From: Ike Brannon
To: Comments
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Comment on the NPRM

Regulations Implementing the Change in Bank Control Act

By Ike Brannon

Senior Fellow, Jack Kemp Foundation, Washington DC

I am a former economist with the U.S. Treasury and the Senate Finance Committee, and I have spent several years researching financial market regulatory policies, and I wish to express my opposition to the NPRM.

I believe that giving additional regulatory power to the Federal Deposit Insurance Corporation (FDIC) over large index funds would accomplish little but that it could potentially dampen investment in bank stocks, with no salutary benefit for the economy.

The Change in Bank Control Act requires any entity owning more than ten percent of the outstanding stock to obtain approval before reaching this threshold and pass certain tests to ensure it does not exert undue influence and possibly enrich itself at the expense of the other shareholders. While several index funds have exceeded this threshold, passive investors have a waiver from this requirement, since their investment holdings in the bank are based on their need to replicate a stock market index and they do not overtly exert any pressure over the companies they invest in. I would note that the one potential exception to this norm has been the very real worry that some large index funds managers may have worked to encourage companies to pursue their preferred environmentally and socially responsible actions, which, unfortunately, if true, would have been done against the backdrop of the explicit approval of the current administration, having pushed other regulations aimed at accomplishing the same goal.

However, and more to the point, the current FDIC management would like to end this exemption, and impose a test on index funds to ensure they do not exert undue influence on banks or try to place directors directly on the board. The rule would give the FDIC more power to police index-fund managers and their stakes in American banks. FDIC director Jonathan McKernan recently made the case on social media that the FDIC should more closely scrutinize big index-fund managers' stakes in U.S. banks.

However, the rationale for extending the FDIC's regulatory tentacles to cover index funds is an example of regulatory overreach. Given that the agency has struggled to perform the tasks Congress has explicitly assigned to it, taking on new activities where there is already existing regulatory authority by other entities, would be a mistake.

In 2023, the closure of Silicon Valley Bank nearly triggered a bank run thanks to a dubious investment strategy that a competent regulatory staff should have been able to catch. Its collapse took a few other banks with it, and for a long two weeks every single bank in America with a significant proportion of deposits over the federal deposit insurance limit was in full panic mode. Three of the four biggest bank failures in the history of the U.S. have occurred within the last 18 months.

We have also learned the longtime head of the FDIC, Martin Gruenberg, has been overseeing an agency where sexual harassment has been endemic and the 500 or so women who dared to report it during his tenure often faced retaliation from their supervisors. A report on the corporation's problems found that Gruenberg's hair-trigger temper meant no one wanted to bring problems to him and as a result, they tended to fester--so regulatory problems often went uncorrected.

A regulatory agency that has spectacularly demonstrated that it cannot accomplish the tasks assigned to it by Congress, with a workplace culture that could be described as "toxic," has no business making a move to hone in on another regulator's existing portfolio. It is telling that the NPRM suggests that the Federal Reserve's regulatory actions are insufficient in this regard are one reason for it to insert itself into this matter. If there's one thing the FDIC leadership should not be doing--besides trying to expand its regulatory authority--it would be to cast aspersions towards one of its regulatory rivals.

Index funds have grown exponentially in the last two decades and for a good reason: For most Americans these represent the most sensible way to invest. Making it more difficult for such funds to invest in banks and imposing a new set of regulations upon them--to be administered by a failed agency--would be bad policy and would likely result in ancillary issues for both retail investors and the very banks they invest in today through index funds that would be deprived of their capital by these new limits.

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Ike Brannon

Senior Fellow
Jack Kemp Foundation
Ibrannon@jackkempfoundation.org
202-309-0893