AMERICAN ECONOMIC LIBERTIES PROJECT

WORKING PAPER SERIES ON CORPORATE POWER #8

The New Money Trust: How Large Money Managers Control Our Economy and What We Can Do About It

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November 2020

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ACKNOWLEDGEMENTS

The views and opinions expressed in this paper are those of the authors and do not necessarily reflect the views of Stanford Graduate School of Business or Stanford University. The author is grateful to Matt Stoller, Sarah Miller, and Olivia Webb of the American Economic Liberties Project for their guidance, assistance, and feedback throughout this process. The author is also grateful to Satyam Khanna, Andy Green, Marc Steckel, Gregg Gelzinis, and Diana Best for their thoughtful comments and feedback. Finally, but most importantly, the author is grateful to Moira Birss for her endless brilliance, moral clarity, and patience.

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INTRODUCTION

In 2018, the late Vanguard founder Jack Bogle sounded an alarm about the risk that "a handful of giant institutional investors will one day hold voting control of virtually every large U.S. corporation."[1] He said that the impact of this "growing dominance" on financial markets, corporate governance, and regulation will be "major issues in the coming era."[2]

It was noteworthy because Bogle was a pioneer in the field of a modern investing model, namely the creation of investment funds that track market indexes and offer low fees to retail investors. That such an ardent champion of the index fund investing model would speak out was an indication of how much the financial markets had changed over the course of his lifetime, and of the troubling growth of a few, large financial firms.

The emergence of a small group of financial companies controlling a vast and growing amount of wealth, and wide swaths of our economy along with it, has happened before. In 1912, a Congressional subcommittee known as the Pujo Committee documented a network of "money trusts," a small cadre of financial companies that controlled vast amounts of financial wealth in the form of shares and directorships in companies from railroads to utilities to industrial firms.[3] At the center of the web of trusts was J.P. Morgan & Co.[4] The "dominating power" of Pierpont Morgan, the bank's namesake, was "so universally recognized in the financial world that even the leaders humbly bow to it."[5] The Committee concluded that the implications of the anticompetitive issues raised by concentrated ownership and control were "fraught with too great peril to our institutions to be tolerated."[6] Congress enacted the Federal Reserve Act in response.

Likewise, the Pecora Commission formed in the aftermath of the banking panic of 1933 observed that the "financing of industrial and public utility corporations" was "concentrated among a small group of investment banking houses and the investment affiliates of several large commercial banks."[7] Congress responded with a variety of reform laws during the New Deal, including the Glass-Steagall Act, the Securities Act, and the Federal Deposit Insurance Act.

Again, in 1968, the House Banking subcommittee led by Congressman Wright Patman reported on the trust operations of Wall Street banks and a "new trend toward control of these vital elements of our economy through control of the voting of large blocks of stock in…corporations

1 John C. Bogle, *Bogle Sounds a Warning on Index Funds*, Wall St. J., Nov. 29, 2018.

2 *Id.*

3 *See* Report of the Pujo Subcommittee, "Concentration of Control of Money and Credit," H. Rep. No. 62-1593, at 129-133 (1913).

4 *See id.*, at 131.

5 *Id.*, at 138.

6 *Id.*, at 133.

7 Report of the Committee on Banking and Currency, "Stock Exchange Practices," S. Rep. No. 73-1455, at 86 (1934).

held for beneficiaries by a relatively few giant financial institutions."[8] As a result, the "snowballing economic power" of these trust banks made them the "single most important force in the economy" by virtue of the amount of resources under their control, as well as their influence over nonfinancial businesses.[9] These structures, the subcommittee warned, could result in anticompetitive behavior and conflicts of interest.[10] Again, Congress responded with the Bank Holding Company Amendments of 1970.

Asset management firms have become a part of a new "money trust"—a system of financial architecture dominated by a few large banks, private equity firms, and hedge funds.

Today, scholars of finance are increasingly raising concerns that the rise of mutual fund ownership of U.S. corporations is "reminiscent of the early 20th century system of finance capital when business was under the control of tycoons such as J.P. Morgan and J.D. Rockefeller."[11] Antitrust experts argue that the "historic trusts that motivated the creation of antitrust law were horizontal shareholders[,]" where a common set of investors own significant shares in corporations that are competitors in a market.[12] In this sense, asset management firms have become a part of a new "money trust"—a system of financial architecture dominated by a few large banks, private equity firms, and hedge funds.

Modern financial markets are distinct from the robber baron era by the fact that ultimate ownership of corporate shares is dispersed across many investors and asset owners, albeit controlled by a small concentrated group of institutions. In this sense, it is a modern version of an old problem.

For a sense of the scale of the problem, the "Big Three" asset management firms—BlackRock, Vanguard and State Street—manage over $15 trillion in combined global assets under management,[13] an amount equivalent to more than three-quarters of U.S. gross domestic product. The outsized footprint of a few large financial companies poses new issues for the governance of corporate America, the competitiveness of our economy, the concentration of political power,

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8 Subcomm. on Domestic Finance, House Banking and Currency Cmte., U.S. House of Representatives, "Commercial Banks and Their Trust Activities: Emerging Influence on the American Economy," at 1 (1968).

9 *Id.*, at 5.

10 Justin Phillips, "DoorDash admits to violating SF's cap on restaurant delivery fees, promises refunds," *San Francisco Chronicle*, July 10, 2020. https://www.sfchronicle.com/food/article/Doordash-admits-to-violating-SF-s-cap-on-15394887.php#photo-19427679

11 Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, at 1 (Feb. 2017), available at SSRN: https://ssrn.com/abstract=2798653.

12 Einer R. Elhauge, *How Horizontal Shareholding Harms Our Economy—and Why Antitrust Law Can Fix It*, at 63 (Feb. 2020), Harv. Bus. L. Rev., forthcoming, available at SSRN: https://ssrn.com/abstract=3293822.

13 *See* David McLaughlin & Annie Massa, *The Hidden Dangers of the Great Index Fund Takeover*, Bloomberg, Jan. 9, 2020.

and the stability of financial markets.

Consider the example of BlackRock, the largest asset manager, and its current entanglements in our economy and our government:

- It currently holds a 5% or greater stake in more than 97.5% of the S&P 500 companies;[14]
- It operates a technology platform that contains trade and ownership information for about 10% of global stocks and bonds;[15]
- Its investments are driving some of the key social and economic challenges of our time; for example, it manages over $87 billion worth of shares in fossil fuel companies and has opposed, or abstained from, over 80% of climate-related shareholder motions at fossil fuel companies between 2015 and 2019;[16]
- It employs a former U.S. Federal Reserve Vice Chairman and the former head of the Swiss Central Bank, among other former and future government officials;[17]
- Its largest ETFs for both investment grade and junk bonds grew to their largest size ever following the Fed's announcement that it would purchase corporate bond ETFs;[18]
- The Federal Reserve hired BlackRock to manage these corporate bond buying programs that will purchase BlackRock's own ETFs (after hiring BlackRock to do something similar in 2009);[19] and
- Its CEO has advised the President of the United States on responses to the COVID-19 pandemic.[20]

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14 *See* Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 Boston U. L. Rev 721, 735 (2019).

15 *See id.*

16 *See* Patrick Greenfield, *World's Top Three Asset Managers Oversee $300bn Fossil Fuel Investments*, The Guardian, Oct. 12, 2019. Abstention can be interpreted as an implicit endorsement of the status quo. Fund companies argue that various factors involving the dynamics around proxy voting itself and the nature of index funds, they engage in behind-the-scenes engagement to shareholder resolutions. For a more comprehensive discussion of funds' voting patterns on climate-related proposals, *see* Rob Berridge & Natasha Nurjadin, Why Do Some Large Asset Managers Still Vote Against Most Climate-related Shareholder Proposals?, Ceres.org, Mar. 13, 2020, https://www.ceres.org/news-center/blog/why-do-some-large-asset-managers-still-vote-against-most-climate-related. Recent reports suggest that BlackRock's voting record is actually decreasing, a contrast with others in the asset management space. *See* Attracta Mooney, *Blackrock Criticised Over Drop in Climate Votes*, Fin. Times, Oct. 4, 2020 (noting that BlackRock supported 6 percent of environmental proposals filed by shareholders globally in the 12 months to June 2020, down from 8 percent in the previous year). For a more comprehensive discussion of large asset managers' recent voting records on director slates and climate-related proxy measures, *see* Majority Action, *Climate in the Boardroom: How Asset Manager Voting Shaped Corporate Climate Action in 2020*, available at: https://www.majorityaction.us/asset-manager-report-2020.

17 *See* Campaign for Accountability, The BlackRock Revolving Door (visited 7/19/20), http://blackrocktransparencyproject.org/the-blackrock-revolving-door/.

18 *See* Katherine Greifeld, *BlackRock's Biggest Credit ETF Swells to Record Amid Fed Pledge*, Bloomberg, May 20, 2020.

19 *See* Richard Henderson & Robin Wigglesworth, *Fed's Big Boost for BlackRock Raises Eyebrows on Wall Street*, Fin. Times, Mar. 27, 2020.

20 *See* Chris Flood, *BlackRock Trounces ETF Rivals After Fed Appointment*, Fin. Times, May 19, 2020 (reporting that BlackRock CEO met with President Donald Trump on March 18, 2020).

This web of connections and influence mean that it is likely that BlackRock has touched the lives of most Americans in one way or another—whether or not people know this fact is another matter.

This paper will discuss the concerns that the outsized growth of the fund industry, especially its three largest participants, poses for corporate governance, competition, and financial market stability. It then explores some policy solutions to address the financial risks and anticompetitive impacts of large asset managers. While the large amount of financial resources concentrated in the hands of a few companies is cause for concern, it should be a source of some encouragement that the financial regulatory and competition laws contain tools that can be used to rein in the growth of this new class of money trusts.

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A BRIEF OVERVIEW OF FUNDS AND ASSET MANAGEMENT

The term "asset manager" is a generic term that often refers to companies that sponsor investment funds for a variety of retail, institutional, or private investors. These firms are largely subject to oversight by the Securities and Exchange Commission (SEC) to the extent that they engage in activities that require SEC registration, such as operating as an investment company, or acting as an investment advisor or securities broker-dealer.[21] These requirements are accompanied by basic financial, conduct, and investor protection standards that ensure that registered firms are safe enough to deal with the investing public. Asset management firms can also be subject to regulation by the Department of Labor to the extent that they manage money for employer retirement plans.[22] Regulation of asset managers is generally focused on conduct standards, for example through disclosures and the imposition of duties to act in their customers' best interest.[23]

Asset managers offer a variety of investment products. The focus of this paper is on index funds, which are investment funds that pool the investments of many individuals and others and invest them in a diversified portfolio of assets, including debt and equity, and attempt to track the performance of a particular benchmark index, like the S&P 500 or Russell 3000.[24] Index funds

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21 *See* John J. Topoleski & Gary Shorter, Department of Labor's 2015 Proposed Fiduciary Rule: Background and Issues 3-4, Cong. Research Svc., Apr. 1, 2016, available at: https://fas.org/sgp/crs/misc/R44207.pdf.

22 *See id.*, at 4.

23 *See* Staff of the Inv. Adviser Regulation Ofc., Regulation of Investment Advisers by the U.S. Securities and Exchange Commission, at 22-59 (Mar. 2013), available at: https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

24 *See* Bebchuk & Hirst, *supra* note 14, at 727.

can be either traditional "open-ended" mutual funds or exchange-traded funds (ETFs).[25]

The language surrounding investment vehicles is important because it can create misleading and inaccurate impressions of how these products operate.

The asset management business was conceived, and has grown, as a result of a variety of tax, investing, and labor laws beginning with the Revenue Act of 1936 and the Investment Company Act of 1940.[26] The first index fund was launched by Vanguard in 1974.[27] The first ETF was established in 1993, when the SEC granted an exemption, known as a no-action letter, from several requirements of the Investment Company Act.[28] State Street offered the first index-based ETF, and the popular iShares index ETF product, now owned by BlackRock, was invented by Morgan Stanley in 2000.[29] Over this period, asset management industry revenues grew substantially, from $82.8 billion, or 0.99% of GDP, in 1997 to $341.9 billion, or 2.43% of GDP, in 2007.[30]

The language surrounding investment vehicles is important because it can create misleading and inaccurate impressions of how these products operate. So while index funds are described as "passive" investment vehicles, there are a number of activities associated with managing index funds, including meeting customer redemptions, portfolio rebalancing, and so on.[31] In one recent example of this, the crash in the price of certain oil contracts following the onset of the COVID-19 pandemic caused managers of the largest oil ETF, United States Oil Fund LP, to reshuffle the contracts comprising the fund as certain oil futures contracts declined steeply, in a move that "wrecked any claim the ETF has to being a passive product."[32]

As discussed more below, the popularity of so-called "passive" investment vehicles like index funds and ETFs in particular have taken off in recent years, with potentially significant

25 Open-end mutual funds are those wherein "shares are continuously issued and redeemed upon demand of investors at net asset value." *See* John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve*, at 8, Harv. Pub. L. Working Paper No. 19-07 (Sept. 20, 2018), available at SSRN: https://ssrn.com/abstract=3247337;

26 *See* Benjamin Braun, "Asset Manager Capitalism," at 9-11 (June 18, 2020), https://osf.io/preprints/socarxiv/v6gue.

27 *See id.*, at 9.

28 *See* Inv. Co. Inst., "Understanding Exchange-Traded Funds: How ETFs Work," at 9 (Sept. 2014), https://am.jpmorgan.com/blob-gim/1383262775476/83456/1323398305717_ICI-RESEARCH-PERSPECTIVE.pdf. To grant an exemption, the SEC must find that it is "necessary or appropriate in the public interest and consistent with the protections of investors and the purposes fairly intended by the policy and provisions" of the Investment Company Act. Id. In that sense, ETFs were illegal, but for the SEC's willingness to grant them forbearance from enforcement of the Investment Company Act.

29 *Id.*, at 10. iShares products currently comprise 40% of the 50 most popular ETF products on the market. *See* Bebchuk & Hirst, *supra* note 14, at 730-31. State Street is the sponsor of the largest ETF by assets, the SPDR S&P 500 ETF. See id.

30 *See* Robin Greenwood & David Scharfstein, *The Growth of Finance*, 27 J. of Econ. Perspectives 3, 8 (2013).

31 Coates, *supra* note 26, at 9.; *see generally* Adriana Z. Robertson, *Passive in Name Only: Delegated Management and "Index" Investing*, 36 Yale J. on Reg. 795 (2019). Economist Thomas Philippon has called them "quasi-indexer institutions." Thomas Philippon, The Great Reversal: How America Gave Up on Free Markets 222 (2019).

32 Luke Kawa & Katherine Greifeld, *Troubled Oil ETF Again Shuffles Holdings Amid Market Mayhem*, Bloomberg, Apr. 22, 2020.

implications. We will turn now to some of the concerns raised by this trend, before considering some possible policy responses.

FUND CONCENTRATION, CORPORATE GOVERNANCE, AND COMPETITION

Since their inception in the 1970s, so-called “passive” investment vehicles have grown to make up a substantial portion of the investment industry. Assets in U.S. index funds have grown to over $11 trillion,[33] surpassing the total assets held in actively managed funds for the first time in the fall of 2019.[34]

In addition to the overall growth of the fund industry, the industry has become an “oligopoly” controlled by the Big Three.[35] Eighty-two percent of all assets flowing into all investment funds—both active and “passive”—over the last decade have gone to the Big Three.[36] The ETF industry is highly concentrated, with the Big Three asset management firms responsible for between 73% percent[37] and 80% of the global ETF market.[38] The numbers are staggering: the largest 1% of asset managers control 61% of sector assets[39]—243 times that of the bottom 50%—while 45 of the 50 largest ETFs are sponsored by the Big Three.[40] Flows in recent years suggest that the ETF industry is only becoming more concentrated into funds offered by the largest asset managers.[41]

With growth in the size of index funds has come larger and more concentrated ownership stakes in the largest U.S. companies. Combined, the Big Three constitute the largest owner in 88% of the S&P 500 firms; these corporations account for about 82% of the S&P 500’s market capitalization.[42] The average combined stake in S&P 500 companies held by the Big Three

33 *See* Robin Wigglesworth & Alex Janiaud, *Index Funds Break Through $10tn-In-Assets Mark Amid Active Exodus*, Fin. Times, Jan. 7, 2020.

34 *See* Dawn Lim, *Index Funds Are the New Kings of Wall Street*, Wall St. J., Sept. 18, 2019 (noting that there are $4.27 trillion in index funds compared to $4.25 trillion in active funds).

35 Braun, *supra* note 27, at 12.

36 *See* Bebchuk & Hirst, *supra* note 14, at 732.

37 *See* Inst. for Energy Econ. & Fin. Analysis, Inaction is BlackRock’s Biggest Risk During the Energy Transition, at 24, Aug. 2019 (citing a report by the consulting firm Mercer), http://ieefa.org/wp-content/uploads/2019/07/Inaction-BlackRocks-Biggest-Risk-During-the-Energy-Transition_August-2019.pdf.

38 *See* Braun, *supra* note 27, at 12.

39 *See id.*

40 *See* Bebchuk & Hirst, *supra* note 14, at 730-31.

41 *See* Michael Wursthorn, *The $4 Trillion ETF Industry Is Creating More ‘Roadkill’*, Wall St. J., Oct. 28, 2019 (“ETFs’ assets grew by 90% over a five-year stretch through August, but just 100 funds captured 83% of those assets, according to a report by CFRA. BlackRock Inc. and Vanguard Group managed more than two-thirds of those funds, according to the report.”).

42 *See* Fichtner, et al, *supra* note 11, at 15. For example, the three largest asset managers are the largest shareholders in three of the four largest U.S. banks. *See* José Azar, Sahil Raina & Martin Schmalz, *Ultimate Ownership and Bank Competition*, at 45 (May 4, 2019), available at SSRN: https://ssrn.com/abstract=2710252. For the fourth bank, Wells Fargo, the Big Three asset managers are three of the four largest shareholders.

reached 20.5% in 2017.[43] In addition, shares held by the Big Three represent an average of about 25% of the shares voted in director elections at S&P 500 companies in 2018.[44] These are levels of concentration reminiscent of that uncovered by the Patman report.[45] Unsurprisingly, activist investors are now urging further consolidation among competing asset managers in order to remain viable against the concentration of the Big Three.[46]

These dynamics have implications for the real economy, as fund managers have outsized influence over the companies that their funds invest in. The fact that stock buybacks have increased more rapidly for companies with a high amount of index fund ownership is one example of the potential consequences of concentrated ownership.[47] The largest asset management firms also provide services to both nonfinancial companies and financial sector competitors that augment their importance and influence.

CORPORATE GOVERNANCE

Former SEC Commissioner Robert Jackson notes that, "a few large institutions today vote millions of American families' money in corporate elections that will help decide our economic future."[48] As of the end of 2017, the Big Three cast about 25% of the votes for S&P 500 companies that they owned, and 22% of the Russell 3000.[49] Jackson has called the dominant role played by a small group of giant asset managers in determining the outcome of corporate elections "an urgent corporate governance challenge of our time."[50]

An average of 92.5% of the Big Three's portfolio companies received no shareholder engagement whatsoever during the years 2017 through 2019.[51] From 2012-2018, BlackRock, State Street, and Vanguard voted against corporate compensation proposals an average of 2.0%, 2.9%, and 4.4% of the time, respectively.[52]

The structure of index funds separates the decision-making authority of the true shareholders—the asset owners—from the companies that they own. This model, described as "asset manager

43 *See* Bebchuk & Hirst, *supra* note 14, at 724. As mentioned above, BlackRock, as well as Vanguard, now hold positions of 5% or more of the shares of almost all of the companies in the S&P 500. *See id.*

44 *See id.*

45 *See, e.g.*, Ron Chernow, The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance 561 (2010) (institutional investors' assets were concentrated in five banks' trust departments; JPMorgan held a 17.5% stake in Kennecott Copper and 15.5% in American Smelting and Refining, and a 7.4% stake in Trans World Airlines, 7.5% in American Airlines, and 8.2% stake in United Airlines).

46 *See* Corrie Driebush, *Trian Takes Stakes in Invesco, Janus Henderson With Eye on Deals*, Wall St. J., Oct. 1, 2020.

47 *See* Philippon, *supra* note 32, at 222.

48 Commissioner Robert J. Jackson, Jr., "Common Ownership: The Investor Protection Challenge of the 21st Century," Testimony Before the Hearing on Competition and Consumer Protection, Fed. Trade Comm'n, at 6 (Dec. 6, 2018). Coates notes that, although a fund complex's shares are held across different funds, the implications for voting and engagement are functionally irrelevant. See Coates, supra note 26, at 14.

49 See Bebchuk & Hirst, supra note 14, at 736-37.

50 Jackson, *supra* note 49, at 5.

51 *See* Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Colum. L. Rev. 2029, 2086-87 (2019).

52 *See id.*, at 2092.

capitalism," is characterized by four attributes: 1) ownership concentrated in the hands of a few small shareholders; 2) strong shareholders with theoretical control over portfolio companies; 3) universal ownership within diversified portfolios; and 4) asset managers with no direct economic interest in the portfolios that they hold.[53]

Given a lack of engagement on the part of most other retail shareholders, the ability to engage renders the ownership stakes of big fund companies even more influential than they initially appear.[54] The passivity of funds, namely fund managers, can also be caused by their lower fee structure, because, in the absence of meaningful competition in the fund industry over proxy outcomes, fund managers lack financial incentives to drive reform given that they do not personally enjoy the upside.[55]

The current situation has striking historical parallels. These dynamics suggest a level of deference to management that replicates a modern version of the "gentlemen's agreements" and implicit codes of conduct that prevailed during the trust era, as documented by the Pujo Committee.[56] While the scale of this arrangement is extreme, it is also reminiscent of the dynamic observed at play with trust banks in the 1960s, where investment managers displayed a significant level of deference to management.[57]

A few large institutions today vote millions of American families' money in corporate elections that will help decide our economic future.

COMMON OWNERSHIP

Justice Louis Brandeis criticized the dynamic of interlocking directorates, arguing "interlocking interests breed inefficiency and disloyalty; and the public pays, in higher rates or in poor

53 *See* Braun, *supra* note 27, at 4.

54 *See* Coates, *supra* note 26, at 14 ("For the most valuable public company in the world, three individuals can in principle swing the vote of 17% of its shares. Generally, a significant fraction of shareholders do not vote, even if in contested battles. As a result, the 17% actually represents more like 25% or more of the likely votes in contested votes. That share of the vote will generally be pivotal.").

55 See Coates, supra note 26, at 15 (given the low fees tied to index funds, fund companies "have weak incentives to do anything."); see also Braun, supra note 27, at 18 ("Unlike alternative investment vehicles such as hedge funds, whose fee structure usually includes a large performance-based component, mutual funds and ETFs typically charge their investors fees that amount to a fixed percentage of the assets invested ... Simply put, asset managers are incentivized to maximize assets under management.").

56 *See, e.g.*, Chernow, *supra* note 46, at 156 (describing "gentlemanly rules of conduct among old-line Wall Street banks" that "competed, but in a manner as formalized and ritualized as a minuet").

57 *See* House Banking Committee, *supra* note 8, at 25 (mutual fund managers can exercise voting influence even when they are not the ultimate owners of the shares they hold "because of an almost unconscious delegation of power by the individual investor in the fund."); *see also* Chernow, *supra* note 80, at 561-62 (noting that the "conservative Morgan bank usually sided with management in disputes and didn't try to substitute its own judgment").

service, a large part of the penalty for graft and inefficiency."[58] He continued: "when a company's important contracts are made through directors who are interested on both sides, the common presumption that money spent has been properly spent does not prevail."[59]

This logic has seen a revival in recent years, as scholars consider how large asset managers, and their ownership stakes in public companies, could affect competitive dynamics. Today, another "vigorous and welcome debate is in full swing" on the issue of common ownership by firms of large shareholders, including how the impacts can be measured effectively.[60] One legal scholar has said that "[h]orizontal shareholding poses the greatest anticompetitive threat of our time."[61]

One of two dynamics arises when large, diversified asset owner/managers are conflicted because they hold controlling stakes in all competitors within a concentrated industry. First, they can take active measures to reward anticompetitive behavior.[62] This anticompetitive behavior can be present either when a common owner seeks to restrain all actors in a given field in order to increase the value of these firms at the expense of consumers or workers, or they can promote favoritism of certain actors at the expense of others.[63]

Although a great deal of work has been done to build out the empirical and theoretical frameworks around this practice, sometimes referred to as horizontal shareholding, the implications of this situation are still not fully understood. Nonetheless, a recent paper finds that managers of firms that operate in industries with high levels of common ownership have compensation structures that are based less on aggressive competition, including cutting prices and gaining market share, than firms with innovative competitors.[64] Prior research also suggests that industry concentration, and common ownership of concentrated industries, implicates a variety of potential harms for customers. These include higher airline ticket prices,[65] higher costs for bank customers,[66] and generic drug prices.[67]

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58 Louis D. Brandeis, Other People's Money—and How the Bankers Use It, Ch. III: Interlocking Directorates (1914).

59 *Id*

60 *See* Azar, Raina, & Schmalz, *supra* note 43, at 34.

61 Elhauge, supra note 12, at 82.

62 *See* Azar, Raina, & Schmalz, *supra* note 43, at 46 ("[S]ome common owners (i) use voice to communicate their preferred product market strategies, (ii) use management incentive (i.e., pay) structures that implicitly reward executives for less aggressive competition, and (iii) use the power of their vote to thwart efforts of undiversified shareholders that push for more competition.").

63 *See* Jackson, *supra* note 49, at 3.

64 *See* Miguel Anton *et al, Common Ownership, Competition, and Top Management Incentives*, Ross School of Business Paper No. 1328 (Oct. 4, 2020), available at SSRN: https://ssrn.com/abstract=2802332.

65 *See* José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. of Fin. 1513, 1517 (2018).

66 *See* Azar, Raina, & Schmalz, supra note 43, at 2 ("The same four institutional investors are among the top 5 shareholders of the nation's five largest banks. The fifth important player is Berkshire Hathaway, which ranks among the top five shareholders of three of the top six banks."); see also, Eric A. Posner, Fiona Scott Morton, & E. Glen Weyl, *A Proposal to Limit the Anti-Competitive Power of Institutional Investors* (Mar. 22, 2017), available at SSRN: https://ssrn.com/abstract=2872754.

67 McLaughlin & Massa, *supra* note 13.

Alternatively, large shareholders may simply be passive actors that fail to impose discipline on management as shareholders are generally assumed to do.[68] There are a variety of incentives that could lead asset managers to be excessively deferential to management.

There is an inherent tension in the two theories regarding how the Big Three can harm competition and corporate governance. Competition problems arise when funds are too active, and passivity leads to poor governance. One BlackRock executive has called this the "Goldilocks dilemma."[69]

Finally, there is evidence that elevated ownership concentration increases wealth inequality.[70]

CONFLICTS OF INTEREST

There is also an inherent conflict that accompanies funds' dual roles managing 401(k) and pension plans for companies in which they also manage significant ownership stakes.[71] Under this theory, funds are deferential to their clients for fear of losing their pension business, but they may also be deferential toward management in general, in the hopes that they may be viewed favorably and win future business.[72]

There are additional conflicts that can be particularly perverse. For example, BlackRock is the largest shareholder in several financial institutions that are, in turn, customers of its technology platform, Aladdin, discussed more below.[73] These interlocking business entanglements raise concerns that companies will feel compelled to purchase the platform services of its largest shareholder in order to placate said shareholder, thus further concentrating economic power on this platform.[74] The Aladdin platform business also raises its own set of interlocking directorate issues.[75]

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68 *See* Fichtner, et al, *supra* note 11, at 21 ("[P]assive index funds have no reason to support aggressive price cuts or other measures that aim to take away revenue from competitors, because in many concentrated industries they own most of the competing firms.").

69 Barbara Novick, *"The Goldilocks Dilemma": A Response to Lucian Bebchuk and Scott Hirst*, 120 Colum. U. L. Rev. Forum 80 (2020).

70 *See* José Azar, *Portfolio Diversification, Market Power, and the Theory of the Firm*, at 6 (Aug. 2017), available at SSRN: https://ssrn.com/abstract=2811221.

71 *See* Bebchuk & Hirst, *supra* note 47, at 2062-64.

72 *See id.*, at 2064-65.

73 *See* Richard Henderson & Owen Walker, *BlackRock's Black Box: The Technology Hub of Modern Finance*, Fin. Times, Feb. 23, 2020.

74 *See id*. Coates hypothesizes that this indeed may be one potential outcome of outsized fund ownership, notwithstanding traditional economic theory suggesting that disciplining functions should run in the opposite direction. *See* Coates, *supra* note 26, at 18-19.

75 *See* Henderson & Walker, supra note 74 ("BlackRock is the third-largest shareholder in Apple, giving it clout over the tech company's shareholder votes, while Sue Wagner, a co-founder of the fund manager, is a board member of both companies. Ms Wagner is also on the board of Swiss Re, another Aladdin client whose former vice-chairman, Mathis Cabiallavetta, is a BlackRock board member. Mark Wilson, former chief executive of Aviva, which uses Aladdin, accepted a seat on BlackRock's board in 2018 while in his former role. This decision angered the UK insurer's shareholders who worried it created a conflict of interest, as Aviva's investment arm competes with BlackRock. He left Aviva six months later and remains on BlackRock's board.").

Finally, while Vanguard is a private company, BlackRock and State Street are themselves public companies. It is worth considering the fact that the engagement and voting patterns of large fund companies could be influenced by the fact that they themselves are subject to shareholder resolutions.[76]

There is evidence that shows that the investment fund business enjoys economies of scale that allow larger funds to spread a variety of fixed costs over their larger customer base and is therefore a driver of fund industry concentration.

FUND FEES AND PRICING AND CONSOLIDATION

Another staple of index and exchange-traded funds is their impact on fees. One of the attractions of index funds is that they offer lower fees than other investment products.[77] This has been a positive development for consumers over the short term; however, the decline in fund fees and broker fees has also driven the growth in the Big Three's market share.[78] There is evidence that shows the investment fund business enjoys economies of scale that allow larger funds to spread a variety of fixed costs over their larger customer base and is therefore a driver of fund industry concentration.[79]

The economies of scale in index fund management, and the lack of margins for brand differentiation, create significant barriers to entry for new competition.[80] In this regard, large fund companies may have inherent competitive advantages that result from their size and scope,[81] some of which has been achieved through aggressive acquisitions.[82]

76 For example, campaign finance reformers have brought shareholder resolutions calling on BlackRock to disclose its political spending. See Lane Hagar, "BlackRock Strikes Down Shareholder Resolution Calling for Lobbying Disclosure," Pub. Citizen, June 4, 2019, https://www.citizen.org/news/blackrock-shareholder-res-disclosure/.

77 *See* Bebchuk & Hirst, *supra* note 14, at 729; *see also* Suzy Waite, Annie Massa & Christopher Cannon, *Asset Managers With $74 Trillion on Brink of Historic Shakeout*, Bloomberg, Aug. 8, 2019. While average fees for traditional asset management services have decreased, particularly with the elimination of up-front "load" charges, from 2% of assets under management to 1% of assets under management from 1980 to 2007, overall fees have increased as the amount of total assets under management have increased. See Greenwood & Scharfstein, *supra* note 31, at 9.

78 *See* Andrea Riquier, *Go On, Cut Your Fees, BlackRock Tells Brokers: More ETF Business for Us*, MarketWatch, Oct. 15, 2019 ; *see also* Dawn Lim, *BlackRock Cuts Fees for Its Largest Exchange-Traded Fund to Match Vanguard*, Wall St. J., Jun. 25, 2020 (noting that BlackRock's iShares Core S&P 500 ETF tripled in size after cutting fees in 2016).

79 *See* Bebchuk & Hirst, *supra* note 14, at 729.

80 *See* Coates, *supra* note 26, at 13.

81 *See* Braun, *supra* note 27, at 14 (fund companies benefit from fixed transaction costs, "network effects" that increase liquidity, and benefits from their tech platform services).

82 *See* Attracta Mooney & Peter Smith, *Larry Fink, Barclays and the Deal of the Decade*, Fin. Times, May 5, 2019 (documenting BlackRock's 2006 acquisition of Merrill Lynch Investment Management and its 2008 acquisition of Barclays Global Investors, including the iShares brand).

It has also been suggested that ETF fees could eventually go negative, with funds adopting a loss leader strategy to attract business to one fund. This could create a "ripple effect," whereby investors are more likely to shift their money into other funds within the fund family, or where funds cross-sell to investors or charge money managers fees for access to their platforms.[83]

* * *

The concentration of the Big Three fund companies, and accompanying concentration of corporate ownership, could continue increasing in the coming years. One study estimates that, if the current ownership trend continues, the entire market will be held by index funds by 2030.[84] Another projects that the Big Three could own 33.4% of S&P 500 equity and 30.1% of Russell 3000 companies by 2038.[85] They would also control 40.8% of S&P 500 votes and 36.7% of Russell 3000 votes in 2038.[86] Further concentration could only serve to exacerbate these issues of corporate governance, competition, and conflicts of interest.

INVESTMENT FUNDS AND RISKS TO FINANCIAL STABILITY

The size, interconnectedness, and concentration of large fund companies do not just impact industrial companies, they also have implications for the functioning of our financial system. Asset managers have grown to such a degree that government regulators now see them as significant financial actors. The Financial Stability Oversight Council (FSOC), an interagency council established to safeguard the stability of the U.S. financial system, has said that funds managed by asset managers are "a critical component of the financial system and economy," the importance of which has "grown in the post-crisis period, accounting for an increasingly large share of U.S. investments and financial market activity."[87] In addition to the importance of the sector overall, concerns have been raised about the fact that the asset management industry is highly concentrated among a handful of the largest participants.[88]

83 *See* Warren Miller, *The Game Theory of Fund Price Wars*, FlowSpring, Mar. 2019, https://www.flowspring.com/research/The-Game-Theory-of-Fund-Price-Wars; *see also* Lim, *supra* note 79 ("BlackRock executives believe that a cheaper S&P 500 fund will encourage financial advisers and investors to come into its other funds and ready-made mixes of portfolios, said people familiar with the matter.").

84 *See* Coates, *supra* note 26, at 13.

85 *See* Bebchuk & Hirst, *supra* note 14, at 737-38.

86 *See id.*, at 739-40.

87 Fin. Stability Oversight Council, 2018 Annual Report, at 115.

88 *See* Ofc. of Fin. Research, Asset Management and Financial Stability 3, Sept. 2013, available at: https://www.financialresearch.gov/reports/files/ofr_asset_management_and_financial_stability.pdf.

The asset management industry often disclaims the financial risks that its companies may present by citing the fact that funds tend to rely on less leverage, or borrowed money, than other financial companies. This is certainly the case,[89] but, unlike some other financial companies and products, many of the potential risks of funds and fund companies derive from their size and, importantly, their interconnectedness across the financial system.[90] The potential financial risks from asset management investments and other activities generally arise from the firms' outsized presence in the financial markets and as a provider of investment in the nonfinancial corporate economy, impacting dynamics like liquidity and asset prices.

A CASE STUDY OF FUND RISKS: FUND PERFORMANCE DURING COVID-19

Disruptions in various financial markets during the early onset of COVID-19 have illustrated both the risks that can manifest in certain funds, as well as the importance of certain fund sectors to financial policymakers. In particular, asset managers were vulnerable due to their heavy involvement in several financial market sectors, including bond ETFs, mutual funds, and money market mutual funds (MMFs) that were impacted by COVID-19. In response, Federal authorities, from the Treasury to the Fed, used public resources to support several of these markets in some manner.

COVID-19 is a useful example of the crisis du jour, but it is not necessarily unique. Instead, it provides a timely example of the sort of disruptions that typically occur in times of crisis.

Corporate bond ETFs

Certain segments of the bond ETF market experienced mismatches between their share price and the underlying securities that constitute those funds in the onset of COVID-19.[91] The liquidity of bond ETFs allowed investors to dump their holdings of the ETFs as the value of underlying corporate bonds declined, leading ETF share prices to fall below their underlying net asset values (NAVs).[92] In response, the Federal Reserve created a facility to purchase ETFs that hold corporate bonds, including junk bonds.[93] As of July, the Fed had purchased about $8 billion in shares of corporate bond ETFs.[94] This step effectively expanded the Federal "safety net" of support to encompass ETFs.[95]

89 The exceptions to this argument are leveraged and inverse ETFs, that use specialized strategies and employ instruments like derivatives to create exposures. *See* Kenechukwu Anadu *et al, The Shift From Active to Passive Investing: Potential Risks to Financial Stability?*, at 14-16, Fed. Reserve Bank of Boston Working Paper No. SRA 18-04, (May 15, 2020).

90 *See* Ryan Clements, *Are ETFs Makings Some Asset Managers Too Interconnected To Fail?*, 5-10, *Forthcoming* 22(4) U. Pa. J. Bus. Law (2020), available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3516936.

91 *See* Dawn Lim, *Bond ETFs Flash Warning Signs of Growing Mismatch*, Wall St. J., Mar. 23, 2020.

92 *See* Katherine Greifeld, *One Month of Fed ETF Buying Redraws $4 Trillion Market Contours*, Bloomberg, June 16, 2020. This was not the first time that fund NAVs and share prices diverged, as more minor market volatility caused some disruptions in August 2015. *See* Fin. Stability Oversight Council, Update on Review of Asset Management Products and Activities, U.S. Dept. of the Treasury, Apr. 18, 2016, at 10 n. 43.

93 *See* Nick Timiraos, *Fed Unveils Major Expansion of Market Intervention*, Wall St. J., Mar. 23, 2020.

94 *See* Matt Wirz & Tom McGinty, *Fed Discloses More Corporate Bond and ETF Purchases*, Wall St. J., July 10, 2020.

95 The "safety net" is a term for the government support provided to the regulated banking sector, including deposit insurance and the Fed's "lender of last resort" function.

Mutual funds

Some mutual fund sponsors also faced redemption risks during the onset of COVID-19, and responded by raising the price of redemptions in their mutual funds to deter outflows, akin to suspending bank withdrawals to avoid a run on bank deposits.[96] As a result of growing market pressures, mutual fund sponsors also received regulatory relief from the SEC to provide financial support to the mutual funds that they sponsor in order to meet the scale of potential redemptions.[97]

Money market mutual funds

Asset management firms also sponsor MMFs, which are investment companies registered under the Investment Company Act that issue shares and pay dividends while required to invest in "safe" and diverse short-term debt instruments—including short-term government securities, corporate commercial paper, repurchase agreements (known as "repos"), and certificates of deposit.[98] Prime MMFs primarily invest in corporate debt securities, providing a large portion of the short-term debt that businesses and governments use to finance immediate needs like payroll or shortfalls in tax revenue, respectively. The Federal Reserve, through its lender-of-last-resort function under section 13(3) of the Federal Reserve Act began purchasing MMF shares, peaking at $51 billion in purchases.[99]

* * *

On the one hand, public interventions have provided benefits from a financial stability perspective. On the other hand, they also create potential risks for the ETF market, including price volatility whenever the Fed withdraws its support and begins selling ETFs.[100] They also create future expectation among market participants that the Fed will backstop the ETF market again in the future, as it has done with MMFs.

Much like the industry as a whole, the Fed's ETF purchases were highly concentrated. Of the 16 ETFs purchased by the Fed, eight were BlackRock's iShares funds, and funds managed by the Big

96 Dawn Lim & Justin Baer, *BlackRock, Vanguard Raise Price of Cash Redemption for Some ETFs*, Wall St. J., Mar. 20, 2020.

97 *See* Dave Michaels, Justin Baer & Paul Kiernan, *SEC Gives Relief to Mutual Funds Facing Redemption Issues*, Wall St. J., Mar. 24, 2020.

98 SEC rules require some MMFs to maintain a stable (NAV) of $1 per share, though because they are not federally insured, this return is not guaranteed, making them akin to uninsured bank accounts.

99 *See* Federal Reserve, Reports to Congress Pursuant to Section 13(3) of the Federal Reserve Act in response to COVID-19, https://www.federalreserve.gov/publications/reports-to-congress-in-response-to-covid-19.htm. In addition, the CARES Act COVID-19 economic response legislation reversed legal limitations on the Treasury's Exchange Stabilization Fund (ESF), allowing the Treasury Department to invest $10 billion in credit protection from the ESF into the Fed's special-purpose Vehicle administering the MMF support program. See Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116–136, tit. IV, § 4015, 134 Stat. 281 (2020); *see also* Bd. of Governors of the Fed. Reserve Sys., Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Money Market Mutual Fund Liquidity Facility, at 1-2, Mar. 25, 2020, https://www.federalreserve.gov/publications/files/money-market-mutual-fund-liquidity-facility-3-25-20.pdf.

100 *See* Greifeld, *supra* note 93 ("'When the Fed buys ETFs they are totally insensitive to price, that's dangerous,' said Maley, chief market strategist. 'When a large price insensitive buyer leaves any market, it leaves it very vulnerable.'").

Three made up 99% of the Fed's ETF portfolio.[101] This public support gave significant benefits to the Big Three.

After the Fed's measures were announced, BlackRock's largest iShares ETF that holds investment grade corporate bonds went from trading at a 5% discount to its net asset value at the close of the week of March 20, 2020, to a premium of nearly 3% higher than its NAV.[102]

For the second quarter of 2020, BlackRock recorded record inflows of $57 billion as a result of the Fed's support, a significant increase over the prior year's performance.[103] BlackRock's share of assets held in bond ETFs grew in 27 funds after the Fed's announcement, and its market share grew from 51% to 57%.[104]

Suffice it to say that smaller competitors have not enjoyed the same benefits as the Big Three firms.

The implications of the market disruptions and government responses during COVID-19 are that, whether we like it or not, public U.S. institutions are now offering some measure of support for certain segments of the ETF industry because of their importance to the financial system.[105]

FINANCIAL RISKS OF INVESTMENT FUNDS

While the disruptions in the financial markets caused by COVID-19 provided some real-world examples of how fund markets can go awry, stock market-driven disruptions are not new phenomena, dating back as far as the Great Crash of 1929 up to the "Black Monday" stock market crash of 1987. While these issues arising around COVID-19 were largely resolved by government intervention, they offer important insights into the general risks that can arise in the modern investment fund sector.

Research suggests that even investment funds that do not rely on leverage, can present risks, and while they may reduce volatility on average they may exacerbate it during extraordinary times.[106] In particular, funds can be exposed to the risk of "fire sales"—the sudden sale of a significant amount of their assets—as a result of several fund characteristics, including large concentrations in certain positions, "crowded trades," market illiquidity, funding mismatches (short-term funding for longer-term assets), and operational risks.

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101 *See* Cezary Podkul & Dawn Lim, *Fed Hires BlackRock to Help Calm Markets. Its ETF Business Wins Big.*, Wall St. J., Sept. 18, 2020

102 *See* Katherine Greifeld, *Traders Pour $1 Billion Into Biggest Credit ETF to Front-Run Fed*, Bloomberg, Mar. 24, 2020.

103 *See* Dawn Lim, *BlackRock's Profit Jumps 21% as Investors Surge Into Bond Funds*, Wall St. J., July 17, 2020; *see also* Podkul & Lim, *supra* note 102 (BlackRock funds took in $34 billion in the first half of 2020, about 160% more than in the first half of 2019).

104 *See id.*

105 *See* Lim, *supra* note 104 (quoting BlackRock CEO Larry Fink that "The quarter illuminates the importance of the ETF market.").

106 *See* David Aikman *et al*, *Rethinking Financial Stability*, Bank of England Staff Working Paper No. 712, at 32-33 (Feb. 2018), https://www.bankofengland.co.uk/working-paper/2018/rethinking-financial-stability.

107 ETF shares are generally redeemed for a basket of securities, reducing liquidity risks, however, some ETFs are starting to offer cash redemption and the SEC has authorized the creation of ETFs without an exemptive order. *See* Anadu *et al, supra* note 90, at 8; *see also id.*, at 8 n.8.

Liquidity risk

Funds are subject to liquidity risks. Unlike other funds, mutual funds and some other vehicles managed by asset managers do not have restrictions on their investors' ability to redeem their interests.[107] Investors, especially institutional investors, may view these funds as safe and liquid assets,[108] meaning they have an expectation that shares can be easily redeemed. This creates potential liquidity mismatches where the assets of the fund are less liquid and are unable to be sold quickly without impacting the price.[109] For funds like mutual funds that do not have limits on redemptions, there is a first-mover advantage: investors that pull their money out first fare better than those that remain and are potentially saddled with losses as asset values decline.[110] Taken to an extreme, this could produce a dynamic called a "liquidity spiral."[111]

Price dislocation

During times of unusual market behavior, investors—especially active traders like hedge funds and other asset managers—may attempt to arbitrage the difference in price between ETF shares and the underlying NAV. One way to do this is to sell shares in ETFs because they are more liquid, in order to purchase the underlying securities at a discount and benefit from their eventual appreciation.[112] If a fund then has to sell assets to meet redemptions at a set share price, but the price of the underlying securities diverges significantly from the share price, they may be forced to sell at a loss, relative to their payout to investors.[113] This can drive down the share price of an ETF even further, and lead to a greater and greater divergence between the share price and the underlying constituent securities.[114] This is what we saw occur during March 2020.[115] Here again, funds that have to meet redemptions can be forced to sell assets, potentially building into fire sales.

Funds that have to meet redemptions can be forced to sell assets, potentially building into fire sales.

108 *See* Clements, *supra* note 91, at 21-22.

109 *See* Fin. Stability Oversight Council, *supra* note 88, at 4.

110 *See id.*, at 4-5.

111 *See id.*

112 *See* Clements, *supra* note 91, at 28.

113 *See id.*

114 *See* Fin. Stability Oversight Council, *supra* note 88, at 9-10.

115 *See* Clements, *supra* note 91, at 26.

Crowded trades

Funds can also engage in "crowded trades,"[116] where a large number of investors pile into the same investments. This can have two effects: it can impact price volatility—driving up asset prices when assets are included in an index and driving them down when they are excluded—and decrease the liquidity of the assets that are held by a large block of concentrated investors.[117] These dynamics may be manageable during normal market conditions, but lead to disruptions and idiosyncratic market behavior during periods where volatility becomes otherwise heightened or liquidity otherwise diminished. Preliminary evidence also indicates that the securities that show the most price sensitivity are "large-cap stocks, held by the most actively traded ETFs,"[118] i.e., the largest companies held by the largest funds.

Co-movement

Research also suggests that an asset's inclusion in an index can impact something called "co-movement," where assets included in the same index experience correlated behavior in both returns and liquidity, regardless of underlying fundamentals.[119] Like many of the other risks outlined above, this correlated behavior—dislocations in returns and liquidity—during times of already stressed market dynamics can exacerbate other underlying market dysfunction.

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All of these characteristics increase asset managers' potential vulnerability to fire sales.[120] This could, in turn, cause funds' sponsors to offer financial support to their funds,[121] spreading distress from an individual fund to the larger parent company and/or fund complex. When asset values drop significantly, large dealers are also unable or unwilling to serve as market makers, failing to buy assets for which they would ordinarily serve as purchaser of last resort, potentially causing financial markets to "freeze."[122] Some market participants have likened the risks from mass fund redemptions to the distressed structured financial products that were central to the financial crisis of 2008.[123]

116 *See, e.g.*, Gregory W. Brown, Philip Howard & Christian Lundblad, *Crowded Trades and Tail Risk* (June 2, 2019), available at SSRN: https://ssrn.com/abstract=3326802.

117 *See* Ofc. of Fin. Research, *supra* note 89, at 9-11; *see also* Anadu *et al, supra* note 90, at 21-22, 24.

118 Marco Pagano, Antonio Sánchez Serrano & Josef Zechner, Can ETFs Contribute to Systemic Risk?, at 19, Repts. of the Advisory Scientific Committee No. 9, European Systemic Risk Board (June 2019).

119 *See* Anadu *et al, supra* note 90, at 24-25.

120 *See id.*, at 21-22.

121 *See* Ofc. of Fin. Research, *supra* note 89, at 12-16.

122 Aikman *et al, supra* note 107, at 32.

123 *See* Reed Stevenson, *The Big Short's Michael Burry Explains Why Index Funds Are Like Subprime CDOs*, Bloomberg, Sept. 4, 2019 (quoting hedge fund manager Michael Burry that the rise of passive index funds is "very much like the bubble in synthetic asset-backed CDOs before the Great Financial Crisis" and that there are liquidity risks because "The theater keeps getting more crowded, but the exit door is the same as it always was."), https://www.bloomberg.com/news/articles/2019-09-04/michael-burry-explains-why-index-funds-are-like-subprime-cdos.

SYSTEMIC FINANCIAL RISKS OF INVESTMENT FUNDS

Some research suggests that the concentration of passive investment vehicles, including ETFs, has implications for financial stability. A sudden and significant fire sale in one asset class or some other sudden portfolio rebalancing could have significant impacts on the real economy, or a so-called “spillover” effect. Such a risk that spreads beyond the financial sector, and that undermines the ability of the financial sector to support the rest of the economy, is known as a systemic risk. Systemic risks are ones that are so widespread that they are generally beyond the power of private actors to contain, meaning that a truly systemic event would require much greater intervention than the Fed executed in March 2020.

Any sudden market movements could have large, unpredictable effects on the significant swath of corporate America owned by these funds. It also impacts any other financial institutions that hold these assets.

As an illustration of how all of these dynamics could play out, in 2015 the Federal Reserve said that, “[a]s mutual funds and ETFs may appear to offer greater liquidity than the markets in which they transact, their growth heightens the potential for a forced sale in the underlying markets if some event were to trigger large volumes of redemptions.”[124] To understand how stresses at a large fund company could then spill over to the nonfinancial economy, consider this example: BlackRock holds investments on behalf of its clients averaging 6.4% and 5.7% of the total equity in the top 20 listed companies in the U.S. and Europe, respectively, as of March 2019.[125] Compare this “fire sale” hypothetical with the House Banking Committee report’s citation of one scholar that trust banks’ “holdings are becoming so large that they cannot easily sell out of a corporation without diminishing the value of an entire issue to the detriment of other shareholders and even themselves.”[126]

FUND PRICE WARS, SECURITIES LENDING, AND FINANCIAL RISK

As discussed above Fund companies have also been engaged in price war, aggressively cutting fees in an attempt to compete with one another and maintain, or gain, market share.[127] It is important to understand that, while rock-bottom fees may benefit investors, they also have potential implications for the risks of these funds.

124 Bd. of Governors of the Fed. Reserve Sys., Monetary Pol’y Rept., at 25, 2015, https://www.federalreserve.gov/monetarypolicy/files/20150224_mprfullreport.pdf

125 *See* Inst. for Energy Econ. & Fin. Analysis, Inaction is BlackRock’s Biggest Risk During the Energy Transition, Aug. 2019 (citing a report by the consulting firm Mercer), http://ieefa.org/wp-content/uploads/2019/07/Inaction-BlackRocks-Biggest-Risk-During-the-Energy-Transition_August-2019.pdf.

126 House Banking Committee, *supra* note 8, at 20.

127 *See* Lim, *supra* note 79.

First, commission-free trading makes it easier for investors to move in and out of funds adding to liquidity and redemption risks.[128] Second, to the extent that lowering fees reduces revenues, fund companies may look to recoup that revenue in other ways. An especially troubling example is through "securities lending," temporarily lending out the funds' securities to other parties for a fee.[129] Securities lending activities are a source of interconnectedness and financial risk that can undermine financial stability.[130]

* * *

It should also be noted that the size and concentration of large asset managers serve as potential sources of risk, by amplifying the potential harms caused by idiosyncratic risks, like a breakdown in operations, that undermine investor confidence and lead to mass redemptions.[131] As the next section discusses, they also offer critical financial market services that would create substantial risks if they were to experience any disruptions.

THE BIG THREE AS FINANCIAL INFRASTRUCTURE PROVIDERS

In addition to their financial risks and outsized market power, the Big Three asset managers provide services to, and within, financial markets that render them important elements of market infrastructure. Whereas railroads and utilities were the critical infrastructure controlled by trusts in the 20th century, they have been replaced by technology platforms and custody services in the 21st century.

THE ALADDIN SOFTWARE PLATFORM

BlackRock operates a technology platform, Aladdin, that provides financial market sales, analysis, and tracking services. It has been alternately described as the "central nervous system" for both the investment industry as well as nonfinancial companies,[132] or "like oxygen"—a product without which some companies "wouldn't be able to function."[133] At least $21.6 trillion in assets

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128 *See id.*

129 *See* Miller, *supra* note 84.

130 *See* Clements, *supra* note 91, at 19-21; *see also* Fin. Stability Oversight Council, *supra* note 40, at 24-25.

131 *See* Fin. Stability Oversight Council, *supra* note 88, at 22-23; *see also* Anadu *et al, supra* note 90, at 19.

132 Henderson & Walker, *supra* note 74.

133 Dirk Andreas Zetzsche, William A. Birdthistle, Douglas W. Arner & Ross P. Buckley, *Financial Operating Systems*, at 43, European Banking Institute (EBI) Working Paper Series No. 58/2020 (Mar. 1, 2020), available at SSRN: https://ssrn.com/abstract=3532975.

sits on the platform, equivalent to 10% of global stocks and bonds,[134] and equal to the annual GDP of the U.S., the total U.S. stock market capitalization, and four times the value of all the cash in the world.[135]

The system is used by 12,000 investment professionals employed by BlackRock clients and it hosts the portfolios of 210 institutions worldwide, including large pension funds.[136] State Street and Vanguard, BlackRock's main competitors, as well as Apple, Microsoft and Alphabet, the three biggest U.S. public companies, all use Aladdin.[137] Aladdin also gives BlackRock a form of vertical integration, a "way to get new visibility and influence" to other wealth managers that is not available to smaller fund companies.[138] It generates licensing fees from BlackRock's competitors.[139] It also raises risks of special access to clients' market information, and the potential for tying arrangements.

In part because of its Aladdin system, BlackRock was given a role contracting for the Federal Reserve Bank of New York to administer some of its COVID-19-related securities purchase programs, in a reprieve of a role that played after the 2008 crisis.[140] The move has been controversial, including because BlackRock is responsible for purchasing its own ETFs.[141] This arrangement is discussed more below, but it is important to note that, although it is charging nominal fees for this work, BlackRock benefits from the inflows that result from the Fed's support for ETFs;[142] it also creates concerns about executives' access to sensitive market information.[143]

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134 *See* Henderson & Walker, *supra* note 74.

135 *See* Zetzsche et al, *supra* note 134, at 16.

136 *See id.*

137 *See* Henderson & Walker, *supra* note 74.

138 Dawn Lim, *BlackRock's Assets Blow Past $7 Trillion in Milestone for Investment Giant*, Wall St. J., Jan. 15, 2020.

139 Zetzsche et al, *supra* note 134, at 34.

140 *See* Richard Henderson & Robin Wigglesworth, *Fed's Big Boost for BlackRock Raises Eyebrows on Wall Street*, Fin. Times, Mar. 27, 2020.

141 *See id.* Indeed, BlackRock was the sponsor of the largest share of ETF purchases reported as of the end of May. *See* Christine Idzelis, *BlackRock Rakes in Big Portion of Fed's ETF Investments*, Institutional Investor, June 1, 2020, https://www.institutionalinvestor.com/article/b1lwhydcxszcmm/BlackRock-Rakes-in-Big-Portion-of-Fed-s-ETF-Investments.

142 *See* Henderson & Wigglesworth, supra note 141. ("Yet BlackRock's dominance in the ETF market raises questions over conflicts of interest. The fund group's $566bn in fixed-income ETFs represents about half the global total. The Fed's buying will probably boost assets across the company's ETFs, improve their liquidity and could even attract new classes of investor who take comfort that the Fed is there beside them.").

143 *See* Americans for Fin. Reform, Can BlackRock Benefit from Inside Information from Fed Facilities?, May 15, 2020, https://medium.com/@RealBankReform/can-blackrock-benefit-from-inside-information-from-fed-facilities-52510a9e869b. Regardless of the Fed arrangement, Aladdin generally gives BlackRock a special "vantage point into markets[.]" Lim, *supra* note 104.

SYSTEMICALLY IMPORTANT CUSTODY SERVICES

These arrangements harken back to a day, before the advent of the antitrust laws, when financiers and government officials arbitrated policy difference behind closed doors, away from public scrutiny.

State Street, the third largest of the Big Three, is a bank holding company that has been designated as a U.S. Global Systemically Important Bank (G-SIB) on the basis that it is one of the two largest "custody banks," with nearly $35 trillion in assets under custody. The custody business, safekeeping client funds and ensuring their transmission from point A to point B, has been described as a "dreadfully dull affair," but one that is "scale intensive [and] IT-dependent."[144]

Nonetheless, the "financial services and products provided by these global custody banks are an essential part of the financial markets' infrastructure, and are not easily substituted by other market participants should these firms be subject to material financial distress."[145] Indeed, while they received less TARP bailout money than other G-SIBs in 2008, custody banks received significant support from other crisis-era government programs.[146] Hence, State Street's custody services are a significant factor in its designation as a G-SIB. Under international rules, State Street's "substitutability" score—the "extent to which a bank provides important financial infrastructure that would be difficult to replace if the bank were to fail"—is among the highest of all global G-SIBs due to its custody services.[147]

The important thing to understand about these services is that, in addition to controlling large amounts of capital, in the form of assets under management, large asset managers offer critical services that increase both their systemic importance and the influence that they have in the financial marketplace.

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144 Raj Date, *Test Case on the Charles: State Street and the Volcker Rule*, 5, Cambridge Winter Ctr. on Fin. Institution Pol'y, June 12, 2010.

145 *See* Statement by Martin J. Gruenberg, Member, Board of Directors, FDIC, "Revisions to the Supplementary Leverage Ratio Capital Rule for Custody Banks," Mar. 29, 2019.

146 *See id.* ("State Street and Bank of New York Mellon between them utilized more than $80 billion of public support from the FDIC's Temporary Liquidity Guarantee Program."); *see also* Date, supra note XX, at 9 (State Street "did not face a liquidity run, however, in major part because of pre-existing funding backstops provided by the Fed's Commercial Paper Funding Facility (CPFF) and the FDIC's Term Liquidity Guarantee Program (TLGP), coupled with taxpayer-supplied capital through the TARP and a post-'stress test' private market equity raise.").

147 Paul Glasserman & Bert Loudis, A Comparison of U.S. and International Global Systemically Important Banks, Ofc. of Fin. Research Brief No. 115-07, Aug. 4, 2015, at 3; *see also id.*, at 5.

THE POLITICAL POWER OF THE BIG THREE

Like other large investment companies throughout history, the influence of large fund companies does not end with their economic power. The Big Three fund companies also possess significant political power, by virtue of their lobbying heft, their stable of connected former policymakers, and their provision of vital privatized government services. These arrangements harken back to a day, before the advent of the antitrust laws, when financiers and government officials arbitrated policy difference behind closed doors, away from public scrutiny.[148]

LOBBYING POWER

The Dodd-Frank Act established a new interagency council, the Financial Stability Oversight Council (FSOC) to deal with the risks posed by nonbank financial companies that could have authority over asset management.[149] The FSOC has authority to designate a nonbank financial company to be supervised by the Federal Reserve and subject to enhanced "prudential" regulations if FSOC determines that a nonbank financial company poses a threat to financial stability.[150]

In 2012 and 2013, the FSOC reviewed the asset management industry, including commissioning the Treasury Department's Office of Financial Research (OFR) for an "analysis of how asset management firms and the activities in which they engage can introduce vulnerabilities that could pose, amplify, or transmit threats to financial stability."[151]

In a potent example of the asset management's influence over its regulator, on September 30, 2013, the SEC solicited public comment on the OFR study,[152] effectively an invitation to criticize

148 The classic anecdote of this arrangement and its demise was the entreaty from J.P. Morgan to preempt President Teddy Roosevelt's "trust-busting" policies that, "If we have done anything wrong, send your man to see my man, and they can fix it up." Simon Johnson & James Kwak, 13 Bankers: The Wall Street Takeover and the Next Financial Meltdown 25 (2010).

149 FSOC's responsibility is to "monitor emerging risks to U.S. financial stability, recommend heightened prudential standards for large, interconnected financial companies, and require nonbank financial companies to be supervised by the Federal Reserve if their failure would pose a risk to U.S. financial stability." The Restoring American Financial Stability Act of 2010, S. Rep. No. 111-176, at 2 (2010). The voting members of the FSOC are the Treasury Secretary, who serves as FSOC's Chairperson; the Chair of the Board of Governors of the Federal Reserve System; the Comptroller of the Currency; the Director of the Consumer Financial Protection Bureau (CFPB); the Chair of the SEC; the Chair of the FDIC; the Chair of the Commodity Futures Trading Commission (CFTC); the Director of the Federal Housing Finance Agency (FHFA); the Chair of the National Credit Union Administration (NCUA); and an insurance expert appointed by the President, by and with the advice and consent of the Senate.
The Dodd-Frank Act also established the Office of Financial Research, cited above, to support FSOC in its purposes and duties, including collecting and providing data and performing research. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 153(a) (2010).

150 *See* Pub. L. No. 111-203 at § 113(a)(1).

151 *See* Minutes of the Financial Stability Oversight Council at 4, Sept. 10, 2013 available at http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2010,%202013.pdf; *see also* Ofc. of Fin. Research, Asset Management and Financial Stability, Sept. 2013, http://financialresearch.gov/reports/files/ofr_asset_management_and_financial_stability.pdf.

152 *See* Press Release, Public Feedback on OFR Study on Asset Management Issues, Securities & Exchange Comm'n, Sept. 30, 2013, http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539852635#.VQ7oa47F98M.

the FSOC's and OFR's work, and extremely unusual act amongst regulators that typically enjoy relatively cordial and respectful relations. After a series of meetings and a furious industry lobbying campaign, the FSOC announced it would not designate any asset managers or funds as systemically important, but would instead look at specific activities.[153] The FSOC then sought information on four areas of the asset management industry: liquidity and redemption, leverage, operational functions, and resolution.[154] The proposal, subsequently published in the Federal Register, focuses on asset management activities rather than entities, and states that FSOC "has not made any determination regarding the existence or nature of any potential risks to U.S. financial stability."[155] The industry's comment letters, including those submitted by the Big Three and their primary trade association, repeat several themes and arguments, including: 1) asset management products do not pose liquidity or redemption risks; 2) leverage is a key source of financial risk and asset management does not pose leverage risk; 3) the operational risks of asset managers are not systemic; and 4) the FSOC should focus on asset management products and activities rather than entities.[156]

The FSOC has largely left any subsequent oversight of asset management to the SEC. The shortcomings of the SEC's efforts will be discussed more, below.

THE "REVOLVING DOOR"

BlackRock employs a stable of former policymakers, underscoring the importance the company occupies in both financial and policymaking ecosystems, in something akin to a shadow government entity.[157] Good government groups have documented 118 examples of "revolving door" activity by the company—cases in which a government official joined BlackRock's roster, or vice versa.[158]

In one particularly troubling example of how Washington's revolving door operates, in 2017, a former BlackRock executive was put in charge of reviewing the FSOC's work for the Treasury Department.[159] Unsurprisingly, the Department's conclusion was that FSOC should "prioritize its efforts to address risks to financial stability through a process that emphasizes an activities-based or industry-wide approach," the company's preferred position.[160] This conclusion all but ensures that BlackRock will not be designated for greater regulation by the FSOC under the Trump administration.

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153 Indeed, the FSOC went so far as to state explicitly in the Federal Register that it "has not made any determination regarding the existence or nature of any potential risks to U.S. financial stability" from asset management. 79 Fed. Reg. 77,488, 77,490 (Dec. 24, 2014). According to the *Wall Street Journal*, BlackRock in particular "mixed public comments and published documents with private pressure on lawmakers" in lobbying against the OFR report and possible FSOC designation. Ryan Tracy & Sarah Krouse, *One Firm Getting What It Wants in Washington: BlackRock*, Wall St. J., Apr. 20, 2016. Its "aggressiveness frustrated many [FSOC] staff members," and "damaged the firm's reputation within the Obama administration." *Id.*

154 *See* Minutes of the Financial Stability Oversight Council at 14, Dec. 18, 2014.

155 Financial Stability Oversight Council, Notice Seeking Comment on Asset Management Products and Activities, 79 Fed. Reg. 77488, 77489-90 (Dec. 24, 2014) available at http://www.gpo.gov/fdsys/pkg/FR-2014-12-24/pdf/2014-30255.pdf.

156 *See* Letter from Stefan M. Gavell to Patrick Pinschmidt, Mar. 25, 2015; *see also* Letter from Barbara Novick to Patrick Pinschmidt, Mar. 25, 2015; *see also* Letter from Paul Schott Stevens to Patrick Pinschmidt, Mar. 25, 2015; see also Letter from Tim Buckley & John Hollyer to Patrick Pinschmidt, Mar. 25, 2015.

157 *See* Henderson & Wigglesworth, *supra* note 141 ("In the last decade, BlackRock has hired extensively from the types of public organisations it seeks to serve in the FMA unit. Philipp Hildebrand, the former head of the Swiss central bank, is BlackRock's vice-chairman. Stanley Fischer, former vice-chairman of the Federal Reserve, and George Osborne, former UK chancellor of the exchequer, are senior advisers.").

158 *See* Campaign for Accountability, *supra* note 17.

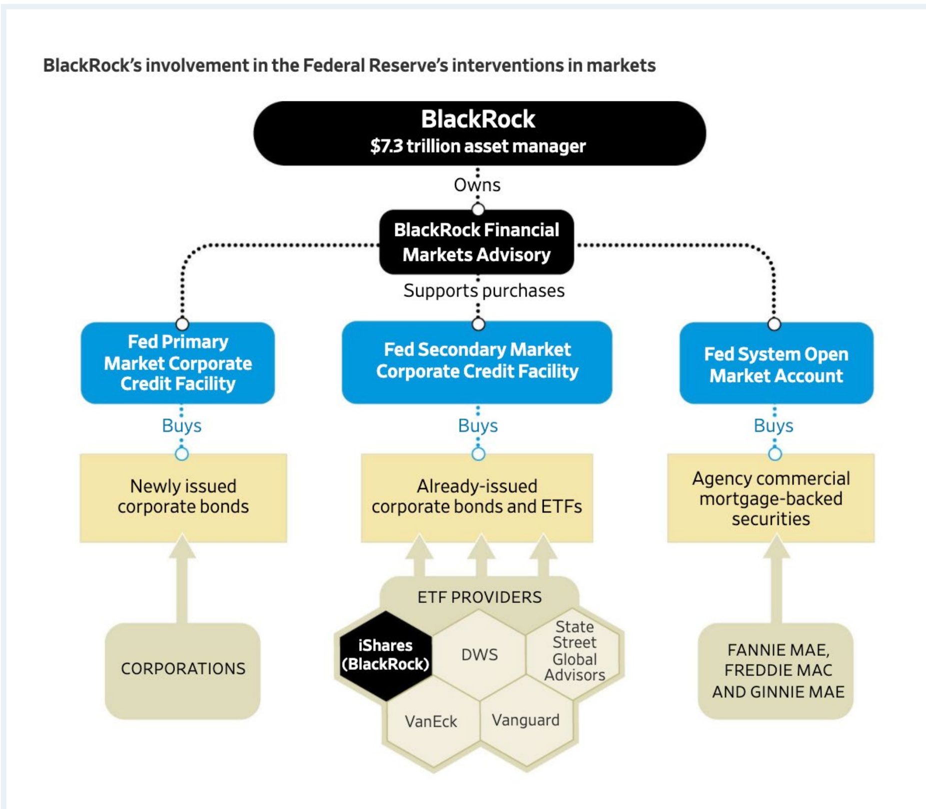
159 *See* Ryan Tracy, *Meet Craig Phillips, the Man in Charge of Trump's Review of Wall Street Rules*, Wall St. J., Apr. 24, 2017.

160 *See* U.S. Dept. of the Treasury, "Financial Stability Oversight Council Designations," Report to the President of the United States, Nov. 17, 2017.

PRIVATIZED PUBLIC FUNCTIONS

Large asset managers also provide an array of services to public institutions to help them carry out important functions.

State Street was hired by the Fed to provide custody and accounting services for its program purchasing the short-term corporate debt known as commercial paper.[161] BlackRock has repeatedly assisting the Fed with its rescue programs—a role in which it has "effectively transitioned from being a monetary policy taker to acting as a monetary policy maker[.]"[162] While BlackRock is earning relatively modest fees for this service, it is earning significant revenues from the inflows that it is enjoying as a result of the Fed's programs, discussed above.[163]



Source: Wall Street Journal

161 See Vendors, Commercial Paper Funding Facility, Fed Reserve Bank of N.Y., https://www.newyorkfed.org/markets/commercial-paper-funding-facility.

162 Braun, supra note 27, at 25.

163 *See* Podkul & Lim, *supra* note 102 ("The firm will receive modest compensation for its role assisting the Fed—a roughly $3 million fee for the six months ending Sept. 30, and $750,000 per quarter thereafter, according to BlackRock's contract with the Fed. BlackRock will also collect fees on the small corporate bond portfolio it manages for the Fed. BlackRock isn't charging any fees on ETFs and is rebating fees from its own iShares ETFs back to the Fed."); *see also id.* ("Across all categories of iShares bond ETFs, beyond just corporate bonds, BlackRock's revenue rose 11.5% to $261 million in the second quarter from the same period last year.").

BlackRock has also been hired to advise the government of the European Union on integrating environment, social, and governance (ESG) factors into financial regulations, despite its holding an estimated $87.3 billion in fossil fuel company stock and its opposition to or abstention from 82% of climate-focused shareholder measures between 2015 and 2019.[164]

There are several tools that an administration or Congress could use to limit the growing dominance of the Big Three investment companies.

There are other, smaller examples of the symbiosis between the Big Three and public authorities. A representative of Vanguard sits on the Commodity Futures Trading Commission's subcommittee on climate-related financial market risk at the same time that Vanguard is being criticized for its investments in fossil fuels.[165] Likewise, a representative of BlackRock was a member of the Group of Thirty team that drafted a report on solving the "fixing the pension crisis," notwithstanding the company's clear pecuniary interest in managing pension and retirement money.[166] The Big Three are being consulted by, and carrying out the functions of, public authorities in areas that impact the companies' bottom lines.

LIMITING THE POWER OF THE BIG THREE: THE IMPORTANCE OF STRUCTURAL REFORM

What is to be done about the various issued raised by the growth of large asset management firms? There are several tools that an administration or Congress could use to limit the growing dominance of the Big Three investment companies. Ultimately, the most meaningful reforms would set hard concentration limits to restrain the Big Three's footprint in the financial system as well as their control of nonfinancial corporations. These proposals would have the largest effect on the Big Three, but could also impact other large financial institutions like bank holding companies that hold substantial investment stakes in industrial companies and play outsized roles in financial markets.

To be clear, there would still be a number of large financial companies that offer their customers economies of scale—however, instead of a small oligopoly there would be a more vibrant market

164 *See* Jasper Jolly, *BlackRock to Advise EU on Environmental Rules for Banks*, The Guardian, Apr. 12, 2020.

165 *See* Commodity Futures Trading Comm'n, Members of the Climate-Related Market Risk Subcommittee as of July 15, 2020, https://www.cftc.gov/About/CFTCCommittees/MarketRiskAdvisoryCommittee/mrac_subcommitteemembers.html; *see also* Attracta Mooney, B*iggest Asset Managers Attacked Over Role in Climate Change*, Fin. Times, Jan. 11, 2020.

166 *See* Braun, *supra* note 27, at 24.

with greater competition wherein asset managers compete on a variety of services and metrics. There would also be a reduced threat that a single company would transmit systemic risk to the financial system or the broader economy. Finally, reducing the size and concentration of the Big Three would create space for proposals to create public options for people to invest their money in institutions that are democratically accountable.[167]

SIZE AND CONCENTRATION LIMITS

To address the growing concentration in company ownership, securities law could take a lesson from banking law, which prohibits any single bank from accumulating more than 10% of the nation's deposits through merger or acquisition.[168] These limitations were instituted at the same time that Congress relaxed restrictions against interstate branching, as a way to prevent banks from accumulating an excessive concentration of financial power.[169] During the legislative debate over the Investment Company Act, the SEC sought limits on the size of fund companies,[170] but the law ultimately only contains general authority for the SEC to study and report on fund company size from the perspective of investor protection, wealth concentration, financial markets, and corporate America.[171]

In addition to restricting the concentration of financial assets on the basis of competition, concentration limits should also be updated to incorporate the financial stability concerns of asset managers. Section 622 of the Dodd-Frank Act institutes a limit on any financial company merging with, or acquiring, any other financial company such that the resulting company would constitute more than 10% of the liabilities in the financial system.[172] This provision contains limitations, exceptions, and other definitional problems that limit their effectiveness.[173] The section 622 restriction should be revised to specifically incorporate the structures of large asset managers—specifically by moving away from a liability-based definition to one based on the broader definition of "economic exposure"—the impact of which should be to significantly reduce the size of the largest fund companies.[174]

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167 *See* Robert C. Hockett, & Saule T. Omarova, Private Wealth and Public Goods: A Case for a National Investment Authority, 43 Journal of Corporation Law 437 (2018).

168 *See* 12 U.S.C. §§ 1831u(b)(2), 1842(d)(2)).

169 *See* Arthur E. Wilmarth Jr., *Reforming Financial Regulation to Address the Too-Big-To-Fail Problem*, 35 Brook. J. Int'l L. 707, 750 n. 170 (2010).

170 *See* Braun, *supra* note 27, at 9-10.

171 See 15 U.S.C. § 80a–14(b).

172 *See* 12 U.S.C. § 1852.

173 See, e.g., Daniel K. Tarullo, Governor, Fed. Reserve Bd., Fin. Stability Reg., Speech at the Distinguished Jurist Lecture, Univ. of Penn. L. Sch., 23 (Oct. 10, 2012) (section 622 is "based on a somewhat awkward and potentially shifting metric of the aggregated consolidated liabilities of all 'financial companies.'"). Section 622 in particular only covers nonbank financial companies if they have been designated by FSOC, and defines "liabilities" in such a way as to exclude assets under management. See 12 C.F.R. § 251.3(c)(2)(defining total liabilities as those measured under GAAP); see also BlackRock, Inc., 2019 Form 10-K, at 48 (reporting $133 billion in total GAAP liabilities).

174 Given the roughly $20 trillion in financial sector liabilities, were this provision to be revised, no asset manager could manage more than about $2 trillion, requiring the two largest asset managers to become at least five or six companies that would be about one-third of their current size. *See* Bd. of Governors of the Fed. Reserve Sys., Announcement of Financial Sector Liabilities, 84 Fed. Reg. 32,169 (July 5, 2019).

OWNERSHIP LIMITS

In addition, common ownership limits should be instituted to prevent the accumulation of large ownership stakes in concentrated industries.[175] Competition laws provide a conceptual basis for addressing the risks of common ownership; namely, the Clayton Act's restrictions on stock acquisitions that have the effect "substantially to lessen competition, or to tend to create a monopoly," which should be invoked to address common ownership by asset managers.[176] Rules that prohibit investment companies from owning more than 10% of any portfolio company apply to individual funds, but not to fund families/complexes.[177] These limits upon the ownership stakes held by asset managers should be strengthened, including lowering ownership limits and applying them at the fund complex level.[178]

Spreading out ownership among more fund companies would give investors more choice. This could, in turn, prompt investors to shop on the basis of other criteria besides prices, such as voting records. In an age when environmental, social, and governance (ESG) factors are becoming more relevant, this could lead to more shareholder engagement and better corporate governance.

STRUCTURAL SEPARATION

The Dodd-Frank Act created a process for treating financial market utilities—including payment, clearing, or settlement activities—as "systemically important," if its transactions, exposures, interdependencies, or the effect of its failure would disrupt critical markets, financial institutions, or the financial system.[179] After a financial market utility is identified as a systemically important, the Fed must prescribe standards that promote robust risk management and safety and soundness, reduce systemic risks, and support the stability of the financial system.[180]

The platform and custody services of the Big Three—BlackRock's Aladdin system, for example—should be designated as systemically important market utilities. Rather than applying the existing framework for utility standards, however, the law should be amended to require a

175 *See* Posner, et al, *supra* note 67 (recommending a 1 percent limit on ownership in "oligopolistic" industries).

176 *See* 15 U.S.C. § 18; *see also* Elhauge, *supra* note 12, at 49-63. There have also been proposals to update the index used for analyzing mergers to incorporate the impacts of common ownership. *See* Azar, Raina, & Schmalz, *supra* note 43, at 34 (proposing a revised merger analysis that takes into account issues like common ownership).

177 *See* Bebchuk & Hirst, supra note 49, at 2129; *see also* House Banking Committee, *supra* note 8, at 9 (proposing a "[p]rohibition against any bank trust department holding in the aggregate in all capacities more than 10 percent of any class of stock of any corporation required to be registered with the Securities and Exchange Commission").

178 *See* Bebchuk & Hirst, supra note 49, at 2128-31 (recommending limits of not more than 5% of any public company); *see also* Coates, *supra* note 26, at 21-22 (recommending concentration limits applied at the fund complex level).

179 *See* Pub. L. No. 111-203 at § 804(a). So far, only eight companies have been designated as systemically important, largely clearinghouses. *See* Press Release, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises, July 18, 2012 available at http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx.

180 *See id.*, at § 805(b). The Fed then regulates them using a set of standards for efficiency, access criteria, and governance. *See* Board of Governors of the Federal Reserve System, Financial Market Utilities, 77 Fed. Reg. 45907, 45910 (Aug. 2, 2012).

separation of systemically important infrastructure activities from other lines of business. Critical market infrastructure that implicates private monopolistic business models delivering public utility-like functions ultimately call for firewalls or structural separations,[181] particularly between the technology platform businesses and other commercial activities.[182] This would help address the risks of conflicts of interest, self-dealing and other market power issues that arise from the concentrated nature of those businesses.

BETTER REGULATION ALONE WILL NOT WORK

Past efforts to solve the dangers presented by the funds and products sponsored by asset managers have focused on instituting better regulations. As noted above, asset manager regulation generally focuses on conduct standards and investor protections—regulations that will not solve the problems outlined above. The SEC has another central mission, and a basis of its various authorities, to maintain fair and orderly markets.[183] An example of one such authority is the SEC's ability under the Investment Company Act to restrict the composition of mutual funds, ETFs, and other funds.[184] The Dodd-Frank Act also created additional authorities for the SEC to engage in more substantive regulations of investment funds.[185] These tools can and should be used; however, the fact is that better regulation is a necessary but insufficient approach to addressing the issues created by large asset managers.

The recent history of the SEC's attempts at better regulation of the fund industry is a cautionary tale for why technocratic regulation is a less desirable option relative to structural solutions. Prompted by the FSOC's work, described above, the SEC has adopted some regulations to address potential risks posed by asset management; namely, better liquidity risk management and shareholder disclosure of liquidity risks.[186] Shortly after taking office, the Trump administration announced its general opposition to more regulation of the asset management industry.[187] The SEC specifically slow-walked a proposed rule to address funds' use of derivatives[188] and ultimately weakened fund liquidity rules.[189]

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181 *See* K. Sabeel Rahman, ***The New Utilities: Private Power, Social Infrastructure, and the Revival of the Public Utility Concept***, 39 Cardozo L. Rev. 1621, 1659-61 (2018).

182 *See* Lina M. Khan, ***The Separation of Platforms and Commerce***, 119 Colum. L. Rev. 973 (2019).

183 *See, e.g.*, 12 U.S.C. §§ 78k-1, 78l, 78m, 78o, 78q-2.

184 *See, e.g.*, Securities & Exchange Comm'n, Investment Company Liquidity Risk Management Programs, 81 Fed. Reg. 82,142 (Nov. 18, 2016).

185 For example, the Dodd-Frank Act requires the SEC to stress test asset managers with more than $250 billion in total assets. 12 US.C. 5365(i)(2)(A). It is important to note that the measure of "total consolidated assets" has been interpreted to include assets under management. See Board of Governors of the Federal Reserve System, Definitions of ''Predominantly Engaged In Financial Activities'' and ''Significant'' Nonbank Financial Company and Bank Holding Company, 78 Fed. Reg. 20,756, 20,774 (Apr. 5, 2013).

186 *See* Fin. Stability Oversight Council, Annual Rep., at 115.

187 *See* U.S. Dept. of the Treasury, A Financial System That Creates Economic Opportunities: Asset Management and Insurance, at 6-10 (Sept. 2017) (reporting that the "Treasury rejects the need for stress testing of asset management firms," recommending "regulations to standardize and simplify the approval process for ETFs," and expressing support for efforts to "reexamine the implications" of a 2016 Department of Labor proposal to strengthen retirement plan fiduciary duties), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf.

188 *See id.*

189 *See* Robert J. Jackson, Jr., Comm'r, Securities & Exchange Comm'n, Statement on Investment Company Liquidity Disclosure, June 28, 2018 (describing the fund liquidity rule as "based on the bizarre claim that investors might find information about liquidity so confusing that we serve them best by keeping the information secret").

The SEC has similarly failed to address other risks of money management activities. In 2012, the SEC was unable to arrive at a consensus for MMF reforms,[190] prompting the FSOC to propose a series of reforms to money market mutual funds, including a floating net asset value (NAV) and stable NAV alternatives with buffers and additional liquidity and disclosure requirements.[191] In response, the SEC proposed less ambitious reforms to the MMF structure, to either require institutional MMFs to adopt a floating NAV or impose a liquidity fee on, or halt, redemptions if a money market fund's weekly liquid assets fell below certain thresholds,[192] which it ultimately finalized in July 2014.[193] The Fed's actions in propping up the MMF and ETF industries—for the second time in 12 years, in the case of MMFs—should also be viewed as a vote of no-confidence in the SEC's MMF oversight.

To be sure, the FSOC could use its authority to recommend prudential standards for systemic activities again;[194]however, this authority is non-binding, and is only intended as a way to "name and shame" intransigent regulators. Others have also proposed comprehensive regimes for the FSOC to designate, and the Fed to regulate, asset management firms.[195] Still, the political power of the Big Three fund companies and their past success bringing the FSOC to heel in its efforts to scrutinize asset management suggest that more lasting, structural changes are the most effective route to avoiding agency capture and other political economy problems. These changes could then create some space for better regulation; however, bigger challenges like the culture of the SEC will require additional efforts and solutions.

CONCLUSION

The rise of asset managers, and the index funds that manage them, has been driven by the ever-greater financialization of our economy, giving rise to new concerns regarding their systemic importance, corporate governance, anticompetitive behavior, and concentrated power. The risks of these businesses cannot be dismissed on the basis that they can be managed or mitigated through measures like internal controls. The mixing of money management and corporate voting are inextricably intertwined. So, too, are the businesses of providing money management services and operating technology platform services. Finally, the outsized economic footprints of giant fund companies cannot be achieved without being accompanied by political power and entanglements with government.

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190 *See* Nathaniel Popper, *A Regulator's Key Role in Failed Mutual Fund Reform*, N.Y. Times, Aug. 26, 2012

191 *See* Fin. Stability Oversight Council, Proposed Recommendations Regarding Money Market Mutual Fund Reform, Nov. 2012, http://www.treasury.gov/initiatives/fsoc/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform%20-%20November%2013,%202012.pdf.

192 *See* Securities & Exchange Comm'n, Money Market Fund Reform; Amendments to Form PF, 78 Fed. Reg. 36834 (June 19, 2013).

193 *See* Securities & Exchange Comm'n, Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47736 (Aug. 14, 2014).

194 12 U.S.C. § 5330(a).

195 *See* Gregg Gelzinis, Strengthening the Regulation and Oversight of Shadow Banks, Ctr. for Am. Progress, July 18, 2019, https://www.americanprogress.org/issues/economy/reports/2019/07/18/471564/strengthening-regulation-oversight-shadow-banks/.

Rather than being isolated business lines, each function of the Big Three asset managers serves the ultimate goal of increasing concentration, power, and, ultimately, profit. Public authorities often approach their responsibilities in silos, caring narrowly about their specific mandates of financial stability, competition, consumer and investor protection, and so on, but the risks posed by the modern asset management industry require an approach that combines structural reforms and better regulation. Policy makers must heed Jack Bogle's warning about the inherent dangers of the rise of a group of Big Three asset managers that controls a slice of the financial markets and corporate America that is ever-increasing, and steadily reaching a size nearly equivalent to the size of our entire economy.

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