

MEMO# 35695

May 2, 2024

ICI Letter, FDIC Board Discussion Relating to Regulated Fund Investments in Banking Organizations

[35695]

May 02, 2024

TO: ICI Members
Investment Company Directors
Bank-Affiliated Member Advisory Committee
SEC Rules Committee SUBJECTS: Bank Regulation
Compliance
Investment Advisers RE: ICI Letter, FDIC Board Discussion Relating to Regulated Fund Investments in Banking Organizations

Last week, the Board of Directors (Board) of the Federal Deposit Insurance Corporation (FDIC) met to discuss proposed resolutions related to the Change in Bank Control Act (CIBC Act). This discussion was prompted in part by an FDIC Director's public statements expressing concern about the level of investment by regulated fund advisers in FDIC-supervised institutions and the level of regulatory scrutiny currently given to those investments. In advance of the meeting, ICI sent a letter to the FDIC Board defending fund investments in banking organizations made pursuant to regulatory determinations by the federal banking agencies. These developments are briefly described below.

Background

When investment in a banking organization reaches a certain threshold, the federal banking agencies are required to consider whether the investor could exercise a controlling interest over the banking organization. Over decades, the federal banking agencies have permitted certain levels of investment by regulated funds, but only after the funds agreed to remain passive investors.

Specifically, in a long line of letters to advisers and their regulated funds, the Federal Reserve Board (FRB) has determined that a regulated fund complex may collectively acquire up to a specified percentage of the voting stock of a banking organization without the funds or their adviser being deemed to control the banking organization under certain banking statutes, including the CIBC Act.[\[1\]](#) The letters rely on the fact that regulated funds do not present the same control risks as investors in banking organizations do generally,

and the relief they allow is conditioned on "passivity commitments" designed to mitigate the ability of the funds and their adviser to control, or exercise a controlling influence over, a banking organization. Further, all three federal banking agencies (the FRB and FDIC, together with the Office of the Comptroller of the Currency) have provided relief for years to regulated funds and their advisers from the requirements of Regulation O, also conditional on passivity criteria.[\[2\]](#)

In a January 2024 speech, FDIC Director Jonathan McKernan called for the FDIC, and the other banking agencies, to "revisit the regulatory comfort" that has been given to large index fund advisers in terms of how much voting stock they can own in a banking organization and the activities in which they engage (e.g., proxy voting, stewardship).[\[3\]](#) Among other things, Director McKernan suggested that the FDIC "revisit how [it monitors] compliance with the passivity commitments made as a condition to" such regulatory relief and that the FDIC "should do more" than rely on self-certifications of compliance by fund advisers. In early April, the Wall Street Journal reported that Director McKernan had developed a plan to enhance FDIC monitoring, which he hoped would be considered by the FDIC Board.[\[4\]](#) The same article noted interest in passivity commitments from FDIC Director Rohit Chopra, who also serves as Director of the Consumer Financial Protection Bureau.

On April 23, the FDIC published notice of an open meeting on April 25, at which the Board would consider two separate proposals relating to the CIBC Act.[\[5\]](#)

ICI Letter

On April 24, the day prior to the FDIC meeting, ICI sent a letter to the FDIC Board explaining that:

- Regulated funds adhere to a uniquely robust regulatory framework that reinforces their fundamental purpose: to invest in securities and other instruments to achieve their stated investment objectives and strategies, providing a means of investment suitable for the general public.
- Regulatory determinations to date ensure against an investment adviser and its regulated funds exercising a controlling influence over a banking organization. This is because regulated funds typically invest in securities (including those issued by banking organizations) for equity exposure and with the expectation of resale, not in order to control companies.
- To ICI's knowledge, the statements by Director McKernan run counter to the actual commitments made by regulated funds and to regulated funds' actual compliance with those commitments.

The letter states that ICI and its members believe any unilateral change in policy by the FDIC will be harmful to American investors who rely on regulated funds and the banking organizations that benefit from investments by regulated funds.

FDIC Board Discussion

All five members of the FDIC Board participated in the April 25 discussion, and their prepared statements are available on the FDIC's website.[\[6\]](#) The discussion focused on:

- A proposed resolution, presented by Director McKernan, calling for (i) enhanced monitoring of compliance with the passivity commitments and other conditions of FDIC relief applicable to certain fund complexes and (ii) an annual determination as to whether any such complex controls or has controlled, directly or indirectly, an FDIC-supervised for purposes of the CIBC Act or Regulation O. Pursuant to the resolution,

the Director of the FDIC's Division of Risk Management Supervision would be required to submit a monitoring plan for the FDIC Board's approval. An attachment to the resolution outlines the steps to be included in the monitoring plan.

- A notice of proposed rulemaking, prepared by the FDIC staff and presented by Director Chopra, that calls for removing the current exemption from filing a CIBC Act notice with the FDIC if the investor files a CIBC Act notice with the FRB. The preamble cites to "fund complexes' increasingly large ownership of voting securities of FDIC-supervised institutions or companies that control FDIC-supervised institutions" and says that the FDIC "must have the ability to require a [n]otice so that...it may independently review and determine whether the proposed acquisition satisfies the statutory factors enumerated in the [CIBC Act] for the institutions it supervises."

Neither proposal had support from a majority of the FDIC Board, and each was retracted before a formal vote. Among the takeaways from the discussion are the following:

- Chairman Martin Gruenberg opined that Director McKernan's monitoring plan was too "prescriptive" and "premature" to adopt without public comment. Chairman Gruenberg noted that he was unaware of another instance in which the FDIC deferred by rule to another agency as the FDIC does in its CIBC Act rules.
- Vice Chairman Travis Hill commented that the willingness of outside capital to invest in banks is critical to financial stability and the FDIC should be mindful of taking actions that would restrict such investment. He expressed support for the McKernan resolution, observing that there is a contradiction between being passive and using voting power to pursue broader policy goals and suggesting the need to come up with a definition of "passivity."
- Acting Comptroller Hsu observed that "the rise of index investing... raises a host of important questions for bank regulators given the potential implications for safety and soundness, consumer protection, and resolvability." Noting that the issue of bank ownership and control is shared across the three banking agencies, Hsu stated that addressing the issue "effectively requires interagency coordination and, ideally, a shared understanding and approach to bank control, notices, and passivity agreements." He opposed both proposals, observing that "reallocating FDIC resources away from supervising banks to monitoring asset manager compliance with passivity commitments would be, at best, inefficient at this time." Hsu concluded his remarks by stating that "asset managers should continue their work of ensuring that their ownership stakes in banking organizations are truly passive and promote safety, soundness, and resolvability" and that "[a]ny evidence to the contrary will compel me to reconsider my posture on this issue."
- Directors McKernan and Chopra agreed that self-certification may not be enough to monitor compliance with passivity agreements.

Chairman Gruenberg concluded the meeting by saying that discussion on this issue was "to be continued."

Rachel H. Graham
Associate General Counsel & Corporate Secretary

Notes

[\[1\]](#) The letters date back to the early 2000s and most are available through the FRB

website.

[2] See, e.g., Extension of the Revised Statement Regarding Status of Certain Investment Funds and their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations (Dec. 15, 2023), available [here](#). Regulation O under the Federal Reserve Act places quantitative limits and qualitative restrictions on extensions of credit by banks to their executive officers, directors, principal shareholders, and related interests of such persons. Regulation O has potential implications for an asset manager whose investment funds and other client accounts own, control or hold with the power to vote more than 10 percent of any class of voting securities of a bank, as well as for companies (both financial and nonfinancial) in which such manager's funds and accounts collectively own a controlling interest.

[3] See [Remarks](#) by Jonathan McKernan, Director, FDIC Board of Directors, at the Session on Financial Regulation at the Annual Meeting of the Association of American Law Schools (Jan. 5, 2024).

[4] Andrew Ackerman, Regulator Probes BlackRock and Vanguard Over Huge Stakes in U.S. Banks, WSJ (April 2, 2024).

[5] The meeting notice is available [here](#).

[6] Id.