BETTER MARKETS

October 18, 2024

James P. Sheesley, Assistant Executive Secretary
Attention: Comments—RIN 3064-AG04
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Regulations Implementing the Change in Bank Control Act; RIN: 3064-AG04; Document Number: 2024-18187; 89 FR 67002 (Aug. 19, 2024)

Dear Mr. Sheesley:

Better Markets[1] appreciates the opportunity to comment on the proposed rulemaking ("Proposal")[2] from the Federal Deposit Insurance Corporation ("FDIC") that would amend filing requirements and processing procedures related to the Change in Bank Control Act.[3]

The Change in Bank Control Act was initially intended to "prevent speculative purchases of small banks by irresponsible individuals with questionable integrity."[4] FDIC information submitted to a Congressional hearing in 1977 indicates that most bank failures since 1960 were caused by fraud, embezzlement, or other insider misconduct.[5]

Recent concerns have emerged from growth in investment funds such as mutual funds and exchange-traded funds ("ETFs"), which has resulted in higher levels of ownership—and therefore more control—of banks and bank holding companies ("covered institutions") by nonbank entities. Many of these investment funds are owned by the same parent company—forming even larger and more powerful "fund complexes." At the end of 2023, passive investment funds held $13.3 trillion

1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Regulations Implementing the Change in Bank Control Act; RIN: 3064-AG04; Document Number: 2024-18187; 89 Fed. Reg. 67002 (Aug. 19, 2024), https://www.federalregister.gov/documents/2024/08/19/2024-18187/regulations-implementing-the-change-in-bank-control-act.

3 12 U.S.C. § 1817(j).

4 Roger D. Rutz, *Chain Banking, Competition, and the Change in Bank Control Act of 1978*, 59 NEB. L. REV. 234, 237 (1980), https://digitalcommons.unl.edu/cgi/viewcontent.cgi?article=2063&context=nlr.

5 *Id*. at 237, n.18.

in total assets[6] and are expected to continue to grow.[7] Some of these fund complexes already own 10 percent or more of the voting securities in banks.[8] They could therefore exert significant control over decisions at the bank or bank holding company.

In the Proposal, the FDIC identifies several reasons why it is concerned about the growth and concentration of outside control of banks:

- First, fund complexes could have material influence or control over management, business strategies, or policy decisions at publicly traded FDIC-supervised banks through regular shareholder voting. This could increase the risk profile at individual banks and lead to excessive risk-taking to enhance profits, investor returns, or stock prices.

- Second, as fund complexes continue to grow and gain control of a larger and larger share of voting shares in the banking system, they have the potential to influence broader decisions that could affect the banking industry and financial stability.

- Third, these forces could increase the vulnerability of the FDIC's Deposit Insurance Fund ("DIF") which is tapped when a bank fails, if shareholder voting leads a covered institution to riskier behavior.[9]

We add a fourth reason to this list, related to resolution planning for covered institutions. Change in control decisions could affect the viability of resolution plans. Therefore, it is vital for the FDIC to be part of the assessment process for changes in control.

Currently, when there is a change in control transaction that exceeds certain benchmarks, the persons or entities involved are required to notify the bank's primary federal regulator or rebut the presumption of control by detailing how the transaction will not directly or indirectly influence the management or policies of the covered institutions. However, for changes in control at the bank holding company level, the FDIC defers to the Federal Reserve. For the reasons detailed above, not allowing the FDIC to evaluate these change-in-control transactions is not in the best interest of Main Street Americans or financial stability.

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6 Regulations Implementing the Change in Bank Control Act, *supra* note 2 at 67004.

7 *Id.*; *see also* Adam Sabban, *It's Official: Passive Funds Overtake Active Funds*, MORNINGSTAR (Jan. 17, 2024), https://www.morningstar.com/funds/recovery-us-fund-flows-was-weak-2023; Benjamin Schiffrin, *Popularity of Index Funds is Both a Blessing and a Curse*, Better Markets (Oct. 17, 2024), https://bettermarkets.org/wp-content/uploads/2024/10/BetterMarkets_Popularity_of_Index_Funds_10-17-2024.pdf.

8 Regulations Implementing the Change in Bank Control Act, *supra* note 2 at 67002, n.25.

9 *Id*. at 67002.

Therefore, we support the Proposal to strengthen the procedures and filing requirements for change in control notices. Removing the exemption that has excluded the FDIC from decisions on changes in control at the holding company level is the right decision. However, the procedures should be improved further by stating that the FDIC ***will*** participate in the decision-making process for all change in control notices for the largest state nonmember banks because these institutions have material significance to the resolution resources of the FDIC and management of the DIF. Moreover, we strongly support the need for an interagency approach to change in control notices that involve the Federal Reserve Board ("Fed") and Office of the Comptroller of the Currency ("OCC"). This was identified as a concern in the FDIC Board discussions of the Proposal,[10] but the Proposal is silent on how a disagreement on a change in control decision between regulators would be handled.

BACKGROUND

The concentration of power among the largest money managers is not a new trend and has been increasingly concerning to academics, policymakers, regulators, and members of the public for more than a decade. It is a problem that permeates publicly-held corporations in every sector of the economy, not just banks. For example, the late Charlie Munger said:

> We have a new bunch of emperors, and they're the people who vote the shares in the index funds.[11]

Similarly, Harvard professor John Coates explained:

> Unless law changes, the effect of indexation will be to turn the concept of "passive" investing on its head and produce the greatest concentration of economic control in our lifetimes.
>
> More fundamentally, the rise of indexing presents a sharp, general, political challenge to corporate law. The prospect of twelve people even potentially controlling most of the economy poses a legitimacy and accountability issue of the first order . . .[12]

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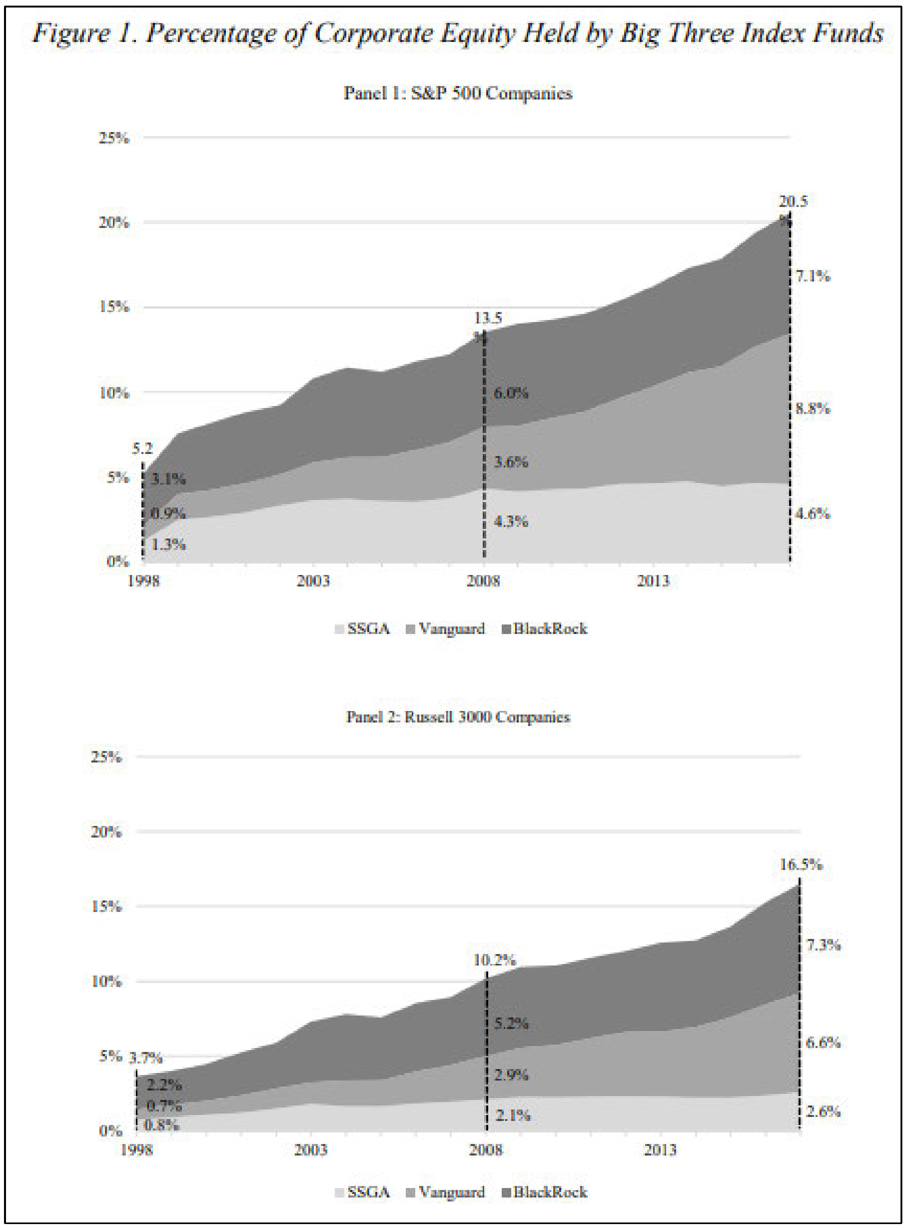
10 *See, e.g.*, Press Release, Office of the Comptroller of the Currency, *Acting Comptroller Issues Statement on the FDIC's Proposals Related to Change in Bank Control Act* (Apr. 25, 2024), https://www.occ.gov/news-issuances/news-releases/2024/nr-occ-2024-43.html; Press Release, Federal Deposit Insurance Corporation, *Statement by Martin J. Gruenberg Chairman, FDIC Notice of Proposed Rulemaking Amending Regulations Implementing the Change in Bank Control Act* (July 30, 2024), https://www.fdic.gov/news/speeches/2024/statement-martin-j-gruenberg-chairman-fdic-notice-proposed-rulemaking-amending.

11 *See, e.g.*, Robin Wigglesworth, *The Power of Twelve*, FIN. TIMES (June 17, 2022), https://www.ft.com/content/cb818afb-4ac3-430b-8e17-2de9129f5ac7.

12 John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 2, Harvard Public Law Working Paper No. 19-07 (Sept. 20, 2018), http://dx.doi.org/10.2139/ssrn.3247337.

The data show a clear and accelerating trend of corporate equity that is held by the three largest index fund managers—BlackRock, Vanguard, and State Street Global Advisors ("SSGA") (collectively "the Big Three"). In 1998, these three companies controlled about 5% of the equity in the S&P 500 companies and nearly 4% of the equity in the Russell 3000 companies. That share grew fourfold by 2017 to more than 20% of the equity in S&P 500 companies and more than 16% in the Russell 3000 companies (see Chart 1).[13]

Chart 1



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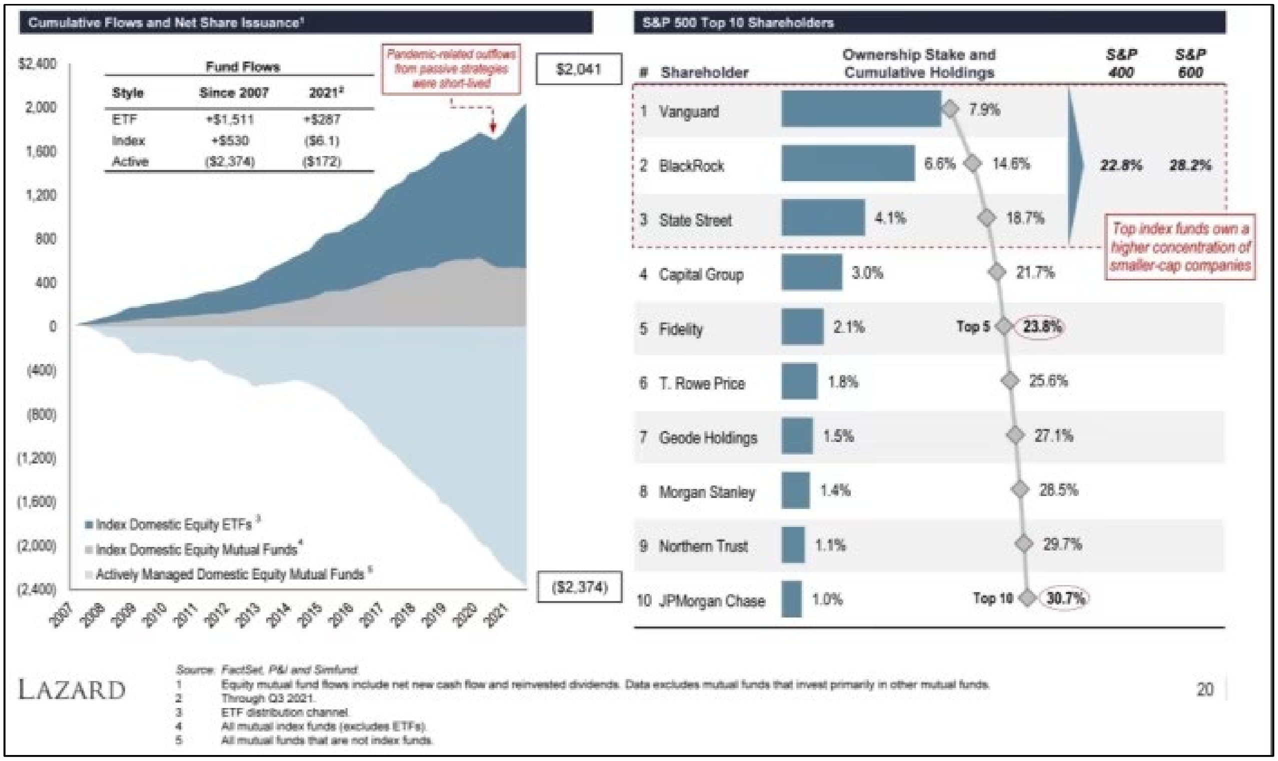
13 Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three* 13-14, European Corporate Governance Institute, Finance Working Paper No. 608 (July 2019), http://dx.doi.org/10.2139/ssrn.3385501.

This concentration of equity ownership is the direct result of a long-term trend of inflows of funds to passive investment funds—mutual funds and ETFs (see Chart 2).[14]

Chart 2

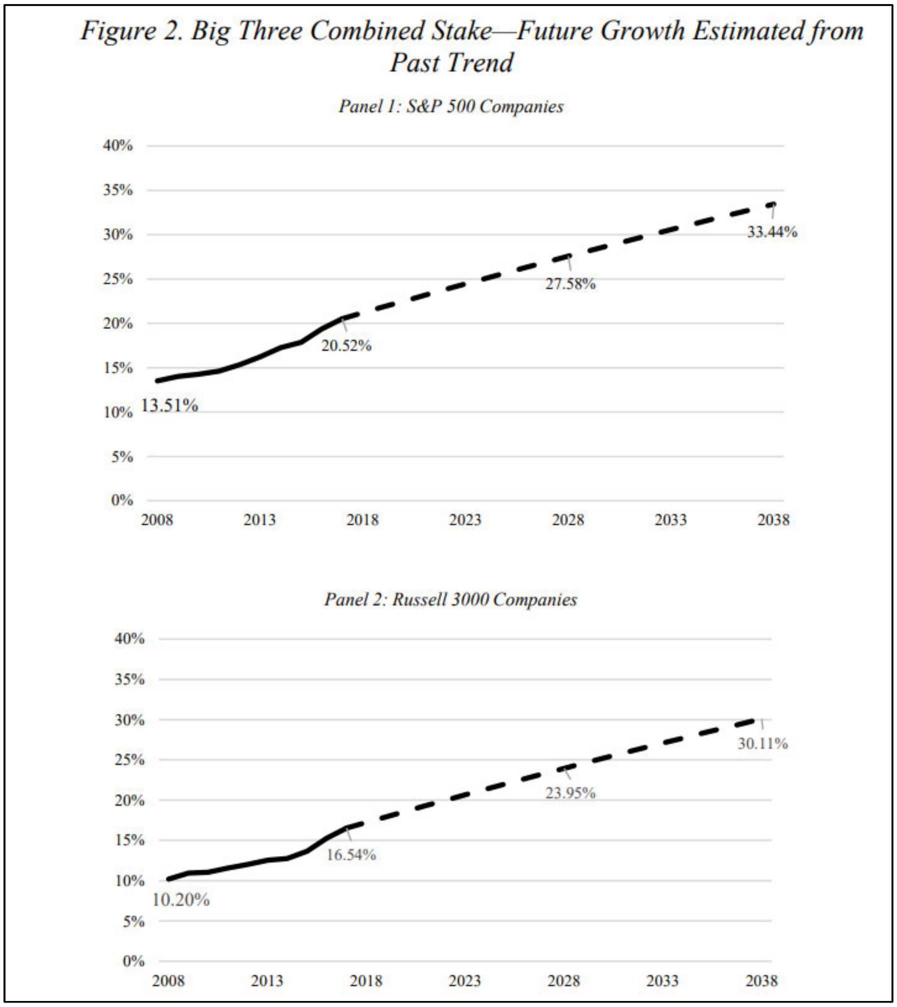


Based on these historical trends, the combined voting share ownership of the Big Three is expected to climb over 33% for S&P 500 companies and over 30% for Russell 3000 companies by 2038 (see Chart 3).[15]

14 Wigglesworth, *supra* note 11; *see also* Schiffrin, *supra* note 7.

15 Bebchuk & Hirst, *supra* note 13 at 18.

Chart 3



Moreover, these estimates are believed to undercount the actual influence of the Big Three. The voting power and influence of the Big Three is even larger in reality because ***fund complexes typically vote every share*** while other individual owners do not.[16]

Recent examples illustrate the flaws in the current FDIC policies and underscore the need for change. FDIC Board Member and Consumer Financial Protection Bureau Director Rohit Chopra detailed how FTX and an investment fund known as Alameda Research were able to work around the rules and avoid FDIC oversight in the takeover of Farmington State Bank, a rural state-chartered community bank in eastern Washington:

16 *Id*. at 18-21.

> [I]n September 2020, the Federal Reserve Bank of San Francisco granted approval to a Maryland shell corporation, which was established by the owner of a Bahamas-based financial firm, to take over Farmington Bancorp, and therefore control Farmington State Bank. It was certainly odd that the owner of a Bahamian financial firm, which was tied to the stablecoin Tether, wanted to take over a tiny rural U.S. bank. Then Farmington made another change. In June 2021, the Federal Reserve Bank of San Francisco approved an application for Farmington State Bank to become a member of the Federal Reserve System. The following year, Bankman-Fried's Alameda Research took a supposed "9.9%" stake in Farmington's bank holding company by investing $11.5 million. In an obvious red flag, the "9.9%" stake valued the bank at $115 million, even though the bank had only $18 million in assets and $6 million in equity at the end of 2021.
>
> Behind the scenes, investors were reshaping Farmington's business model away from its rural banking roots and towards speculative crypto asset activities. Law enforcement would later seize tens of millions of dollars at the bank held by entities tied to Bankman-Fried. So many individuals continue to feel the pain of the financial fraud associated with FTX.[17]

By joining the Federal Reserve system as a state member bank, Farmington State Bank avoided FDIC review of the change in control transactions. However, even if it had not changed its charter, the FDIC review would have been bypassed because of the FDIC's procedure of deferring to the Fed for reviews of transactions at the holding company level.[18] Farmington State Bank eventually received an enforcement action from the Federal Reserve in 2023 for violating commitments it made not to change its business plan or enter into a business strategy involving digital banking or digital assets. Farmington proceeded to voluntarily close and sell its loans and deposits to another bank.[19]

While this example demonstrates the need to make changes outlined in the Proposal, it also underscores the need to make the Proposal stronger. Had the events that occurred at Farmington State Bank, one of the smallest banks in the country,[20] happened at a larger or systemically important bank, the results could have been much more widespread and devastating for Main Street Americans or the financial system.

SUMMARY OF THE PROPOSAL

The Proposal would make a small but important change to the filing requirements and processing procedures filed under the Change in Bank Control Act. It would remove the exemption that is currently in place for transactions at the bank holding company level that the Fed reviews.[21] This change would allow the FDIC to contribute to the decision to approve or disapprove such a transaction, rather than solely relying on the judgment of the Fed.

The original purpose of this exemption was to avoid the duplication of work, with staff at both the Fed and FDIC reviewing the same transactions. However, as the FDIC explains in the Proposal, the trend toward ever-increasing levels of control detailed earlier in this letter justify the need to devote more time and resources to understand and manage change in control actions that could endanger individual banks or lead to financial stability risks or increased cost to the DIF as a result of more bank failures.[22]

The Proposal also emphasizes the importance of developing an interagency approach for change in control notices together with the Fed and OCC.[23] Even with the changes in this Proposal, there is a likelihood that agencies may disagree and the process for handling or resolving such disagreements is not specified. The Proposal also states that the FDIC may ***choose*** not to review every proposed acquisition, but it does not specify the metrics or data on which that decision would be based.[24]

SUMMARY OF COMMENTS

As stated earlier in this letter, Better Markets supports the Proposal to strengthen the procedures and filing requirements for change in control notices. The data clearly show that mutual fund and ETF investments in the largest companies have grown substantially in recent years and are expected to continue to grow. While we do not have data for investment funds' ownership of banks specifically, we assume that general trends are in line with the trends for the S&P 500 and Russell 3000 companies. Therefore, involving the FDIC in change in control decisions at the holding company level for banks that it supervises is the right decision.

However, the procedures should be strengthened even more in the following ways:

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17 Rohit Chopra, *Statement of CFPB Director Rohit Chopra, Member, FDIC Board of Directors, on Reviewing Investments in and Takeovers of Banks*, Consumer Financial Protection Bureau (Apr. 25, 2024), https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-member-fdic-board-of-directors-on-reviewing-investments-in-and-takeovers-of-banks/; *see also* Stephen Gandel, *Crypto Firm FTX's Ownership of a U.S. Bank Raises Questions*, N.Y. TIMES (Nov. 23, 2022), https://www.nytimes.com/2022/11/23/business/ftx-cryptocurrency-bank.html.

18 Chopra, *supra* note 17.

19 *See, e.g.*, Press Release, Board of Governors of the Federal Reserve System, *Federal Reserve Board Issues Enforcement Action with Farmington State Bank, and its Holding Company, FBH Corporation* (Aug. 17, 2023), https://www.federalreserve.gov/newsevents/pressreleases/enforcement20230817a.htm.

20 As of June 30, 2023, Farmington State Bank reported total assets of about $16 million and 8 full time employees. *See* FEDERAL DEPOSIT INSURANCE CORPORATION, BANK FIND SUITE: FARMINGTON STATE BANK, FINANCIAL & REGULATORY REPORTING - FDIC CERT #6149, REPORT FOR JUNE 30, 2023, https://banks.data.fdic.gov/bankfind-suite/FinancialReporting/details/6149 (last accessed Oct. 15, 2024).

21 Regulations Implementing the Change in Bank Control Act, *supra* note 2 at 67005.

22 *Id*.

23 *Id*. at 67002.

24 *Id*. at 67005-06.

- Require the FDIC to participate in the decision-making process for all change in control transactions for the largest state nonmember banks. The Proposal makes the FDIC's participation in change in control decisions optional in all cases. It also does not detail how the FDIC's decision on whether or not to weigh in will be made. We recommend setting an asset size threshold or defining a set of risk characteristics that would clearly identify the riskiest change in control transactions. The FDIC would always weigh in on these. The FDIC's participation would remain optional for transactions involving banks below the defined size and risk thresholds.

- Coordinate with the Fed and OCC on an interagency approach to handle change in control notices. All three banking regulators need to be working together on change in control issues. Furthermore, additional detail is needed to specify how disagreements on change in control decisions will be handled.

COMMENTS

I. REQUIRE THE FDIC TO PARTICIPATE IN THE DECISION-MAKING PROCESS FOR ALL CHANGE IN CONTROL TRANSACTIONS FOR THE LARGEST STATE NONMEMBER BANKS.

According to the Proposal, the FDIC would have the option to review and contribute to the decision on change in control notices, even when the Fed is the appropriate federal regulator. We support this for several of the reasons that are included in the Proposal:

- fund complexes having increasing amounts of control over decisions made at the holding company level which may affect individual banks;

- change in control decisions increasing the risk at banks and as a result increasing the risk to the DIF; and

- fund complexes gaining increasing levels of control at the largest banks and as a result threatening financial stability.

We also recognize that the FDIC has an interest in decisions that could affect, weaken, or endanger bank resolvability in the event of failure. Decisions on which corporate shareholders vote—including management, business strategies, or policy decisions—could certainly affect resolvability and are therefore relevant to the FDIC.

We recommend that the FDIC's participation in change in control notices should ***not be optional in all cases***. Instead, there should be asset size or other thresholds developed for risk factors such as involvement in risky products or business lines to clearly designate the largest most systemically important banks for which the FDIC should always be involved in change in control decisions.[25] The FDIC's participation in change in control decisions for banks that are smaller or less risky could remain optional.

<u>Note: this comment also relates to the following questions in the Proposal</u>:

Question 3. Should the FDIC and other [Appropriate Federal Banking Regulators] consider an approach whereby a notice would be required at either the bank level or holding company based on specific criteria, such as the percentage of assets of the insured depository institution in relation to the consolidated assets of the holding company?

> <u>Answer</u>: Yes, as detailed in this comment, the FDIC and other federal regulators should develop a set of standard criteria that specify the level of review that is required for change in control transactions. This is important because of the potential for large banks' failures to cause large losses to the DIF or cause significant challenges in resolution.

Question 6. What facts and circumstances should the FDIC consider when determining whether to require a notice to be filed with the FDIC for an indirect acquisition of control of an FDIC-supervised institution?

> <u>Answer</u>: The effect that an acquisition could have on a bank's risk profile and resolution plan should be considered, in addition to the factors listed in the Proposal.

II. <u>COORDINATE WITH THE FED AND OCC ON AN INTERAGENCY APPROACH TO HANDLE CHANGE IN CONTROL NOTICES.</u>

<u>Note: this comment also relates to the following question in the Proposal</u>:

Question 19. How can the FDIC and the other Federal banking agencies best ensure consistency in the review of notices under the CBCA? What steps should be taken on an interagency basis to ensure the appropriate review of transactions involving an indirect acquisition of control of an institution?

All three banking regulators need to work together on change in control issues, to support Main Street Americans and financial stability. As Acting Comptroller of the Currency Michael Hsu stated:

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[25] The Category I-IV framework for capital requirements and other supervisory oversight is already established and could be used. *See, e.g.*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REQUIREMENTS FOR DOMESTIC AND FOREIGN BANKING ORGANIZATIONS, https://www.federalreserve.gov/about the fed/boardmeetings/files/tailoring-rule-visual-20191010.pdf, (last accessed Oct. 15, 2024).

> These [bank ownership] questions are relevant to ***all three of the federal banking agencies***, not just the FDIC. To put this in context, of the more than 600 publicly traded banks, nearly all—over 95%—issue voting securities via a holding company, which is supervised by the Federal Reserve. In aggregate, of the 4,577 insured depository institutions (IDI) in the U.S., less than 20 are publicly traded and issue voting securities directly from the IDI. The statistics for OCC-supervised institutions tell a similar story of bank ownership via holding companies, with the addition that the FDIC also has backup supervisory authority for all OCC banks with insured deposits.
>
> Thus, this issue of bank ownership and control is shared across the FDIC, OCC, and Federal Reserve. We are ***inextricably linked*** on it given how banking organizations have structured themselves. ***To address this effectively requires interagency coordination and, ideally, a shared understanding and approach to bank control, notices, and passivity agreements. In short, I believe we should work together to strengthen bank control assessments, instead of creating more process and opportunities for turf battles or fragmentation.***[26]

The Proposal takes important steps in the right direction toward coordination by removing structural divisions such as exemptions that exclude the FDIC from decisions on transactions at holding companies of state nonmember banks. However, more work is needed. For example, additional detail is needed to specify how disagreements on change in control decisions will be handled. There will likely be different viewpoints among the banking agencies that are considering questions related to bank ownership. There must be a clear set of rules that the regulators follow and that the banks understand.

We recognize that establishing such frameworks takes time, but we urge the regulators to prioritize this coordination and rulemaking effort. Nevertheless, interagency coordination should be implemented as soon as practicable.

[26] Press Release, Office of the Comptroller of the Currency, *supra* note 10 (emphasis added).

CONCLUSION

We hope these comments are helpful as the FDIC works to finalize this rule.

Sincerely,

[redacted]

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