Vanguard

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November 18, 2024

James P. Sheesley, Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, DC 20429

Re: Change in Bank Control Act – RIN 3064-AG04

Dear Mr. Sheesley:

Vanguard[1] appreciates the opportunity to comment on the Notice of Proposed Rulemaking ("NPR") issued by the Federal Deposit Insurance Corporation ("FDIC") regarding the FDIC's proposed changes to its regulations under the Change in Bank Control Act ("CBCA").[2] The NPR recognizes that investors have increasingly benefitted from passive investment vehicles like index mutual funds and exchange-traded funds ("ETFs") and have seen their balances grow over recent decades, and raises questions about whether this success implicates CBCA and other banking laws. More specifically, the NPR expresses concern that increasing ownership of equity securities of banking organizations in these high-quality, low-cost vehicles with broadly diversified shareholders might create situations where managers of these funds can have outsized influence over these institutions.

Vanguard appreciates the important questions raised by the FDIC and offers several observations and suggestions in response to the NPR. In addition, though we agree with many commenters that rulemaking in this area may be unnecessary because the FDIC is interpreting the same federal statute (CBCA) that is also interpreted by the Board of Governors of the Federal Reserve ("Federal Reserve") and Office of the Comptroller of the Currency ("OCC"), we support the FDIC's pledge, if necessary, to pursue a joint process with these agencies to facilitate a consistent, transparent set of standards for investments in banks and bank holding companies. Relative to a unilateral process, a joint process would ensure a common understanding of jurisdictional lines and prevent the imposition of duplicative filing requirements that could increase investor costs and reduce the ability of depository institution holding companies to rely on investment funds as a steady and predictable source of capital. Given the value equity index funds provide to millions of Americans, and to reinforce expectations around passive investments, we are eager to address reasonable policy concerns, improve transparency, and

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[1] "Vanguard" refers to the Vanguard Group, Inc., and its subsidiaries, which act as investment advisers under the Investment Advisers Act of 1940 ("Advisers Act"). The Vanguard Group, Inc. provides corporate, administrative, distribution, and investment advisory services to over 200 U.S.-domiciled investment companies registered under the Investment Company Act of 1940 and is subject to the oversight of each fund's board and offers over 200 additional investment companies in markets outside the United States (collectively, the "Vanguard Funds").

[2] Regulations Implementing the Change in Bank Control Act, 89 Fed. Reg., 67002 (August 19, 2024) *available at* https://www.govinfo.gov/content/pkg/FR-2024-08-19/pdf/2024-18187.pdf.

buttress existing protections around passive investing. The clarity that results from a joint agency action is critical for the investing public to assess and comment on policymakers' passivity expectations and will help minimize misunderstandings and policy shifts that can create unnecessary uncertainty for retail investors, banking organizations, and the markets.

Introduction

As the fund company that popularized index investing almost 50 years ago, Vanguard is built around passive investing and a unique mission to help individual investors reach their financial goals. Vanguard offers a diversified product suite (consisting of both index and actively managed funds), supported by a corporate structure and an internal compliance infrastructure that both helps individual investors reach their financial goals and facilitates passive investments on behalf of fund investors in a manner so as not to create "control" of a banking organization or any other company. This is precisely the type of retail, client-oriented, passive investing that the FDIC should seek to encourage.

Vanguard is a unique investor-owned asset manager whose mission is to put the interests of individuals and families first and help them meet their most important financial goals, such as enjoying a secure retirement, purchasing a home, or saving for college. We do this by offering a large selection of low-cost mutual funds, ETFs, and related services that are used by more than 50 million investors. We do not manage separate accounts for large pension firms, sovereign wealth funds, or other institutions that may seek to promote certain corporate practices or behaviors.

Unlike other fund managers that are owned by external parties, Vanguard is a mutual company, owned by the U.S. funds it advises which, in turn, are owned by their investors. As a result, when an investor invests in these funds, they also own Vanguard, the asset manager. With this structure, rather than increasing fees to grow earnings and pay dividends to external owners, Vanguard's earnings benefit fund investors. We have lowered expenses more than 2000 times—cumulatively more than 80%—since our founding, allowing fund investors to keep more of their gains.

Our focus on providing high-quality, low-cost products is central to our core purpose to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success. Indeed, a recent Morningstar study compared asset managers for delivering value to investors and found that Vanguard ranked first—delivering $3.8 trillion over a 10-year period ending in 2023—more than double the value creation of any other fund family.[3] Vanguard is proud to have lowered the cost of investing to help millions of investors keep more of their earnings so they can meet their financial goals. In light of the success enjoyed by investors,

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[3] *See* Morningstar, *15 Top Wealth Creators in the Fund Industry* (2024) *available at* https://www.morningstar.com/funds/15-top-wealth-creators-fund-industry-2. Additionally, seven of the top fifteen wealth creating funds were Vanguard index funds.

especially index fund investors, cash flows into these mutual funds tend to grow, periodically requiring regulators to confirm our passivity.

Summary

The NPR posits that the FDIC's regulations enacting CBCA may no longer be appropriate in light of the growth of index funds. Specifically, the NPR expresses concern that fund complexes could exercise significant influence or control over management despite the existence of "passivity commitments" that serve to rebut the presumption of control,[4] and implies that different standards of passivity, as applied by different federal banking regulators, could present risk to banking institutions. Though we agree that the current host of overlapping and inconsistent standards set independently by the various federal banking regulators interpreting the same statute can create unnecessary costs, there are no examples of where existing passivity agreements have come up short. Not only have passivity agreements successfully buttressed passivity expectations for regulated entities—and provided tangible benefits to millions of retail investors (and banks)—they have helped streamline what can otherwise be a difficult and taxing approval process that can disadvantage both investors and banks.

Vanguard is proud of the steps we have taken to ensure that neither we nor the Vanguard Funds influence the strategy or operations of public companies, including FDIC-regulated institutions. As described in more detail below, these steps include instituting a clear, transparent and accountable stewardship[5] methodology focused on maximizing investment returns by promoting strong corporate governance practices, and empowering retail investors to participate in the proxy voting process through our investor choice proxy voting pilot program. We understand, however, the FDIC's desire to further reinforce the safeguards around passive investment in the institutions over which it has regulatory authority. To that end, we recommend that the FDIC:

- Acknowledge the value and successes associated with existing passivity agreements and work constructively with institutions, and fellow regulators, to build on those successes.

- <u>Participate, if necessary, in a joint agency process to align on a common interpretation of long-standing jurisdictional lines and CBCA interpretations of passivity</u>. Currently, the FDIC, Federal Reserve, and OCC each review notices to acquire voting securities for the institutions for which they serve as the "appropriate federal banking agency." However, each regulator uses different standards when assessing whether an acquiring person or entity has sufficiently rebutted the presumption of control their acquisition raised—and a unilateral FDIC action would make this worse. Absent common updated passivity agreements, a joint agency process would allow federal banking regulators the opportunity to address any policy concerns and align on appropriate conditions for demonstrating passivity while offering investment companies clear expectations

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[4] NPR at 67004.

[5] "Stewardship" is the term that Vanguard and other asset managers use to describe activities related to engaging with portfolio companies to inform proxy voting decisions.

regarding passivity across all U.S. banking organizations, regardless of which agency is reviewing the acquisition. This is a common, and successful, approach in other parts of banking regulation.

- Consider practices that further reinforce passivity for index and other mutual funds committed to passive investment. In addition to improving clarity for investment companies, the FDIC could consider, in conjunction with the Federal Reserve and OCC, requiring that investment companies commit to further practices appropriately designed to ensure passivity and provide certainty and transparency for banks and investors. These practices must be clear to facilitate the FDIC's ability to confirm ongoing compliance. For example, the FDIC could have a requirement for firms to have public stewardship policies and annual reports that outline their proxy voting philosophy and summarize their activities over the previous year. Additionally, disclosures describing any stewardship activities with respect to banking organizations that are coordinated with other firms or organizations could further assuage regulatory concerns around undue influence.

  Vanguard follows these practices, and others, and believes measures like these would address concerns the FDIC may have about undue influence over a U.S. banking organization. Such an approach would encourage passive investors to remain truly passive while permitting the FDIC to verify compliance at appropriate intervals.

I. The FDIC should avoid abrupt and unilateral changes to their CBCA regulations, especially absent demonstrated deficiencies in its current standards, and should work with the other federal banking regulators to establish consistent, high quality, standards.

a. Removing the FDIC's existing exemption from duplicative CBCA filings would create unnecessary confusion in light of long-standing statutory interpretation of CBCA.

The CBCA (and the regulations implementing it) requires the "appropriate federal banking agency" to review and approve transactions for more than 10% of the voting securities of an insured depository institution (which is specifically defined in the CBCA to include bank holding companies).[6] The CBCA designates the FDIC as the "appropriate federal banking agency" for state nonmember banks, industrial loan companies, and state savings banks, while the Federal Reserve is the "appropriate federal banking agency" for bank holding companies and savings and loan holding companies.[7]

Under the terms of the CBCA and the related aids to statutory construction, only the Federal Reserve has jurisdiction over bank holding companies and savings and loan holding companies.

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[6] 12 U.S.C. § 1817(j)(1).

[7] Under this framework, the OCC is the "appropriate federal banking agency" for national banks and federal savings associations.

The FDIC, by contrast, has jurisdiction over state nonmember banks and industrial loan companies. The investments contemplated by the FDIC's current exemption occur in the bank holding company and have long been recognized as being subject to the Federal Reserve's standards. Accordingly, the current exemption in the FDIC's regulations is superfluous, but does at least recognize the unnecessary duplication of any FDIC review.

The NPR unilaterally seeks to remove this longstanding "exemption."[8] Although the exemption is superfluous, this change, taken together with the text in the preamble to the NPR, would create uncertainty that could have far-reaching negative consequences for banks and investors. Operationally, it appears that the FDIC intends the NPR to require duplicative FDIC review of transactions that are statutorily properly reviewed only by the Federal Reserve, namely those involving voting securities in bank holding companies with state nonmember bank subsidiaries and savings and loan holding companies with state savings bank subsidiaries. Any requirement that the FDIC review transactions in bank holding companies or savings and loan holding companies would be contrary to the plain text of CBCA—which requires that the "appropriate federal banking agency" review a transaction—and could potentially lead to inconsistent outcomes and increased costs, all for an unsubstantiated benefit.

b. The NPR does not provide any evidence that existing passivity protections, including existing passivity commitments, are ineffective or have been breached.

The NPR expresses concern that the flow of capital from passive investment vehicles into FDIC-supervised institutions may present the risk of undue influence at those institutions. The NPR goes on to allege that this undue influence "… could potentially lead to excessive risk-taking to enhance profits, investor returns, or stock price"[9] and that there is "… potential [for] concentration of ownership that may result in [asset managers] having excessive influence or control over the banking industry as a whole."[10]

These statements are antithetical to passive investment, unsupported, and inaccurate. Policymakers would be hard-pressed to find a class of investors *less* interested in second guessing corporate management or policymakers, or more averse to promoting excessive risk-taking. Passive investors, and particularly index funds, invest to experience market returns, not to control companies.[11] Vanguard leaves management decisions to company boards and management teams and public policy decisions to policymakers. We do not nominate directors, submit shareholder proposals, or otherwise attempt to influence day-to-day management decisions of any portfolio company. Our long-term, hands-off investment philosophy provides a

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[8] NPR at 67002.

[9] NPR at 67005.

[10] *Id*.

[11] As we note in more detail in the Appendix, index funds make purchase and sale decisions as a function of changing index weighting and cash flow, and do not purchase any securities for the purpose of encouraging an issuer to engage in risk-taking to enhance profits.

stable source of capital to companies in a way that aligns with all historical regulatory passivity standards.[12] Index investors are passive, long-term investors and the NPR contains no evidence to the contrary.

The NPR goes on to ask a series of questions regarding the efficacy of the current passivity agreement framework, which is purportedly designed to reduce the risk of concentrated ownership and undue influence noted above.[13] The NPR suggests, in proposing that the FDIC review CBCA applications for transactions that have already been approved by the Federal Reserve, that the Federal Reserve's criteria—which are derived from the same statutory language used by the FDIC—are in some way deficient, and therefore present a risk to FDIC-supervised institutions.

While Vanguard agrees that inconsistent regulatory approaches can present risks, this is not at all consistent with our experience as a passive investor subject to passivity standards of numerous other regulators, including the Federal Reserve and OCC. Moreover, joint agency action would *enable* high consistent standards, whereas unilateral action absent evidence is counterproductive to the FDIC's goals. Accordingly, we encourage the FDIC to refrain from any action that could lead to confusion, delay, and uncertainty in the marketplace while generating unnecessary costs for the agencies and investors—including Main Street investors who rely on mutual funds and other investment companies to meet their financial goals—and ultimately threaten access to capital by banking organizations.

Passivity agreements ensure that mutual funds do not use their ownership stakes to influence the day-to-day operations or management of FDIC-supervised institutions. Indeed, the behaviors with which the FDIC expresses concern are prohibited by passivity agreements, agreements the FDIC does not suggest have been breached.[14] To that end, the FDIC should refrain from throwing away the current passivity commitment framework that has benefitted investors (who receive certainty that the funds they purchase will be able to acquire the securities they wish to hold to meet their investment objectives), banks (which benefit from knowing they will continue to have access to stable capital provided by fund investors), and federal banking regulators (who promote the flow of passive capital into U.S. banking organizations).

In addition, regulators should not restrict an investor's ability to rebut the regulatory presumption of control without compelling evidence, given the clear language of the CBCA. The term

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[12] The federal banking regulators' historical regulatory passivity standards are well established: once an entity passes the 10% regulatory threshold, the acquiring entity may rebut the regulatory presumption of control—namely by entering into a "passivity commitment." These commitments, which vary depending on the facts and circumstances of the transaction, detail factors that will ensure that the acquiring institution will not have the power to direct the management or policies of the U.S. banking organization. The FDIC has entered into several of these agreements with asset management companies—including Vanguard.

[13] NPR at 67007.

[14] The NPR acknowledges that the FDIC is a party to these passivity commitments and that they are enforceable "under sections 8 and 50 of the FDI Act." NPR at 67003. However, to our knowledge, the FDIC has never brought an enforcement action for a violation of a passivity agreement, despite their assertion of their authority to do so.

"control" is explicitly defined in the CBCA as either 25% stock ownership or the "*power*, directly or indirectly, to *direct* the management or policies" of an insured depository institution.[15] As described in greater detail below, passive investors do not "direct" the management or policies of any company in which they invest and have no interest in doing so. The federal banking regulators have adopted regulations that require a significantly lower threshold—10%—even though the CBCA did not authorize the regulators to establish a presumption at a lower level of share ownership or, more generally, to define "control." In these circumstances, the standards for rebuttal of a presumption of control at 10%, a level 60% below the statutory standard, should be reasonable and carefully calibrated to be consistent with the high statutory standard. The adoption of a different approach would open the question of whether the 10% presumption as revised is consistent with the statute.[16]

c. *The FDIC should work with the Federal Reserve and OCC to align on a common approach to CBCA filings.*

As Acting Comptroller of the Currency Michael Hsu, in his capacity as a member of the FDIC Board, urged at the July 30 Board meeting, the federal banking agencies should engage in a coordinated effort with respect to what constitutes a change in control, the process to review transactions implicating the CBCA, and other issues implicated by the NPR. Vanguard applauds that commitment.

This is not only a matter of sound policy, but compliant with statutory standards. The Riegle Community Development & Regulatory Improvement Act of 1994 requires the federal banking agencies to work jointly to make uniform all regulations and guidelines implementing common statutory policies[17] and to eliminate, to the extent practicable, duplicative or otherwise unnecessary requests for information in connection with applications or notices to the agencies.[18] The CBCA is such a common statutory policy, which has been recognized by the agencies in connection with reports filed with Congress since the mid-1990s.[19]

Consistent with these statutory requirements, if the banking agencies believe a rulemaking is necessary, we urge the FDIC, Federal Reserve, and OCC to engage in an interagency process to confirm the statutory mandate as to which agencies have jurisdiction over investments in bank holding companies and savings and loan holding companies and to develop common passivity

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[15] 12 U.S.C. § 1817(j)(8) (emphasis added).

[16] *See Corner Post, Inc.* v. *Bd. of Governors of the Fed. Rsrv. Sys.*, 144 S. Ct. 2440, 2447-48 (2024) (holding that a claim under the Administrative Procedure Act begins to accrue "when the plaintiff is injured by final agency action," not when a regulation is first promulgated).

[17] 12 U.S.C. § 4803.

[18] 12 U.S.C. § 4804.

[19] *See* Federal Financial Institutions Examination Council, Report on Section 303(a)(3) of the Riegle Community Development and Regulatory Improvement Act of 1994, at III-13 (1996), *available at* https://www.ffiec.gov/PDF/Riegle/Riegle_part3.PDF.

commitments to rebut the presumption of control.[20] These passivity commitments should reflect the unified view of the federal banking agencies as to practices that constitute undue control or influence at the institutions for which they have regulatory authority.

d. The comment file further highlights the need for a common approach to CBCA filings.

One letter attempted to augment the dearth of evidence in the NPR with other, unsubstantiated arguments. Rather than supporting the NPR, however, these arguments raise new questions about the goals or purpose of this effort and emphasize the importance of a common approach to CBCA filings. Two of the more extreme of these arguments call for a ban on investor discussions with portfolio companies and using the Financial Stability Oversight Council ("FSOC") to penalize certain proxy voting activities. We rebut both arguments below.

The FDIC should not ban discussions with portfolio companies because passive investment stewardship engagements promote healthy companies and shareholder returns.

One letter suggested that the FDIC should consider a "complete ban" on conversations with portfolio companies, arguing that "the scale of…voting power means any engagement…would be tantamount to exercising control."[21] This statement is deeply flawed, and the proposal is counterproductive.

- Vanguard initiated contact with the FDIC in 2012 to proactively address any questions on this topic and has been operating pursuant to a passivity agreement—established by the FDIC—since 2019. This passivity agreement establishes a host of requirements to further buttress passivity, even beyond traditional limits for non-control investors, including a provision that we "mirror vote" shares above 10% in these institutions. Vanguard agreed to these passivity commitments specifically to demonstrate that we do *not* seek to control the institutions in which the Vanguard Funds invest. Moreover, and as noted above, neither the FDIC nor any banking organization alleges that we have attempted to exercise control in the way the commenter suggests.

- Companies routinely reach out to investors to explain their thinking with regard to certain proxy matters, particularly items that third parties put on the company's ballot. Vanguard routinely listens to portfolio company perspectives on these matters, as well as the views of shareholder proposal proponents, consistent with our clear, transparent, and accountable approach to investment stewardship, which we describe below. Prohibiting

[20] Even if there were not a clear statutory determination as to jurisdiction, such an interagency effort should be conducted to avoid the waste of duplicative filings.

[21] Letter from AFL-CIO and 37 other organizations to James P. Sheesly, Assistant Executive Secretary, FDIC, dated October 30, 2024, *available at* https://www.fdic.gov/federal-register-publications/americans-financial-reform-education-fund-and-37-other-organizations ("AFL-CIO Letter") at 4.

an investor from listening to a portfolio company's perspective is antithetical to good corporate governance and could be detrimental to banks and investors.

FSOC's mandate is to address systemic risks, not to promote political or social agendas.

More concerning, however, is the letter's willingness to invoke financial stability and weaponize FSOC. Specifically, the commenter asserts: "the largest asset managers' outsized influence…means they have the power to either compel public companies to address financial stability risks, or conversely, to serve as a veto point when other shareholders seek to do so."[22] The implication of this argument is that traditional financial stability topics (e.g., leverage, capital, or activities that put the company or financial system at risk) are being placed on corporate proxies and leads the reader to presume that asset managers are voting for options that promote "risk taking." This is inaccurate, inconsistent with how index investors invest, and how passive managers like Vanguard steward.

As noted above, Vanguard is a passive investor, and under the law, does *not* invest for control and operates within a host of guardrails associated with passivity. Moreover, Vanguard was built around passivity and has voluntarily supplemented its already passive behavior with additional covenants that go above and beyond many other non-control investors. For example, we have an explicit passivity agreement with the FDIC and have been on the leading edge of empowering retail investors to guide the proxy voting decisions within their funds.[23] As a company with deep roots in high-quality, low-cost index funds that help retail investors—of all political persuasions—we leave management decisions to company boards and management teams and public policy decisions to policymakers. Further, the investors in the index funds we offer seek steady market-tracking returns over the long-term.[24] It is hard to imagine an investor *less* likely to push management in any strategic direction that implicates financial stability.

This passivity is reflected in the fundamental principles of index fund investing. Vanguard does not pick whether an FDIC-bank is in a given index—the index provider does. Vanguard does not control the "flow" of funds into or out of the fund—investors do. Nor do we try to influence strategy or day-to-day management, despite some proponents' suggestions to the contrary.

Interestingly, the "financial stability" topics at issue for the commenter are "climate change," "economic inequality," and "racial inequity."[25] These are three highly complex social and political challenges, about which our 50 million investors may have very differing views. We also note that seeking to address such topics is not a traditional use of a corporate proxy. While we have long supported disclosure of material risks, including climate and other risks, we view legislatures as the appropriate venues for addressing complex social and political challenges. Moreover, the notion that proxy voting on these issues represent a "financial stability" issue

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[22] AFL-CIO Letter at 5.

[23] More detail regarding Vanguard's proxy choice pilot is included in Section II.C below.

[24] On average, Vanguard investors hold each of their mutual fund investments with us for over seven years.

[25] AFL-CIO Letter at 5-6.

requiring FSOC intervention is inconsistent with the language of the Dodd-Frank Act and spirit of the FSOC. Finally, the suggestion that FSOC operate in this way represents an unfortunate effort to politicize the FSOC that we hope policymakers will resist.

II. The Vanguard Funds are passive, employ varied investment strategies, and never invest for control. They provide investors with economic exposure to stocks without interfering with strategy, management, or operations of portfolio companies.

Vanguard offers investors a range of low-cost, diversified mutual funds and ETFs designed to help them meet their investment goals. A mutual fund is an investment vehicle that pools money from and invests on behalf of its shareholders—typically, in the case of the U.S. domiciled Vanguard Funds, a widely dispersed group of retail investors—to invest in stocks, bonds, or other assets.[26] The fund's investment adviser manages fund assets—but does not own them—and must make investment decisions solely for the economic benefit of the fund without regard to the adviser's interest or the interest of any other party.[27]

The funds Vanguard offers can be categorized as index funds or actively managed funds.[28] The Vanguard Funds, regardless of their investment strategy, never seek to control or influence the day-to-day management or operations of any company in which they invest.[29]

A. No Vanguard Fund invests to control or influence the business decisions or strategies of any company in which it invests.

The owner of a security generally has the ability to exercise shareholder rights associated with that security, including proxy voting. The Securities and Exchange Commission, recognizing that shareholders have the potential to influence companies, requires disclosure of ownership stakes exceeding five percent of a company's total issuance. The required disclosures mandate that a shareholder declare whether its acquisition was made with an intent to control the issuer. Investors that do not seek to control a company (and that meet other criteria) may file one type of disclosure (Schedule 13G), while investors that may seek control file another (Schedule 13D). Moreover, investment companies are subject to civil monetary penalties for any misrepresentations they make. The index funds that Vanguard advises are eligible to file Schedule 13G because they acquire securities in the ordinary course of business and do not seek to exercise control or influence over any of the portfolio companies in which they invest.[30] Some

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[26] Shareholders participate in the investment returns and cost of the fund on a *pro rata* basis. An ETF is a type of mutual fund that is listed on a national securities exchange.

[27] The Advisers Act establishes a federal fiduciary duty for investment advisers that prohibits an investment adviser from placing its own interests ahead of the interests of its client.

[28] Approximately eighty percent of the total assets managed by Vanguard are held by index funds.

[29] The Appendix describes this passivity in more detail.

[30] As part of each Schedule 13G filing, the investor must certify that the securities were acquired and are held in the ordinary course of business and were not acquired and are not held for the purpose of or with the effect of changing

mutual funds—including other funds offered by Vanguard—hand-pick securities with the goal of outperforming market returns. These actively managed funds are also eligible to file Schedule 13G because they do not seek to control the companies in which they invest (e.g., they refrain from nominating directors or making shareholder proposals). In contrast, some hedge funds and private equity firms take an activist approach, and seek to change, or even control, a company's board, strategy, or operations to improve returns for their investors. Accordingly, such activist funds are required to file Schedule 13D.

B. Vanguard has taken a number of significant steps to demonstrate our commitment to passive investment.

The index funds Vanguard advises epitomize passivity. They execute investment decisions based on factors outside their control to track an index as closely as possible. These funds hold a company's stock for as long as that stock remains in their benchmark indices, which can be decades, and have adopted an approach to investment stewardship that embodies passivity because it is:

- Subject to a clear, transparent and accountable stewardship methodology focused on maximizing investment returns;
- Clear about its independence from external groups;
- Restrained in its use of shareholder tools (including the ability to transact in a stock to attempt to influence management); and
- Empowering fund shareholders to express *their* views and preferences.[31]

In addition, Vanguard, as an adviser and steward to passive index funds, takes no action intended to influence the day-to-day management or operations of any company.

Our approach to passive investment management may help provide a path forward should the FDIC decide to work with the Federal Reserve and OCC to provide greater clarity on the investment activities it considers passive.

C. Vanguard has taken additional action to demonstrate our commitment to clear, transparent, and targeted stewardship, including empowering millions of retail investors to participate in the proxy voting process.

Vanguard is leading the way to empower individual, retail investors in the United States to actively participate in proxy matters, proportionate to their ownership. We are proud of our approach to stewardship, yet we also understand that investors have different preferences and we have been taking steps to give underlying investors more voice in corporate governance. In 2023,

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or influencing the control of the issuer of the securities. *See* Rule 13d-1(c)(1) of the Securities Exchange Act of 1934.

[31] As noted in greater detail below, Vanguard's Investor Choice program is giving investors in the Vanguard Funds that we advise the ability to direct how proxies for the portion of the fund they own are voted.

Vanguard launched a potentially transformative pilot program that focused on enabling individual investors in certain equity index funds to direct how proxies associated with their investments are voted. Our inaugural investor choice voting pilot empowered investors to choose from a selection of four proxy voting policy options that directed the funds' proxy vote for certain portfolio companies, proportionate to the investor's ownership.[32] In 2024, the pilot was expanded to additional funds, and following the 2024 proxy season we announced a commitment to continuing to expand the offering at scale.

The initial iterations of our investor choice program demonstrated both the potential and challenges of providing index fund investors with choices related to proxy voting. We believe that some investors are interested in playing a larger role in determining how their votes are cast on some shareholder proposals. Recently, Vanguard unveiled the results of the most recent pilot and underscored continued commitment to the expansion of the program. From the pilot, we saw that, in addition to significant support for Vanguard's voting policy, over 50% of participating investors chose policies other than Vanguard's policy, demonstrating real interest in exercising their own preferences. While we noted that investors who invest directly with Vanguard participated at higher rates, we continue to work through various operational hurdles to empower participation for a wider investor base that holds Vanguard funds in a variety of ways.

Our exploration of innovative solutions (such as investor choice models of proxy voting, as noted above) are consistent with our intent to remain passive investors and act for the sole benefit of long-term individual investors in the Vanguard Funds. We believe that our continued work can provide valuable insights to federal banking regulators who are seeking to buttress the safeguards around passive investments in the institutions over which they have regulatory authority.

III. Though we are proud of our approach, Vanguard supports reviewing the effectiveness of the existing passivity commitments to further ensure passivity by funds, including index funds, when they invest in banking organizations.

As indicated above, we are unaware of any situation where the current passivity commitments have been ineffective. Nonetheless, we believe that it is appropriate to ask whether the commitments and their implementation could be enhanced. More specifically, we support the federal banking regulators developing a single standard for passivity and incorporating that standard into their passivity agreements to reduce regulatory burden and increase certainty for investors.

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[32] Participation in the pilot was voluntary, and participating investors could choose among the following policies: (1) an option to vote with management's recommendation; (2) an option to vote according to a publicly-disclosed third-party policy with recommendations from an independent third-party provider; (3) an option to vote based on the Vanguard policy; or (4) an option to abstain. More information is available on Vanguard's website.

The passivity agreements that the FDIC and Federal Reserve have published on their websites contain numerous provisions designed to ensure passivity.[33] We believe these measures are fully consistent with passive investing and appreciate Federal Reserve Chair Powell's statement that he "[didn't] have any reason to think that [asset managers are] not in compliance" with the passivity agreements they entered into with the Federal Reserve.[34] Nevertheless, we recognize the agencies' interest in verifying the passivity of parties to these agreements and we are open to implementing additional compliance measures to ensure a clear and common understanding of truly passive investment. Additional measures that could be incorporated into existing and future passivity agreements could include:

- Making an investor's proxy voting policies and procedures available publicly;
- Restricting an investor from coordinating voting activities with other shareholders regarding a proposal at a banking organization;[35]
- Providing a clear disclosure of passivity at the outset of any engagements with a federal banking organization, clarifying the limits of the investment company's role (including that they do not seek to influence the strategy or operations of the company);
- Drafting and maintaining "meeting minutes" of each engagement with a federal banking organization, and making them available to the appropriate federal banking agency upon request; or
- Enlisting a third-party to periodically evaluate the investment company's policies and procedures for compliance with existing passivity commitments.

Each of the measures above is designed to ensure transparency and further reinforce guardrails constructed to demonstrate compliance with their passivity commitments. Furthermore, these types of measures would allow investment companies to implement specific controls to demonstrate adherence to each measure through an auditable compliance regime. Moreover, these measures are fully consistent with helping banks attract and retain investment while promoting long-term investment returns for shareholders in those banks.

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[33] For example, both the FDIC's and Federal Reserve's passivity agreements with Vanguard contain restrictions on proposing directors, exercising or attempting to exercise a controlling influence over management or policies, and disposing (or threatening to dispose of) securities in an effort to influence company management.

[34] Proquest, Hearing Transcript, House Financial Services Committee Hearing on Semiannual Monetary Policy Report (June 21, 2023).

[35] Cases where the shareholder is the publicly named proponent of the proposal or the nomination do not, in our view, constitute coordination. In those cases, an investment company should be able to engage with the shareholder proponent to discuss whether the proposal or nomination is in the best interests of the investment company's shareholders and their long-term investment returns. In addition, any restriction on coordinating voting activities should allow mutual funds to continue to allow their investors to have a voice in corporate governance (e.g., through an investor choice program).

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Vanguard appreciates the opportunity to work with the FDIC and other federal banking regulators. We would welcome the opportunity to discuss any of the host of passive investing practices that we currently apply or revisions aimed at balancing the important public policy issues raised by the NPR.

If you have any questions or would like to discuss our views further, please contact George Gilbert, Head of U.S. Regulatory Affairs, at [redacted]

Sincerely,

/s/ Ricardo R. Delfin

Ricardo R. Delfin
Principal, Global Head of Regulatory and Public Policy
The Vanguard Group, Inc.

Appendix: Background on Vanguard, Mutual Funds, and Our Commitment to Passivity

A. Mutual Funds Background

The funds Vanguard offers can be categorized as either index funds or actively managed funds.[36] An index fund (such as Vanguard Total Stock Market Index Fund) aims to provide shareholders with the returns of a benchmark index (e.g., the CRSP US Total Market Index)—constructed and maintained by an independent third-party—less fund expenses. The index provider determines the components (i.e., securities) that comprise the index and the weighting of each component (how much of each security to hold) in a manner outlined by the index's methodology. A Vanguard portfolio manager then buys and sells securities to track the index. Trading may occur in response to a variety of external factors including: investors' decisions to buy or sell, index providers' decisions to change or "rebalance" an index, or company decisions to repurchase shares or engage in a merger.[37] Vanguard, as the manager of the index fund, manages the fund to respond to these external changes but does not make decisions regarding which companies go into or out of the index.

In addition to index funds, Vanguard offers investors access to actively managed funds that retain portfolio managers who hand-pick securities with the goal of outperforming market returns. These managers use robust economic, financial, and market analysis to make investment decisions consistent with the fund's investment objective and policies. Unlike index funds, actively managed funds are not constrained by the need to track a specified benchmark and their portfolio managers can use their research and judgement to try to beat the market or manage risk. Almost all actively managed equity funds Vanguard offers are managed by third-party external investment firms, and each of these external managers has sole investment discretion.[38] Additionally, these third-party managers are empowered to vote proxies and engage with portfolio companies independently from Vanguard, in a manner consistent with their funds' investment objectives.

Whether index or actively managed, the Vanguard Funds have made long-term investing accessible to millions of investors, enabling them to achieve their financial goals. These funds also play an important role in allocating capital across the economy and, with respect to banks,

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[36] Approximately eighty percent of the total assets managed by Vanguard are held by index funds.

[37] Vanguard evaluates portfolio managers of index funds based on how closely the fund tracks its benchmark index, which creates a strong incentive to "replicate" equity indices (i.e., holding all of the stocks in the same proportion as the index).

[38] Collectively, these externally advised funds have retained investment advisory services from twenty-four external managers. Vanguard provides investment advisory services for a small portion of actively managed portfolios through Vanguard Quantitative Equity Group ("QEG"). As of January 31, 2024, these QEG portfolios account for less than one percent of Vanguard's total assets under management.

fostering deep, liquid, and efficient capital markets that provide banks with a reliable, long-term source of capital.[39]

B. How Vanguard Stewards the Funds it Advises

Vanguard has established a clear, transparent, and accountable stewardship program focused on maximizing investment returns. Each Vanguard-advised fund retains the authority to vote proxies with respect to the shares of equity securities it owns. The board of each Vanguard-advised fund has tasked Vanguard's investment stewardship team with discharging each fund's proxy voting rights, consistent with that fund's goals and objectives.[40] Given our core focus as a passive, index fund manager for retail investors, Vanguard's investment stewardship approach seeks to promote high quality corporate governance practices that preserve and promote long-term shareholder returns at each individual company held by a fund.

When Vanguard's investment stewardship team votes proxies or engages with portfolio company directors and executives around that voting, it does so not to influence the operations or strategy of the portfolio company but to understand their approach to corporate governance and to share perspectives on corporate governance practices associated with long-term investment returns. These include practices around board composition and independence, board oversight of strategy and risk, executive compensation, and shareholder rights. These discussions have no impact on fund investment decisions and Vanguard has not, and would not, submit a shareholder proposal, nominate a director, or seek to influence the corporate strategy or operations of an issuer.

As part of our commitment to transparency and accountability, each Vanguard-advised fund has adopted proxy voting policies and procedures that detail general positions of the fund on matters that appear on public companies' proxy statements. These policies are informed by our research and analysis into corporate governance practices that we believe generate long-term investment returns at individual companies. When we encounter a ballot item that our proxy voting policies do not explicitly address, we determine the vote on a case-by-case basis consistent with the fund's proxy voting policies and stated investment objective. Vanguard's investment stewardship

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[39] Across the industry, at the end of 2022, more than fifty percent of U.S. households owned mutual funds, and mutual funds and similar investment products comprised more than twenty percent of U.S. household wealth, underscoring the importance of these investment companies to investors and the capital markets. Investment Company Institute, *2023 Investment Company Factbook: A Review of Trends and Activities in the Investment Company Industry*, 19 and 85, *available at* https://www.ici.org/system/files/2023-05/2023-factbook.pdf.

[40] As noted in the prior section, most of the actively managed funds Vanguard offers are managed by external third-party advisers. The boards of those funds delegated proxy voting and engagement authority to the unaffiliated third-party investment advisers who manage those funds in 2019. Accordingly, our stewardship methodology is the same for all funds we advise, the vast majority of which are index funds.

team has led the industry in ensuring that its stewardship activities are transparent to investors, regulators, and portfolio companies.[41]

Vanguard has been clear that external groups do not alter our approach to stewardship. The NPR asks several questions about the potential for investment companies to influence the behavior of FDIC-supervised institutions through engagements, either with company management directly or through industry groups.[42] We recognize these concerns and appreciate the opportunity to address them from the perspective of a passive index fund steward.

As detailed in our annual investment stewardship report, Vanguard participates in certain external organizations and industry initiatives. We routinely assess participation in external organizations to ensure that they align with Vanguard's investment goals and mission and, as we note below, take action to address any credible confusion regarding our independence and commitment to passive investing. Regardless of our participation in any trade association, external organization or industry initiative, Vanguard maintains its independence in company engagement activities and proxy voting decisions in accordance with our duty to our investors and with the goal of promoting long-term shareholder returns.[43]

Examples of this include Vanguard's decision to leave the Net Zero Asset Managers ("NZAM") initiative in 2022 and our decision not to join Climate Action 100+. Vanguard joined NZAM in 2021 as part of our efforts to promote investment returns by advancing good corporate governance practices, such as disclosure of material financial risks, including those arising due to climate change. Although Vanguard was explicit that the index funds it advises would be excluded from the NZAM commitment and thus not be aligned to "net zero,"[44] we withdrew from NZAM to make clear that Vanguard speaks independently on matters of importance to our investors.

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[41] The stewardship team provides regular disclosure of its engagement activities to inform investors of the meetings it conducts on behalf of the Vanguard-advised funds. This disclosure takes the form of an annual report that outlines engagement and voting for the year, quarterly reporting of significant votes, and articles designed to demonstrate the application of our policies with respect to voting and engagement. *See* Vanguard Investment Stewardship: About Our Program *available at* https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/about_our_program_2023.pdf, at 13. Vanguard has also advocated for stronger disclosures in SEC Form NP-X. *See* Letter from John Galloway, Principal and Investment Stewardship Officer, Vanguard, to Vanessa A. Countryman, Secretary, SEC, dated December 14, 2021, *available at* https://corporate.vanguard.com/content/dam/corp/public-policy/pdf/Vanguard_Comment_Letter%20SEC_Proxy_Voting_Disclosure_N-PX_Proposal_12.14.2021.pdf.

[42] NPR at 67007.

[43] *See* Vanguard Investment Stewardship: About Our Program *available at* https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/about_our_program_2023.pdf at 17.

[44] *See* Net Zero Asset Managers Initiative – Initial Target Disclosure Report (May 2022), *available at* https://www.netzeroassetmanagers.org/media/2022/05/NZAM-Initial-Target-Disclosure-Report-May-2022-1.pdf at 76.