July 15, 2019

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Ave. NW
Washington, DC 20551

RE: Control and Divestiture Proceedings (RIN 7100-AF 49; Docket R-1662)

To Whom It May Concern:

The Americans for Financial Reform Education Fund (AFR Education Fund) appreciates the opportunity to comment on the above referenced Notice of Proposed Rulemaking (the "Proposal") concerning the definition of control in the Bank Holding Company Act and the Home Owner's Loan Act. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

The definition of "control" is critical as it determines whether entities investing in the ownership of banks, and possibly having management or board interlocks, will be designated as bank holding companies and subject to the appropriate regulation. A lenient control definition could permit hedge or private equity funds to control or heavily influence bank decision making without themselves being regulated as the owner of the bank. In such a case, the fund could influence the bank to make e.g. financing decisions that benefit the fund but create inappropriate risks to the bank's depositors and indirectly to the public that insures the bank's deposits.

These risks have in our view been heightened by the wave of actions by legislators and bank regulators proposing deregulation of smaller banks. Banks up to $10 billion in size have been exempted from Volcker Rule constraints on proprietary trading, exempted from Basel risk-based capital requirements, and the exam cycle for smaller banks has been lengthened. All of these measures lower the constraints on riskier activities by smaller banks. The presumption behind these steps has been that community banks follow a more traditional and less complex business model than larger banks. In most cases this may well be true, but it could become less true if the constraints on ownership of or influence on smaller banks by outside investors are loosened.

The Board's discussion of the proposed revisions to the control framework is somewhat ambivalent. On the one hand, the proposed revisions are described as simply improving transparency and "providing the public with a better understanding of the facts and circumstances that the Board generally considers most relevant when assessing controlling influence". At other points, however, the Proposal is described as loosening standards and expanding the scope of ownership and influence that could occur without triggering a finding of

[1] A list of coalition members is available at: http://ourfinancialsecurity.org/about/our-coalition/

control. For example, the Board also states that "compared to past practice, the proposal would permit an investor to have a greater number of director representatives at the target company without triggering a presumption of control, and would allow investors seeking to terminate an existing control relationship to do so while retaining greater levels of ownership."[2] The Board also states that, as compared to current practice, the Proposal will significantly facilitate the process of removing an existing control determination, as firms divesting to a certain threshold of ownership of a bank may have the control determination removed despite a long history of a controlling relationship to the bank.[3]

There is also ambivalence concerning whether this Proposal signals a move from a facts and circumstances determination of control to a bright-line definition of control. The Board appears to wish to preserve some power to determine control on a facts and circumstances basis while at the same time signaling to the market that the new formal, bright-line presumptions of control specified in the Proposal will generally govern its determinations. As the Proposal states:[4]

> "The proposed presumptions are intended to assist the Board…Notwithstanding the presumptions of control or non-control, the Board may or may not find there to be a controlling influence based on the facts and circumstances presented by a particular case. ***However, the Board would generally expect not to find that a company controls another company unless the first company triggers a presumption of control with respect to the second company***". [Emphasis added]

In our view, weakening the standards for control would be an unjustified step, and this Proposal does not provide any tangible evidence demonstrating the need for such weakening. We are concerned that the Proposal would, in fact, go beyond simply creating greater transparency for the public concerning the Board's standards for control and act to facilitate greater influence by non-bank investors in bank decision making. We also believe that the Board should maintain its current practice of making careful facts and circumstances judgements of control, and should make clear that the presumptions in this Proposal can and will be set aside if the facts of a particular case indicate that an acquiring company could exercise substantial and effectively controlling influence over a bank it has invested in.

As the Board implicitly admits several times in this Proposal, bright-line standards are simply not suitable for control determinations. The control implications of a specific ownership stake varies considerably depending on the pattern of other ownership stakes in a bank. For example, a ten percent share of voting stock in a bank could be extremely significant if other ownership is highly fragmented and is inactive in bank management, while if other ownership is highly consolidated (e.g. there is a single 51% owner) a ten percent ownership stake might not have strong control implications at all. Similarly, controlling a quarter of bank equity and multiple board members might be extremely meaningful in some contexts and not in others, depending on the representation of other stakeholders and the ability of the bank to raise outside capital.

We are also concerned that the specific bright line standards laid out in the Proposal excessively weaken the standards for a control determination. In securities law, a ten percent share of voting

[2] Federal Register 21635
[3] Federal Register 21645
[4] Federal Register 21637

stock in a corporation is often taken as indicative of control. For example, a classic legal analysis of control states that ten percent ownership "has become something of a benchmark and when this is encountered a red warning flag should run up."[5] A more recent analysis by the law firm Hogan and Lovell states that "Although the SEC has not defined by rule under the Exchange Act or the Securities Act the ownership level that would confer affiliate status, the SEC staff on occasion has expressed the view that ownership of 10% or more of an issuer's voting equity creates a rebuttable presumption of control."[6]

Yet this Proposal would permit voting share ownership of up to 25 percent *and* substantial representation on the Board *and* solicitation of proxies without triggering bright-line presumptions of control. Voting share ownership of up to 15 percent may be combined with being chair of a bank's board of directors without triggering any presumption of control. And even firms with a long history of controlling a bank, and hence numerous informal connections to that bank, could remove the control presumption simply by divesting below 25 percent of voting stock for two years, or below 15 percent immediately.

While the Board would retain some discretionary ability to overrule these presumptions, the Proposal makes clear that they are intended to describe the normal or assumed practice for control determinations. Thus, the presumptions would create very strong pressure against determining that control exists even in situations where it would be completely accepted to find that control exists under standard securities law practice.

The thresholds here do not appear to reflect a minimal level of investment and interaction below which control would be highly unlikely to occur, as would be appropriate for a presumption in a very context-specific situation such as control determinations. They instead represent interlocks between companies which could easily accommodate a very significant degree of control. These generous thresholds should not be used for what is effectively a rebuttable presumption of a lack of control. The evidentiary threshold for introducing this kind of presumption should be high. But the Proposal does not present any clear, much less conclusive, evidence that current practices in consulting facts and circumstances for control determinations harm the public interest.

In the absence of such evidence, and in light of the dangers of an excessively lenient definition of control, we do not believe that the move toward bright line thresholds for control determinations in this Proposal is warranted. At the very least, the thresholds in this Proposal need to be significantly adjusted so that they are much closer to a truly de minimis level of investment and interlock.

Thank you for the opportunity to comment on the Proposal. If you have questions, please contact Marcus Stanley, AFR's Policy Director, at 202-466-3672 or marcus@ourfinancialsecurity.org

Sincerely,

Americans for Financial Reform Education Fund

[5] A.A. Sommer, Jr., Who's "In Control"?, 21 Bus. Law. 559, 575 (1966)
[6] Hogan Lovells, "SEC Issues Guidance on Sanctionable Activity Involving Iran", SEC Update, December 10, 2012. Available at https://bit.ly/2Lnz7q6