

April 15, 2024

MEMORANDUM TO: The Board of Directors

FROM: Jonathan McKernan
Member, Board of Directors

SUBJECT: Monitoring Covered Fund Complexes' Compliance with
Passivity Commitments and Other Conditions in FDIC
Control Comfort

Summary: Director McKernan presents for adoption by the Board of Directors (the “Board”) of the Federal Deposit Insurance Corporation (the “Corporation”) a resolution providing for the Director of the Division of Risk Management Supervision (“Director, RMS”) to submit within 90 days for the review and approval of the Board a plan to (i) monitor compliance by covered fund complexes (as defined below) with passivity commitments and other conditions in FDIC control comfort (as defined below) and (ii) determine annually whether covered fund complexes control, or have controlled, directly or indirectly State nonmember insured banks or State savings associations (each such bank or association, an “FDIC-supervised institution”).

Discussion: Companies that sponsor, manage, or advise investment companies, other pooled investment vehicles, and institutional accounts, including some advised by third-party managers (each such company, vehicle, or account, a “fund,” and, together with the company that sponsors, manages, or advises one or more funds, a “fund complex”) acquire and hold the voting securities of FDIC-supervised institutions and controlling affiliates of FDIC-supervised institutions. The FDIC has provided or entered into, and may in the future provide or enter into, statements, agreements, and other regulatory comfort that fund complexes rely on to acquire and hold up to a specified percentage of the voting securities of one or more FDIC-supervised institution, or a controlling affiliate of an FDIC-supervised institution, without being considered

to control directly or indirectly the FDIC-supervised institution for purposes of certain Federal banking laws enforced by the FDIC (each such existing or future statement, agreement, or other regulatory comfort, “FDIC control comfort”).¹ A fund complex’s reliance on FDIC control comfort is conditioned on its compliance with the passivity commitments or other conditions included in the FDIC control comfort.

Due in part to the growing popularity of funds that track the S&P 500 index and other stock indexes, several of these fund complexes have experienced recently large increases in their holdings of voting securities of FDIC-supervised institutions or their controlling affiliates. For example, the fund complexes of BlackRock, Inc., State Street Corporation, and The Vanguard Group, Inc. may together have a median stake of more than 20 percent of the voting securities of S&P 500 companies, which could amount to approximately 25 percent of the votes cast at annual meetings of these companies.² Several of these fund complexes have proposed, without being deemed to control an FDIC-supervised institution for purposes of certain Federal banking laws, to increase their holdings in some controlling affiliates of FDIC-supervised institutions to as much as 24.9 percent of a class of voting securities and to have director representation on the board of directors of controlling affiliates. The growing role played by these fund complexes

¹ This includes (i) the Extension of the Revised Statement Regarding Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations, dated December 15, 2023 and (ii) passivity agreements between and among the FDIC and one or more fund complexes. The FDIC is also contemplating potential changes to its approach to the Change in Bank Control Act that might be expected to lead in the future to fund complexes offering to provide to the FDIC new or amended passivity commitments.

² Lucian A. Bebchuk & Scott Hirst, *Big Three Power, and Why It Matters*, 102 B.U. L. REV. 1547, 1552 (2022) (“[W]e estimate that, as of the end of 2021, the Big Three [Vanguard, BlackRock, and State Street] collectively held a median stake of 21.9% in S&P 500 companies, which represented a proportion of 24.9% of the votes cast at the annual meetings of those companies.”); Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 736 (2019) (“[T]he average share of the votes cast at S&P 500 companies at the end of 2017 was 8.7% for BlackRock, 11.1% for Vanguard, and 5.6% for [State Street] As a result, for S&P 500 companies, the proportion of the total votes that were cast by the Big Three was about 25.4% on average”).

raises important policy issues, including as to whether any fund complex might alone, or acting in concert with another covered fund complex or any other person, control directly or indirectly an FDIC-supervised institution for purposes of certain Federal banking laws enforced by the FDIC.

The FDIC's program for monitoring compliance with the passivity commitments and other conditions of FDIC control comfort relies primarily on periodic certifications of compliance by the applicable fund complex. The Change in Bank Control Act of 1978 ("Change in Bank Control Act")³ gives the FDIC authority, including by taking depositions and issuing subpoenas, to investigate whether a person has violated, or is about to violate, the Act's prohibition on any person acquiring control directly or indirectly of an FDIC-supervised institution (including through any of its controlling affiliates) unless the FDIC has been given at least 60-days prior written notice and, within that time, the FDIC has not disapproved the proposed acquisition.

Pursuant to the exemption under 12 C.F.R. § 303.84(a)(8), an acquisition of voting securities of a depository institution holding company for which the Board of Governors of the Federal Reserve System (the "Board of Governors") reviews a notice pursuant to the Change in Bank Control Act does not require notice to the FDIC under the FDIC's regulations implementing the Change in Bank Control Act. "[T]he FDIC's longstanding practice [is] to recognize this exemption only when the Board of Governors actually reviews a Notice under the Change in Bank Control Act and not when the Board of Governors does not require and review a Notice. Accordingly, if the Board of Governors determines to accept passivity commitments in

³ The Change in Bank Control Act amended the Federal Deposit Insurance Act ("FDI Act") to add section 7(j), 12 U.S.C. § 1817(j).

lieu of a Notice, the FDIC will evaluate the facts and circumstances of the case to determine whether a Notice is required to be filed with the FDIC for the indirect acquisition of control of an FDIC-supervised institution.”⁴ The Board of Governors has determined to accept passivity commitments in lieu of notices under the Change in Bank Control Act from at least two large fund complexes.⁵

Especially given that certain fund complexes have shown a willingness to use their voting power to drive change,⁶ it is appropriate to (i) enhance the FDIC’s monitoring of compliance with the passivity commitments and other conditions of the FDIC control comfort provided to, or otherwise applicable to, any fund complex that (A) sponsors or manages one or more funds that track a broad-based equity index and (B) owns or otherwise controls more than 5 percent of a class of voting securities of a large number of FDIC-supervised institutions or their controlling affiliates (including each fund complex that has entered into a blanket passivity agreement with the FDIC) (each such fund complex, a “covered fund complex”) and (ii) annually determine whether any covered fund complex controls, or has controlled, directly or indirectly an FDIC-supervised institution for purposes of any of (A) the Change in Bank Control Act, 12 U.S.C. § 1817(j), or (B) 12 C.F.R. § 337.3, which applies generally Regulation O, 12 C.F.R. pt. 215, to FDIC-supervised institutions (each, a “covered banking law”).

⁴ Filing Requirements and Processing Procedures for Changes in Control With Respect to State Nonmember Banks and State Savings Associations, 80 Fed. Reg. 65,889, 65,897 (Oct. 28, 2015).

⁵ See Letter from Mark E. Van Der Weide, General Counsel, Federal Reserve Board, to William J. Sweet, Jr., Retired Partner, Skadden, Arps, Slate, Meagher, and Flom LLP (Dec. 3, 2020) (BlackRock); Letter from Mark E. Van Der Weide, General Counsel, Federal Reserve Board, to Anne E. Robinson, Managing Director, General Counsel, and Secretary, The Vanguard Group, Inc. (Nov. 26, 2019) (Vanguard).

⁶ See generally MINORITY STAFF OF THE U.S. SENATE COMM. ON BANKING, HOUS., AND URB. AFFS., THE NEW EMPERORS: RESPONDING TO THE GROWING INFLUENCE OF THE BIG THREE ASSET MANAGERS 4–7 (Dec. 2022).

The attached resolution would require the Director, RMS to submit within 90 days for the review and approval of the Board a plan to (i) monitor compliance with any passivity commitment or other condition of any FDIC control comfort provided to, or otherwise applicable to, a covered fund complex and (ii) annually determine whether any covered fund complex controls, or has controlled, directly or indirectly an FDIC-supervised institution (including through control of a controlling affiliate of an FDIC-supervised institution or through action in concert with another covered fund complex or any other person) for purposes of any covered banking law (such plan, the “Monitoring Plan”).

The Monitoring Plan must include steps to both identify and assess any act, practice, policy, or program of a covered fund complex that could, whether on its own or together with another act, practice, policy, or program of the covered fund complex or in concert with another covered fund complex or other person, indicate or otherwise pose a risk that the covered fund complex directly or indirectly controls, or has controlled during the review period, an FDIC-supervised institution (including through a controlling affiliate of an FDIC-supervised institution) for purposes of any covered banking law.

The Monitoring Plan must include the submission of a report to the Board by March 31 of each year, except that the initial report must be submitted to the Board within 90 days after the approval by the Board of the Monitoring Plan. The review period for each report to the Board must be the preceding calendar year, except that the review period for the initial report to the Board must be January 1, 2019 through December 31, 2023.

To identify such acts, practices, policies, or programs, the Monitoring Plan must include steps to develop an understanding of the facts and circumstances relating to, at a minimum:

- The engagements by management or the investment stewardship team of each covered fund complex with FDIC-supervised institutions or their controlling affiliates, including whether those engagements entailed discussion of proxy voting by the covered fund complex (including any potential for the withholding of proxies);
- The voting guidelines of each covered fund complex and its other policies and practices relating to voting in elections for directors, “say on pay” or other votes on executive compensation, votes on shareholder proposals, or other shareholder votes, whether in elections involving shareholders of FDIC-supervised institutions or their controlling affiliates, including whether the covered fund complex communicates that it may withhold proxies with an aim to influence corporate policy;
- Any coordination of voting or other investment stewardship activities (including engagements with FDIC-supervised institutions or their controlling affiliates) with another covered fund complex or other asset managers through industry trade associations, alliances, or international economic or other forums;
- Any effort by a covered fund complex (including by withholding proxies) to influence the composition of the board of directors of an FDIC-supervised institution or any of its controlling affiliates;
- Any effort by a covered fund complex to influence the credit, lending, investment, divestment, trading, share buyback, dividend, or similar policies of an FDIC-supervised institution or its controlling affiliates; and

- Any effort by a covered fund complex to influence the political spending or lobbying activity of an FDIC-supervised institution or its controlling affiliates.

To assess such acts, practices, policies, or programs, the Monitoring Plan must include, at a minimum:

- An assessment of whether each covered fund complex complied during the review period with each passivity commitment or other condition of any FDIC control comfort provided to, or otherwise applicable to, the covered fund complex; and
- An assessment of whether each covered fund complex directly or indirectly controls, or has controlled during the review period, an FDIC-supervised institution (including through a controlling affiliate of an FDIC-supervised institution or through action in concert with another covered fund complex or any other person) for purposes of any covered banking law.

Conclusion: Director McKernan recommends the Board adopt the attached resolution directing the Director, RMS to submit within 90 days for the review and approval of the Board a Monitoring Plan.

Attachment

RESOLUTION