

Whistleblowers and Indexing



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By [Matt Levine](#)

Whistleblowing.

"Our whistleblowing process is one of the most important means by which we protect our culture and values at Barclays," says Barclays PLC Group Chief Executive Officer [Jes Staley](#), "and I certainly want to ensure that all colleagues, and others who may utilise it, understand the criticality which I attach to it." And now they do! When an anonymous whistleblower sent a letter to Barclays's board criticizing Staley and another senior employee, Staley decided to go find out who the whistleblower was. He did not succeed, though he did go far enough that Barclays's information security team "contacted and received assistance from a U.S. law enforcement agency in identifying its author." (That is according to Barclays's [own investigation](#).)

So it is easy to see how much criticality Staley attaches to Barclays's whistleblowing process, which is: none. This is useful information if you are considering blowing the whistle on executive wrongdoing at Barclays: The CEO will make it his mission to track you down, and will bring in the cops to help do it. I mean, maybe he won't now. He has been reprimanded, and [grudgingly half-apologized](#), and will get a "very significant compensation adjustment," presumably down. The Prudential Regulation Authority and Financial Conduct Authority are investigating. But the message has been sent that whistleblowing is not a particularly protected activity at Barclays.

This is not a huge surprise, I guess, nor is Barclays alone. (Remember all the [Wells Fargo & Co. bankers](#) who said they were fired for calling the ethics hotline to report fake account openings?) And you can understand how it would happen. The whistleblower letter here raised "concerns about a senior employee who had been recruited by Barclays earlier that year," including "concerns of a personal nature," and criticized Staley's "knowledge of and role in dealing with those issues at a previous employer." So

it was an anonymous personal attack on someone who worked closely with Staley -- one that Staley thought was wrong. (It's unclear whether the board ever actually did anything about the allegations in the letter, which for all I know were totally wrong.) Staley told the board "that he was trying to protect a colleague who had experienced personal difficulties in the past from what he believed to be an unfair attack." He could perfectly plausibly have read the letter and made an informed decision that (1) the target of the letter was blameless and being unfairly attacked and (2) the author of the letter was a poisonous lying menace and needed to be gotten rid of. As a manager, his job was to keep good people and get rid of bad lying people. His decision to call the cops on the letter writer might have just been good management.

But that is the point of a whistleblower program: It's supposed to constrain you from doing this sort of thing, *even if you think it's a good idea*. You create a safe space for people to complain, and then you expect it to be used mostly by misguided cranks, and you just let it go. If you punished all the cranks, the people with valid useful complaints would never work up the nerve to go to the board. A CEO who respects the whistleblower program only when he agrees with the complaints doesn't respect it at all.

Indexing and voting.

My basic model of corporate governance is: Do whatever you want. You have money and want to invest it in my company, I have a company and want to raise some money from you, we get together and negotiate, and whatever terms we work out are fine. If you want to give me the money without any say in how I spend it -- or, more to the point, if you don't exactly want that but are willing to live with it to get a stake in my awesome company -- then go ahead, we are both grown-ups, that is fine. And if lots of people with money and lots of people with companies do this a lot, then most companies will end up with a reasonable market-driven set of corporate governance norms that mostly work for everyone, and a few companies will be weird outliers if their entrepreneurs or investors have more bargaining power than usual.

If it's a broad market where everyone makes their own decisions then that should basically work. But these days the investors are increasingly giant institutional asset managers. So you'd think they'd have more bargaining power than the traditional population of smaller investors, and corporate governance standards would be getting

more shareholder-friendly. But in fact the rise of the big institutions seems to have come along with a rise of nonvoting share structures that give power to entrepreneurs rather than shareholders. Why? Well, there are other [bargaining-power explanations](#). But there is also the weird fact that a lot of those big institutions are index funds, or otherwise widely diversified "[quasi-indexers](#)" who end up owning a whole lot of stocks and comparing their performance to an index. And if you have to own every stock, then you have very limited bargaining power over corporate governance. You can complain, of course, but giving people money and complaining about it is not nearly as effective as not giving them money.

But this means [the index providers have lots of power](#):

FTSE Russell issued a statement last week in response to concerns about stocks with no voting rights, such as the Class A shares Snap sold in March. The firm plans to consult with investors and other stakeholders over the next few months about whether to include companies with no voting rights in its indexes.

On the one hand, sure: The index providers poll the investors, the investors say what they want, the index providers provide it. It is not the elegant invisible hand of the marketplace driving corporate governance, but I guess it is fine. (Competing index providers will spring up! Invisible hand, etc.) On the other hand, it is a little weird for FTSE Russell -- whose business, in essence, is writing down a list of all the stocks -- to be the arbiter of corporate governance. The appeal of indexing is that it is a way to conform your investing to some external objective reality: You don't pick the stocks to buy, you just buy all the stocks that exist. But it turns out there are some judgments involved in deciding, if not which stocks exist, at least which stocks are acceptable investments by some baseline set of criteria -- which stocks are in the universe of stocks that normal investors normally invest in, the universe to which you're supposed to compare yourself. Those judgments aren't a matter of objective reality; they're just judgments that you either make yourself or outsource to an index provider. And what is the argument that an index provider is better at making them than an investor would be?

Indexing and active management.

I [said a while back](#) that:

The way mutual funds used to work is:

1. The manager picks some stocks.
2. He buys the stocks.

But that has fallen out of fashion, because it is "active management." The new way mutual funds work is:

1. The manager picks some stocks.
2. He writes them down in a list.
3. He calls the list an "index."
4. He buys the stocks.

[Here is a prospectus](#) for the Bernstein U.S. Research Fund and Bernstein Global Research Fund, two exchange-traded index funds whose index is explicitly "stocks we like," or rather, "stocks somebody likes":

The Index is designed to measure the performance of large-cap U.S. stocks rated "Outperform" by sell-side analysts of Sanford C. Bernstein, LLC ("Bernstein" or the "Index Provider") and ranked within one of the top three quintiles of Bernstein's published quantitative alpha model.

Stocks rated Outperform and meeting the quantitative requirements are added to the index, which is equal-weighted and adjusted every month. "The Fund uses a passive management strategy designed to track the performance of the Index." It uses a passive management strategy to implement active stock picking, because that is what's cool these days. Weirdly, the funds are *not* affiliated with Bernstein -- they just license Bernstein's research for their index -- but that does not seem like an essential limitation. If you are a stock picker running an active fund, you might consider picking stocks for a proprietary index instead, and then passively tracking that index.

Indexing and futility.

"An overlooked statistical concept shows why it's so hard to beat a benchmark," [it says here](#), and the concept isn't [Sharpe's equality](#). (Everyone knows that one: For any asset class, the returns to asset management have to equal the returns to the index, before fees, so the average active manager will underperform the index after fees.) No, it is that most stock returns come from a few stocks:

The distribution of returns in the stock market is bizarrely lopsided. Often, equity benchmarks are so reliant on gigantic gains in just a handful of stocks that missing them—as most managers do—consigns the majority to futility. “Your intuition is that you can randomly pick stocks and start at zero,” Heaton says. “But the empirical fact is if you randomly pick, you are starting behind zero.”

Ah but of course you *don't* randomly pick. And what if you pick only the stocks with gigantic gains?

Indexing and antitrust.

Should index funds be illegal? Who knows, [shrugs Menesh Patel of Columbia](#):

Because there is no unequivocal answer to whether and to what extent common ownership in a given market will generate competitive effects, and because economic understanding of those competitive effects is in an early stage, common ownership should continue to be evaluated on a case-by-case basis rather than restricted or subject to widespread antitrust investigation or, alternatively, protected with safe harbors or presumptions of legality.

Infrastructure.

One well-known public position of Larry Fink, the BlackRock Inc. chief executive officer, is that companies and investors are [too focused](#) on short-term profits and are unable to invest for long-term growth. So of course he is calling to [privatize U.S. infrastructure](#):

“Substantial expertise must be dedicated to bring projects to market in a format appropriate for institutional investment,” Mr Fink says. “These projects must deliver competitive returns and that will often require efficiencies that can only be achieved through private ownership.”

"Policymakers, workers and unions must work together to find a model that will allow private enterprise to generate the long-term returns necessary to attract capital and build a more prosperous future," says the guy who thinks that private enterprise pays insufficient attention to long-term returns.

Libor.

I'm not really a big conspiracy-theory guy, but I absolutely believe that central banks and governments [knew that](#) big banks were understating their borrowing costs in Libor submissions in 2008, and were fine with that, and probably encouraged them to do it. I don't get particularly worked up about it -- 2008 was a crazy time, and officials were right to want to encourage confidence in the banking system -- but I do believe it, even if people would prefer to forget it now. [Anyway](#):

A secret recording that implicates the Bank of England in Libor rigging has been uncovered by BBC Panorama.

The 2008 recording adds to evidence the central bank repeatedly pressured commercial banks during the financial crisis to push their Libor rates down.

It's not exactly a smoking gun: It's a call in which one Barclays PLC employee tells another that "we've had some very serious pressure from the UK government and the Bank of England about pushing our Libors lower," but that's just hearsay; for all you know he made it up. The recorded call occurred on the same day that an executive director of the Bank of England called the then-CEO of Barclays to discuss Barclays's Libor submission, though. Also why would he make it up?

Spies.

Last year Dutch police raided the offices of Royal Dutch Shell PLC to investigate claims of bribery in a Nigerian oil deal, and Shell CEO Ben van Beurden called chief financial officer Simon Henry to talk about the raid, and that call was recorded by Dutch police, and now [BuzzFeed has the recording](#), and here's what van Beurden said:

"There was apparently some loose chatter between people from a team, particularly the people that we hired from MI6...er who...er must have said things like 'Well, yeah, you know, I wonder who gets a payoff here' and whatever so...er helpful – unhelpful email exchanges," van Beurden told Henry. "I haven't seen them but apparently it was judged to be, y'know, just pub talk in emails, which was stupid, but nevertheless, is there ..."

MI6 is of course the U.K.'s [foreign intelligence service](#); Shell apparently hired two ex-spies to deal with Nigerian officials, as one does. And then the *spies* said dumb stuff in email that got Shell in trouble. The lesson here is that executives at multinational

corporations are trained not to say incriminating things in email, but apparently you don't learn that in spy school.

People are worried that people aren't worried enough.

The worry [here](#) is that asset managers used to hedge by buying volatility (that is, basically, options); now markets are so calm that they have been selling volatility. So banks have been buying volatility from their customers, and the banks dynamically hedge those trades, which [reduces volatility](#). The headline is "Are Traders Creating a Bizarre New Feedback Loop... Feedback Loop... Feedback Loop?" But I feel like most financial-markets feedback loops described as bizarre really aren't. Here, the basic story is: People think that asset prices aren't going to move very much, and so asset prices don't move very much. It would be bizarre if it worked the other way! This is what markets do. When people think that Apple Inc. should be worth a lot, it is. Markets *are* a feedback loop from consensus opinion to asset prices. Anyway the point is that people are worried that other people aren't worried:

But if the loop is depressing volatility, investors are exposed to a sudden return of sharp swings, some warn.

"It's like digging a hole in the ground deeper and deeper," said Aleksandar Kocic, an analyst at Deutsche Bank. "It becomes harder to get out."

Elsewhere [here is Robin Wigglesworth](#) on "an unlikely doomsday scenario of how the volatility complex could turn a manageable wildfire into an unholy inferno."

People are worried about unicorns.

Are you excited for the [Spotify AB direct listing](#)?

The Swedish company, last valued at \$8.5 billion, is seriously considering not holding a public sale of shares. Instead it is exploring simply listing its shares on an exchange in what is known as a direct listing, according to people familiar with the matter. It wouldn't raise money—the hallmark of an IPO—or use underwriters to sell the stock.

This makes sense: Like many unicorns, Spotify doesn't really need the money it would get in an initial public offering, so it seems a little silly to pay fees and sell a lot of shares

and sign lockups and go through the rest of the nonsense when it could just fill out some forms and have its formerly private stock listed on an exchange.

Still there is a downside. When you do an IPO, you sell a bunch of stock to people who are used to trading stock. And then, the next day, they trade it. If you go public just by filling out forms, then the next day, the only people who own your stock are the people who owned it the previous day: your employees and executives and venture capitalists. If they all decide to sell at once, then you have a problem: You haven't hired investment bankers to go out and drum up buyers. They'd just be selling on the exchange -- basically, to high-frequency traders with limited capacity to buy a lot of stock at once -- and things could get dicey. But if they *don't* all decide to sell at once -- if they're just as happy to hold public Spotify shares as they were to hold private ones -- then it's even weirder. How does your stock trade? Who is going to be the first person to sell 100 shares? Who's going to be the first person to *buy* 100 shares, and be the only public holder of the stock? It seems like there would be *some* value in organizing some sellers, and some buyers, and doing a big first trade all at once. That seems like something an investment bank might be good at?

Elsewhere, [here is a claim](#) that Uber Technologies Inc. is sneaky about its bid-ask spreads:

When a rider uses Uber's app to hail a ride, the fare the app immediately shows to the passenger is based on a slower and longer route compared to the one displayed to the driver. The software displays a quicker, shorter route for the driver. But the rider pays the higher fee, and the driver's commission is paid from the cheaper, faster route, according to the lawsuit.

With technology like that they should be [bond traders](#).

People are worried about bond market liquidity.

Here's a Bank for International Settlements working paper worrying about the effect of quantitative easing on [bund market liquidity](#):

We find economically significant price impacts at high (minute-by-minute) and low (daily) frequencies, highlighting the relevance of scarcity effects in bond markets. Asset purchase policies are not without side effects, though, as the induced scarcity

has an adverse impact on liquidity conditions as measured by bid-ask spreads and inter-dealer order book depth.

Things happen.

Corporate Pension Funds About to Become [Huge Players](#) in Bond Markets. New Retirement Rule Is Delayed, but [Not Its Impact](#). Men Bet She Would Fail; Now She Runs a [\\$26 Billion Fund](#). Wall Street Made Charles Murphy Successful and Rich, but [Happiness Eluded Him](#). How Goldman Sachs Made More Than \$1 Billion With Your [Credit Score](#). [Quants Skeptical](#) of Big Data, Machine Learning Hype. Record [Bond Issuance](#) Shows Many Investors Still Doubt Economic Growth. A Foreign [Threat to U.S. Treasuries](#) That Dwarfs Fed's Debt Hoard. Bros Don't Let Bros [Lend Money](#). Judge Kills Suit Seeking \$213M On 140-Year-Old [Guano Notes](#). Quarter of a million British pets [face 'jail'](#) in Europe if Brexit talks fail. "A 33-year-old man ate two lobsters, downed 17 vodka oyster shots and six Coronas at a Gold Coast restaurant before dodging the bill and [running into the surf](#), police allege." [Rat tickling](#): A systematic review of applications, outcomes, and moderators.

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