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The Harms of HSR Aggregation: Antitrust's Misunderstanding of Mutual Funds and Their Investors

Antitrust authorities are considering serious changes to the antitrust rules that, if enacted, would cause significant disruption and new costs for investors saving in mutual funds and other investment products. Yes, they're startling. Their proposal presents not only a real threat to how regulated funds operate and serve the needs of everyday savers, but also creates risks for our capital markets, which are critical to financing businesses and supporting our economy.

Since Congress enacted the Sherman Act in 1890, our country's markets have been governed by a comprehensive antitrust framework that protects competition for the benefit of consumers. This includes the Clayton Act's Section 7, which prohibits mergers and acquisitions that substantially lessen competition. As a procedural safeguard, the Hart-Scott-Rodino Improvements Act of 1976 (HSR Act) and its rules require that parties making certain stock acquisitions notify the Federal Trade Commission (FTC) and the Department of Justice (DOJ) and observe a 30-day waiting period before completing the transaction. This period gives the authorities time to determine whether there is more to investigate. Beyond the 30-day "hold," the parties prepare a detailed filing and pay filings fees that range between $40,000 to $280,000 per transaction.

While most associate an antitrust review with companies merging or acquiring control over another company (think Facebook buying Instagram), the HSR process is not so narrow; it applies to any stock acquisition that exceeds certain thresholds. Absent certain HSR exemptions that were built in by Congress from the outset, it would affect even a mutual fund or an exchange-traded fund (ETF) buying a company's shares.

Regulated funds are a core way for Americans to save for retirement and other financial goals. Mutual funds, ETFs, and closed-end funds provide benefits to retail consumers such as professional management, diversification, and reasonable cost, all while being subject to regulation and oversight by the Securities and Exchange Commission (SEC). They are highly transparent, providing detailed information to their investors, markets, and others regarding their investments and activities.

When your mutual fund acquires a company's stock, that purchase counts as a reportable acquisition under today's HSR regime if it exceeds the thresholds and no exemptions otherwise apply. Looking at this as a fund investor, the fund is simply doing what it's supposed to do: invest in a manner consistent with what is described in the documents that

investors and others read to understand and monitor the fund. Congress understood this when it enacted the HSR Act—namely, that HSR requirements could inadvertently affect investors such as mutual funds, even when antitrust concerns are not implicated by the stock acquisition. With that concern in mind, Congress designed exemptions for mutual fund investments and other "acquisitions…made in the ordinary course of business…[and] solely for the purpose of investment."

HSR Aggregation Proposal: Adverse Impacts for Ordinary Regulated Fund Investments

The FTC has a pending proposal to change the HSR rules that would require an investment manager to aggregate the holdings of every one of its clients to determine whether a transaction is subject to the HSR notification requirement, and thus its attendant delays and costs. This means that it's no longer your fund making the acquisition nor your fund's holdings that are relevant to the HSR notification regime. Rather, all the investment manager's clients are treated as a single person even though each client (such as a mutual fund) has different investment objectives, strategies, and contractual relationships with the manager.

This aggregation approach would have significant and consequential impacts for the activities of regulated funds and thus everyday savers. HSR thresholds would be exceeded more frequently, and the existing exemptions provided by Congress for mutual funds and others would often be unavailable. If adopted, it would lead to a huge increase in HSR filings—for ordinary course portfolio transactions—that would impose real burdens and costs for investors and companies in which they invest but provide no benefit to the DOJ and FTC, which are already drowning in what they have called a "tidal wave" of HSR filings.

More fundamentally for fund investors, an HSR filing by your investment manager means your mutual fund is ensnared by the 30-day hold for all the manager's clients—for example, the fund would be prohibited from buying securities until the next month, thus impairing the fund's trading, interfering with the fund's investment strategy, causing index tracking error, and otherwise undermining the fund's performance.

The Crux for Fund Investors: Investment Hold and Substantial Cost

To get a better idea of the impact of aggregation, ICI surveyed its members and learned that based on the positions held at the end of 2020, investment managers would be required to immediately prepare and submit hundreds, and potentially more than 1,000, additional HSR filings. This would be a remarkable increase, considering that the average annual total HSR filings for 2019 and 2020 were around 2,000. The burdens of aggregation further double when you consider that if the manager and fund make an HSR filing related to the purchase of a company's shares, that company also must make their own companion HSR filing.

Imagine your mid-cap equity fund being pulled into the HSR review process simply because of a routine purchase of some shares of a mid-cap stock. All of the complexities and costs of that process would cascade down toward the fund's ordinary investors when the fund—or another completely unrelated client of the investment manager—wants to acquire shares of a company that causes the manager's individual clients "together" to exceed the HSR criteria for an exemption. *All* of the clients would be stopped from buying the company's shares for 30 days. Time would be needed to prepare the filing and then there would be the difficult question of which of the manager's clients should bear the HSR fees and preparation costs and in what proportions.

The FTC's lens for viewing investment activity on an aggregated basis hardly aligns with the fiduciary and contractual relationship between regulated funds and their managers. Funds' investment managers are agents hired for expertise to manage investments. The investment manager follows a client's investment objectives and policies set forth in agreements and fund prospectuses. No client wants their investment objectives frustrated by the activities (or holdings) of another client.

Aggregating all of an investment manager's clients for the purpose of determining whether HSR obligations are triggered would directly affect how the manager acts on behalf of funds and other clients. The ability to get investment timing right in real-time market conditions and transact at the best price is at the heart of the manager's job. Imagine if a fund manager looking to make an investment—one in line with the fund's investment objectives, whether with an index-based or active strategy—instead must stop for an HSR filing. Along with preparing the filing, the manager must wait up to 30 days for regulators to conduct a largely perfunctory review to confirm the obvious—that the investment transaction does not harm competition. This is an incredibly strange sequence of requirements for fund investors and clearly inconsistent with what Congress built into the HSR Act.

And the costs associated with an aggregated HSR regime would be high and not just limited to millions of dollars in HSR filing fees. There would be costs to monitor, coordinate, and prepare HSR filings across a maze of clients, organizations, and borders. This would be relatively uncharted territory for funds—our survey data show that regulated funds, for obvious reasons, have had little to no experience with HSR filings. Additional filings in turn would impose new burdens on the companies that funds seek to invest in, as those companies must submit companion filings. When all elements are considered, the overall costs of aggregation quickly escalate, and much will be borne by everyday investors.

Ultimately, with the proposed aggregation requirement, investment managers would be faced with high costs and a most unwelcome dilemma: either submit preemptive but possibly unnecessary HSR filings, or otherwise limit all client investments to stay under the HSR thresholds. Yet seeking to stay below the threshold for all of a manager's clients raises thorny questions. How would a manager allocate the consequences of that approach among disparate clients? Is it first come, first serve? Does one fund or client get denied the benefit of a fund's investment strategy because of what other clients hold? How too should the many costs to comply with this proposed aggregation approach be allocated or shared?

Regulated funds, which hold the savings of millions of Americans, are certain to suffer negative impacts as a consequence of this proposal. Any chilling effect of the aggregation proposal on investment and trading activity also adversely affects our capital markets and the way in which those markets have long helped finance companies and support our economy. The tentacles of aggregation are far-reaching, yet the FTC does not appear to have fully analyzed the ramifications of its proposal.

What's the End Game?

Households (i.e., retail investors) *hold 94 percent of long-term mutual funds*.[1] Mutual funds also represent 58 percent of defined contribution plan assets and 44 percent of individual retirement account assets.[2] This is how Americans are investing to achieve their most important financial goals.

The FTC suggests that the growth in investment vehicles, including funds such as mutual funds, requires them to investigate whether investment managers—as agents and in the aggregate with their clients—are acquiring ownership stakes in companies that are harming

competition. Nothing concrete has been advanced to suggest that mutual funds with minority interests are having an impact on competition. Even the FTC stated in the aggregation proposal that common ownership—the hypothesis that simultaneous minority ownership in competing companies poses competitive concerns—is unsettled.[3] Further, an HSR filing would be an unhelpful tool for considering that hypothesis. Yet if adopted, HSR aggregation could have enormous implications, disrupting the way professional investment services are delivered as well as effects for market-based financing.

Moreover, the HSR aggregation proposal is unnecessary to obtain information on ordinary course investments. Much information is already available about the investment activities of regulated funds, investment managers, and others, including public filings related to holdings and transactions in certain securities. Funds and managers make numerous public filings with the SEC throughout the year. They have done so for decades, and many make use of this information. While the FTC and the SEC's missions differ, the substantial public data available (and widely used) deserve more careful and thorough examination.

Before imposing any change in the HSR reporting rules, the FTC needs to remain mindful of congressional intent, clearly substantiate the antitrust concern, evaluate available public information, and then design a tailored proposal to address any identified problem. Consumers expect the FTC to protect and promote competition in markets as envisioned by Congress and they expect the FTC to fairly consider the purposes, costs, and burdens of regulation.

Notes

[1] *2021 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry* (Washington, DC: Investment Company Institute, 2021), 68.

[2] Id. at Figure 2.5.

[3] Federal Trade Commission, "Premerger Notification; Reporting and Waiting Period Requirements," Notice of Proposed Rulemaking, *Federal Register* 85, no. 231 (December 1, 2020): 77053–77061.