Common ownership of shares faces regulatory scrutiny

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Global regulators are starting to home in on an academic theory on the drawbacks of overlapping corporate ownership by investors, a trend that could pose a threat to the $80tn asset management industry.

The theory is known as “common ownership”, which refers to shareholders, or owners, holding shares in competing companies within the same sector. According to the argument, managers of companies have fewer incentives to invest in new products or services, or to try to lure customers from rivals, if they know that big owners of their shares also have big stakes in their rivals. In other words, common ownership hurts competition.

The theory is gaining traction at a time when markets have been transformed by the rise of passively managed index and exchange traded funds, which now own huge swaths of some of the biggest companies in the world. If valid, the theory has ramifications for every corporation and investor — and also every consumer.

“The stakes are enormous,” said Scott Hemphill, a law professor specialising in antitrust and regulation at New York University. “Critics are asking whether mutual funds — long regarded as a benign and familiar force in the economy — might require regulation on the grounds that actually they harm consumers.”

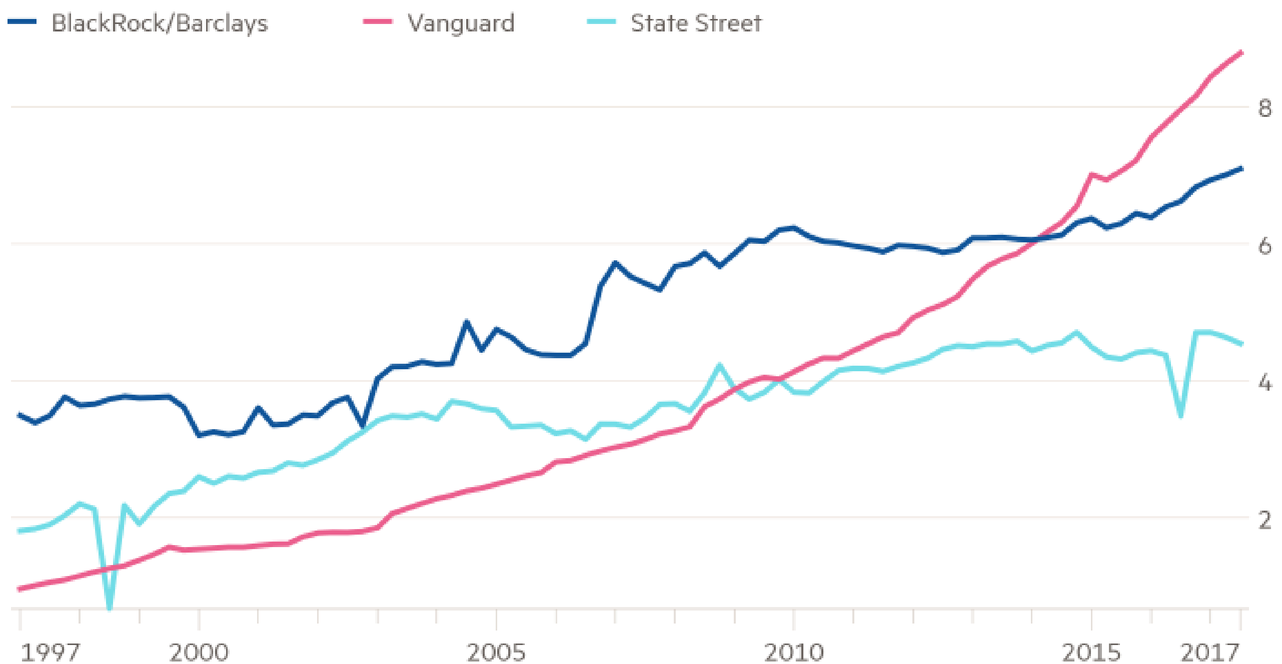
The idea began to spread five years ago, when three academics — José Azar, Martin Schmalz and Isabel Tecu — published a paper arguing that common ownership appeared to stunt competition between markets for products.

Late last year the US Federal Trade Commission gathered a group of academics, regulators, investment executives and lawyers from NYU’s law school for a hearing to discuss the matter. The FTC followed the US Department of Justice, the OECD and the European Commission in recognising the potential merits of the common ownership argument.

Even Jack Bogle, the founder of Vanguard and creator of the world’s first index mutual fund, waded into the debate before his death last week. He scoffed at the common ownership theory, calling it “absurd”, though he admitted unease about the rising clout of the index industry’s dominant players.

BlackRock, Vanguard and State Street, the three biggest index-fund managers, control about 80 per cent of the US equity ETF market, about $1.6tn in total. Put together, the trio would be the largest shareholder of 88 per cent of all S&P 500 companies. Together, they own about 14 per cent to 20 per cent of each major US airline, for example.

“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,” Noah Phillips, a sitting FTC commissioner, said at the hearing in December.



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At the end of 2017, index funds and ETFs accounted for more than one in three dollars invested in long-term funds, according to the Investment Company Institute. This represents a 130 per cent growth in market share from a decade earlier, and the trend shows no signs of slowing.

Many asset management professionals disagree that common ownership has anti-competitive effects, and have rejected suggestions that it be addressed with regulation. “We don’t need these remedies, because there isn’t a problem,” Barbara Novick, BlackRock’s powerful vice-chair and head of investment stewardship, said at the FTC hearing.

The ICI, the US asset management industry’s trade body, said in an open letter to the FTC that it “strongly” disagrees with the theory, arguing that it rests on “misinformation”, faulty assumptions about the industry’s incentives, and “flawed empirical work”.

As early as March 2016, the DoJ began investigating whether the rise of common ownership violated antitrust laws. Mr Phillips, the FTC commissioner, indicated that the hearing should be considered the start of its journey into studying the potential problem. Robert Jackson, a commissioner at the Securities and Exchange Commission, also expressed concerns at the hearing.

Under current US antitrust laws, common ownership would need proven anti-competitive effects in order for it to be considered illegal. Professor Einer Elhauge of Harvard Law School argues in a recent paper that the anti-competitive effects of horizontal shareholding, as he calls it, have been empirically confirmed, and that it is in fact illegal under US and EU antitrust laws.

“To take any kind of aggressive action, a regulator would first need a better handle on how, exactly, common owners might be having these kinds of effects,” said Prof Hemphill.

One proposal to address the issue, put forward in 2016 by professors Eric Posner, Fiona Scott Morton and E Glen Weyl, suggests limiting institutional investors to holding either 1 per cent of an industry, or shares in only one company in each industry.

Another paper late last year pointed out that the potential beneficiaries of anti-competitive behaviour — investors — are often wealthier than the consumers who pay the higher prices. That is a sensitive subject at a time of rising concerns over inequality.

The fundamental question that regulators, academics and investors must answer is this, according to Mr Schmalz: “Is there any plausible story why these secular changes in the ownership structure of firms would *not* lead to a lessening of competition?”