FDIC Must Stop Overregulating or Face Another Slew of Bank Failures

By Jared Whitley
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Though Congress is in August Recess, the Federal Deposit Insurance Corporation (FDIC) has a board meeting scheduled for July 30. Board Member Jonathan McKernan took to X this past week stating that the FDIC "must fix our broken monitoring of the Big Three asset managers' compliance with the banking laws." In principle, ensuring all asset managers are following laws sounds fine. But what does this really mean from the agency whose purpose is to maintain public confidence and stability in the US financial system?

McKernan is championing an order that would direct FDIC staff to regularly examine large asset managers who own a stake of more than 10% in FDIC-regulated banks to ensure they are not "improperly influencing their operations." However, long-standing legal precedent and statutes indicate the Federal Reserve serves as the primary regulator for overseeing the ownership of bank holding companies. This is a notable overstep of the FDIC's regulatory authority, and it's also duplicative since these companies are already regulated by the Fed.

The major asset managers – BlackRock, State Street, and Vanguard – manage more than $23 trillion that passively mimic indices such as the S&P 500. These large index-fund managers are currently allowed to own stakes of more than 10% in banks because they're not like other shareholders. Index-fund managers don't seek to use their stakes in banks to influence the management of those banks. Index-fund managers just seek to guide every day, small investors' capital, such as pensions and 401(k)s, into well-run investments, including banks. They do not agitate for change. They just serve as a steward of capital.

Just four years ago the Federal Reserve settled whether asset and index-fund managers needed to acquire special permission for client shares to rise above the 10% threshold. The finalized rule "clarifie[d] and increase[d] transparency by describing the combination of factors that would and would not trigger control concerns." Vanguard and BlackRock already have agreements with the Federal Reserve to remain passive. Vanguard also already has one with the FDIC. The FDIC taking this on would be a redundant and unnecessary process. Worse yet, if successful, this would restrict access to capital.

Their new oversight would limit or potentially depress the stock prices of banks – particularly the smaller community and regional banks, many of which are already teetering due to high interest rates. A lot of these holdings are passive investments owned by retirees around the country, limiting their opportunity to invest in regional banks through mutual and index funds could make it harder for the banks to fully tap into capital markets.

Strong capital markets are vital to ensuring investments in the country more generally. Without access to

funds, the necessary investments into infrastructure, communities and business will dwindle. This type of restriction makes its way down to consumers eventually. A 2023 report found that small business owners found it difficult to access capital. In fact, 70% reported it was difficult to access capital. Worse yet, 76% said this lack of capital has negatively impacted their business. If businesses can't get capital and are forced to close their doors, it will mean fewer jobs, less competition, and generally worse economic conditions across the board.

Ironically, the FDIC turned to BlackRock to help in distributing bank assets that the FDIC had taken ownership of after the Silicon Valley Bank and Signature Bank failed. And if small and regional banks are harmed by the FDIC's order, the agency would likely find itself back in that position of turning to the very firms it's targeting to help with another potential slew of bank failures.

Board member McKernan's plan is unnecessary and unhelpful. Though there has been slight growth in the second quarter of 2024, exceeding most expectations, it's still a precarious time in a wildly unexpected election year.

We know that markets like certainty and we can be certain this new rule will do more harm than good.

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