The FDIC Should Look Inward Before Taking On More Regulation

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October 10, 2024

Much has been said about the turmoil at the staff level at the Federal Deposit Insurance Corporation ("FDIC") following the release of an outside law firm's review of troubling allegations of workplace misconduct at the FDIC. From Congressional oversight hearings to editorials in the *Wall Street Journal*, questions have been raised about the leadership and direction of the usually staid regulator. So it was somewhat interesting to see that in August of this year the FDIC took a partisan vote to move forward to not directly tackle these workplace issues, but to instead seemingly expand their authority in areas of the financial system that already operate with adequate oversight and regulation by other federal entities. The newest proposed rule from the FDIC would seek to assert the FDIC's currently-exempted authority to review changes in bank control – generally, ownership stakes of between 10% and 25% of stock – of bank holding companies.

But such entities already report their ownership to the Federal Reserve Board. The FDIC's proposal is important because it seeks to duplicate authority for such review already held and developed through rules outlined by the Federal Reserve Board.

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The FDIC's proposal would also increase its power to influence bank holding company operations. For instance, JP Morgan Chase, the largest bank holding company in the U.S., has 1,133 entities under its holding company, only 2 of which are banks that hold deposits amounting to roughly half of the holding company's total assets. The FDIC's proposed rule, however, would subject all of JPMorgan Chase – and asset managers like BlackRock, Inc., State Street Corporation, and The Vanguard Group, Inc., as shareholders – to the FDIC's scrutiny.

The FDIC would also increase such control at a time in the FDIC's history when it – like other regulatory agencies – has become increasingly politicized. FDIC Chair Martin Gruenberg's continued delay resigning in response to the May 2024 revelations of the FDIC's "scathing independent investigation detailing pervasive sexual harassment, discrimination and bullying at the agency" continues to be inexcusable and sets a bad foundation for far-reaching new agency policies.

The FDIC's proposal is, in large part, a response to the FDIC's fears that bank holding company ("BHC") stock ownership in S&P 500 index funds issued by BlackRock, Inc., State Street Corporation, and The Vanguard Group, Inc. may somehow be voted by such entities in a manner that would undermine safety and soundness and place the insured deposits of the banks within those holding companies at risk.

Jonathan McKernan's April 15, 2024 Memo to the FDIC Board of Directors suggests that the FDIC's concerns are driven by a couple of recent academic articles that have been hotly debated among academics and practitioners. That debate notes, in part, that other influences over bank Boards, like ISS or Glass Lewis shareholder proxy recommendations, are also unregulated and deserve attention. McKernan's memo reasonably recommends only monitoring and studying the influence of asset managers. But the FDIC proposed rule goes far beyond that.

In fact, there is little reason to fear that asset managers holding bank shares in order to replicate S&P 500 Index returns would vote their shares adversely to regulatory safety and soundness concerns. Those asset managers – being bound to replicate the Index returns – cannot freely buy and sell. They will hold as long as the bank remains in the index. Such "buy and hold" investing is widely regarded as consistent with incentives to steward responsible growth and profitability. And since those asset managers also seek to attract capital to their Index funds over those offered by other firms, voting their shares in a manner acceptable to a broader public can form the basis of a marketing strategy that also helps those banks adhere to an acceptably popular social and environmental agenda, a win-win for all involved.

The Bank Holding Company Act clearly designates the Federal Reserve as the primary regulator for bank holding companies and details its role in reviewing any control and influence companies have over bank operations and management – not the FDIC. To the extent that the FDIC wishes to review ownership of the banks holding insured deposits within those bank holding companies, it already possesses such authority to review ownership of those institutions. The FDIC's setback in the Hurry v FDIC lawsuit, in which the Court agreed that the FDIC acted "FDIC acted arbitrarily, capriciously, and contrary to law" in not accepting a Change in Bank Control application, suggests that it may be better off crafting sound procedure to use appropriately its authority where that already exists, rather than expanding that into the broader financial services sector. Or perhaps at a minimum it should focus on cleaning up its own workplace issues before attempting to encroach onto the turf of other regulatory entities without a clearly outlined policy need.