

MEMO# 35805

August 13, 2024

FDIC Issues Proposal Relating to Regulated Fund Investments in Banking Organizations; ICI Plans to Comment

[35805]

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TO: ICI Members

Investment Company Directors

Bank-Affiliated Member Advisory Committee

SEC Rules Committee SUBJECTS: Bank Regulation

Compliance

Investment Advisers RE: FDIC Issues Proposal Relating to Regulated Fund Investments in Banking Organizations; ICI Plans to Comment

On July 30, the Federal Deposit Insurance Corporation (FDIC) Board of Directors approved a notice of proposed rulemaking (NPR) that would amend the agency's existing regulations under the Change in Bank Control Act (CBCA). The NPR reflects concerns expressed by various FDIC Board members about the level of investment by regulated fund advisers in FDIC-supervised institutions and the level of regulatory scrutiny currently given to those investments. The NPR is briefly summarized below.

ICI intends to submit a comment letter to the FDIC. Comments are due 60 days after publication of the NPR in the Federal Register.

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. 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 CBCA.[\[1\]](#) The relief 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. It also obviates the need for the adviser to file notice with the FRB under the CBCA.

Under current FDIC regulations, an investor that would directly or indirectly acquire an

interest above a certain threshold in an FDIC-supervised institution must file a CBCA notice of the transaction with the FDIC, unless an exemption is available. One such exemption applies when an investor acquires voting securities of a depository institution holding company for which the FRB "reviews a notice pursuant to the CBCA" (for convenience, referred to in this memorandum as the FRB Exception).[\[2\]](#)

In April of this year, the FDIC Board met to discuss two separate proposals intended to increase FDIC monitoring and oversight of transactions implicating the CBCA. One of those proposals was substantively similar to the NPR.[\[3\]](#) Although neither proposal garnered support from a majority of Board members at that time, FDIC Chairman Gruenberg indicated that the agency would continue to consider the matter.

Brief Summary of NPR

The NPR asserts that "recent developments in equity markets may be contributing to elevated risk of excessive indirect control or concentration of ownership in FDIC-supervised institutions." It points to "exponential growth of index funds" and expresses concern that "fund complexes will continue to increase their ownership percentage of FDIC-supervised institutions to potentially significant amounts as investments in their respective index funds grow," which may lead to situations where "the investor can have an outsize influence over the management or policies of [a banking] institution." The NPR states that "[s]uch outsized influence may flow naturally from exercise of their votes as large shareholders...or through other indicia of control, such as engagements with portfolio companies whereby investors meet with directors or management to influence the direction of the company." It highlights changes to proxy access and discretionary broker voting as giving fund complexes "more potential for control over the companies in which they hold a large equity stake in voting securities." The NPR also raises concerns about "the potential to create a concentration of ownership that may result in [fund complexes] having excessive influence or control over the banking industry as a whole."

The FDIC proposes to amend its regulations to remove the FRB Exemption, having determined that the exemption's original purpose (of avoiding "duplicative regulatory review of the same transaction by both the FRB and the FDIC") is "no longer warranted in light of the widespread impacts resulting from growth in, and changes to the nature of, passive investment strategies." According to the NPR, the proposal would "ensure appropriate review of transactions that would result in control over FDIC-supervised institutions by allowing the FDIC to disapprove of a proposed acquisition if the proposed transaction would fail to satisfy any of the statutory factors enumerated in the CBCA."[\[4\]](#) The NPR further states that the proposal would "reduc[e] the likelihood that certain transactions would result in an adverse effect on the Deposit Insurance Fund."

The NPR states that the FDIC "is committed to engaging in dialogue and coordination with the FRB and the Office of the Comptroller of the Currency to develop an interagency approach to the issues discussed in this proposal." Acting Comptroller Michael Hsu based his support for the proposal on that commitment, a position that is consistent with his remarks at the FDIC Board's April meeting.[\[5\]](#) Hsu's statement in support of the NPR further indicates that, if the three banking regulators agree upon such an approach, he expects that the regulators would issue an interagency notice of proposed rulemaking before this NPR is finalized.

Request for Comment

The NPR seeks public comment on all aspects of the proposal and existing regulatory

framework "that applies to the role played by asset managers and other institutional investors with FDIC-supervised institutions in the context of the CBCA and passivity agreements." It also includes questions such as:

- Are fund complexes "directing the management or policies of FDIC-supervised institutions as a result of their voting securities holdings?"
- "Are investors coordinating voting or otherwise acting in concert in ways that the FDIC should be monitoring more closely?"
- "Has concentrated ownership of FDIC-supervised institutions and their affiliates affected banking sector competition?"
- "Should the FDIC limit the voting power of persons who acquire 10 percent or more of a class of voting securities of an FDIC-sponsored institution or its parent company?"

The NPR indicates that, concurrent with this rulemaking, the FDIC "will continue[] to perform a comprehensive review of its overall regulatory and supervisory approach to issues that arise under the CBCA."

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Notes

[1] The letters date back to the early 2000s and most are available through the FRB website.

[2] 12 CFR 303.84(a)(8).

[3] In advance of the April meeting, ICI sent a letter to the FDIC Board defending fund investments in banking organizations made pursuant to regulatory determinations to date. For more detail about the ICI letter and the FDIC Board meeting, see [ICI Memorandum 35695](#) (May 2, 2024).

[4] According to the NPR, the FDIC could disapprove of a proposed acquisition if: (i) the acquisition would result in a monopoly or may substantially lessen competition and the anticompetitive effects are not clearly outweighed by the public interest; (ii) the financial condition of any acquiring person or the future prospects of the institution is such as might jeopardize the financial stability of the institution or prejudice the interests of its depositors; (iii) the competence, experience, or integrity of any acquiring person or any proposed management would not be in the best interests of the depositors or the public; (iv) any acquiring person neglects, fails, or refuses to furnish the FDIC with all required information; or (v) the FDIC determines that the proposed transaction would result in an adverse effect on the Deposit Insurance Fund.

[5] See [Statement by Acting Comptroller Michael Hsu](#) (July 30, 2024); ICI Memorandum 35695.

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