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Common Ownership: Impact of institutional investors' minority shareholding on competition in an industry sector

Policy makers, media and academics are debating an alleged detrimental influence of institutional investors who hold a minority stake in most or all companies in one industry sector ("Common Ownership") on the competition and ultimately consumer prices in that sector. The hypothesis is that investor's portfolio value might benefit from price fixing or other forms of collusion among the portfolio companies because margins would rise in the industry in aggregate, and taking a market share from peers would no longer increase the shareholder value under Common Ownership. The investor might therefore have an economic interest in exerting influence to discourage competition in the given sector. Managers of affected portfolio companies, on the other hand, might be actively discouraged or simply less incentivised to compete, thereby effectively prioritising market returns of the sector over competitive excellence of the own company.[1] While no plausible causal mechanism has been identified, some commentators suggest that Stewardship activities may be present a channel by which investors could encourage companies to compete less.

This discussion needs to be put in context with institutional investors' regulatory environment including the in fact practiced and politically desired shareholder engagement, the legal framework applicable to listed stock corporations and the duties of both shareholders and management of companies. From the perspective of asset managers as institutional investors, we[2] would like to highlight the following aspects:

- **Asset managers represent diverse investors with different interests.** Asset managers act as fiduciaries in the best interest of their specific investors. Such investors range from regulated investors such as pension funds, insurance companies, banks to other companies and retail investors (see Annex). The asset managers apply a range of different strategies such as different asset classes, regional or sectorial specifics and ESG criteria. Since the interests of the investors vary, asset managers' investment decisions, shareholder engagement and the exercise of voting rights depend on these specific interests and strategies. Having said this, the interests regarding stewardship are usually aligned in order to seek a responsible management and control of companies aimed at long-term added value.

- **Stewardship is part of asset managers' duties.** As a core element of their understanding as fiduciaries, asset managers are conducting stewardship activities, in particular engaging with investee companies to improve their overall business strategies and create long-term value. Policy makers around the world are increasingly encouraging, and in some cases requiring, institutional investors' shareholder engagement since it is one of the levers that can help improve the financial and non-financial performance of companies to the benefit of all shareholders and the overall economy.[3]

[1] Azar, José/Schmalz, Martin C./Tecu, Isabel: Anticompetitive Effects of Common Ownership, OECD session on Common Ownership (2017), http://www.oecd.org/competition/common-ownership-and-its-impact-on-competition.htm
[2] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.
[3] See e.g. Recital 14 of the Directive (EU) 2017/828 (Shareholder Rights Directive II)

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- **Reduced competition is not in the asset managers' or their investors' financial interest.** Diversified investors are typically not only shareholders of competitors, but also shareholders of suppliers and/or customers. This naturally limits the economic interest in non-competitive behaviour, as potential benefits from cooperation are outweighed by higher costs for affected companies along the value chain. Moreover, any potential short-term benefits must be related to negative long-term effects: Low competition tends to reduce companies' focus on innovation and customer orientation and endangers future profits through inadequate reaction to market trends and losing business to "independent" players (e.g. non-listed companies) or new market entrants.

- **Coordination to facilitate anti-competitive behaviour among investee companies is hardly feasible.** Adverse effects on competition within a market can only occur if a (hypothetical) interest of a diversified shareholder coincides with benefits for both the affected companies and other investors. Otherwise, there is little way for the investor to exert influence: Asset managers in general only hold minority stakes in investee companies – therefore, they have only limited influence on the management.[4] Non-diversified investors, who only hold an interest in one company of an industry (e.g. other asset managers, but also families or the state), also play a significant role. Their incentives may differ markedly from those of diversified investors.[5] Both could easily make attempts for illicit influence public, thereby restricting it. Finally, even when interests coincide, it remains unclear whether shareholders are a feasible platform for coordination. They are not responsible for voting on competitive strategy or business management decisions such as a pricing and are generally not involved in a company's day-to-day business, i.e. would need to steer anti-competitive behaviour indirectly. The amount and complexity of factors needed to facilitate non-competitive behaviour therefore makes the abuse of Common Ownership rather unlikely in practice – despite a theoretical possibility.

- **Seeking to abuse Common Ownership for anti-competition effects would be illicit.** Besides the lack of economic interests and practical feasibility, seeking to abuse Common Ownership would also trigger legal and reputational risks. Asset managers and asset owners such as pension funds, insurance companies or banks are subject to rules regarding diversification and investment restrictions. UCITS management companies[6] specifically are not allowed to acquire holdings for the entirety of UCITS they manage which would enable them to exercise a significant influence over the management of an issuer.[7] This already limits the influence of institutional investors. Furthermore, asset managers have to act in their clients' best interest which of course includes abiding to the law. Explicit coordination on anti-competitive behaviour between institutional investors bears the risk of acting in concert with at least a requirement to notify attributed voting rights[8] and – in case the investors involved gain control of a company (e.g. if it holds 30 percent of the voting rights also by way of attribution) – the requirement to issue a mandatory takeover offer[9]. This would regularly not be compliant with investment restrictions and in many cases even in breach of fund legislation. In addition, investors as shareholders are bound to the duty of loyalty towards the company. Lastly,

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[4] See for instance German Monopolies Commission, Biennial Report XXII: Competition 2018 (http://monopolkommission.de/de/gutachten/hauptgutachten/hauptgutachten-xxii.html), p. 179 regarding holdings in the German DAX

[5] See e.g. for Germany, German Monopolies Commission, Fn. 10, p. 181

[6] A UCITS Management Company is a company whose regular business is the management of funds that are specifically regulated under EU law, so-called UCITS. UCITS are Undertakings for Collective Investments in Transferable Securities authorised according to the EU Directive 2009/65/EC. As of May 2018, some 10 trillion Euros are managed in UCITS.

[7] Art. 56(1) Directive 2009/65/EC (UCITS Directive); the implementation under German law restricts the management company to hold more than 10% of the voting rights of an issuer in all UCITS it manages, see § 210(2)(1) KAGB

[8] See Art. 9 Directive 2004/109/EC (Transparency Directive)

[9] See Art. 5(2) Directive 2004/25/EC (Takeover Bids Directive)

also the management has to manage the company in its best interest, with the objective of sustainable value creation. Acting anti-competitive would not be compliant with these duties.

- **Research on Common Ownership falls short of providing robust evidence of detrimental effects, or a plausible causal mechanism.** Research on Common Ownership so far has not proven any detrimental effect on competition in an industry sector. This is not surprising, given the fact that the theoretical possibility is often in practice not in the interest of the investor, hardly feasible and possibly illicit. Furthermore, it is limited in number and scope, i.e. it has a narrow focus on three very specific US markets. Consequently, results of this limited, early stage research cannot be generalised, given that these markets are in no way representative. While the German Monopolies Commission identified a **potential** risk of anti-competitive effects of Common Ownership, it also acknowledges numerous critiques of the data and methodology of the existing studies on this topic, and clearly states that **any regulatory measures would be pre-mature**.[10] For the same reason, U.S. antitrust agencies are not prepared to make any changes to their policies or practices with respect to Common Ownership at this time.[11]

In sum, asset managers as minority shareholders lack the incentives and ability to influence competition dynamics. Hence, we believe that research and analysis of the current situation should take into account all aforementioned factors and should analyse thoroughly whether detrimental effects in practice occur. Until then, **existing law should be used to deal with any practical problems, if any.** Common Ownership is already taken into account within merger control. Existing law provides for a set of measures to prohibit illicit behaviour. Further measures should be pursued only if research reveals compelling evidence of competitive effects, as well as a clear causal mechanism. In addition, any potential measures require thorough impact analysis. Otherwise unintended consequences could occur, like reduced risk diversification and increased costs to the detriment of end investors[12], but also obstacles to desirable shareholder engagement.

[10] German Monopolies Commission, Fn. 4, p. 215
[11] Hearing on Common Ownership by institutional investors and its impact on competition – Note by the United States, 6 December 2017, https://one.oecd.org/document/DAF/COMP/WD(2017)86/en/pdf, p. 9
[12] Hearing on Common Ownership by institutional investors, Fn. 11, ibid

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Annex: