July 29, 2024

MEMORANDUM TO: The Board of Directors

FROM: Jonathan McKernan
Member, Board of Directors

SUBJECT: Monitoring Covered Fund Complexes' Compliance with Passivity Commitments

**Summary:** Director McKernan presents for adoption by the Board of Directors (the "Board") of the Federal Deposit Insurance Corporation (the "Corporation") a resolution:

- requiring after October 31, 2024 a fund complex[1] that (i) sponsors or manages one or more funds that track a broad-based equity index and (ii) owns or otherwise controls more than 5 percent of a class of voting securities of a large number of FDIC-supervised institutions, or their parent entities or bank holding companies (each such fund complex, a covered fund complex) to either (i) file a notice under the Change in Bank Control Act (CBCA)[2] with the FDIC with respect to any acquisition of voting securities of any FDIC-supervised institution, or its depository institution holding company, that equals or exceeds 10 percent of the class of that voting securities and thus gives rise to a presumption of control under the FDIC's rules implementing the CBCA at 12 C.F.R. part 303 (FDIC's CBCA Rules)[3] or (ii) rebut that presumption with respect to each such acquisition;
- suspending each passivity commitment or other similar arrangement between the FDIC and a covered fund complex as of October 31, 2024;

[1] For this purpose, a "fund complexes" are companies that sponsor, manage, or advise investment companies, other pooled investment vehicles, and institutional accounts, including some advised by third-party managers.

[2] Section 7(j) of the Federal Deposit Insurance Act (12 U.S.C. § 1817(j)).

[3] 12 C.F.R. §§ 303.80–.88.

- sending a letter to each covered fund complex regarding the foregoing; and
- reserving to the Board the approval of the FDIC's entry into any passivity agreement or other commitments with any covered fund complex.

**Discussion:** The CBCA and the FDIC's CBCA Rules generally prohibit any person,[4] acting directly or indirectly or in concert with other persons, from acquiring control of a "covered institution"[5] without providing at least 60 days prior written notice to the FDIC. While the CBCA defines "control,"[6] it does not describe what constitutes the power to direct the management or policies of an insured depository institution. Thus, the FDIC's regulations contain a rebuttable presumption that an acquisition of voting securities of a covered institution constitutes control and triggers notice requirements under the CBCA if, immediately after the transaction, the acquiring person will own, control, or hold the power to vote 10 percent or more of any class of voting securities, *and either* the institution has registered securities under section 12 of the Securities Exchange Act of 1934, *or* no other person will own, control, or hold a greater percentage of that class of voting securities after the transaction.[7] A rebuttal to the presumption of control generally will set forth factors that demonstrate that the acquiring person

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[4] 12 C.F.R. § 303.81(g) defines "person" as "an individual, corporation, limited liability company (LLC), partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, voting trust, or any other form of entity; and includes each party to a voting agreement and any group of persons acting in concert."

[5] 12 C.F.R. § 303.81(e) defines "covered institution" to include "an insured State nonmember bank, an insured State savings association, and any company that controls, directly or indirectly, an insured State nonmember bank or an insured State savings association" and carves out certain holding companies in situations for which the FDIC does not require notice.

[6] The CBCA defines "control" as "the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25 per centum or more of any class of voting securities of an insured depository institution."

[7] 12 C.F.R. § 303.82(b)(1).

will *not* have control, and may include various passivity commitments, such as that the acquiring person will not seek representation on the board of directors of the covered institution, take certain actions to influence the policies of the institution, or acquire further voting securities above a certain threshold.[8]

The FDIC's CBCA Rules implement the CBCA with respect to FDIC-supervised institutions. 12 C.F.R. § 303.84(a) provides an exemption from the requirement to file a CBCA notice with respect to an acquisition of voting securities of a depository institution holding company for which the Board of Governors of the Federal Reserve System (FRB) reviews a notice under the CBCA. This provision in the regulation is consistent with the general practice of the FDIC to avoid duplicative regulatory review of the same transaction by both the FDIC and the FRB.[9] However, the FDIC's long standing practice is that in situations where the FRB has accepted a passivity commitment in lieu of a CBCA notice, the FDIC will evaluate the facts and circumstances to determine whether a notice to the FDIC is required for the indirect acquisition of control of an FDIC-supervised institution.[10] In recent years, however, the FDIC typically has not determined that CBCA notices must be filed with the FDIC when the FRB accepts a passivity commitment in lieu of a CBCA notice.

Due in part to the growing popularity of funds that track the S&P 500 index and other stock indexes, several fund complexes have experienced recently large increases in their holdings of voting securities of FDIC-supervised institutions or their depository institution

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[8] 12 C.F.R. § 303.82(b)(4). Rebuttal of presumptions must be presented in writing.

[9] 80 FR 65889, 65897 (Oct. 28, 2015).

[10] *Id.*

holding companies. 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.[11] 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 depository institution holding companies 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 depository institution holding company. The growing role played by these fund complexes 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 passivity commitments relies primarily on periodic certifications of compliance by the applicable fund complex. Especially given that certain fund complexes have shown a willingness to use their voting power to drive change,[12] it is appropriate to enhance the FDIC's monitoring of compliance with the passivity commitments by any covered fund complex.

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[11] 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 . . . .").

[12] *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).

To enhance the FDIC's monitoring, the attached resolution and form letter would provide for covered fund complexes to either (i) file a CBCA notice with the FDIC with respect to any acquisition of voting securities of any FDIC-supervised institution, or its depository institution holding company, that equals or exceeds 10 percent of the class of that voting securities and thus gives rise to a presumption of control under the FDIC's CBCA rules or (ii) rebut that presumption with respect to each such acquisition. Each letter would note that the FDIC is open to accepting passivity commitments as a means to rebutting the presumption of control with respect to these acquisitions of voting securities. However, any such passivity commitments must include commitments intended to facilitate the FDIC's monitoring of compliance with those commitments, such as delivering to the FDIC a periodic report from an external auditor of compliance with those passivity commitments.

For any covered fund complex with a passivity commitment or other similar arrangement with the FDIC, the attached resolution and form letter would suspend those arrangements as October 31, 2024, after which any such arrangements, and the corresponding rebuttal of the presumption of control, will continue only with respect to the holdings of voting securities in the covered institutions listed in the covered fund complex's most recently executed self-certification to the FDIC, up to the percentage limitation included in that arrangement.

Because the entry into new passivity commitments is likely to establish or change existing FDIC policy, could attract unusual attention or publicity, or would involve an issue of first impression, the attached resolution would reserve to the Board the approval of the FDIC's entry into any passivity agreement or other commitments with any covered fund complex.

**Conclusion:** Director McKernan recommends the Board adopt the attached resolution:

- requiring after October 31, 2024 a covered fund complex to either (i) file a CBCA notice with the FDIC with respect to any acquisition of voting securities of any FDIC-supervised institution, or its depository institution holding company, that equals or exceeds 10 percent of the class of that voting securities and thus gives rise to a presumption of control under the FDIC's CBCA Rules or (ii) rebut that presumption with respect to each such acquisition;
- suspending each passivity agreement between the FDIC and a covered fund complex as of October 31, 2024;
- sending a letter to each covered fund complex regarding the foregoing substantially in the form of the form letter attached as Attachment 3; and
- reserving to the Board the approval of the FDIC's entry into any passivity agreement or other commitments with any covered fund complex.

## ATTACHMENTS

Attachment 1: Board Resolution.

Attachment 2: Form Letter.

**ATTACHMENT 1**

**BOARD RESOLUTION**

**ATTACHMENT 2**

**FORM LETTER**