AN ANALYSIS OF PROPOSALS TO RESTRICT INSTITUTIONAL OWNERSHIP

April 2019
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Founded in 2006, the Committee undertook its first major report at the request of the incoming U.S. Secretary of the Treasury, Henry M. Paulson. Over ten years later, the Committee’s research continues to provide policymakers with an empirical and non-partisan foundation for public policy.
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Introduction

Part I of the Committee’s statement describes two proposals that would restrict institutional ownership of stocks: one offered by Professor Einer Elhauge1 (referred to herein as “Elhauge”) and another offered by Professors Eric Posner, Fiona Scott Morton and Glen Weyl (referred to herein as “PSW”).2 These proposals would expose institutional investors to antitrust liability for owning stocks in multiple firms in a concentrated industry to address anticompetitive effects from “common ownership”.3 To avoid such potential antitrust liability, institutional investors could hold stock in only one firm-per-concentrated industry.

Part II analyzes the potential consequences of the proposals, including their impact on U.S. capital markets and the ability of retail investors to diversify their savings. Part III then reviews and analyzes two alternative “safe harbors” to the one firm-per-concentrated industry restriction. To qualify for the first safe harbor, institutional investors would have to act as “passive” owners, meaning that they would be effectively prohibited from engaging with firm management. The second safe harbor would allow institutional investors to invest in multiple firms in the same concentrated industry so long as their stake in each firm does not exceed 1% of each firm’s equity.

The Committee concludes that the negative consequences of the proposed restrictions on institutional ownership could be widespread, severely impeding the efficient funding of U.S. businesses and significantly increasing the cost of diversification for U.S. investors. Furthermore, as the Committee has addressed in detail in past releases, there is a substantial lack of evidence that any reforms are necessary to prevent anticompetitive behavior due to common ownership.4 The Committee therefore strongly recommends against the adoption of these policy proposals.

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4 Id.
I. The One Firm-Per-Concentrated-Industry Proposals

At the heart of each of the Elhauge and PSW proposals is potential antitrust liability for institutional investors that own equity in multiple firms in a concentrated industry. To avoid antitrust liability, institutional investors must limit ownership to one firm-per-concentrated-industry, which we will refer to as the “one firm-per-concentrated industry” restriction. We note that both proposals consider the aggregate holdings of all funds managed by an asset manager to be owned by that asset manager; the one firm-per-concentrated industry restriction would therefore apply at the fund-family, rather than the individual fund, level.\(^5\)

Elhauge’s proposal relies on a novel extension of current antitrust law: he argues that antitrust liability can arise even without any communication between management and shareholders encouraging anticompetitive behavior.\(^6\) Others, including Judge Douglas Ginsburg, argue that this would at most be a kind of conscious parallelism, which the Supreme Court has deemed “not in itself unlawful.”\(^7\) Elhauge argues that institutional investors with holdings in a concentrated market can avoid antitrust liability by investing in only one of the competing firms.\(^8\) PSW propose a prohibition on institutional ownership of more than one firm in a concentrated industry. In different venues, PSW have advocated variously for the enactment of an explicit one firm-per-concentrated industry restriction on institutional investors through legislation or through rulemaking by the Federal Trade Commission (“FTC”),\(^9\) and for the adoption of an official enforcement policy issued by the Department of Justice (“DOJ”) or FTC against institutional investors that violated the one firm-per-concentrated industry restriction.\(^10\)

Elhauge and PSW use different methodologies for determining which industries are concentrated and therefore subject to antitrust scrutiny and potentially the one firm-per-concentrated industry restriction. Elhauge’s methodology is based on the modified Herfindahl-Hirschman Index (“MHHI”), a measure that augments the standard Herfindahl-Hirschman Index (“HHI”) measure of industry concentration currently used in antitrust analysis to account for common ownership by institutional investors. MHHI is formally defined as \(\text{MHHI} = \text{HHI} + \text{MHHI delta}\), where \(\text{HHI}\) captures the number and relative market share of competitors in an industry and \(\text{MHHI delta}\) captures the extent to which those competitors share common

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5 Posner et al., *Proposal to Limit* at 34; Elhauge, *Horizontal Shareholding* at 1268.
6 Elhauge, *Horizontal Shareholding* at 1305-12.
10 Posner et al., *Proposal to Limit* at 34-35.
ownership. Under current DOJ and FTC guidelines, a market is considered to be “highly concentrated” if the HHI exceeds 2500. Elhauge recommends that this 2500 threshold should include MHHI for purposes of determining potential antitrust liability based on common ownership: specifically, he argues that investors whose stock ownership results in an MHHI delta of 200 in an industry with an MHHI exceeding 2500 are vulnerable to antitrust liability.

Under PSW’s proposal, the primary factor for designating an industry as concentrated would be an HHI of 2500 or above, the traditional threshold used by the DOJ and FTC to determine whether an industry is “highly concentrated.” However, PSW would encourage the DOJ and FTC to exercise broad discretion in determining industries that would be subject to the one firm-per-concentrated industry restriction – even if HHI is below 2500 – by taking into consideration measures of common ownership such as MHHI. Importantly, PSW argue that “any uncertainty about whether to classify an industry as an oligopoly [i.e. concentrated] should be resolved in favor of classification because there are little incremental costs to so doing.”

Table I on the next page describes key aspects of both proposals.

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14 Posner et al., Proposal to Limit at 23-25.
15 Id at 24.
16 Id at 36.
Table I

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<tr>
<th>Restriction</th>
<th>Elhauge Proposal</th>
<th>PSW Proposal</th>
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<tr>
<td>Institutional investors face potential antitrust liability if owning equity in multiple firms in a “concentrated” industry.</td>
<td>Institutional investors are prohibited from owning equity in multiple firms in an “oligopolistic” industry.</td>
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</tr>
<tr>
<td>Industry Designation</td>
<td>Antitrust liability possible in industries with MHHI &gt; 2500.</td>
<td>List of industries designated as “oligopolies” published annually based on HHI &gt; 2500, but not dispositive; HHI &lt; 2500 can still be designated as an oligopoly; level of MHHI also a factor in designation.</td>
</tr>
<tr>
<td>Type of Restricted Owners</td>
<td>Institutional investors and other large shareholders.</td>
<td>Institutional investors and other large shareholders.</td>
</tr>
<tr>
<td>Implementation</td>
<td>No new legislation or regulation, but rather antitrust claims filed against institutional investors by either:</td>
<td>Enacted as an explicit restriction on institutional investors, either through legislation or rulemaking by the FTC, or adopted as an official enforcement policy issued by the DOJ or FTC; violations would trigger antitrust enforcement by the DOJ or FTC.</td>
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<td>(i) DOJ or FTC,</td>
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<td>(ii) State governments,</td>
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<td>(iii) Private plaintiffs claiming injury from anticompetitive behavior.</td>
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17 Elhauge, Horizontal Shareholding at 1301, 1303-04, 1314 (arguing for antitrust liability for investors that have large enough holdings in the same competitors to cause the MHHI delta to exceed 200 in an industry with MHHI of 2500 greater).  
18 Posner et al., Proposal to Limit at 33. PSW define “institutional investors” to include “companies that manage mutual funds and index funds, asset managers, and other firms that buy and hold equities on behalf of their customers.” Id at 5. Note that the Securities Exchange Act defines “institutional investment manager” as “any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person.” 15 U.S.C. § 78m(f)(6)(A).
II. Analysis of the One Firm-Per-Concentrated Industry Proposals

We will now evaluate the impact that the implementation of a one firm-per-concentrated industry restriction would have on the U.S. capital markets. We first identify the fundamental problems that the implementation of such a restriction would pose for U.S. businesses that need access to capital. We then examine the significant negative impact that such a restriction would have on the ability of investors to diversify at a low cost.

(1) The Proposals Could Result in Institutional Ownership Restrictions on the Majority of U.S. Industries

A fundamental problem with the Elhauge and PSW proposals is that their methodology for defining an industry as concentrated and therefore subject to antitrust scrutiny is over-inclusive. Professors Andrew Koch, Marios Panayides and Shawn Thomas (“KPT”) find that out of the 206 industries in the United States with at least two public companies for 20 quarters, 121 industries (58.7%) have an HHI above 2500; the PSW proposal would therefore apply the one firm-per-concentrated industry restriction to the majority of U.S. industries.\(^\text{19}\) KPT also find that 199 industries out of 206 (96.6%) have an MHHI above 2500.\(^\text{20}\) Moreover, the lowest MHHI among all industries is close to 2200, meaning that the seven industries not above 2500 are dangerously close to Elhauge’s lower bound. Investors would likely be discouraged from owning meaningful stakes in multiple firms in industries that are close but not yet at the 2500 mark, so as to avoid any potential future antitrust liability. The Elhauge proposal would thus potentially expose institutional investors in all U.S. industries to antitrust liability.

The following stylized example usefully demonstrates how over-inclusive the MHHI is as a measure of industry concentration – in particular, how even a highly competitive industry (one with low concentration as measured by HHI) with minimal common ownership can be deemed “concentrated” when measured using MHHI. Suppose an industry has 100 competitive firms, each with a 1% market share.\(^\text{21}\) The HHI for the industry is 100, far below the current 2500 threshold for antitrust concerns. Further suppose that there are only three institutional investors with common ownership and that they each own 1% of the equity in each of the 100 firms (3% common ownership in aggregate across the three institutions). These conditions would produce an MHHI of 10,000, well above the 2500 threshold used by Elhauge.

\(^{19}\) Based on data provided to CCMR by Andrew Koch, Marios Panayides and Shawn Thomas from their paper Common Ownership and Competition in Product Markets (February 22, 2019), available at http://dx.doi.org/10.2139/ssrn.2965058. CCMR thanks Professors Koch, Panayides and Thomas for kindly sharing their MHHI and HHI data. Professors Koch, Panayides and Thomas calculated HHI and MHHI quarterly from 1985-2012. We present the data from Q4 2012, the most recent quarter that they provide. Note that industries are defined based on their 4-digit NAICS code.

\(^{20}\) Id.

\(^{21}\) Equal market share among firms is not a necessary assumption, but rather simplifies the example.
Notably, neither proposal’s methodology would require that there be evidence of anticompetitive effects from common ownership before an industry is determined to be “concentrated”, and therefore subject to antitrust scrutiny. And indeed, as the Committee has addressed in previous statements, such evidence does not exist.

(2) The Proposals Could Result in a Massive Reorganization of Equity Ownership, Posing Serious Funding Challenges For U.S. Companies

In today’s U.S. public equity markets, institutional investors collectively own an increasingly large share of the stock of public companies—80% of the average S&P 500 company as of 2017. Both proposals could therefore result in significant sales of stock by institutional investors seeking to avoid antitrust scrutiny or liability. Committee staff have determined that 443 of the 500 largest U.S. companies in the S&P 500 are in “concentrated” industries, defined as any industry with an MHHI exceeding 2500. Based on calculations by Committee staff, the sale by institutional investors of their stakes in all but one firm in each of these industries would involve the sale of $4 trillion of stock, representing nearly 18% of the aggregate market cap of these 443 companies. The effects of such stock sales within individual industries could be even more significant. For example, Committee staff found that institutional investors seeking to avoid antitrust scrutiny or liability by complying with the one firm-per-concentrated-industry restriction would have to sell more than half of the total shares outstanding of the largest U.S. airlines. Further details of the required sales for each U.S. airline are set forth in Appendix I.

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22 Elhauge emphasizes that, in the case of purely passive investments, antitrust liability requires evidence of anticompetitive effect. Elhauge, Horizontal Shareholding at 1307-08. Nonetheless, using MHHI as a measure for industry concentration and potential antitrust liability can be expected to have a significant deterrent effect on institutional ownership of multiple firms in an industry even absent any evidence of anticompetitive effects.

23 Committee on Capital Markets Regulation, Common Ownership and Antitrust Concerns (cited in note 3); Committee on Capital Markets Regulation, Common Ownership Theory Meets Reality (cited in note 3).


25 Using the MHHI calculations for industries (designated by 4-digit NAICS code) provided by Koch, Panayides and Thomas, 443 firms in the S&P 500 were identified as being in an industry with an MHHI of 2500 or greater. For each of those 443 firms, institutional ownership data was collected from Form 13F filings (the most recent ownership data available are holdings as of Sep. 30, 2018). Only institutional holdings above 1% of a firm’s market cap were collected. Stock prices as of Sep. 30, 2018 for each of the 443 firms were also collected in order to calculate the dollar value of each institutional holding. Institutional investors are assumed to sell all shares except their single largest investment (by dollar value) in each industry. The total number of shares to be sold under this assumption were then aggregated for each of the 443 firms.
A reorganization of equity ownership of this magnitude could pose serious challenges to market stability and the ability of affected companies to raise capital, which could in turn have a negative impact on their productivity and performance.\textsuperscript{26}

(3) The Proposals Could Result in Frequent Re-Allocations of Capital by Institutional Investors That Would Impose Costs on U.S. Companies and Investors

A further problem with both proposals is that the industries identified as concentrated could change frequently, creating significant problems for institutional investors. That is because the measures used by both proposals to determine industry concentration can fluctuate quickly and unpredictably. HHI changes as the market shares of firms within an industry change. A firm’s market share (for example, Delta’s market share within the airline industry) can change based on a multitude of factors that are unrelated to common ownership. MHHI is even more volatile, as it fluctuates as both common ownership and the market share of firms within each industry change. Implementation of the proposals could therefore result in a cycle of institutional investment and liquidation, which would be highly inefficient for capital allocation by public companies and would raise costs for investors as a result of increased turnover.

We use a stylized example to demonstrate how a minor change in institutional ownership can result in a dramatic increase in MHII and designation as a concentrated industry. Suppose an industry has an MHII of 2136 (below the 2500 threshold). The MHII of that industry can spike from 2136 to as much as 14,106 if a single non-common owner with a 10% stake in a single firm in that industry decides to sell their shares – even if there is no other change in ownership by common owners of firms in the industry. Exposing institutional investors to antitrust liability from investing in multiple firms in an industry simply because another institutional investor made the independent investment decision to sell their stake in one company in that industry could lead to a highly unstable market.

(4) Costs of the One Firm-Per-Concentrated Industry Restriction for Diversified Investors

A fundamental tenet of modern investing is that investors should seek to hold a diversified portfolio of stocks to maximize their risk-adjusted returns.\textsuperscript{27} The primary vehicles through which U.S. investors and retirees do so today are diversified mutual and exchange-traded funds managed by large asset managers, such as funds that seek to track the S&P 500

\textsuperscript{26} The one-firm-per-concentrated industry also could potentially lead to increased concentration of corporate control as institutional investors increase their holdings in individual firms. Consolidating corporate control in fewer owners could have negative consequences, as legal and economic scholars have shown that the presence of large controlling shareholders can lead to poor corporate governance at the expense of minority shareholders. See Ronald Gilson, \textit{Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy}, 199 Harv. L. Rev. 1641 (2006).

\textsuperscript{27} For the seminal article on modern portfolio theory, see Harry Markowitz, \textit{Portfolio Selection}, 7 J. of Finance 77 (1952).
index.\textsuperscript{28} Of course, these funds hold stock in the largest public companies, including many in the same industry. However, according to the proponents of the one firm-per-concentrated industry restrictions, such diversification – holding multiple firms in the same industry – can have anticompetitive consequences. In this section, we therefore focus on the tension between the proposals and the benefits of diversification. First, we examine whether the proposals could meaningfully reduce the ability of investors to maximize their risk-adjusted returns through diversification. We then consider the potential impact that the proposals would have on the cost of asset management.

We note at the outset of this section that the logic of the common ownership theory on which the one firm-per-concentrated industry restriction relies would predict anticompetitive effects from common ownership even if common ownership were highly dispersed among retail investors rather than concentrated among large institutional investors.\textsuperscript{29} Therefore, the proposals, which focus on common ownership by institutional investors, could fail to have an impact on common ownership and its purported anticompetitive effects, if retail investors are otherwise able to diversify.

\section*{\textit{(i) The Proposals Could Prevent Institutional Investors From Maximizing Their Risk-Adjusted Returns Through Diversification.}}

Elhauge and PSW contend that, despite their proposals, investors could still achieve effective diversification by diversifying investments across industries.\textsuperscript{30} PSW cite a study to support the assertion that “a randomly chosen portfolio of any 49 stocks – one from each industry – would achieve more than 90\% of the available diversification (reduction in the standard deviation of a portfolio) in the market.”\textsuperscript{31} Presumably, Elhauge and PSW believe that such diversification is sufficient and that the impact on U.S. investors’ ability to maximize their risk-adjusted returns is minimal.

However, the returns of S&P 500 companies clearly illustrate the necessity of owning a much larger number of stocks to maximize risk-adjusted returns. For example, over the past 20 years, the average S&P 500 stock rose 215\%, whereas the majority of S&P 500 stocks rose

\begin{footnotesize}
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\item[30] Posner et al., \textit{Proposal to Limit} at 10; Elhauge, \textit{Horizontal Shareholding} at 1303.
\item[31] Posner et al., \textit{Proposal to Limit} at 35. Parenthetically, we note that PSW’s reference to the paper by Campbell et. al inaccurately suggests that Campbell et. al studied the diversification benefits achieved by investing in 49 stocks, one from each U.S. industry. Campbell et. al did not select one stock from each U.S. industry. Instead, Campbell et. al selected 50 stocks randomly from the entire universe of publicly-listed U.S. stocks. See John Y. Campbell, Martin Lettau, Burton G. Malkiel, and Yexiao Xu, \textit{Have Individual Stocks Become More Volatile? An Empirical Exploration of Idiosyncratic Risk}, 56 J. of Finance 1, 23-26 (2001).
\end{itemize}
\end{footnotesize}
To be sure to achieve the higher average return of 215%, investors must have invested in all S&P 500 companies. Otherwise, if investors must choose only one firm-per-concentrated-industry, some investors will end up with a portfolio of the underperforming stocks.

The economic consequences of the proposals are further described in a recent comment letter by BlackRock to the Federal Trade Commission. BlackRock’s comment letter reports the results of a study by a third party consultant, Analysis Group, hired by BlackRock, examining the returns of hypothetical portfolios constrained by the one firm-per-concentrated-industry restriction versus the returns achieved by the S&P 500 index from 1990 to 2017.

The study finds a significant negative impact on the ability of investors’ to reduce risk through diversification. The study established a benchmark portfolio return based on a $1 investment in the S&P 500, beginning in 1990. By 2017, a $1 investment would have grown to $13.74. The study then ran 1,000,000 simulations with different portfolios that complied with the one firm-per-concentrated-industry limitation. The results illustrate how volatile the returns would be for such portfolios. The best performing portfolios (95th percentile) yielded a value of $15.42, while the worst performing portfolios (5th percentile) yielded a value of only $12.61, a significant difference of 22%. Since the goal of broad-market based index investing is to generate market returns while minimizing volatility, these results illustrate that the one firm-per-concentrated industry restriction would prevent investors from achieving the full benefits of diversification.

Exhibit 1, based on the Analysis Group study, further illustrates the negative economic consequences that the one firm-per-concentrated industry restriction would have on retirees. For example, on an initial investment of $100,000, the worst performing portfolios (5th percentile) subject to the one firm-per-concentrated-industry restriction would have earned at least $112,709 less from 1990-2017 as compared to an investor that had simply held an S&P 500 fund during that period.

34 Id at 18-20.
35 Id at 20.
36 Committee staff substituted the $1 initial investment in the Analysis Group study with a $100,000 initial investment to illustrate the potential impact on retirees from the one firm-per-concentrated industry proposal.
(ii) *The Proposals Could Increase Costs for Investors by Effectively Banning S&P 500 and other Broad-Based Index Funds.*

Index funds aim to track the returns of a reference index (such as the S&P 500 index). Distinct from active fund management, index fund managers do not seek to maximize investment returns by identifying the best performing stocks. Rather, index fund managers buy and sell stocks in a nondiscretionary, mechanical fashion, driven entirely by reference to the composition of the index. This mechanical style of investing allows investors to diversify their savings at a lower cost than active investing, which requires more costly stock analysis by investment professionals.

These lower costs and the strong performance of index funds relative to active funds have driven a marked increase in the assets under management ("AUM") by index funds in recent years. Index investing as a percentage of the U.S. investment fund market has grown from 15% in 2007 to 35% as of the end of 2017.\(^{37}\) AUM for equity index funds in the U.S. have grown from $548 billion in 2005 to $2.74 trillion as of the end of 2017.\(^{38}\) As index investing

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\(^{38}\) Id at 125.
has grown, costs for investors have dropped significantly. Annual management fees for index equity mutual funds have dropped from an average of 27 basis points (0.27%) in 2000 to a historical low of 9 basis points (0.09%) in 2017, with the least expensive funds charging fees under 6 basis points (0.06%).\(^{39}\) and one – Fidelity – offering multiple index funds with zero fees.\(^{40}\) The lower fees offered by index funds have also helped drive a reduction in fees charged by active funds. In 2018, active equity mutual funds charged average fees of 75 basis points (0.75%), down from an average of 1.07% in 2002.\(^{41}\) Researchers at S&P Global estimate that index funds “save investors more than $20 billion annually in management fees alone [emphasis added].”\(^{42}\)

However, the one firm-per-concentrated industry limitation could result in a de facto ban on the most prevalent types of index funds—broad market-based index funds, such as the S&P 500, Russell 3000 or Wilshire 5000 index funds\(^{43}\) because these indices include multiple firms in so-called concentrated industries.\(^{44}\) For example, the S&P 500 index consists of multiple firms in each industry, including airlines (Alaska Air, American, Delta, Southwest, and United) and banks (Bank of America, Citigroup, Comerica, JPMorgan Chase, U.S. Bancorp, and Wells Fargo). A de facto ban on broad-based index funds would increase the cost of diversification for investors because asset managers would have to be compensated for the higher cost of actively choosing specific firms in each concentrated industry. Indeed, the choice of the specific firm is significant, given the vastly differing returns of competing firms in an industry: in 2018, for example, United Airlines stock was up 23%, while Delta Airlines was

\(^{39}\) Id at 126.


\(^{43}\) The proposals would also ban sector-specific index funds that are focused on a concentrated industry. Sector funds, by design, limit fund holdings to a specific industry (such as the financial or technology sector), providing investors access to more narrowly focused investments. For example, investors seeking exposure to the financial sector can invest in the Financial Select Sector SPDR Fund (ticker: XLF), which represents financial companies in the S&P 500. The effect of the ban on sector-specific index funds would also be substantial, as sector mutual funds and ETFs had more than $765 billion in AUM as of the end of 2017. See Investment Company Institute, 2018 Investment Company Fact Book at 218, 261 (cited in note 28).

\(^{44}\) The one firm-per-concentrated industry limitation would also affect active funds that diversify by owning multiple firms in a concentrated industry. For example, the Fidelity Magellan Fund owned stock in six different banks as of its latest annual report. See Fidelity Investments, *Fidelity Magellan Fund - Annual Report 7* (Mar. 31, 2018), available at https://institutional.fidelity.com/app/literature/annual-report/702307/magellan.html.
down 11%. Similar differences are found in other industries, including telecom (Verizon up 6%; AT&T down 27%), and aerospace (Boeing up 9%; Lockheed Martin down 19%).

(iii) The Proposals Could Increase Costs for Investors by Preventing Asset Managers from Managing Multiple Investment Funds.

In practice, one asset manager often advises dozens to hundreds of legally-independent investment funds with distinct investment strategies and different investors. This business model has become increasingly prevalent because asset managers can centralize certain business functions, such as risk-management, corporate governance and investment expertise, which enables these asset managers to offer investment funds at a low cost to investors. However, the Elhauge and PSW proposals would impose the one firm-per-concentrated industry restriction on all investment funds managed by the same asset manager. That would make it highly difficult, if not impossible, for an asset manager to manage multiple independent investment funds with distinct investment strategies, because an asset manager would be limited to investing in the same firm for each concentrated industry across all funds that they offer. For example, if a fund manager of a “value fund” were to determine that American Airlines is the appropriate “value stock” to best meet the investment objectives of that value fund, no fund in that fund complex could invest in any other airline – even if, for example, another fund manager at the same asset manager were to determine that Southwest is the appropriate “growth stock” for the asset manager’s “growth fund.” The proposals would therefore further increase costs for investors by eliminating the economies-of-scale offered by asset managers that manage multiple investment funds with distinct investment strategies.

45 Based on available Yahoo! Finance data for each company’s stock.
46 Posner et al., Proposal to Limit at 34; Elhauge, Horizontal Shareholding at 1268.
III. Assessing the Proposed Safe Harbors

Elhauge’s proposal includes a de-facto safe harbor for “passive” ownership. If an institutional investor commits to not vote their stock (or alternatively, purchases only non-voting stock), then potential antitrust liability for owning multiple firms in a concentrated industry would be minimized.\textsuperscript{47} Elhauge does not consider this a full safe harbor, because he argues that management may still be incentivized to behave anticompetitively by common ownership, even if the institutional investor refrains from voting altogether.\textsuperscript{48} Indeed, financial economists that are proponents of the theory that common ownership has anticompetitive effects have argued that these effects can be achieved simply by common owners not pressuring management to compete.\textsuperscript{49}

PSW include an explicit safe harbor: they would permit an index fund (not actively managed funds or any other type of institutional investor) to hold stock in multiple firms in a concentrated industry, so long as the fund is “purely passive.” A fund would be purely passive if it committed to (i) not communicate with firm management, (ii) exert no influence in shareholder votes, and (iii) own and trade stocks only according to clear, non-discretionary rules.\textsuperscript{50}

The PSW proposal also includes a safe harbor for minority investments that would permit institutional investors to hold stock in multiple firms in a concentrated industry so long as their ownership of each firm constitutes less than 1% of the firm’s market capitalization. For example, an institutional investor would be permitted to own 1% of the equity of American Airlines, 1% of the equity of United, and 1% of the equity of Delta, but would not be permitted to increase its ownership above the 1% threshold in any of the firms without divesting its interest in all other airlines. Table II summarizes the proposed safe harbors.

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\caption{Proposed Safe Harbors}
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\begin{footnotesize}
\textsuperscript{47} Elhauge, \textit{Horizontal Shareholding} at 1315.
\textsuperscript{48} Id. But see Ginsburg and Klovers, \textit{Common Sense about Common Ownership} (cited in note 7) (arguing that, as a matter of current antitrust law, the behavior that Elhauge describes is a kind of \textit{conscious parallelism}, which the Supreme Court has deemed “not in itself unlawful”).
\textsuperscript{49} Guy Rolnik and Asher Schechter, \textit{The Anti-Competitive Effects of Common Ownership: Q&A with Martin Schmalz}, ProMarket (December 16, 2016), available at \url{https://promarket.org/threats-competition-common-ownership-asset-managers-qa-martin-schmalz/} (“Perhaps the most important insight from thinking about this is that common owners need not do anything for common ownership to have effects on firms’ strategic behavior.”).
\textsuperscript{50} Posner et al., \textit{Proposal to Limit} at 34, 44-45. Regarding the shareholder vote limitation, PSW do not restrict the casting of shareholder votes \textit{per se}, but rather require that the votes have no impact on the outcome (that is, the index fund must mirror the votes of the other shareholders). Presumably, the goal is to effectively restrict shareholder voting (similar to Elhauge) but to allow index funds to technically meet any legal obligations to cast a shareholder vote.
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Table II

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<th>Passive Investor Safe Harbor</th>
<th>Elhauge Proposal</th>
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<td>Antitrust liability for owning multiple firms in a concentrated industry is <em>reduced</em> if investors do not vote their shares.</td>
<td>Index investors permitted to own multiple firms in a concentrated industry if they: (i) do not communicate with management, (ii) refrain from voting (or equivalently vote only by mirroring the votes of other shareholders), and (iii) own and trade stocks only according to clear, non-discretionary rules.</td>
</tr>
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| Ownership Stake Safe Harbor | None. | Institutional investors permitted to own multiple firms in a concentrated industry if they own less than 1% of the equity of each firm in the industry. |

Professors Edward Rock and Daniel Rubinfeld have proposed an alternative safe harbor that would enable institutional investors to avoid antitrust liability if they: (i) hold less than 15% of each firm in an industry; (ii) do not have board representation for any firm; and (iii) only engage in “normal” corporate governance activities.  

Rock and Rubinfeld outline multiple practices that constitute “normal,” including adoption of proxy voting policies and reporting of shareholder votes, and engagement with firm management on issues such as “board composition and governance, board responsibilities, shareholder rights, transparency, succession planning, executive compensation, and responsibilities of asset manager.”

(1) The “Passive” Safe Harbor Would Adversely Affect Corporate Governance

Safe harbors for “passive” ownership would disrupt the balance of control struck between public companies and their owners and prevent beneficial shareholder engagement. If the passive ownership safe harbor were widely used, voting power would become

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52 Id. at 31-32.

53 To the extent that this safe harbor applies only to index funds, and not active funds, it may also serve to distort the balance between index funds and active funds in favor of index funds, potentially reducing any market benefits provided by active funds.
concentrated in management and institutional investors that do not own shares in other firms in the same industry.

The effects on corporate governance could be dramatic. For example, public companies could become more exposed to short-term pressures, as activist investors could buy significantly smaller stakes in a public company to attain voting power. The purely passive safe harbor could also serve to insulate management from beneficial institutional pressures.54 While asset managers vary their voting strategy across firms on governance issues, they tend to support greater board independence, oppose antitakeover provisions, and oppose unequal voting rights, as occurs when firms maintain a dual class share structure. Accordingly, firms with greater ownership by index funds, for example, are found to have more independent directors than firms with less index fund ownership.55 Index fund ownership of firms also contributes positively to the removal of takeover defenses (i.e. poison pills), which have been shown to have negative consequences on firm performance and shareholder returns.56

In addition to improving the corporate governance of firms, active engagement by index fund owners also contributes positively to firm performance. Firms with higher index fund ownership are found to have significantly improved returns on assets (ROA).57 Indeed, prominent legal experts argue that regulators should in fact be encouraging additional shareholder engagement by institutional investors.58

Although the Rock and Rubinfeld safe harbor might not have the same drastic effects on corporate governance as the Elhauge and PSW proposals, defining “normal” for purposes of enforcement could prove challenging, leaving the scope of permissible corporate governance activities to be quite ambiguous. As a result, the proposal might have a chilling effect on corporate governance activities similar to the “purely passive” safe harbor.

(2) The Safe Harbor for Small Holdings Would Result in Large Disruptions and Increase Costs for Investors

The PSW proposal includes a safe harbor that would permit institutional investors to hold stock in multiple firms in a concentrated industry, so long as the institutional investor owns no more than one percent of each firm. Since the largest asset managers (such as BlackRock and Vanguard, and State Street) own substantially more than one percent of the equity in many

54 Thomas A. Lambert and Michael E. Sykuta, The Case for Doing Nothing About Institutional Investors’ Common Ownership of Small Stakes in Competing Firms, University of Missouri School of Law Legal Studies Research Paper No. 2018-21 49 (May 4, 2018), available at https://ssrn.com/abstract=3173787 (noting that “[t]he separation of ownership and control may lead managers to direct firm resources not to their highest and best ends…”).
56 Id at 124-25.
57 Id at 129.
firms,\(^59\) they would not be permitted to take advantage of the safe harbor unless they liquidated a significant portion of their positions, which would have an effect even larger than the one firm-per-concentrated industry restriction. Committee staff estimate that compliance with the 1% cap safe harbor by institutional investors would result in the sale of \$5.1 trillion\(^60\) of stock of 443 of the largest U.S. public companies, representing nearly 23% of their aggregate market cap. For the airline industry in particular, divestitures for all but two airlines included in the S&P 500 would exceed 40% of their outstanding shares. Further details of the sales of stock in U.S. airlines are set forth in Appendix II. Therefore, concerns about market disruption and increased funding costs for U.S. businesses would still apply under the one percent safe harbor.

Retail investors seeking to maximize their risk-adjusted returns would be able to simply shift their savings to smaller asset managers that are able to diversify and remain below the one percent threshold. The Rock and Rubinfeld proposal, which would set the relevant threshold at 15%, would allow for a similar re-allocation of retail investors to smaller asset managers and away from the largest asset managers. If retail investors choose to do so then the primary effect on retail investors from the safe harbor would be the deprivation of the lower costs often associated with large asset managers, due to their economies of scale for risk management, corporate governance and investment expertise.

\(^59\) Backus et al., Common Ownership Hypothesis at 12-14 (cited in note 24) (reporting that the three major asset managers went from each holding under 1% of a typical S&P 500 firm to holding roughly 5% (State Street) to over 7% (Vanguard)).
\(^60\) This estimate assumes that shareholders that own shares in more than one firm in a concentrated industry will sell any such shares that exceed the one percent threshold. That is why the estimate for required sales here exceeds the estimate for required sales in the absence of a one-percent safe harbor. In practice, common owners might opt for a mixed strategy of relying on the 1% safe harbor for certain industries and retaining their stake in one firm-per-concentrated industry for other industries.
Conclusion

This statement evaluates the impact on the U.S. capital markets from policy proposals by Professor Einer Elhauge and Professors Eric Posner, Fiona Scott Morton and Glen Weyl that would expose institutional investors to potential antitrust liability for owning multiple firms in a concentrated industry.

The Committee finds that these proposals rely on over-inclusive and unstable measures to designate industries as concentrated and could result in the sale of stock worth over $4 trillion, or nearly 20% of the stock in the affected firms in the S&P 500. The proposals could therefore be extremely disruptive to the efficient funding of U.S. businesses. In addition, the proposals could prevent investors from maximizing their risk-adjusted returns through diversification. The proposals could do so by effectively banning S&P 500 funds and preventing asset managers from managing multiple investment funds, both of which have been critical for providing retail investors and retirees with low-cost investment management services.

The Committee further concludes that safe harbors that would require institutional common owners to be “passive” investors by restricting their ability to engage with the firms that they own, through voting and other means, would pose immeasurable harm to effective corporate governance. An alternative safe harbor that would allow institutional investors to invest in multiple firms in the same concentrated industry so long as their stake in each firm does not exceed 1% of each firm’s equity would be highly disruptive for the funding of U.S. businesses as it would require the sale of more than 20% of the equity of the largest U.S. public companies in affected industries.

The Committee therefore concludes that the proposals could impose immense costs on U.S. businesses and U.S. investors. We therefore strongly recommend that policymakers not adopt these proposals.
Appendix I

Potential Divestitures in the Airline Industry

The following table shows that for seven of the nine U.S. airline stocks, at least 44% of the shares outstanding would be sold if all institutional investors in the U.S. airline industry sought to comply with the one firm-per-concentrated industry restriction. 61 Delta would suffer the least under our assumptions, since Delta stock is the largest airline holding for three of the largest institutional investors (Berkshire Hathaway, Vanguard, and BlackRock). 62

<table>
<thead>
<tr>
<th></th>
<th>% of Shares Outstanding Sold</th>
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<tbody>
<tr>
<td>Spirit</td>
<td>55.3%</td>
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<tr>
<td>Hawaiian</td>
<td>54.2%</td>
</tr>
<tr>
<td>SkyWest</td>
<td>53.9%</td>
</tr>
<tr>
<td>United</td>
<td>53.5%</td>
</tr>
<tr>
<td>Alaska</td>
<td>48.3%</td>
</tr>
<tr>
<td>American</td>
<td>45.1%</td>
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<tr>
<td>JetBlue</td>
<td>44.3%</td>
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<tr>
<td>Southwest</td>
<td>30.8%</td>
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<tr>
<td>Delta</td>
<td>9.5%</td>
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61 For each airline, ownership data from 13F filings were collected for all institutional owners holding 1% of more of the airline’s equity. Total shares owned by such owners (1% or greater) were then aggregated for each airline, excluding an institutional owner’s shares for a given airline if that airline represented the owner’s largest airline holding by dollar value. The resulting net shares aggregated for each airline were then divided by the airline’s total shares outstanding, represented in the column labeled “% of Shares Outstanding Sold.”

62 CCMR calculations based on 13F filings.
Appendix II

Potential Divestitures in the Airline Industry with a One Percent Safe Harbor

The following table shows that for seven of the nine airline stocks at least 40% of the shares outstanding would have to be sold if all institutional investors sought to comply with the one percent safe harbor.\(^6\)

<table>
<thead>
<tr>
<th>Airline</th>
<th>% of Shares Outstanding Sold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spirit</td>
<td>47.3%</td>
</tr>
<tr>
<td>Hawaiian</td>
<td>41.2%</td>
</tr>
<tr>
<td>SkyWest</td>
<td>44.8%</td>
</tr>
<tr>
<td>United</td>
<td>47.5%</td>
</tr>
<tr>
<td>Alaska</td>
<td>41.9%</td>
</tr>
<tr>
<td>American</td>
<td>40.7%</td>
</tr>
<tr>
<td>JetBlue</td>
<td>41.4%</td>
</tr>
<tr>
<td>Southwest</td>
<td>36.2%</td>
</tr>
<tr>
<td>Delta</td>
<td>34.8%</td>
</tr>
</tbody>
</table>

\(^6\) For each airline, ownership data from 13F filings were collected for all institutional owners holding 1% or more of the airline’s equity. The total number of shares owned by these owners that exceeded 1% of the airline’s total shares were then aggregated for each airline. The resulting shares aggregated (i.e. the total amount in excess of 1%) for each airline were then divided by the airline’s total shares outstanding, represented in the column labeled “% of Shares Outstanding Sold.”