From: Palmer Schoening
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In today’s political environment, regulation is often seen as necessary for protecting consumers, but it's important to consider the unintended consequences that can arise from overregulation.

It's an election year, markets have been volatile, and the economy is uncertain. Unfortunately, small businesses are more likely to be hit hardest when there is economic turmoil or precariousness. We saw that with the collapse of Silicon Valley Bank and Signature Bank. Many small businesses learned from that episode and now “stress test” their banks, but there is only so much that small businesses can control.

In a one-week stretch earlier month, the Dow Jones Industrial Average dropped over 1,000 points and the S&P 500 had its biggest daily loss since September 2022. The economy and small businesses go hand-in-hand since small businesses employ 61.7 million Americans – or nearly half (46.4%) of private sector employees. And a good chunk (27%) of those small businesses are family owned businesses. Volatile economic conditions have rarely ever been fixed by more government intervention, but that’s not stopping the FDIC from overstepping.

At its July 30 board meeting, the FDIC followed up on a prior proposal regarding monitoring index fund passivity. Generally, this would reassert its authority to review changes in control relating to bank holding companies. This would effectively put asset managers – specifically the Big Three (BlackRock, State Street, Vanguard) – on notice that any stake held in FDIC-supervised banks exceeding 10% could trigger a response from the regulator.

The FDIC claims asset managers have been acquiring significant stakes in many bank holding companies and are failing to remain passive owners. But passivity is important for these index managers because it’s important to their customers – the everyday investor.

The ability to hold client assets in banks in a non-controlling manner also encourages capital investment in those institutions. Index funds in particular have become crucial to long-term investing and saving for retirement. Warren Buffet has endorsed this type of investing; Back in 2017 he advised to "consistently buy an S&P 500 low-cost index fund…Keep buying it through thick and thin and especially through thin."

These funds are also critical, stable sources of capital for banks, especially the small and regional banks that are so central to the economy, particularly on Main Street. Extensive regulations and compliance requirements like the FDIC is proposing could restrict access to capital and even depress stock prices for banks. smaller regional banks – which often provide capital to small businesses – may find it harder to compete with larger institutions, reducing the number of banking options for businesses seeking loans.

It also could lead banks to allocate capital towards assets with lower regulatory burdens, reducing the availability of credit for business expansion and growth.

The changes proposed by the FDIC will create regulatory friction and discourage capital investments, ultimately weighing on access to capital for entrepreneurs, small businesses and other Main Street businesses.. Roughly 60% of small businesses get their loans from a community bank who could be impacted by efforts that restrict passive investment in banks.

The FDIC highlights concern about index managers’ influence encouraging “risky behavior,” but what’s riskier yet is overregulating in a way that’s inadvertently harmful to small businesses and the economy in such an economically unstable time.

While the U.S. bank regulator may have good intentions in tightening control of asset managers' bank stakes, it is important to consider the potential negative impacts on small businesses and consumers.

Striking a balance between regulation and supporting economic growth is crucial to ensure a healthy and competitive financial market that benefits all stakeholders. It is essential for regulators to carefully assess the implications of their actions and consider alternative solutions that do not hinder small businesses' access to funding or limit consumer choice.

Palmer Schoening