is indexed, everybody buys the market portfolio and you either buy X percent of Firm 1 or Y percent of Firm 2. It might very well be that you put a weight of more than one on another firm's profits. In fact, you know, if everybody does that, the best predictor of what the profit weights are going to be, at least in a cross-section, is the institutional share or one minus the retail share, right, and I’ll show you that, right?

So, yeah, the other thing that I should point out is that the thing that doesn't seem to matter much is investor concentration. What matters is how relatively concentrated investors are, that is, are your investors more concentrated than mine. So here is sort of -- here's sort of the long-run trend.
So we do this for all the firms in the S&P, every pair of the 500 firms. We plot this from 1980 to the present, we’d find that a firm might put a weight of .2 on another firm’s profits. It could be in a completely different industry, and by today, that weight is closer to .7, so it's really changed a lot over time.

Do the control assumptions matter if I put more weight on the largest investors or more equal weight on investors? Those are what all the different colored lines are, and basically, towards the end of the sample, they all pretty much converge. Right, so, the answer is control should matter and in practice it mattered a lot less than we thought it was going to.

What actually drives these profit weights? So one of the best predictors in the cross-section, not looking across time, is just retail share. So the firms that seem to really like their competitors are companies like Apple and Pepsi and these big behemoths with lots of retail investors, right?

What's driving the long-run trend? It seems to not so much be that investors are getting larger but all the investors are buying the index. Right, it's that more and more investors are holding portfolios that look like the market portfolio. And
that seems to be what’s driving these long-run results.

Right, so now let me get to sort of the micro data. So this is where we looked at the market for cereal. Right, and we sort of -- we took sort of every approach we could. So we started with -- we started with sort of Martin's approach, and we regressed prices on the HHIs and MHHI deltas. And we found that HHIs increased prices but that the MHHI delta for a thousand-point increase in the MHHI delta, prices went down between 8 and 12 percent in a way that was statistically significant and robust to every specification we could throw at it.

Now, we don't think increasing common ownership is going to actually reduce prices for cereal. Right? We then took the approach that Serafin and Dan recommended. Suppose -- now I only have 16 profit weights because there’s four firms that really matter in cereal. If I run the regression of prices on those things, what did we find? Well, we found that about three of them were positive and significant, about three or four of them were negative and significant, and that the rest were zero. And, so, we didn't know what to make of that, right?

And, so, then what we did is we said, well,
look, how would the FTC approach this as if it were a merger case. So we could estimate a model of demand, just like we would conduct a merger simulation. We could back out marginal costs from estimates of demand, assuming that either firms were playing the Bertrand game, like we usually do, or assuming that firms were following these common ownership weights, and we could recover estimates of marginal cost. Then we could take everything we think that should shift that marginal cost and we could project our estimates of marginal cost on that stuff, right?

And what I've plotted here is fake, but what I've plotted is sort of those marginal costs -- those recovered, leftover bits of marginal cost over time, right, and what we could do with those recovered bits of marginal cost over time is we can see if they respond to other things that marginal costs absolutely shouldn't respond to.

And what are those things? Those are things that move markups around, right? So one thing might be to look at events in the financial space, right, to look at things like the BlackRock or Barclays merger. But another thing might be to look at things that don't shift my marginal costs but do shift the marginal costs for other products.
So for cereal, this was actually quite easy.

So we have cornflakes. Cornflakes should respond to the price of corn. The cost for cornflakes should respond to the price of corn, but they absolutely should not respond to the price of rice. Now, the markup on cornflakes might respond to the price of rice, but the idea is we’ve subtracted off already the right markup. So if we have the right model of competition, we have the right markup. And, so, that shouldn't be in what remains in marginal cost. And, so, that's the basis of our test, right?

And, so, the idea is I've drawn sort of two squiggly lines here, and so if I have the right model, my marginal cost should look pretty flat. And if I have the wrong model, then around these events I should see big spikes in my marginal cost, right? And we use that and we use multiple events in both directions. We use multiple events in both directions that both led to increases or decreases, and we found that they don't line up so well for common ownership.

In fact, for ready-to-eat cereal, we found that actually Bertrand fit the data pretty well. And in some sense, this was a bit surprising, you know, because this wasn’t like we chose this as a case where we knew ex ante, you know, cereal was going to behave
this way. Why? Because the ready-to-eat cereal industry has been, you know, accused of being in price wars and in price-fixing cartels and in various conspiracies going back to the '70s, and about once a decade, they get involved in something like this. So this is an industry where we could have found something and we didn't. All right, so that's where I'm going to leave it for now.

MR. WILSON: Thanks very much, Chris.

And our last speaker will be Nancy Rose.

MS. ROSE: Thanks. So I wanted to thank the FTC for inviting me to participate and particularly to correct a misimpression, which is I'm not one of the authors. I’ll say a little bit more in a minute about that, although this is a topic that I have followed with a lot of interest and quite closely since Martin's presentation of his airline paper to the Department of Justice Economic Analysis Group Seminar Series in the fall of 2014, shortly after I arrived there. So I haven't been at it as long as Martin has, but I’ve been following this with intense interest.

And I just also wanted to echo the important debt that I think we owe to Martin and to José Azar and to their various collaborators for conducting the seminal empirical work on this issue, which has
sparked the debate on which today’s entire set of hearings has been founded. And as an academic and as a former antitrust enforcer, I think flagging these issues, getting people excited about them, getting people interested in them, and trying to learn the truth is really important.

That said, I find myself as one of 23 speakers in the category that Martin labeled as no own empirics, factually incorrect, industry-affiliated, or sponsored, and that Fiona, after deducting herself and Einer from that, seemed to suggest the rest were seemingly superfluous, if not -- did not belong in the debate. And I’m hoping that that won’t be your conclusion.

While I haven't written on this topic, one of the things that I teach my students in the MIT Department of Economics is that one can and should read and critically analyze papers, even if you haven't done your own empirical original research on that topic, and I’d like to share with you some of the thoughts that have emerged from my analysis of this literature.

To give the top-line conclusion for reasons that I'll explain, I don't think that one can conclude that case for anticompetitive effects of common
ownership has been proven at this point, and I want to say that the reason someone who is as passionate about invigorating antitrust enforcement as I am is putting that view out there because I think it's important for us to base policy discussions in particular on bedrock and not on shifting sand, both so that we get to the right place and so that if we do need to undertake either changes in the way we're approaching antitrust enforcement or in legislation around these issues, that those policies are not derailed by somebody proving that the empirical paper you're using to support your analysis is noncredible.

And that's why I think I'm very encouraged. I think there are many more economists that are engaging empirically with this question, particularly people coming out from the industrial organization tradition, which I think has a lot to contribute to it. And for those of you who haven't read Chris' and Matt's and Mike Sinkinson's work in this space --

they've now got three papers, which I think are all terrific, terrifically interesting, and I'd pair them up with Scott Hemphill's as sort of your foundational knowledge in this.

Okay, so what are the two main points I want you to come across with? To some extent, most of them
have been said before, but I think they’re worth emphasizing. The first is that the way we're empirically implementing common ownership measures I think does not reflect really anyone's incentives accurately. So most empirical papers look like something on -- I guess it's your right -- where you’ve got one guy who owns all four airlines and is thinking about how to maximize the value of his extremely large portfolio. But, in fact, the common ownership ecosystem is much more complicated. We’ve got lots of people -- retail investors, some pension funds, some union funds and so forth -- that might be contracting with a fund or investment vehicle that's managed by what I'll call big asset management.

But big asset management is not a monolith either. Big asset management is composed of Bob's Value Fund, which in this example holds American Airlines, Hyatt, Dollar Tree, lots of other stuff; Betsy's Growth Fund, which might hold United Airlines, Marriott, and lots of other things; and an S&P index fund, which maybe is managed by a computer algorithm which holds, you know, everything in the S&P.

And, now, if we ask sort of what are the incentives that are driving this, so first note, even for the guy on your right, Ron, yeah, if all he owns...
is airlines, we’ve estimated the right -- we're looking in the right space, but if he also owns hotels, he's not maximizing the value of his portfolio by maximizing the value of his airline holdings.

And while Dan said he's going to make that simplification to be able to make some progress in empirical work, I don't think we can learn about this theory if we’re saying, well, we think these guys maximized the total value of their portfolio but only silo by silo, right? I just think that’s a really -- it’s a good place to start, it's a good place to get us engaged with the problem, but it's certainly not a place to finish.

So if we look on the right and we ask what's going on there, now let's think about Bob and Betsy's incentives. So big asset management owns both American and United, but people are investing in Bob's fund, an actively managed fund, because they expect him to beat the benchmark, and people are investing in Betsy’s fund, an actively managed fund, because they’re expecting her to beat the benchmark. Neither of them have an incentive to sacrifice the profitability or the value of the airline that they own so that the other airlines can make money.

And I think that's what's been lost in a lot
of the discussion and a lot of the literature is that it's not particularly interesting, I think, to tell us that the big four airlines, particularly as we get past the financial crisis and the merger wave, also seem to be pretty cozy with one another. And in contrast, if you're in a market where it's got one or two of the big airlines but you've also got Spirit and Allegiant, I think if I asked most of you to say, here are two airline markets; HHI is 5,000; two firms, equal shares; one is American United, the other is American Spirit, which market has the lowest price, I think almost none of you would say I can't answer that question until you tell me what the ownership structure looks like among these institutional asset managers.

So I would urge us to sort of recognize that and to key very tightly on Scott's, I think, very careful thinking about what these tests can tell us, and I think common ownership tests are going to tell us most about that theory when we can observe firms' declining profitable deviations from collusion, sacrificing their own profits from rivals' profits. And, yet, what I've heard throughout the day are comments like, but, of course, everybody is happier if profits go up.
I will leave you with the thought, happy to talk about it during the discussion, that we have two airline data points that suggest to us that that theory of, of course, everybody's happier with higher prices, they'll all go along, is first not a test of common ownership but maybe also not a good characteristic of that particular market. Let me stop there.

MR. WILSON: Thanks very much, Nancy.

At this point, I want to loop back to some of the issues that came up in various folks' initial presentations and kind of drill down a little bit more, perhaps identifying areas of disagreement and potentially leading to tests that may resolve some of that disagreement in the future.

And the first issue I wanted to kind of touch on was the issue of measurement. In particular, people have talked about the various ways of addressing common ownership in different forms of empirical analysis, and some have preferred one versus another. And I guess I'm particularly interested in hearing about how alternatives to the ones you may have employed or preferred could be driving in one way or another the results of papers that you have questions about.
And I'm certainly also interested in anyone's thinking about kind of concrete ways of measurement kind of unrelated to my primary question. Perhaps Dan would like to take first crack at this.

MR. O'BRIEN: Sure, Nate. So measurement -- so we're trying to measure common ownership and we want to know whether or not changes in common ownership cause anticompetitive effects. So my first observation, and I made this clear in my remarks, I think, is that the MHHI is not a great measure of common ownership, at least in a price regression, because it can move in directions that reflect increases or decreases in common ownership because it's complex, it's multidimensional, it just doesn't move in directions when common ownership changes that tell us common ownership has gone up, and then how those movements relate to price changes also doesn't tell us whether or not common ownership is affecting price because they can move in the same direction or opposite directions. So I don’t think that’s a great way to measure things.

But it's a conundrum for reduced form empirical work because if you buy into the theory, and perhaps we need a new theory about how to think about this that’s simpler. If you buy into the theory, you
have all of these common ownership incentive terms, these weights that Chris talked about. And they all matter, and in an oligopoly model, they interact in complex ways with everything, and you can't run a simple reduced form price regression that captures all of that.

And to give -- to throw some credit to Martin, he was faced with this problem, and he chose to use the MHHI, which is an index that relates in some way to common ownership, and so it's probably not a bad first choice in thinking about how to summarize this.

So I think a better way to go is a structural model that tries to model how the oligopoly works, effectively estimates different control scenarios to see which one is most consistent with the data, and that's the approach that we adopted in the structural analysis of the airline market that we did. And we found that, in fact, we couldn't reject that common ownership has no effect on price -- well, we couldn't reject that common owners had no control. We could reject that common owners had proportional control.

As Martin said, there are positive levels of common ownership that we couldn't reject if your
hypothesis was that those would hold. I think that’s a better approach, but there needs to be, you know, more thought about how best to estimate this, and this is -- Serafin talked about some things and Chris is talking about some things. So that’s my observation.

MR. WILSON: Thanks, Dan.
Chris, would you like to add anything to that?

MR. CONLON: Yeah, I guess the one thing I would add on top of that, yeah, I’m clearly, I think, in the camp that I’m not -- I think we've learned as much as we're going to learn from MHHI. I think it was -- it's useful in the same way that HHI is useful as sort of an initial screen to sort of, you know, describe markets, but, you know, in terms of, like, is it -- do I believe we can get a causal link between overlapping ownership and prices by regressing things on HHI or MHHI, if only we had the right instrument? I'm a little bit skeptical, I think for the same reason that the IO literature, you know, 30 years ago sort of stopped running these price concentration regressions.

I will say, actually, in the appendix of one of Dan's papers is another measure that actually bothers me a little bit less, and that’s his sort of
like delta-PPI measure. And that looks a lot like what the agencies also do in sort of screening mergers again in sort of a differentiated product world, which says if I knew the profit weight and I knew the diversion, the ratio at which people switch to the competing good, well, then, that should give a model of how much common ownership could increase my effective costs, right? And you can think about what is common ownership doing. It's raising the opportunity cost of selling my product because now when I raise my price, well, some people are going to switch to your product, and will I care at least 30 percent about them or 40 percent about them?

And I think there might be some ability to sort of push in that direction so that we can bring in things like differentiated products, because I think we know most of the markets we care about today actually have differentiation, which I think was maybe not true 50 years ago when we were making bars of steel and pulling coal out of the ground and things like that.

MR. WILSON: Thank you.

Anyone else? Martin.

MR. SCHMALZ: People might want to look at the CRCO terms that are in the airlines papers which I
applied similar to what Chris just mentioned, so it's not just based on MHHIs.

If I may, I’ll also just clarify once more, my point was not that there's no role of other people on the panel other than those that have done empirical research. All I said is that today's panels and this panel is not reflective of the empirical literature that has been done today. So I'm sorry you feel this way, but this was not the intended criticism.

MR. WILSON: Thanks.

So before we leave the issue of measuring common ownership, I want to kind of keep us focused a little bit, particularly given that I’ve received a question that seems related, about dealing with the endogeneity of ownership itself. Is there some way that we can be concretely confident that we are accurately accounting for the selection into owning different stocks and the validity with which different papers may have addressed that question?

MS. ROSE: Could I kick that off, because I don’t have a particular empirical ax in this, but my suspicion is, and this is based a little bit on looking at some of the profit weights or common ownership rates and some of the just broad literature on pairwise common ownership measures, say of
companies, is that to some extent, what we're learning
with common ownership is almost an indicator that says
these are both big, national or global companies,
right?

   It's not purely that, but to some extent,
what it's picking up is, for instance, a lot is
driven, say, by S&P index funds, right? So if you're
in the S&P 500, your degree of common ownership is
very high. If you're way far out of the S&P 500, then
your degree of common ownership with another firm is
likely to be quite low.

   And, so, one of the things that I think --
it's not an endogeneity in the way we usually think
about it. It's more an omitted variable or a
heterogeneity. But that goes back to my airline
example, it was chosen for that particular point,
which is, you know, Delta, American, United, Southwest
are all the big guys and we might think have more
common interests in softening competition among them,
maybe common business strategies, much less so with
the smaller guys. And I think what we need to
struggle with is how can we find variation in common
ownership that isn't driven by that.

   It's one of the things I like in the cereal
application because Chris has found with his
coauthors, have found a setting where you’ve got some variation in common ownership not being driven by kind of firm size.

MR. WILSON: Sure.

MR. SCHMALZ: So to speak from a finance researcher perspective, basically all equilibrium models in finance we have just say all shareholders should be perfectly diversified. The only reason why you wouldn't do that is in order to have an increased influence on your portfolio firms. And there are some literature on -- in the VC space that deals with this that you might want to reduce the breadth of your portfolio to have a greater impact on your firms. But other than that, we don't have much at all.

For sure, we don’t have a well-accepted model that spells out the endogeneity of ownership, product prices, asset prices, voting behavior, and I don’t know what. You know, all the others that have been mentioned today is open issues. Yes, they are open issues. But if you wait until that model has been written, that could be 250 years or so then. So that’s a sure -- you know, and then just estimate that model in a beautiful IO way. So that's just not going to happen.

So if one wants to make any progress on this
issue, we have to accept some limitations of the models that they make and so the endogeneity of ownership is certainly one where we don't have much theoretical guidance at all.

MR. WILSON: Okay, thanks.

Dan?

MR. O'BRIEN: Yeah, I mean, I was just going to -- you know, we had to tackle that a little bit in our structural model as well, and, I mean, ideally, you know, a big model would have a structural model of the airline industry or whatever industry you're studying and also, you know, you would model the investment process itself. Nobody's developed that model at the level of being able to empirically test, so -- but you can think about instrumental variables, right, that capture, you know, the extent of ownership in a -- in a company. And so -- that capture the extent of common ownership.

So that's what we tried to do using the BlackRock/Barclays merger as Martin did and also the Russell stock indices as instruments.

MR. CONLON: Yeah, so, in the cereal industry, I think what was nice about our set -- the reason we chose it was that Kelloggs is dominated by a large family foundation, so they're the largest
shareholder. And, so, you can basically see they
don’t care so much about the profits of other players.

Post, the fourth largest -- third or fourth
largest firm, starts out as part of Philip Morris,
gets spun off by Philip Morris, sort of goes and gets
IPO'd, and so it's bouncing in and out of various
indices. And, so, you see huge spikes, both up and
down, in sort of the weight that they put on the other
firms in the market.

The other firm that's sort of interesting is
that Quaker Oats is a division of Pepsi, and Pepsi has
this massive retail share. It’s like what retail
investors invest in, they invest in stuff like Pepsi.

And, so, they often put a weight of more
than 100 percent on sort of their -- what should be
their competitors' profits. And I think that’s in
part what led us to choose this, was that we got a lot
of variation in common ownership because when we
looked at sort of the macro evidence, those plots I
showed before, what we kind of showed was, like, these
profit weights were going up over time and they were
kind of just going up, up, up, and it seemed to mostly
be driven by indexing.

We might worry that indexing isn't, you
know, endogenous in the sense that people aren't
buying -- you know, investing in Fidelity and BlackRock because, you know, these firms are colluding in the product market. But I think our fear was that we didn’t want to just pick up a positive increasing trend, and so we wanted stuff that was sort of moving both up and down over time. And so that’s why we chose cereal in the first place.

MR. GRUNDL: So kind of to emphasize this point, I think it’s useful, though, with industries where some of the firms are not actually listed on the stock market. So, for example, in banks there are about 5,000 banks in this country not publicly traded that did not experience an increase in common ownership over the last, you know, 20 or 30 years. Their traded competitors did.

Theory predicts that these traded competitors, they pulled their competitive punches, and the privately owned banks, they should benefit from that. So that’s a prediction of the theory that can be tested at this kind of broad level if you have competitors that are not on the stock market.

MR. WILSON: Thank you.

Martin.

MR. SCHMALZ: So just to continue this conversation, I'm skeptical. So it's nice to have
this variation. It’s nice to have the variation from private actors, but, then again, we have no idea what the objectives are. So a private firm shareholder might maximize all kinds of things, including the private benefits of running a firm or being able to expense stuff on his business account.

So it's nice to have that variation, but it raises new issues at the same time. My favorite example of that is always I think there's some anecdotal evidence that large shareholders, other than Richard Branson, also tend to stand for competitive strategies. So when I think of a very competitive, say, car company, I think of Tesla, and Elon Musk holds a huge stake in it, and then people tell me, oh, yeah, but that’s because he's crazy. So maybe the same reason he holds this large stake is the reason for the competitive strategy and it has nothing to do with competitive incentives.

So all that is just to illustrate, beautiful, here we have lots of variation, but it doesn't really solve the question of answering the question of what the endogeneity is at cost variation in the first place. So that brings me just back to the point that we don't have good models of that, and that’s why, for the moment, finding shocks that are
plausible -- plausibly exogenous to the product market is the best thing we can do.

MR. WILSON: Okay. Keeping the focus on kind of heterogeneity and diversity, I want to kind of turn to an issue that has come up I think already today a bit, which is that some owners are different than others and the potential implications that may have for appropriate empirical framing.

And, Serafin, do you want to start us off on that?

MR. GRUNDL: Yes. I think this is a really important issue, and that's probably why it came up so often. So for the most part, we treat, you know, Jeff Bezos and Vanguard and Berkshire Hathaway and the Swiss Central Bank and maybe the Norwegian Sovereign Wealth Fund, you know, all the same way in these common ownership studies. Martin just mentioned that they started to work on this a little bit. We, in our latest paper, try also to differentiate between different kinds of shareholders and have good reasons to believe that different kinds of shareholders have both different incentives and different means by which they can affect firm management.

So, for example, the distinction between asset managers and investors who invest their own
money could be important, could not, but it’s an
empirical question. The distinction between actively
managed or asset managers that mostly have funds that
actively -- you know, are actively managed as opposed
to asset managers of most VF funds that are passively
managed could be irrelevant.

And perhaps one, you know, thing that I
would like to stress in this context is that this
matters no matter what your preferred candidate
mechanism is. So if you think that your candidate
mechanism involves the common owners to influence the
managements of the firms that they commonly own, then
does heterogeneity among shareholders matter?

But if you kind of, you know, flip the
burden of proof, as I think Martin wants to do and
say, well, the default state of the world is that
managers, you know, they don't want to compete and
someone has to push them or incentivize them to
compete, then it also matters if these shareholders
are different, then it matters in their role as, you
know, large undiversified shareholders that could
potentially push for more competition.

So either way, I think shareholder
heterogeneity is important and at least in principle
it can be investigated empirically.
MR. WILSON: Thanks.
Martin, do you want to pick up from there?
MR. SCHMALZ: Nope.
MR. WILSON: That's totally fair.
Chris?
MR. CONLON: Sure. So I'll say we actually tried to do this. We tried to get data on who was active and who was passive. It's very hard. You know, even like for a large firm, like Fidelity, like is Fidelity -- do they have some actively managed funds, they have some, you know, clearly just low-cost index funds, and so there is some within the finance literature, there is some kind of agreement, I think that Brian Bushee put together on sort of who's active and who's passive.
You know, the list looks okay, but it wouldn't look super convincing, at least not the parts that we were able to match up. So, yeah, I think -- I mean, I think, like, as long as you don't put -- I think what we found, like, it was pretty robust to -- at least in aggregate, it was pretty robust to how much weight we put on different people. And, so, the massive driver in aggregate seems to be the move towards indexing. And, so, unless you put, like, all your weight on these really concentrated active folks,
I think you're going to find at least in the long run that these weights have been going up.

Now, whether or not these weights are translating to anything in the product market I'm not willing to say, but, yeah, that's about what we found.

MR. SCHMALZ: So I didn't say this because it's obvious in the literature but not -- perhaps not in all literatures. This active/passive distinction is difficult also because you have fund families that host both active and passive funds. So Fidelity, one example; BlackRock another. Vanguard is probably the most passive one of them all. But the empirical fact seems to be that in most cases, all of the funds get voted together and that the engagement and stewardship happens.

I see the people who have actually studied voting nodding here. So there are exceptions from that rule, and it seems to be that the predominantly passive asset managers tend to be those that tend to vote all the shares together more so than others, but, you know, to which extent -- where we're going to draw the line between calling that an actively managed one and not.

Another one is like a crook of the finance literature. How many indexes do we have now? The
answer is 3.7 million, okay? So we have 3.7 million
indexes, and anything that tracks an index is
considered a passive fund, like the ETF nowadays are
out there is, like, on South American timber or
whatever, or the Jets ETF. Now, that has very little
to do with diversified investment as, you know, we
talked about democratizing investment for the American
customer. But it counts as a passive fund, but it’s
ridiculous because literally the 70th percentile of
indexes is used by only one fund. In other words,
that’s as active as it ever gets. So these statistics
are which fraction of an asset manager are actively
managed versus passive. You have to take them with
lots of grains of salt, and this classification is,
therefore, very difficult and perhaps also just not
even useful, given that voting happens in a
centralized way.

MR. WILSON: Thanks. One quick followup on
that from me, which is that it seems like there is
wide agreement that there is diversity here. The
extent to which that diversity may or may not manifest
itself in different behavior in terms of common
ownership is a bit in question. But is there any
sense in which we could -- we can sign or come up with
a reasonable theoretical hypothesis about the effect
that mismeasuring these things may have on the estimated relationship between common ownership and various product market outcomes?

MR. SCHMALZ: The obvious first answer is if it’s measurement -- pure measurement error, you get an attenuation of the coefficients, so in order to get a false positive coefficient, you have to cook up a story of why there's an endogeneity here that goes this way, and I'm not aware of one.

MR. CONLON: Do you want me to cook one up? This is like -- I guess this is my specialty, I don’t know. No, I would say, like, I think the -- I mean, I think there are cases where we see in the data where when you look broadly, you see cases where the set of investors really changes around certain events. And a lot of -- there is some randomness about, like, we only see these investor holdings once a quarter.

And, so, like, when are investor holdings kind of the weirdest? They're the weirdest usually around a big corporate event, so like takeovers and bankruptcies and stuff like that where the set of -- you know, you see all of a sudden these large hedge funds coming in, playing some merger arm strategy or they’re buying distressed firms or all of a sudden, you know, on the reporting day it happens that all the
former debt holders are now the equity holders because
the previous equity holders got wiped out.

And, so, like, I don’t know, when we looked
at all the data across all 500 firms in the S&P 500,
like almost every time we found something that looked
super weird, it was around one of these financial
events. So, you know, if something goes up -- if the
weight goes up to like 1,000, you know, or down to
zero, you know, that could be all the variation in
your data. And, so, these outliers, you know, screwed
stuff up for us when we looked with the broad index.

MR. WILSON: Thank you.

All right, moving on to another topic kind
of themed around a question received from the
audience. So there's, I think, pretty clear
disagreement on the panel about the relevant merits of
different approaches and certainly the lay of the
evidence on the ground. But if we set the past aside
and we look prospectively towards the future, are
there approaches that academics or policymakers or
anyone interested in this issue could adopt that would
be at least reasonably acceptable or be taken
seriously by all panelists?

Dan, do you want to start us off on the
research design?
MR. O'BRIEN: Okay. I think the three warning signs that I put in my earlier talk play into the research design question for trying to answer the question about the effects of common ownership by institutional investors, okay? And two of the signs -- two of the warning signs are, you know, institutional investors are investing, you know, in a broad set of industries. And the existing empirical work is not paying any attention to that as far as I can tell, or not much.

Okay, so the industries involve -- so the investments involve companies that are substitutes for each other and compete and companies that are vertically related, okay, and companies that are independent and maybe they’re related for other reasons besides traditional complementarities or substitutabilities. And if you're going to apply a theoretical framework to motivate your empirical analysis, you have to take that into account.

So this is not so much a research design point as it is, you know, there's a real need if you want to apply this to the institutional investor problem, to write down the right objective where, you know, you're modeling, you know, what's actually motivating the investment.
And then the second point I would say, and again, I hate to sound unrealistic, this is more a call for research, it’s that, you know, what are institutional investors really interested in in exerting whatever influence they might exert over managers of companies. You know, is it maximizing shareholder value across one industry as assumed by the theory -- as the theory's applied to the empirical work that got us here, or is it, you know, something else that involves competition with, you know, other institutional investors and that whole competitive process. What that means for ways in which influence is exerted, I think that’s just kind of an open question.

My opinion is that, you know, that model, which has been used to motivate a key explanatory variable, holding aside the issues with that explanatory variable, doesn't really apply to the institutional investing problem because of these big problems of asset managers having incentives that I'm not sure we understand and the fact that what I called the relevant common ownership group should include all interrelated entities and it should model -- okay, the MHHI is the wrong index, is another way to put it if you're not accounting for all the interrelationships.
MR. WILSON: Okay, thanks.

Chris.

MR. CONLON: Yeah, okay, I want to sort of -- yeah, I’m going to propose two additional things we could look for in the data to find evidence that I don’t think anybody has done yet. So one is, look, if we’re already sort of quasi-cooperating, that is, if I’m already putting the weight of a half on your profits, well, then, we should systematically overpredict the price effects of mergers that we see, right? Because once we merge, the most weight I’m going to put on your profit is 100 percent.

So if I’m already putting 40, 50, 60 percent weight on your profit, now, a merger is actually going to raise prices by less than we would expect, right? Now, that presents other issues for the FTC about how they should, you know, think about mergers in this world, but I’m not going get into that.

And I think the other sort of implication from the theory, if you take the theory seriously, is that there could be these wild asymmetries in the weight that I put on your profit, versus the weight that you put on my profit. And I think we should be able to see -- we kind of miss those when we mush everything together in this MHHI, but if we see those
in the data, you know, we should be able to go looking
for stuff that looks like that, where one firm is just
very generous to this other firm, while the other firm
just really doesn't care and is competing pretty hard.

MR. WILSON: Thanks.

MR. O’BRIEN: Can I add one thing?

MR. WILSON: Sure.

MR. O’BRIEN: Just one thing. So I talked
about the institutional investing context and trying
to do empirical work there. I think there are
examples, which I don't have at the front of my head,
but there are examples in antitrust where you have
large investors that are taking positions -- you know,
the Richard Bransons of the world, the
noninstitutional investors where you have large
investors taking positions in multiple companies where
the theoretical framework that people have in mind
actually applies quite well, and it would be very
useful to study the impact of transactions that
involve, you know, changes in common ownership that
comes through those large investors or a few large
investors as opposed to institutional investors that
are investing across entire industries.

MR. SCHMALZ: Where do you see Berkshire
Hathaway in that space?
MR. O’BRIEN: I’d have to study exactly what Berkshire Hathaway’s holdings are because it’s pretty broad. And so I’m -- across a lot of industries.

MR. SCHMALZ: It's pretty concentrated in airlines and banks.

MR. O’BRIEN: Okay, so it might work is what I would say. But, you know, if it's airlines and banks, is it airline suppliers and airlines buyers and is it bank suppliers and so on? I mean, you need the right group to study this, right? Or is it primarily focused on one industry? And if it's one industry, then I think the framework applies quite well.

MR. SCHMALZ: So let me respond to that. Is it fair to call you predominantly a theorist?

MR. O’BRIEN: I am predominantly a theorist, yes.

MR. SCHMALZ: Okay. So here’s the thing. I sympathize with all that. The entire day we’ve heard speculation, mainly theoretical considerations of all the things that the existing models and measures don't capture. The question is how far you want to drive this. And if you want to wait until we have a theory of partial vertical common ownership, we have the world authority sitting in the audience, Yossi Spiegel here, and who has tried for decades to try to do this,
right, and doesn't, you know, manage to resolve all these issues we're bringing up here.

In addition, you want to know what precisely guides a firm's objective. Oliver Hart, a Nobel Laureate, tried this for a few decades and hasn't come up with anything better than saying it's not going to be maximizing own-firm profits and all on your own. And, in fact, we have, you know, Arrow's impossibility theorems that tell us, you know, it's not so clear that there even exists such a thing as a firm objective. They want that, you want vertical -- a vertical theory. In addition, you want to endogenize the asset manager's incentive problems, and this is just a theory.

And next, how am I going to apply this vertical theory to the actual data, right? So I would need which fraction of the sales of, like, this bank goes in terms of bank loans to an airline to figure out if the Berkshire Hathaway common ownership in this vertical relationship matters or not. Where am I going to get this data from? It doesn't exist. I don't think anybody collects this. So I think what we have to be a little careful about in this debate is also to only ask questions or put this as like roadblocks in the way of the literature that can
actually be answered and that have not been proven to be unanswerable, like literally in some cases for decades, and just say, oh, but there's these unresolved questions, and the number of sunshine hours is not in the models either.

MR. O’BRIEN: A real quick response, Martin. I'm not asking for a theory of everything; I'm asking for an empirical methodology, you know, that's defeensible and robust and valid and has an interpretation.

MR. SCHMALZ: Very good.

MR. O’BRIEN: Yeah.

MS. ROSE: And I would just echo that. I think it's not fair to say -- you’ve got a theory that says that these asset managers are performing very complex analyses to decide what their portfolio company should be doing to maximize the value of their portfolios. And either -- or maybe even more heroic, the portfolio companies are figuring out what the various owners must be doing in terms of -- or want them to do in terms of maximizing these complex portfolios.

And I understand to say, well, that's really hard. But then where do you draw the boundaries? And you've drawn them, you know, siloed within an
industry, and I'm just not sure that there's any
defensible argument to say that comes from the theory;
it doesn't. It's informing on the empirical
motivations or the underlying incentives because it
doesn't.

And, so, I do think one of the -- and then
to say, well, you know, cereals, Chris did, it doesn't
show -- that's just one example, but I think the
theory says it should show up everywhere where there
are incentives.

And, so, I struggle with this because I
think if we really believe that common owners, that
asset management companies are behaving in this way or
their portfolio companies are interpreting this set of
incentives and responding to them, it should be
ubiquitous and we should be able to find places where
there is variation that would, like the cereals
variation, distinguish between these are similar,
large companies in this market and some small ones
over here that are dissimilar. We should be able to
look for places where we see what the theory predicts,
and the theory is richer than the tests have been so
far.

MR. SCHMALZ: So that's not the theory. I
think I've been very clear about this during the day.
The theory is not that anybody sits there and is a puppet master. I'm not going to repeat all the points I made this afternoon, but that was a misrepresentation of what the theory is.

MR. WILSON: Okay, Serafin, do you want to chime in? Fair enough.

All right, we are winding down, and so I want to get to more of the questions from the audience. And the first I want to tee up I think is going to be extremely narrow insofar as it is directed entirely to Serafin.

The Federal Reserve enters into passivity agreements that limit voting by large asset managers. How does your banking paper adjust voting rights?

MR. GRUNDL: So we don't adjust voting rights in our paper. What the Fed does in general is something I can't comment on here.

MR. WILSON: Okay. And to be honest, I overlooked the fact that Martin was also an author of banking papers. Do you adjust the issue of voting rights?

MR. SCHMALZ: So I'm not perfectly understanding the question. Is the question about the 10 percent limit the Fed imposes on asset managers, like the reason Warren Buffett can't hold more than 10
percent in Wells Fargo? Is that the -- I’m not sure precisely -- what precisely the question is.

AUDIENCE MEMBER: May I clarify the question?

MR. WILSON: Yes.

AUDIENCE MEMBER: The Federal Reserve requires that asset managers do not vote (off microphone).

MR. SCHMALZ: Mm-hmm.

AUDIENCE MEMBER: So you’ve got a banking paper that is predicated on (off microphone). How do you adjust for that?

MR. SCHMALZ: So that's not adjusted at all.

AUDIENCE MEMBER: So the paper really is based on (off microphone).

MR. SCHMALZ: No, the paper is based on a model that is imperfect. It’s based on data that’s imperfect. The question is if any of these imperfections matter for the conclusions, and I don't think we have evidence of that. If you're willing to supply better voting data as the one you mentioned and better than the regulatory filings, that would be very useful to the research community.

MR. WILSON: Thanks. So this one is directed to Martin and Dan. Professor Schmalz has
suggested that some of the criticism and responses to
his original airline paper actually confirm those
original paper's findings. And I guess the question
is about does Dan agree that his paper confirms
Martin's original findings?

MR. O’BRIEN: Yeah, so I agree that when we
run a regression, that's the same regression as
Martin, José, and Isabel's regression. We get the
same answer or pretty close, and the reason we did
that was to try to see if we had the same data set,
because if it’s identical, we should get the same
thing.

So, now, we did not replicate -- I do not
agree that our analysis confirms their results at all.
The whole point of the paper was to say we don’t think
this is the right methodology, and we adopted two
other methodologies that yield different answers.
They both yield the answer that common ownership did
not raise airfares.

MR. SCHMALZ: So the only -- I agree the
only thing this proves is probably our results were
not driven by a coding error, or we made the same one
or one with a similar effect.

MR. O’BRIEN: I agree with that.

MR. SCHMALZ: And any particular way in
which you’d treat one particular individual
shareholder’s voting rights versus another is not
going to lead to the particular empirical results we
have. Differences in interpretation of these results
are completely -- I didn't mean to suggest that we
agree on that part.

    MR. O’BRIEN: Yeah, so, Einer had a slide
up, too, that said we’ve confirmed their results.
That's just really an interesting observation.

    MR. WILSON: Thanks. So I think moving on
to quite a different point, which is that vast
majority of the literature that Martin has summarized
has focused on listed U.S. actors. To what extent do
we think that there is scope for extending to consider
I guess non-U.S. data to see if this hypothesis holds
in other sectors and areas?

    MR. SCHMALZ: Sorry, it’s a question to me?
It's difficult to find ownership data and
product market data in general. Scandinavian
countries have good data, and then it relatively --
stops relatively quickly. So this call to action also
goes to competition authorities elsewhere to try and
make ownership data more accessible. In many cases,
they simply don't know who owns the firms they're
regulating, okay, so they can't even study these
MR. WILSON: Just a factual followup question for me. So the Scandinavian ownership data, is that relatively easily accessible to researchers?

MR. SCHMALZ: There, you can match the ownership of a firm with the personal records of the owner. So it's pretty good in many cases.

MR. WILSON: That does seem pretty good.

MR. CONLON: As a counterexample, you know, my favorite industry is chocolate confections. And, so Hershey is publicly trade and Mondelez is publicly traded on U.S. exchanges. Mars, the largest seller in the U.S., is the third or fourth largest privately held firm in the United States. You know, the family mostly owns them, but the other firm is Nestle, which is a Swiss firm. And it's been quite clear to me I'm never going to get the data who owns Nestle stock.

MR. SCHMALZ: Or with other stocks the Kelloggs Foundation owns, right? So this is just extremely scant in terms of data.

MR. WILSON: Thanks. We are winding down. I guess let's go for a lightning round of roughly one-minute closing statements from the panel. Maybe let’s start with Nancy and work backwards.

MS. ROSE: Sure. So I’d like to make two
points about airlines that I think haven’t been flagged. So one was we’ve heard that we need the enforcers to be investigating this. I would like to point out that in 2015, the Washington Post reported on a Department of Justice investigation of potential capacity discipline and coordination among airlines. The Post writes, “U.S. Airlines received a letter Tuesday demanding copies of all communications between carriers, their shareholders, and investment analysts about their plans for limiting seat capacity.”

In January of 2017, the national press reported that that investigation did not seem to have gone anywhere. I can't comment on it because I was at the DOJ during that period, but those are two public statements that you might just put into your fodder about the likelihood that demanding all communications between companies and their investors will shed a lot of light on this phenomenon. That's all I have to say about that aspect.

And the other I would say with respect to airlines, another interesting episode for you to perhaps take home with you and look at, Martin mentioned that that airline continues to have extraordinarily high levels of common ownership. I would invite you to look at what’s happened with
United Airline between 2016 and the middle of 2018 when United deviated from its previous low-capacity growth rates that were common across the industry.

They had a couple of relatively small investors, one of which owned a number of other airlines, one of which only owned United, who pushed a proxy fight, ended up with a board seat. United grew much faster. It tanked a lot of the other airline industry stocks in early 2018, I think it was, when they announced they were going to pursue this -- continue to pursue this growth strategy, but it raised United's fares.

And I think this is just an example if there's a profitable deviation, if you can raise your company's market value, companies are tempted to take it, and the common owners didn't seem to block.

MR. WILSON: Thank you.

Chris.

MR. CONLON: All right, I've said most of what I want to say, so I'm just going to do a quick plug. In five weeks, Matt, my coauthor, and Mike Sinkinson and I are going to be at Brookings unveiling one of our three common ownership papers. So I think it's going to be -- I think they told us the 16th or the 17th of January. So if you're in D.C. and you
want to hear more debates and discussions about common
ownership, hopefully we'll see you there.

MR. WILSON: Many thanks, Chris.

Martin.

MR. SCHMALZ: I just want to say that I have
no stakes or strong opinions about which particular
approach should be taken going forward in this
literature. There are many great minds who are
thinking about this question.

What I do want people to walk away with is
that just assuming, without evidence, that if two
firms’ shareholder base overlaps by 100 percent, that,
therefore, they are completely independent, that this
is just not something that is backed by either theory
nor the existing empirical evidence. So declaring
this a nonissue and an issue that regulators and
researchers shouldn't study strikes me as absurd.

MR. WILSON: Thank you.

Dan.

MR. O’BRIEN: Yeah, so, I'll say, so this is
all really interesting to me, having participated in
work on the theory years ago, and I think it's really,
you know, great that Martin and his coauthors kind of
took that and said what can we do with this and did a
bunch of empirical work, and that's great.
I think it's true that we don't have
evidence today that with respect to institutional
investors there's a problem with common ownership.
I do think there are -- we all agree that, you know,
some degree of common ownership could have
anticompetitive effects. And I think that's probably
quite testable in contexts that are simpler than the
institutional investor context and that I look forward
to more research that, you know, tells me whether or
not that model makes any sense.

MR. WILSON: Thank you.

Serafin.

MR. GRUNDL: Yeah, so perhaps a few words
about what I think the academic debate can deliver and
what it cannot deliver. So I think we can maybe reach
conclusions about what different methods, how the
results of different methods ought to be interpreted,
and there are going to be isolated empirical results
for certain industries, but if you want to kind of
settle the empirical matter, it cannot come out of the
academic literature, it has to be institutions, say at
like the FTC, that collects data from many industries
to kind of give a comprehensive view of whether there
is an effect and, if yes, how big it is.

MR. WILSON: Thank you. And with that, I'm
afraid the panel must come to a close. I thank you
all for your attention and for sticking around for
discussion.

(Appause.)

(Hearing concluded.)
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