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Federal Deposit Insurance Corporation
50 17th Street NW
Washington, DC 20429

Change in Bank Control Act: RIN 3064-AG04

Proposed FDIC Rule: The Downstream Impact on Capital Availability and Small Business

The Small Business & Entrepreneurship Council (SBE Council) is submitting the following comments regarding the Change in Bank Control Act proposal: RIN 3064-AG04.

The Federal Deposit Insurance Corporation (FDIC) exists to maintain stability and public confidence in the U.S. financial system. However, the FDIC's most recent Notice of Proposed Rulemaking appears to be focused on gaining agency influence, and creating more complexity and confusion rather than upholding stability.

In August, the FDIC announced proposed rules on "Regulations Implementing the Change in Bank Control Act." The proposed amendment would require investors who own more than 10 percent of a stake in a regulated bank to submit written notice and request approval of the investment from the FDIC. The proposal is meant to limit investors from gaining majority interest or outsized sway over banks. This would largely affect index fund managers, but the outcome would also have a downstream impact on small businesses and consumers.

The FDIC is seeking to expand its regulatory reach – thereby creating a duplicative regulatory structure – due to the prevailing belief throughout the Biden-Harris administration that large businesses and/or investors necessarily bode ill across industries and our economy.

Is there any evidence for this? No.

In this case, the FDIC is zeroing in on stakes in insured depository institutions and their holding companies held by large fund complexes and other asset managers.

Are there actual problems that would need to be addressed by an additional layer of regulation by the FDIC in addition to what the Federal Reserve already does? Again, no.

Instead, in its proposed rule, the FDIC provides a list of speculations rooted in a big-is-automatically-bad presumption, with words and phrases like "potentially significant," "may," "potential," and "could." This amounts to a flurry of mere speculation, topped off by the FDIC's wild conclusion:

"Finally, as fund complexes continue to purchase more shares of banking organizations across the market to match the growth of investments in index funds, there is the potential to create a concentration of ownership that may result in such investors having excessive influence or control over the banking industry as a whole."

Later, the FDIC puts forth: "The FDIC has determined that the original purpose of the current exemption, which was to avoid duplicate regulatory review of the same transaction by both the FRB [Federal Reserve Bank] and the FDIC, is no longer warranted in light of the widespread impacts resulting from growth in, and changes to the nature of, passive investment strategies… Accordingly, the FDIC has determined that this proposal is necessary in light of the risks created by possible outsized control over and concentration of ownership of FDIC- supervised institutions."

But there are no "widespread impacts" or "risks," that is, other than what the FDIC presumes.

Large investors, such as BlackRock, State Street, and Vanguard, often invest in banks through passive index funds – meaning they apply no pressure or influence on the companies in which they are invested. These funds aim to provide long-term returns to investors who are often saving for their retirement needs through mimicking the market environment.

While this proposal, on the surface, may not appear to be one that affects small businesses, the opposite is true.

As is always the case in a deeply integrated economy, targeting parts of one industry with increased regulatory burdens, risks and uncertainties, in turn, creates regulatory burdens, risks and uncertainties in other parts of our economy. So, targeting banks and large investors means that smaller banks will feel the effects, such as fewer investors and investment dollars, and therefore, a less robust financial sector that helps to fund business startups, investment and innovation. For good measure, the increased costs and delays for index funds would negatively affect returns for investors.

Travis Hill, the Vice Chairman of the FDIC, voted against the proposed rule due to his concerns about the rule's impact on the capital markets. In hearing testimony, Hill stated that the proposed rule "might result in asset managers reducing their investments in banks." Hill warned that the FDIC should proceed with caution.

The banking industry is widely dependent on small businesses – both as financial institutions and as providers. In the United States, there are over 4,000 small banks, and, on average, each commercial bank employs 31 employees. If the outcome of the proposed regulation means reduced investments in banks, the downstream impact will greatly affect the health and wellbeing of Main Street banks and businesses.

Community banks lead in lending to small businesses. These banks are better suited to understanding the needs of local businesses and organizations and to more effectively meet those needs. The potential for less capitalization via the proposed rule's limitations will have an outsized impact on these small to mid-size banks and the local communities they serve.

With more limited capital availability, financing for startups and small businesses will get tighter. Moreover, this regulatory proposal is being pushed at the same time the Basel III Endgame is being pursued. The latter aims to reduce operational risks for banks by requiring that they increase their capital requirements. The more capital that banks are mandated to hold onto, the less that is available for small business lending. While the Basel III rule will not impact smaller banks, capital availability in general will take a hit. And, the combination of the FDIC rule on top of Basel III could prove to be quite damaging to capital access, which means fewer business launches, fewer jobs, less investment, and perhaps more business failures.

Furthermore, over half of Americans either work for or run a small business. The majority of these companies do not offer employees a retirement plan, meaning they need to rely on personal investments and savings to get them through their retirement years. Passive index funds are growing in popularity as they are seen as the safest ways to invest as they offer lower management costs and stability. The proposed FDIC rule could significantly disrupt existing index funds and prevent them from building appropriate positions in bank stocks – an important part of any portfolio.

Unfortunately, this FDIC proposal perpetuates the current and harmful trend of overregulation by the federal government. Again, it is aimed at addressing a problem that does not exist. And again, matters concerning bank control and passive investment are already monitored and approved by the Federal Reserve. While the FDIC is allowed to review indirect changes in control, the Federal Reserve has historically been the agency responsible for approving any passivity agreements. There have been no concerns over the Federal Reserve's ability to oversee and regulate these passive funds, so adding additional regulatory layers or requirements will merely create confusion around agency superiority and standards.

Rather than creating more confusion and uncertainty in the financial markets through competing governmental standards, the FDIC should be focused on protecting consumer and small business access to capital, which would help to strengthen the U.S. economy via business growth and opportunities for individuals to build financial security. Especially at a time when worry about the economy is a top concern of consumers and small business owners alike, stability should be the focus.

In short, the proposed FDIC rule is an unnecessary intrusion that will disrupt capital markets and limit access to capital for small businesses. In the proposed rule, the FDIC offers the following under "Alternatives Considered":

"The primary alternative to this proposed rule that the FDIC considered was maintaining the existing regulatory structure in which an entity is exempt from submitting a notice to the FDIC when the FRB actually reviews a notice to acquire voting securities of a depository institution holding company."

This one sentence is where the FDIC makes regulatory and economic sense. Please contact us if you have further question or need additional information.

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