4711 - Session III Commissioner Rob Jackson

[Start of recorded material at 00:00:00]

Jack: Oh, he is here. Good heavens. I was going to say, the problem with introducing him is like the problem with making duck soup. First thing you do is catch a duck, and the duck has now entered the room. Okay. So sit down and let me introduce you.

Robert Jackson has been an SEC commissioner now for one year, one month, and 18 days –

Male Voice: He's counting.

Jack: – not a memorable anniversary, but I had to point out that I could count. Okay. During that time, however, he's blazed quite a trail and addressed a lot of issues that he alone is focused on and, I think, deserve exactly the attention he's giving them. Let me start, however, with the prosaic details.

He's a summa cum laude graduate of Wharton, later received an MBA there in 2000. He also has a master's in public administration from the Kennedy School and a JD from Harvard Law School. Then he took a research fellowship at Harvard. What all this evidence points out is that he would do anything to avoid going to work for 42 years; but eventually he did go to work, practicing at Bear Stearns and then Wachtell, Lipton where he specialized in executive compensation.

After the 2008 financial crisis, the went to Washington to work with Ken Feinberg at the U.S. Treasury, where he helped design the rules in the Dodd-Frank provisions dealing with executive compensation. If those rules had been adopted and implemented, we'd be in a much better position; but for some reason they didn't quite get all the way through Congress and the administration.

Then in 2009, tired of doing real work, he retired to the Columbia Law School faculty where, in 2012, he received the Willis Reese Prize for excellence in teaching, which goes to only one person and year, [and said 00:01:48] the students thought he was the greatest thing they had seen. It sounds like I'm giving him a hagiography, but he's not been uniformly successful at everything. I want to point to, maybe, his leading failure that he can still resurrect.

His article with Lucian Bebchuk, arguing that the poison pill is unconstitutional has not received overwhelming acceptance from the courts. He may want to explain to you what he's going to do with the SEC to make the poison pill disappear from the face of this earth or whether he's even possibly reconsidered that position, but I'll leave that to him.

Over his year as commissioner; year, one month, and 18 days; he has boldly expressed skepticism about whether there is adequate competition among stock exchanges, and I think he has some good evidence on that point. Even more broadly – maybe this relates to some of the things Jeff was saying – he's really the first on the commission to see potential problems in the common ownership of public companies by a very limited number of institutional investors. Now here he's following on some work that's been done by Einer Elhauge at Harvard, John Coates at Harvard, and a bunch of economists.

That may be one of the issues of the future. We're talking about wanting Black Rock and others to be able to lobby Congress. Well, there might be problems if they have too much power already, if they've got a majority of the stock under the control of – in John Coates' view, it will be eventually – 12 people or so.

Going back to Rob Jackson, what lies ahead for Rob Jackson? Well, he's going to get married in June. Boy, that will slow him down. Now I'll really let the cat out of the bag; and he will deny this, but his denials won't be fully credible. He is shortly going out to Iowa, where he's meeting with community groups, local political leaders, and the citizenry; and maybe we'll see the waters tested. What you hear today might be a political campaign in just a few more weeks; because frankly, there are already 13 democratic candidates for the democratic nomination.

But do any of those 13 have his intelligence, his credentials, his ability? I find it hard to point to someone who's clearly ahead of him. So with that note I've sort of dug a little hole for Rob. He can dig his way back out of that. Tell us what you're going to do at the commission and elsewhere. Thank you.

Rob: Well, thank you very much, Jack, for that very kind and very dangerous introduction – so good to see so many friends. It's good to be back. I'm really very grateful to you and to the Millstein Center, to everybody, for the opportunity to be here today. I want to begin just by saying how much I've learned from the conversation so far and also how glad I am to be in a room with so many important thinkers, policymakers. Really those are the cutting edge of the debates in corporate law today.

So what I'm going to do is be brief. I'm going to speak for about 10 or 15 minutes, and then I'd prefer just to take questions and have a conversation; because it felt very much to me, standing at the back of the room for the last hour, that this is an ongoing debate about some of the issues that you've raised in the book and that really deserve our attention at the policy level. So I will be brief.

There are three issues I want to talk about today that we're facing at the SEC and the things that I really think are going to be most important on our agenda in 2019, but they all relate to two themes that I want you to keep closely in mind as we have this conversation over the next hour. The first is, all good ideas that I have ever had, ever will have, and that I'm turning into policy at the SEC, I have stolen from people here. I am an unabashed thief. I give footnotes and no more, and I have found that the ideas in these conversations have been absolutely invaluable to the policy conversations we're having in Washington.

I'll talk a little bit about from whom I have stolen in this room – it's basically everyone – and why I'm so committed to this theft, but the fundamental thing to understand is that the conversations you're having today are informing the way that folks like me are thinking about what the future of securities law policy should be. I'm very proud of the fact that a lot of what has come out of these conversations in rooms like this one has become or is becoming policy in the United States.

So first of all I want to assure all of you that the time today here is very well spent. That's why I want to spend some time on Q&A, because I'd like to hear where you're all coming down on the important notions raised in this book. The second thought I'll give you, and just leave with you here, is that fundamentally what I learned from the book, from the conversation, is that we should stop pretending as a nation that the decisions we make in our markets are not fundamentally decisions with significant social implications.

You see, when I was a scholar, when I was a professor, I used to teach corporate law just across hall here at Columbia Law School. What I did on the first or second day – I would say, for purposes of this course, we're going to do the following exercise. We are going to maximize what I refer to as [unintelligible 00:07:08] utility. We're going to just maximize that side of the pie, and all these other social questions we're going to leave for your other professors; because they're smarter than me and have intelligent views on the subject.

Looking back at it I think I was cheating. I think I was cheating. I think fundamentally it was easier to teach a world where we just do that one thing and don't worry about the implications for the rest of society, but it was not the right way to think about the task, actually. I think what we've learned as a nation in the last decade or two is that those choices have significant implications, like the ones Jeff was just talking about; in terms of the risks that employees face by being employed by large public companies that are increasingly being pushed to earn profits at almost any other expense; about the social bargain we have between those companies, their consumers, their investors; about what our expectations are for the large investment funds that hold the savings and futures of millions of American families.

I fundamentally think that we can no longer pretend as if there is a neutral corporate law or securities law policy in that respect. I don't think there's any such thing. I think the decision to do or not to do something in that area is fundamentally a social decision. We should accept and embrace that fact and have the conversation thusly and not pretend like there's a way intellectually to avoid that part of the conversation, because it's hard.

Now that's my basic proposition. I have three policy areas I'd like to talk to you about and ways that that has played out that I don't understand, in a different way than I did when I taught across the hall now that I'm in the chair that I'm in. Then I'll wrap up, and we can have a conversation.

So first let's talk about the American stock exchanges. The history of U.S. stock exchanges is one that I hadn't spent a lot of time on; although Merritt Fox, my colleague, has written the world's leading scholarship on the subject, and I commend it to you. When I was on this faculty I just let Merritt handle the complicated stuff. So I have learned, over the last year or two, the way that the [bargain 00:09:05] with our stock exchanges has fundamentally changed our markets, in a way that I don't think is fully appreciated and in a way that has real implications for the bargain between American investors and public companies.

You know the long-run history of the stock exchange. It used to be collectively controlled and owned by most of Wall Street, pursuant to the famous Buttonwood agreement. Over the years it evolved in a fashion where, in the mid-2000s, the SEC passed a new set of regulations that was meant to protect investors and make sure they got the best price when they dealt on the stock exchange; regulation – NMS and the rules thereunder.

What followed was an astonishing, incredible decade-long arms race in which investors pushed forward and invested millions of dollars in the highest possible speed trading available to either take advantage or prevent themselves from being taken advantage of in what is known as latency arbitrage. Over the years I can't tell you the massive the amount of investment in technology, in lobbying, in legal fees, that has been spent to either create or protect that franchise.

Now fundamentally, if you ask me whether that was a good idea, if I still were an academic, I might say, well, price discovery; yay; but I just want to point out to you that the pursuit of price discovery in this fashion has very real costs. The cost that it has is, at the moment, we have 13 [lit 00:10:31] stock exchanges in the United States. We've got 13 different venues at which an order that you place for shares can be delivered to, and of those 13, 12 of them are owned by three conglomerates.

Now you might say, that sounds like a weird M&A strategy: Let's buy all the units that do mostly the same thing, and then just have them compete against each other. Well, it doesn't make any sense. The answer is, they don't compete against each other. What they do is, they charge connection and access fees that investors pay for. They are used to extract what are essentially monopoly rents by stock exchanges.

Now whether or not that's – we can debate whether that's a good thing or a bad thing, but fundamentally what's astonishing to me when I arrived at the SEC is that for years the exchanges had managed to extract those costs, which are basically rents, from American investors with very, very little public debate; which strikes me, I should say, as an astonishing feat of lobbying, but also something very troubling for America; and it matters.

When I have this conversation with people, they say, boy; this sounds really technical; this doesn't sound like it's interesting from a social – like from a Colin – point of view. My point to you today is that that's wrong. When you talk to an ordinary American investor – and part of my job is to do that throughout the United States – and you try to explain to them why there are 13 stock exchanges, and 12 of them are owned by three conglomerates; and they extract fees on a daily basis from folks across America; it's very hard to explain to them why that's good for them.

It gives them the very strong impression that the system is arranged in a way that is meant to profit somebody else rather than them. I will say I'm very proud of the SEC's work in this respect; because for the first time in a generation, we have gotten very serious about examining these issues. I gave a speech on the subject at George Mason University back in September and have been joined by my colleagues, as we've moved forward, on a number of policy initiatives that I'm very, very proud of. These are all bipartisan and have been unanimously adopted at the SEC.

We'll soon have a transaction fee pilot in which we test the effects of certain payments that the exchanges make. I'm happy to talk more about the details in the Q&A, but for now I just want to say that taking on that subject, the notion that exchanges have concentrated power that they use to extract from American investors – I think it's just an important conversation that we need to have, and I'm proud that we're having it. That's first.

Second I want to talk a little bit about the role of institutional investors. I testified on this subject at the Federal Trade Commission not that long ago, and more or less my testimony said the following. There's a broad public conversation we're having right now about the degree to which common ownership by large institutions and public companies is affecting competition in this country. My own view is that that conversation is important but misdirected.

Actually what this strikes me as is a challenge of corporate governance; because something that hasn't been discussed, something that hasn't been focused upon until very recently in two ways I'll talk about in a moment, is the role that these institutions play in the outcomes of corporate elections. This is an enormously powerful task that we've charged you with as a society; and those corporate lawyers who are in the room, those who practice or those who advise boards, will tell you that most corporate questions are decided by just a few large funds. Persuade them, and you carry the day.

No I'm not prepared to say that's a good or a bad thing. It's just a thing that deserves our attention. As I said, I'm a really excellent thief. That's why, when I testified on the subject, I based my testimony largely on a tremendous paper by John Coates at Harvard, who explains why it's actually possible to imagine a corporate world in which a dozen or fewer individuals have that kind of control over our destiny.

Fundamentally for me the reason that's important to understand is the reason the chief justice who is here today has pointed out; which is that, to the degree you feel that corporate America has let you down, to the degree you think that they've done something that isn't fair; like, for example, spend dark money on politics, whatever your issue is; it's time to call to account the institutional investors who sat silently while that happened. I think Leo's right about this. I think if you're me, and you're a guy who's serious about this subject, it won't do to blame corporations by themselves on this issue.

No, I think I've got to be candid and look Black Rock, Vanguard, Fidelity, in the eye and say, you guys have overseen this, and where have you been. I think Leo's right about that. I think fundamentally, as a society, part of what we've done in the public conversations we've had about corporate America and the choices that they've made is, we really like to blame them. It's a moment we're at as a country. It's really great to have somebody to point to and say, it's your fault; but everyone in this room knows that corporate America is a lot more complicated than that. There's a broad range of constituents, and all of us bear responsibility for where we are as a nation.

That's why, when I've talked about this subject both publicly and privately at the SEC, I've pushed people to answer those questions in a way that I could explain to an ordinary American investor. I must tell you that, at the moment, trying to explain to them why corporations participate in politics the way they do, why they make the choices they do about executive compensation, is not an easy thing. That's a problem that all of us have to bear responsibility for. That's second.

Third, I want to talk about this fundamental idea that the solution to part of our social problems might be to allow corporations expressly to consider more broadly other subjects, other constituents, when they make decisions. Man, it's a tempting idea. I totally understand its appeal. I really do. The notion that you might have a wise council of individuals who will consider all these things and come up with the right answer and solve these problems for us – it's a very tempting idea, but I'm convinced it's a mistake. I'm sure it's a mistake.

The reason is, it is a burden we cannot expect the board of directors as an institution to carry. Look, I've been in those boardrooms. I've talked with these people. These are good people who are trying to do the right thing, but they do not hold the keys to our environmental future. They can't solve those problems this way. They should be responsible for them, for sure; but putting that burden on them and then watching them fail is going to be an exercise that won't be productive in terms of the policy solutions that we need.

That's why I think the chief justice is so right to point to other corporate constituents who are responsible for where we are in the subject he was commenting on. That's why I think more generally we should have that conversation. If we're worried about the degree to which corporations do or do not take those kinds of considerations into account, in my judgment it follows not that we should adopt a rule that invites them to consider other things. That has dangers that those who studied the subject in the '70s and '80s understand.

No, I think what we should do instead is ask whether those should be part of the obligations of all the constituents to the corporation; the investors, the board, and those who represent them. That is, whether or not – my challenge to you, Colin, might be, do we want to think more broadly not just about the corporate enterprise but about the enterprise of investing; and to the degree we do, do we want to have conversations?

You mentioned this in the text. We've talked about this, you and I: What are the responsibilities of being an investor in this world? What are the ways that they should think about their duty to the underlying shareholders? Let me give you an example of what I mean. Those of you who are interested in this subject: The degree to which large institutional investors actually vote in a way that reflects the preferences of their shareholders – are you confident about that? Do you feel we have good science and a good understanding of the degree to which a large institutional investor votes their shares in the way the ordinary underlying retail investor would want them to?

I don't think we know that. I think we should, for the reason that the chief justice and others have pointed out; that if we're really going to have a conversation about what we want, about what we want corporations to achieve and what investors want from them, then we should understand the way underlying investors think about those issues and whether or not the votes that are getting cast reflect those interests. That, to me, is just part of the intellectual enterprise of understanding what we're asking corporations to do and why.

The fact that we haven't explored it strikes me as a notable and actually telling omission. It makes me wonder whether the question we're really asking is whether corporations are doing what their individual shareholders want them to do, or whether we're really playing a different game. So my request for all of you would be to begin those conversations today; not just to come away with an answer to the question, which is 30 or 40 years old, about whether or not boards should be able to consider other interests, [consistency 00:19:08] statutes, et cetera – that's important, and I'm happy to have the conversation – but more generally whether we should set before corporations a task for solving the broadest social problems we have.

If we're going to do that, should we ask the same thing of the investors and be prepared to hold them responsible for the choices they've made over the last 30 years that have brought us to the place we're in as a nation?

So that's my pitch to you today. I really prefer to have a conversation, so I'm going to take your questions. Thanks so much for having me and for having this important conversation. Tell me what's on your mind.

Jack: As you heard, he gave us three topics he wanted to discuss. The first was competition among stock exchanges. The next was institutional investors, whether there was danger in consolidation there, and the third was the degree to which boards and others should be able to consider and subordinate profit to – I guess today you would call this ESG; environmental, social, and governance decisions.

Let's take these one at a time. I'm going to ask for questions first on the stock exchange issue. As you will recall, he has said – as he's said several times; I've read his testimony – that of the 13 public stock exchanges, 12 are owned by three entities. By the way, those three are NASDAQ, ICE, and the CBOE. That's who the owners are. He also makes the point – I think a very good point – that generally when you acquire lots of firms, you consolidate them; but there hasn't been this consolidation, because you love charging fees for sending orders back and forth. That's anticompetitive.

In any event, that's the backdrop. Now we have people here interested in stock exchanges, and I may have to call on Merritt to come out and make a question; but – anyone have a question on this first thing? All right, Merritt, you've been called the world's leading expert. What do you have to say?

Merritt: I think there's a lot to your identification of potential problems, basically in the industrial organization of the trading industry, but at the same time we see that trading costs are much lower than they've ever been before. Now I realize maybe we could do even better; but it makes me wonder whether it's as serious a problem as you suggest.

Jack: You're pointing to the increasing reduction of the spread.

Merritt: In the spreads and commissions, basically the total cost to people making trades.

Rob: Yes. So just to give some context for those of you – Merritt's question is fundamentally, Rob, I understand why you're concerned based on the structure of the market, et cetera; but look, it's cheap to trade stocks, and getting cheaper. So is this really a serious problem? So let me say two things about that.

First of all there's no better place to [hide rent 00:22:11] than in falling prices, because we don't know the [counterfactuals]. The question is, how fast should those prices be falling? You and I don't know that in the counterfactual world where exchanges don't have the political or legal power that they have, so it's hard to say; but fundamentally – put that completely to one side. I want to pitch you on something else, man, which is that just having the structure we do – the fact that that describes the deepest, most liquid capital markets in the world is, by itself, costly. Do you see what I mean?

Fundamentally the idea that the stock exchanges are set up to send orders around New Jersey and then back here so that they can profit, the fact that there's a firm that exists for no other purpose than to trade stocks at breathtaking speed – this is a hard thing for us to explain to people who are wondering why they can't make their rent. Fundamentally that's a challenging thing to explain to American investors.

That doesn't mean we can't explain it. I'm happy to talk to people about price discovery. I'm happy to – I believe that price discovery is socially valuable. It's clear that it is, but I think there's a cost just to having this structure. Now if you want I can pitch you on other costs of it that are, maybe, less headline worthy. For example, the exchanges have made claims to regularly immunity, which allows them to take less than optimal care; and we've allowed them to make those claims.

These are things that you've written about for a long time. So those are, to my mind, real costs with respect to the optimal level of care that exchanges do or don't take. That's a conversation we should have, but more fundamentally, I think we should just think through, do we have the system for trading stocks that we would have imagined we'd have in a world with the kind of technology we have. I've got to say that I think the answer is no.

The notion that exchanges can charge the rents they do for very significant – for basic technological services like connection fees and cords to connect to their computers; the idea that this is what people pay for when they buy and sell stocks is something that I think is worthy of scrutiny, whether or not you believe that more generally there have been benefits to those investments. Oh, let me say one more thing about that, by the way.

Rob: The fact that the exchanges have taken those steps might have been very beneficial. In fact we can agree that – and you've written this, too, not that long ago – that investors have a better deal on the stock exchange today than they did a decade ago. I'm happy to concede the point. The question is, what's the path forward? It's not at all clear to me that allowing this system to perpetuate itself is the right path forward for the nation.

Jack: Any other questions on the stock exchange competition? Over here – I saw your hand first.

Jim: So Rob, with estimates that 50 percent of stock trading volume is now in dark pools, what's your reaction to the impact of the structure of public exchanges on that increasing trend?

Rob: It's a good question. Everybody knows Jim, I assume. No. He used to be my boss. Seriously. People don't know –

Male Voice: Long time ago –

Rob: I had the very great privilege of working with Jim when he was the chief restructuring officer of the Treasury Department, and people don't know this story, but they should. For a long time Jim was the only thing standing between AIG and, therefore, the nation in total catastrophe. He restructured the firm with astonishing success; and I'm so sorry to do this to him, but would you join me in a round of applause for the man's public service?

I had the great opportunity to see – yes, I know. It's hard, man. I had the great opportunity to see that work day to day –

Male Voice: [unintelligible 00:25:50]

Jack: Sort of like your inaugural address, isn't it?

Rob: One of the great privileges of my career was, I got to see him do that up close; and it was really an astonishing thing. I'm very proud to have been there.

Male Voice: Answer the question, commissioner.

Rob: His question is: What but dark pools? Half the volume is now off exchanges; isn't that a bad thing? So a couple things about that. First of all, as Merritt has taught me over the years, dark pools tend to provide – in fact, as a legal matter, must provide – price improvement on the margin. So there's an argument that investors do a little better by dark pools. I do have a concern about it that I'd like to get your views on.

The dark pools have sucked so much volume off the exchanges that I worry about – and Merritt and I – he's going to teach me more about this. I worry about the degree to which the price discovery we get on the exchanges is right, man. I worry about it especially at the close. So one of the great things about being in this job is, I can ask, and have asked, to stand on the floor of the New York Stock Exchange and watch them close stocks at 4:00. The reason that moment is important for so many investors is, at the 4:00 close will be the price that they get, for example, in a mutual fund. It's an important price setting moment.

My concern is that, to the degree, a lot of that volume comes off the exchange, and we don't get a true price at 4:00, we'll have some systematic disadvantage and a lot of arbitrage around 4:00. Now at the moment what the exchanges tell me is that that's not a critical concern yet, but that we could easily end up in a place where it would be. That would be one of the things we'd have to figure out if we're going to do something different on exchange regulation, because they do provide – just to be clear, I've been hard on them today and in the past, but they provide a very valuable service in terms of that price discovery; especially at the close. That's something we can't impede.

Jack: Okay, I'm going to take one more question on stock exchanges, and then move on to common ownership. Yes, your hand was up earlier. Would you identify yourself?

Doug: Doug Chia from the conference board. In terms of your comments on the monopoly of stock exchanges and the rents that they extract from all of us, it seems to me that what has to happen – and probably will happen at some point – is, there'll be some kind of disruptor to come into that industry like we see in so many industries today; an Uber, a Netflix, type of player that comes to just change the game entirely. So much of that – when that happens, a lot of it is about disintermediation. It's why ESPN is going to be gone at some point.

In order for that to happen, there has to be technology; and there also has to be changes in the regulations. The stock exchanges are the way they are today and don't have a lot of competition because they're regulated by the SEC. You do have attempts to come up with alternatives, but they have to go through this process. So I guess it's not a question. It's more of an urging to the SEC to really think about that in terms of the SEC's role in essentially encouraging that type of innovation in the system and not making it – preventing some of the really good ideas from being, essentially, crushed at the beginning because they just realize, it's going to be too damn expensive for us to get through that process.

Rob: So first of all, Doug's absolutely right about this. We just aren't creating the kinds of incentives we need for people to create new technologies that can compete on the margin. I think that's absolutely right, but I want to get to what

I think is the most important thing you said; which is that, we did this. They created the system they did because it's within the rules we set up, and it maximizes their profits under those rules. I try hard in life – I don't always succeed, but I try hard in life not be mad at people for following the incentives I give them; because the problem there is not the people. It's the incentives. This is my problem, not theirs. That's why I've been proud to be a part of looking through those regulatory incentives.

If you take one thing away from my talk, this is the idea that I want to share with you. When we make that kind of choice, it feels narrow. It feels small. It isn't. It's a choice about the kind of system we want to have, the kind of market we want to have, the kind of country we want to have. I'll give you another example.

Another former boss of mine, Trevor Norwitz from Wachtell, Lipton. For years he has come to these events. He raises his hand, and he says, you have to do something about activist investors; they're a terror upon the nation. I'm paraphrasing. Is it fair?

Trevor: Scourge [unintelligible 00:30:39] scourge –

Rob: Scourge [unintelligible] – I said, well Trevor, you know, it's complicated; agency [unintelligible] – fundamentally I think what I've become persuaded of by Trevor and by others in the space is that a choice to – the securities law we have is a choice about the role those people should play in the agenda setting and investments in American society. What you've been pushing me to do is ask myself if that's the right choice for the nation. That's the view I've come to, having been in this job for a little while; that that's really the question I should have been asking myself all along.

Having gotten there, it doesn't make the answer more clear; but it makes the question more important and more evident for me.

Jack: I'd like to move on now to this second topic, which was common ownership. As I indicated in my introduction, and as you validated immediately, you've been reading a lot the work of John Coates and others who – and I think Einer Elhauge is even a stronger proponent of this view. Elhauge has been arguing that, as we see great consolidation among institutional investors, there's the chance they'll get together and agree on anticompetitive behavior.

John Coates has been pushing more the political impact. We've heard that 12 people or less can influence corporate elections, but Jeff Gordon out here wants them to influence Congress as well, and that gives me some pause if 12 people can bash that heavily. So against that backdrop, what questions do we have about the role of institutional investors? Over here.

Eric: Yes, hi. I'm Eric Orts from the Wharton School, and I'm really happy to hear about really great people who have high grades from the Wharton School making such a huge public statement. My question has to do with finance.

Jack: Well excuse me. If you feel that way are you going to [publish Rob's 00:32:22] grades?

Eric: Also Rob – no. I was referring to Rob Rosenstein, also a Wharton graduate. Anyway – so my question has to do with the increasing financial power we had in terms of lobbying effect. So I think we know that finance is the highest lobbying group, and there's increasing concern about the influence of finance over our political system. If you look at the – increasingly finance is a large part of GDP compared to what we might call the real economy. In the '50s it was two percent of GDP. In 2008 it's eight or nine percent.

So my question is about the concentration. What can you do – is the SEC interested in doing – about curtailing the influence or at least making public disclosure of what the finance industry is doing politically? It used to be lobbying – a long time ago lobbying was even I illegal. If there's really the public interest, and we have the public interest as stake, should the SEC take some more forceful approach about this?

Just one quick anecdote to end the question: The whole idea of a retail investor – I raised that issue in an MBA class recently, and someone put up their hand and said, the whole idea of a small investor these days is a joke. It doesn't really exist, so maybe we should get away from that model of who we're really regulating for.

Rob: So let me get back to the small investor. First of all thank you for the kind remarks about my grades. Let me get back to the small investor point in a moment. Let's talk first about –

Eric: Oh, I didn't disclose that. Jack said you had that – I just want to make clear I didn't disclose anything about your grades. Jack said a nice thing about your honor, by the way.

Rob: Thanks. So let me talk first about the first question you asked, Eric, because it's a good one. You asked, should the SEC be doing more to provide transparency with respect to what the effects of this lobbying are. The answer to that question is straightforward. It's yes. I'm somebody who has advocated very forcefully for that. When I first joined the Columbia faculty, I read an article with Harvard's Lucian Bebchuk on the subject. We later petitioned the Securities and Exchange Commission. I was joined in that petition by both Jack and Jeff Gordon and others in the room.

We urged them to make rules that would require more transparency in this respect. More than 1.2 million people have written to the SEC to urge them to adopt those rules, and we can't right now; and the reason is that Congress passed a law saying we can't. Yes, crazy time. So there's an appropriations bill that says that we can't spend any money to finalize a rule in that respect. So to me, because I like empirics, that's evidence that it's important; because otherwise people would not invest political and other capital to prevent it. I think it's something that we should be considering when the law permits. For now I think having more transparency in that respect would be very desirable for the reasons that you've given.

You asked another question that I want to say more about, which is, what can we do about the concentration that we see in the financial services industry and the cost it has for ordinary Americans. I think at a minimum we should be pushing that industry to explain and account for what the cost of that concentration might be. So the first speech I gave – or one of the first speeches I gave – as an SEC commissioner, stealing again from academia, I pointed out a fact that has existed since I was a banker, which was a long time ago, and that still exists today; which is that when a banker brings a company public, if that company is worth less than a billion dollars, 97 percent of the time the banker charges seven percent on the spread; not six and a half, not seven and a half; seven percent.

I called it a tax and said, it's hard to understand why that prices is the same price it was when I was a banker. It was a very different time. It was dialup internet. I was one of the guys who were taking a company public that were – like the dot-com boom. Sorry, but seriously, there's been no development, no improvement in the efficiency on that topic. I have to ask – and I would ask you – whether or not the concentration we see in the industry is a driver of that.

So one of the things I've been trying to do with the SEC – and we're working very hard on this – shining light on those kinds of very real costs that people pay in light of that concentration. Whether or not it's a problem that can be solved at the SEC is a good question. Another talk I gave a little while ago, to the Open Markets Institute – I remarked that it's unusual and, seems to me, a problem that there is no office of competition economics at the Securities and Exchange Commission.

The reason I say it's historically unusual and very strange is that, many people don't know this but, when the securities laws were first enacted, there was no Securities and Exchange Commission. The '33 act, when first passed, charged the Federal Trade Commission with oversight for the securities laws. It wasn't until Joe Kennedy persuaded FDR that you needed a separate agency that the '34 act was passed, and that the SEC was created. Even then it was thought that competition was essential to the agency's mission.

How do I know that? Because the statutes that empower us to make rules require examination of concentration when we make them, but we ordinarily don't do it. I've been trying to move the agency in that direction to fulfill our statutory mandate, but also to grapple with the reality we face, which is that the rules we adopt have effects of concentration of power in this country, and we should be held to account for that.

Jack: You got us into the topic of investment bankers and common fees and limited competition, but the area that people talk about most is the growing concentration among institutional investors; and, in particular, three of them – Vanguard, Black Rock, and State Street – account for about 20 percent of the stock of all publicly held corporations. I want to get to what that means. I think I saw Ron Gilson's hand up. This is the kind of topic you might want to address.

Ron: That looks like it works. What I actually wanted to comment on – but I'll talk about that as well – is the suggestion that Rob made that institutional investors, funds and the like: How much do we think that the votes cast by the asset manager reflect what their shareholders want? I want to take a pretty aggressive position on that. The answer is, nobody's got a clue; but it's worse than that.

Given the way these are held, it would be easier to figure out whether Al Gore won the Florida – than find out who these people are; because it is layered between so many intermediaries that, in truth, for most of the companies, most of the fund managers don't know who their shareholders are, let alone what they think. It would make the CDOs during the financial crisis look transparent. So my point is simply not that it wouldn't be a really great idea to know, but I guess I think without a kind of restructuring that isn't feasible, I don't think it's noble.

Rob: So it's a good point that Ron's making. I want to say something about it. So this is something – Jack, I think you were saying a moment ago – the three I often have in mind are Black Rock, Vanguard, and Fidelity.

Jack: I said –

[talkover]

Rob: Yes. So for me there's a couple things about what Ron has just said. First of all he's right. That system is a complete mess – very hard to know what the answer is. Ron, it's unacceptable. Here's something that I proposed about six months ago at a roundtable at the SEC that, at the time, I thought was really mundane and trivial, like most of my ideas; but this – people reacted and said, this would be actually really hard and important to do, and we're working on it right now.

Right now an ordinary American investor – we know this from the P&G fight; we know it from long experience with shareholder voting – wants to know, was my vote counted in the election in which I voted; they're not legally entitled to get that answer. The leading lights of the field, like Ron Gilson, think that they can't know it. That's an astonishing thing.

Ron: [I said 00:41:19] something slightly different. That is, they can tell. The fund will disclose their votes; but it won't tell them, what there isn't any way to find out, is the correspondence between what a group of shareholders – how they would have voted individually on that. I think the answer is, they wouldn't have; but that's beside the point of how that reflects. Now, it may be that for investors who care, the way to make that effort is to identify which funds you invest in; because there are special purpose funds.

There's a huge cost to that, because there – inevitably it will be a concessionary investment; but the broader point that Jack was raising was, how and when do we want those votes to count; because the complexity of the restructuring and the privacy issues associated with getting the funds access to those shareholders are complex and troubling. The first step may be figuring out what it is we want those votes to do.

Rob: So I think that's right. You're right. I was making a slightly different point, which is just the very basic first step of knowing what votes were counted in a contested election – that's just –

Ron: [unintelligible 00:42:58]

Rob: No. You're wondering about, what would we do in step four. I'm back here at step zero. I'm just saying fundamentally I think we should have this. We should have the ability for individual – as it is people are rationally apathetic in their collective action problems with respect to casting their votes. Why should they vote if they don't even know if it will be counted in a close case? The Procter & Gamble fight – everybody involved agrees, not only do we not know who won, we will never know who won. They treat it like an unknowable thing like faith and love. It's unbelievable.

To me it's very important, actually, that the SEC step forward and mandate this kind of – I think we're going to, actually. I've advocated that from end to end it should be the case that, in a corporate election, if an investor wants to know whether their vote was counted, they can get an answer to that question. I'm actually very optimistic that the SEC will take that step.

Jack: Now you've gotten to one question about what ballots count. As the moderator I'm going to push this small prerogative. The other question that's hiding behind that is whether the middle managers at mutual funds who actually vote the shares are voting either the way the ultimate owners want, the ultimate holders, or the way that the CEO wants; because it could be that the middle managers who vote shares vote the way their incentive compensation leads them. That brings us back to the old debate about short-term versus long-term, because if you're compensated on the short-term rise in the portfolio as a middle manager, you may look at what short-term stock prices are going to do.

On this area how do we determine whether or not middle managers are listening to anyone other than their compensation?

Rob: It's a great point. So I think one of the hardest things for me to see in my new job is how little change there has been in the incentives of senior managers with respect to short-term versus long-term stock prices. The reason is probably – the world's leading scholar on executive compensation, Jesse Fried, is here. He wrote a paper in the University of "Pennsylvania Law Review" about a decade ago where he said, these are the things you should do to [pay for 00:45:01] long-term performance. It's got to do with the degree to which executives can trade in the stock when they unwind and take liquidity from their positions, et cetera. It's a great paper. Take a look – easy things to do.

The truth is, we're just not doing them. For one thing Dodd-Frank contains a number of provisions that would help corporate boards and managers understand and disclose to investors whether or not they're taking those steps. Of all the rules in Dodd-Frank, of all the thousands of regulatory initiatives, all the things we had to do, four rules remain unfinished. They're all about executive comp.

Jack: Never will be finished.

Rob: Yes, not a coincidence. So first of all I think we haven't addressed that issue. Actually one of the things I've seen as a commissioner, which is really troubling for me, is many of the things that – the corporate behaviors that are most challenging, or most hard to understand, are driven by short-term incentives. As a rule I try hard not to be mad at people who do what they get paid for but instead to try to regulate the framework in which they get paid.

So I'll give you an example. I did a speech about a year ago on a subject that's got a lot of attention, which is stock buybacks. I said, you can see in the data – it's very clear – that the day executives announce stock buybacks, they engage in more stock sales on that day than any other day, like three times as much stock sales. I said, this is worthy of attention, because it gives them incentives to do stock buybacks; whether or not those are long-run beneficial for the firm, because they can cash out their shares today.

It's a funny thing. You do this – I did the speech. I had the data. I put it online. People's reaction was like, that must be wrong. I was like, but look, the data – no, no, that can't quite possibly be right. Either it's illegal, or it should be, or it doesn't happen, or – I'm like, look, man; it's numbers. I don't know what to tell you. This is fundamentally, Jack, why I think it's been frustrating. We have been talking about executive compensation and long-term incentives as a nation for a very long time. We haven't solved that problem or got even close. We have a lot of work to do. Others –

Jack: I'd like us to move on to the last topic. We have 10 minutes. The last topic is whether or not managers should be considering these environmental issues, or is that some kind of political determination that's beyond their competence and expertise? At least that's the kind of issue that I think you were leading up to. I see a hand way back there. I'll come to Colin next.

Cynthia: Hi, Cynthia Williams from Osgoode Hall Law School. I'm wondering if we could avoid the stakeholder debate simply by emphasizing one of the points that Colin Mayer emphasized. That is, ought we not to be measuring corporate performance, or ought we not to be measuring different kinds of capital such as human capital, social capital, and natural capital that are inputs into the firm. If companies were required to disclose more information of this sort, might we not be able to avoid the shareholder versus stakeholder debate a bit; because all we would be asking corporate managers and boards to do is disclose, what are the implications of the actions that they are taking, no matter how they consider the ultimate beneficiary of their fiduciary duties; either stakeholders or shareholders?

Rob: It's a good question. So first of all, just to be clear, a rule like that – Jill Fisch is here. She signed an ESG petition not long ago.

Female Voice: Cynthia wrote that.

Rob: Oh, really? Yes, for sure. It's a great petition. It's important work. So I'm very interested in the petition and the rules that were promulgated under it. I wouldn't be against such a rule, but we're at a law school. It's an intellectual exercise, so let me push back. Suppose they had to make disclosure about that subject, about the various human capital. Now, your thinking is that that might be helpful with respect to getting corporate managers to think through the human capital investments they're making and providing accountability therefore.

Female Voice: No, maybe not.

Rob: Good. That's right, and that's, I think, what Colin would say. He'd say, yes maybe; but to the degree shareholders and managers agree together that what might be best is to do something bad for employees, they will continue to agree. All we'll do is provide transparency with respect to that agreement – does that make sense? – which is why I think Colin might push for something more, for boards that have to say no; even if we could agree with our shareholders in perfectly transparent terms, it would be [right 00:49:47] to screw over our workers, we're not allowed to do that a matter of fiduciary obligation. Does that make sense?

Cynthia: Well, that makes sense; but I guess what I'm saying is, we don't even have to go that far in the fiduciary duty argument. Boards and managers are already making decisions that are having implications on social capital, are having implications. I think that this also could solve Jeff's political problem, which is, you might not need to get Congress to agree to a new social insurance scheme if you could get accounting firms to see a new business opportunity by better measures of these kinds of implications and more information.

Rob: So look, just to be clear: I think those were the important steps forward. I'm not against it. What I am against is pretending – is not wanting to pitch to you a solution that is complete when it's not. What I worry about is that – disclosure will be an important step forward in that respect. I think it would encourage people to make the investments that we know they are making and should make. Then it would be about coming up with measurement devices, and that would be an interesting debate, et cetera. I'm sure the accountants would be happy to help us.

So yes, by the way, if you wanted to be critical of such a proposal, you'd say it's a gift to the big four; because they're going to decide the rules – you see. So there's a political economy to that. Jack, how did we do on the political economy of accountants, the political economy of the accounting firms? Can they be trusted to handle all this stuff?

Jack: Do I trust accounting firms to do anything other than their own self-interest? No.

Rob: See – yes. So I guess my pitch here would be, that would be an important step forward. I'm not against it, but details would matter. I'm not sure it would solve the whole problem.

Jack: We're getting short on time. I want to give Colin a chance to ask his question.

Colin: Rob, thanks very much for your observations. A question I'd like to pose to you is: I don't understand how you came to the conclusion that I wasn't saying exactly what you and, in particular, Leo, have said on this; namely that the whole focus of the book is really on the importance of ownership, the importance of institutional investors; that in many cases management wants to do the sorts of things that I'm talking about in the book, but are prevented from doing so because of the disconnect with the way in which investors are thinking about it.

It puts forward a whole series of suggestions as to how to deal with it, for example thinking about whether or not one could have direct investments by institutional investors like some of the funds are doing rather than going [far into 00:52:24] into fund managers and the investment [chain] being a large source of the problem.

So really my second question is – there are ideas being put forward to deal with this. Luigi Zingales and Oliver Hart have put forward the notions of having mutual funds, which I don't think does deal with the investment [chain] problem, but have you got other ideas about how to do it; and how did you come to the conclusion that I'm not saying exactly that?

Rob: So first of all I think the book does say that, and I want to be clear. I think what I'm trying, Colin, to push back against is, those who would read the book in the frame that I'm describing as a move toward giving corporate managers more latitude as a solution to social problems. That's not what the book says; and I think if it were read that way, it would be – and I'm trying to nudge people in the other direction, for the reasons that you and Leo have given.

You asked, do I have concrete ideas about how to do that. I do. In my FTC testimony I talked a little bit about this. For me it's an important thing that we have not yet, as a nation – when people make a retirement savings decision, when people hand their money over to an institution, they get very, very little information about how the institution is going to vote those shares. I think we should change that, man. Fundamentally I think we should change it because I think that Black Rock, Fidelity, and Vanguard should be held accountable by the people whose money it is for the way that they vote; good or bad.

There's a number of new papers that talk about the various – there's spatial political analysis. I saw Emiliano Catan here a little while ago. He did some great work on this, where he talks about the various places those institutions reside in terms of the way they vote these matters. I think giving people that information might be useful.

Now a skeptic would say, Rob, individual investors have no idea what to do with that information. They don't care about that information. It's irrelevant to them. So two things about that: First of all, that's an empirical assertion for which I'd like some proof. I understand that the general wisdom is that retail shareholders don't vote. Actually, empirically no one's looked at that carefully for a very long period of time. I think you'll find a [timeframe 00:54:36] that might surprise you, et cetera. So my first challenge would be, prove it.

Second, even if it's true, let's allow the individual investors or at least the significant financial advisors who are in this space, to make that decision more consciously; that is, to look at the page, see that they're making the kinds of choices you're describing in the book, and decide that they don't want to play that game. That would be a different world than the one in which we reside, where in general billions of dollars are put at the voting disposal of a few individuals who get to vote those shares without talking to the people whose money it is.

Jack: One or two more questions – Trevor's had his hand up for a while.

Trevor: Just a quick one – I think we've been talking about, Rob, you being concerned about the concentration of power in hands of too few people, but I think we need to remember, these are not just ordinary mortal people. What we're talking about here is a race of supermen. We have one person at the moment who is trying to take over the board of directors at Magellan, Dollar Tree, who did take over Papa John's Pizza, tried to take over the board of Bristol-Myers Squibb and terminate a big transaction.

This is a person who not only know how many breadsticks should go on a table but knows which molecules a major pharmaceutical company should be investing its R&D dollars in. The institutions support these people. Black Rock only 20 percent of the time will [vote with 00:56:00] the activists. Vanguard it's 30 percent. T. Rowe Price is 50 percent. The government obviously believes in their superhuman-ness, gives them better tax rates than any other working American. It allows them to circumvent rules like [13D] that were put in place to ensure people know when they're sneaking up on companies.

So everyone recognizes that these people are really a master race of people, so should we really be worried that they are asserting so much power? We're basically giving it to them.

Rob: You get the sense Trevor has a view about this. Yes. So actually it's a fair question. So let me put it a different way. I think the concerns you're raising are very real, and I want to be specific about the way in which they're real. My second year on this faculty, Jeff Gordon and Ron Gilson wrote a paper about the degree to which hedge funds have increasingly been setting the agenda that gets in front of investors. It's published in the Columbia [Law Review 00:57:06]. It's a good paper, worth reading.

The reason I think it's connected to the point you're raising, Trevor, is that we have to ask, are those the folks who should be setting that agenda. Put to one side decision making authority for the moment, because their paper talks about that, too; but just the act of asking the question about breadsticks or molecules: Should they be the ones who do that agenda setting for corporations? I think that's a really valid question to ask. I'll leave it to all the smart people in this room to help answer.

You're not wrong that our securities laws are set up in a way that these folks can and do take advantage of; but fundamentally as a nation, I think what we should be asking is, are those the folks who should be setting our corporate agendas. I think it's a question to which the answer is not obviously yes.

Jack: We've reached the end of our time. I want to say that, now that we've heard him speak, how many of you agree with me that he should go after [unintelligible 00:57:52]?

I have to tell you that we are now scheduled for lunch. It will be right outside this room. You have until 12:45 when your next panel –

[End of recorded material at 00:58:07]