COMPETITION: THE FORGOTTEN FOURTH PILLAR OF THE SEC'S MISSION

ROBERT J. JACKSON, JR.*

Thank you so much, Sarah [Miller], for that kind introduction. It's a privilege to be here with you and the Open Markets Institute and Village Capital today. I've long admired the Institute's leadership in putting the concentrated power choking our economy at the forefront of the national agenda, and I share your commitment to making sure our markets are competitive and fair for all Americans. So it's a real honor to be here with you today.

Now, before I begin, let me just give the standard disclaimer: the views I express here are my own and do not reflect the views of the Commission, my fellow Commissioners, or the SEC's terrific Staff. And let me add my own standard caveat: I fully expect that, given time and wisdom, my colleagues will discover that, as usual, I was absolutely right.

Today I'd like to explain why the unprecedented concentration of power in the American economy is among my top concerns as a Commissioner. But since the SEC rightly requires full and fair disclosure, I'll need to start with a disclosure of my own.[1] When I graduated from school years ago, my dream wasn't to become a public servant or a law professor. No, I spent my senior year in school recruiting at Wall Street's accounting firms and investment banks.[2]

I remember running from office to office in the late 1990s trying to persuade serious people of the silly proposition that high finance was really what I wanted to do with my life.[3] And at that time, there were many stops to make: investment banking league tables featured a dozen significant players,[4] and all Big Six accounting firms recruited college graduates.[5] The dot-com boom was fueling enormous growth. We all imagined that Wall Street would soon feature dozens of new firms, all competing to take America's most exciting companies public.

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[1] *See* Securities and Exchange Commission, Final Rule: Selective Disclosure and Insider Trading, 17 C.F.R. Pts. 240, 243, and 249.

[2] *See* LODGER, *I Was Young, I Needed the Money*, *in* HONEYMOON IS OVER (2008).

[3] *See* MITU MISRA, DIR., LIES WE TELL (2018); *see also* MICHAEL LEWIS, LIAR'S POKER (4th ed. 2011) (noting the author's astonishment that the Wall Street cautionary tale he'd written had served, instead, as a how-to guide for college students like me to pursue a career in finance).

[4] *See, e.g.*, Robert J. Rhee, *The Decline of Investment Banking: Preliminary Thoughts on the Evolution of the Industry 1996-2008*, 5 J. BUS. & TECH. L. 75, 95-96 & tbls. 1-2 (providing investment banking league tables for this period); *see also* ALAN D. MORRISON & WILLIAM J. WILHELM, JR., INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW (2007) (same).

[5] *See* ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, ROUNDTABLE ON COMPETITION AND REGULATION IN AUDITING AND RELATED PROFESSIONS (2009) (tracing the history of consolidation in the accounting industry).

But twenty-five years later, when I arrived at the SEC, the number of banks dominating the league tables had shrunk to fewer than five.[6] The Big Six accounting firms had become the Big Four.[7] From college graduates to corporations, everyone has less choice today than they did decades ago when they seek advice from Wall Street. I've argued in several speeches before that this leads to puzzling practices across our economy, affecting everything from the price of going public to the design of our stock markets.[8]

How did we get here? The answer is that we at the SEC have forgotten a crucial part of our mission: to pursue the kind of vigorous competition that American investors deserve. We have made the mistake of assuming that competition policy is reserved to the Federal Trade Commission and Department of Justice—and that the Commission's work does not demand analysis of the competitive implications of what we do. As I'll explain in a moment, that's wrong as a matter of law, economics, and history—and bad for investors as a matter of policy.

That's why I'm calling on all of you today to help the SEC reclaim its historical role of ensuring competition in our capital markets. Over the past two decades, the Commission has stood by while power in our financial markets has become more concentrated than ever before. It's time to bring competition economics back to the SEC.

COMPETITION AND THE COMMISSION: A HISTORY

Even before its birth, the SEC was conceived as an agency with competition at the heart of its mission. Early drafts of the Securities Act of 1933 were introduced by none other than a Commissioner of the Federal Trade Commission.[9] After reviewing the early proposal, Texas Congressman Sam Rayburn famously turned to then-Harvard Law School Professor Felix Frankfurter for drafting help.[10] In the debates leading to the passage of the Act, Rayburn remarked:

> The operation of half of our industry is now in the hands of 200 companies. This concentration has brought a change in the character of competition, and production is carried on under the ultimate control of a very few individuals.[11]

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[6] *See* Rhee, *supra* note 4; *see also* MORRISON & WILHELM, *supra* note 4.

[7] *See* ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, *supra* note 5.

[8] Commissioner Robert J. Jackson, Jr., *The Middle Market IPO Tax* (April 25, 2018), *available at* https://www.sec.gov/news/speech/jackson-middle-market-ipo-tax; Commissioner Robert J. Jackson, Jr., *Unfair Exchange: The State of America's Stock Markets* (September 19, 2018) *available at* https://www.sec.gov/news/speech/jackson-unfair-exchange-state-americas-stock-markets.

[9] A bill initially drafted by FTC Commissioner Houston Thompson was the precursor to the 1933 Act. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 54 (3rd ed. 2003).

[10] For an exceptionally thoughtful history of the passage of the Act *see* Adam C. Pritchard & Robert B. Thompson, *Securities Law and the New Deal Justices*, 95 VA. L. REV. 841 (2009).

[11] 77 Cong. Rec. 3, 2917 (1933). Congressman Rayburn's statistics were drawn from two academics who were especially influential in President Roosevelt's thinking—and still influence contemporary analysis of corporate law today. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY, 11-18 (11th ed. 2010).

It was no surprise, then, that when the '33 Act became law the statute vested oversight of our securities markets in a new Securities Division at the FTC. President Roosevelt appointed Frankfurter's colleague, the young Harvard Law School Professor James Landis, to run it.[12]

In the months after the Act passed, Frankfurter and Landis worried that investment bankers and corporate lawyers in New York were working to undercut it.[13] So when Roosevelt decided it was time for legislation to bring the New York Stock Exchange under federal oversight, both men pushed for the creation of a new agency to administer the securities laws. Frankfurter especially worried about who might be appointed to the new Commission. In a letter to the President just before the creation of the SEC, the future Justice wrote:

> The lack of moral zeal and intellectual capacity to meet the powerful resources on the other side on the part of public service commissioners . . . have been responsible for . . . building up of concentrated financial power.
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> Now the administration of the Stock Exchange Act will, I am sure, be even more difficult [than the FTC's work]. The problems are more subtle, the abuses less obvious, the public more misleadable and the consequences of non-action more far reaching. . . .
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> And what is involved is not merely the Stock Exchange Control Act. Nothing less is involved than to keep Wall Street in its place, to furnish a counterpoise against its aggrandizement of power . . . .[14]

So from the moment of its birth, the framers and founders of the Commission—Landis, of course, went on to become our Chairman—were concerned about ensuring competition in America's capital markets. Those concerns are, of course, no less important eighty years later. Yet today we're told that the SEC has only a "tripartite" mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[15] Repeating that phrase by rote is a rite of passage that every Commissioner goes through prior to confirmation.[16]

Bizarrely, that formulation skips over a word in the most important statutes we oversee: competition. As the '33, '34, and '40 Acts read today, Commissioners must "consider, in addition to the protection of investors, whether [an] action will promote efficiency, *competition*,

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[12] *See, e.g.*, SELIGMAN, *supra* note 9, at 79.

[13] Pritchard & Thompson, *supra* note 10, at 854 ("Frankfurter's main concern was that any criticism of the law would further the conspiracy that he perceived among investment bankers and their lawyers to gut the Act" (quoting Letter of Felix Frankfurter to William O. Douglas (Jan. 16, 1934) (on file with the William O. Douglas Collection, Library of Congress)).

[14] Letter of Felix Frankfurter to Franklin D. Roosevelt, President of the United States (May 23, 1934).

[15] *See, e.g.*, Securities and Exchange Commission, *The Role of the SEC: Mission*, *available at* https://www.investor.gov/introduction-investing/basics/role-sec.

[16] Myself included. *See* Statement of Robert J. Jackson, Jr., *Nominations of David J. Ryder, Hester M. Peirce, and Robert J. Jackson, Jr.: Hearing Before the S. Comm. On Banking, Housing and Urban Affairs*, 115th Cong. 74 (2017) (Statement of Robert J. Jackson Jr.) ("[T]he SEC's three-part statutory mandate requires the agency to protect investors, maintain fair and efficient markets, and facilitate capital formation. I believe in all three of these noble goals, and in the thousands of SEC Staff across the Nation who work every day to achieve them.").

and capital formation" when making rules.[17] Indeed, the word permeates our statutes and rules.[18] Regulation NMS, which guides our oversight of stock markets, is by its own terms "premised on promoting competition among individual markets."[19]

So the from the founding of the Commission to the modern Congress, it's long been understood that we at the SEC are charged with ensuring competition in our capital markets. Yet today's SEC rarely invokes competitive concerns when making rules or engaging in oversight of our financial markets. That omission has been costly for investors—and for the Nation.

THE COSTS OF NEGLECTING COMPETITION IN OUR CAPITAL MARKETS

There is a striking lack of competition across crucial areas of our capital markets. Although I'll emphasize just three today, the concentration of power in just a few players of enormous size and scope is a potential problem in nearly every area the SEC oversees.[20]

First, as I pointed out in recent remarks, the state of America's stock markets raises real questions about whether they reflect the competitive marketplaces investors deserve.[21] We currently have 13 public stock exchanges, which sounds like competition, until you realize that 12 of them are owned by just three corporations.[22]

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[17] All four of these Acts contain the following language: "Whenever . . . the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, *competition*, and capital formation." Securities Act of 1933, 15 U.S.C. §77b(b) (2012) (emphasis added); Securities Exchange Act of 1934, 15 U.S.C. § 77b(f) (emphasis added); Investment Company Act of 1940, 15 U.S.C. § 80a-2(c) (2012) (emphasis added); Investment Advisor Act of 1940, 15 U.S.C. § 80b-2(c) (emphasis added).

[18] The Dodd-Frank Act, for example, requires us to adopt rules in certain areas where necessary to "promote competition." 15 U.S.C. § 8323(b), 8343(b). The Exchange Act of 1934 commands that the SEC consider "any material anticompetitive burden on trading or clearing" when adopting any rules or taking any actions. *See* 15 U.S.C. § 78c-4(d)(1) (2012).

[19] Securities and Exchange Commission, Regulation NMS: Final Rules and Amendments to Joint Industry Plans, Release No. 34-51808, 17 C.F.R. Pt. 200 *et seq.*; *see also* Statement of Chairman William H. Donaldson, Securities and Exchange Commission, Regulation NMS (noting that the Commission adopting Regulation NMS was acting "pursuant to the mandate Congress gave us" "to enhance competition among our markets."); *see also* Yesha Yadav, *Oversight Failure in Securities Markets*, Cornell L. Rev. (forthcoming 2018) (noting the SEC's "focus on competition" in developing certain equity market structure policies).

[20] For a particularly compelling assessment of this issue in the context of corporate governance, see John C. Coates IV, *The Future of Corporate Governance Part I: The Problem of Twelve* (October 2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 ("The prospect of twelve people even potentially controlling most of the economy poses a legitimacy and accountability issue of the first order."). For a similarly striking analysis that has also been helpful to my thinking on these questions in the context of corporate law, see Stephen M. Bainbridge, *Corporate Purpose in a Populist Era* (August 2018), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3237107.

[21] Commissioner Robert J. Jackson, Jr., *Unfair Exchange: The State of America's Stock Markets* (remarks at George Mason University) (Sept. 19, 2018), *available at* https://www.sec.gov/news/speech/jackson-unfair-exchange-state-americas-stock-markets.

[22] Five of the 13 public equity exchanges in the United States today are owned by InterContinental Exchange, three are owned by NASDAQ, and four are owned by CBOE Global Markets. *See id*. at n.6.

It's odd, of course, for conglomerates to acquire virtually identical businesses yet continue to operate them independently. But our exchanges do this is so they can charge investors to connect to each exchange. And in a world where the cost of connectivity is constantly falling, exchanges have asked us at the SEC to raise these prices over and over again. We have largely stood on the sidelines while investors pay for these price increases.

Second, as I mentioned earlier today, a lot has changed since my time on Wall Street. But one thing has remained the same: the price investment bankers charge small companies to go public. When I was a banker, we charged a standard fee for a middle-market IPO: seven percent. If the client was big and influential enough, we would negotiate a smaller fee, but for middle-market firms our fee was always exactly seven percent.

As a young banker, I assumed that technology and competition would eventually bring those costs down. So when I arrived at the SEC, I asked my team to dig into the data to see how middle-market IPO pricing has changed. In a speech earlier this year, we shared our results: between 2001 and 2016, more than 96% of middle-market companies paid Wall Street exactly 7% to go public.[23] During the two decades of technological revolution since I left investment banking, prices have fallen on virtually everything in our economy—except the cost America's young, growing companies pay Wall Street to access our public markets. It makes little sense to address the decline in smaller public companies without grappling with the 7% IPO tax. In an economy increasingly built to benefit our largest companies, the middle market should be able to access our public markets at a competitive price.

Finally, there is a striking lack of competitive pressure among the Nation's credit rating agencies. Just three firms are responsible for rating most debt securities, and these ratings are relied upon across the marketplace.[24] The dominance of just a few players leads me to worry whether competitive forces will discipline the credit-rating firms that fail to detect risk in the securities they rate.[25] A decade ago, failures in the credit ratings industry famously contributed to a financial crisis that so many American families are still recovering from.

It's not just these three examples, of course: there is concentration across our financial markets. There are only four major accountancies; two firms advising investors on how to vote their shares; and one company that counts the votes in of the vast majority of corporate elections.

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[23] Commissioner Robert J. Jackson, Jr., *The Middle Market IPO Tax* (April 25, 2018), *available at* https://www.sec.gov/news/speech/jackson-middle-market-ipo-tax; Commissioner Robert J. Jackson, Jr., *Unfair Exchange: The State of America's Stock Markets* (September 19, 2018) *available at* https://www.sec.gov/news/speech/jackson-unfair-exchange-state-americas-stock-markets.

[24] Lawrence J. White, *Markets: The Credit Ratings Agencies*, 24 J. ECON. PERSP. 211-226 (2010). For a helpful history of the consolidation of the credit-rating industry, *see* Securities and Exchange Commission, Release No. 34-55231, Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations (February 2, 2007), *available at* https://www.sec.gov/rules/proposed/2007/34-55231.pd ("Moody's and Standard and Poors represent over 80% of the industry market share as measured by revenues.").

[25] Frank Partnoy, *Overdependence on Credit Ratings Was a Primary Cause of the Crisis*, *in* THE PANIC OF 2008: CAUSES, CONSEQUENCES, AND IMPLICATIONS FOR REFORM (Lawrence Mitchell and Arthur Wilmarth, eds.); *see also* Frank Partnoy, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, *in* FINANCIAL GATEKEEPERS: CAN THEY PROTECT INVESTORS? (Yasuyuki Fuchita and Robert E. Litan, eds.) (noting, before the recent financial crisis, that although credit rating agencies had to that point "performed at least as poorly as other gatekeepers during the past five years, their market values have skyrocketed").

Each of these institutions plays a crucial role in our economy as gatekeepers of capitalism. They're vital to how capital—and the opportunity that comes with it—is allocated throughout our economy. Yet each of these critical pathways to our capital markets features, at most, just a few players.

As a result, ordinary investors are driving on roads riddled with tollbooths. You see, when an industry is dominated by just a few players, those players can exploit their market power to extract rents from the broader economy. The bundling, cross-subsidization, exclusive contracts, and price discrimination we see throughout our securities markets aren't free. American investors and entrepreneurs pay for them in the form of higher costs and distorted decisions about the capital allocation that will define our economic future.

THE PATH AHEAD

So the concentration of power in our capital markets—and the SEC's failure, in the past, to grapple with its implications—has left us with a marketplace in which investors have only the slimmest menu of choices. And ordinary American investors who rely on those markets to pay for college or fund their retirement pay for it out of their hard-earned savings.

There are three steps we at the SEC can take to begin to change that.[26] There are three steps we at the SEC can take to begin to change that. First, although the economic analysis that accompanies our rulemakings technically includes, as the law requires, an assessment of the effects of the proposal on competition, that work doesn't sufficiently engage with the lack of competition in the markets we regulate. The absence of meaningful competition in certain markets ought to inform the policies we make in those areas. For example, although a competitive landscape may not require conflict of interest rules, where there is a lack of competition, we may need to be more aggressive about developing or enforcing such rules—because without competition, investors have few alternatives and may be forced to accept agents who have costly conflicts. In short, as regulators, we must appreciate that the free market is less able to resolve issues on its own when that market suffers from severe concentration.

Second, we should more formally bring competition economics into our work at the SEC. That's why I'm calling for the creation of an Office of Competition Economics within our Division of Economic Research and Analysis. As we all know, DERA's expertise in trading, finance and investment is incredibly important, and has served the Commission well in the past. But without the input of experts who specialize in the complex dynamics of competition economics, I worry we will struggle to fully understand the concentrated industries we oversee. Combining expertise in competition economics with the cutting-edge research of our financial economists will help the Commission better pursue our competition mandate.

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[26] In the few limited contexts where there is a "clear repugnancy" between the securities laws and antitrust considerations, that is, where the two sets of statutes are "clearly incompatible," there may be limits to the degree to which certain competition considerations can inform our judgments. *See Credit Suisse Securities (USA) LLC v. Billing,* 551 U.S. 264 (2007). But as the Supreme Court has noted, "the SEC is itself required to take account of competitive considerations when it creates securities-related policy." *See id* at 18. Because, as Congress has recently and repeatedly recognized when amending our operative statutes, concerns related to competition are well within our mandate in most rulemaking contexts. *See supra* n. 17 (noting that Congress recently amended, inter alia, the 1933 and 1934 Acts to require the Commission to consider "competition" in our rulemakings).

Third, we can and should collaborate more closely with our colleagues at the Federal Trade Commission. The FTC, as I mentioned earlier, is the SEC's birthplace, and we should keep that heritage more keenly in mind in our work. It is a mistake to leave addressing the lack of competition in our capital markets solely to our sister agency. Instead, the FTC and SEC should be working closely together—sharing information, ideas, and personnel—so we can better oversee our markets together.

One thing we should not do is simply withdraw from the areas we oversee in hopes that this will jump-start competition. For those who would argue that so-called red tape—or so-called "burdensome regulation"—is the reason for poor competition, I think the answer is more complicated than that. Deregulating these industries won't sweep in new competitors to challenge the existing powerful players—it will likely just let the existing dominant firms run rampant. So, if anything, we need to be more vigilant, not less.

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It's common at the Commission to refer to our "tripartite" mission at the SEC: investor protection, fair and efficient capital markets, and capital formation. But I hope I've convinced you today that as a matter of history, law, and economics, our mandate also includes ensuring robust competition in our capital markets. And the forgotten fourth pillar of the SEC's mission reinforces the other three: more competitive markets are more likely to be efficient, promote capital formation, and most of all, protect investors.

I took office at the SEC at a time of unprecedented economic inequality and ever more concentrated financial markets. In a world in which control of America's financial future is increasingly concentrated, ensuring that the SEC pursue the vigorous competition that investors deserve has never been more important. Thank you to all of you for all that you do to promote competition across our economy and protect American investors.