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March 31, 2023

VIA ELECTRONIC SUBMISSION

Adrienne Harris, Superintendent
New York State Department of Financial Services
1 State Street
New York, NY 10004-1511

Re: Request for Public Comments regarding the Presumption of Control of a New York-Chartered or Licensed Depository or Non-Depository Institution

Dear Superintendent Harris:

The Investment Company Institute ("ICI")[1] appreciates the opportunity to comment on the Industry Guidance (the "Guidance") proposed by the New York Department of Financial Services ("NYDFS") regarding the presumption of control that applies to both New York chartered depository institutions ("Banking Organizations") and New York licensed non-depository organizations ("Non-Bank Regulated Entities" and, together with Banking Organizations, "Regulated Entities").

We applaud the NYDFS for proposing the Guidance and, thereby, acknowledging the unique circumstances presented by investments in Regulated Entities by Regulated Funds and other vehicles that the Guidance calls "Managed Funds" and recognizing that the normal control presumptions, as typically applied to other investors in Regulated Entities, may not be appropriate in the context of Managed Funds' passive ownership of the securities issued by these entities. Regulated Funds seek to invest not to control portfolio companies, including the Regulated Entities in which they invest, but to meet the investment objectives of fund shareholders. Millions of Americans rely on Regulated Funds to meet their most important personal financial goals, such as saving for the purchase of a home, preparing for a secure retirement or paying for higher education. Importantly, Regulated Funds also channel investment to the US capital markets, thereby fueling economic activity in the United States.

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[1] The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds ("ETFs") and other funds regulated under the Investment Company Act of 1940 ("Regulated Funds"). Its members manage total assets of $29.7 trillion in the United States, serving more than 100 million investors.

ICI, although supportive of the NYDFS' approach, respectfully submits that the Guidance should be modified and clarified in several respects to ease compliance, to accord with other regulatory frameworks and to avoid imposing artificial barriers and hurdles to Managed Funds' investments that impose costs and burdens for both the funds (and their investors) and Regulated Entities but which accrue no benefits. Specifically, we recommend the following modifications and clarifications:

- First, the Guidance should align its aggregation of ownership positions of different Managed Funds with the existing framework under section 13(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Leveraging this familiar and well understood approach will promote a more consistent and coherent compliance regime, as advisers to Managed Funds already have existing designed and tested compliance and reporting systems in place. Per this approach, the NYDFS should only require aggregation of positions held by funds and other clients that share the same investment adviser, where the funds and other clients are investing for economic exposure and not with the purpose or effect of changing or influencing the control of a Regulated Entity.

- Second, the proposed passivity commitments presented in the Guidance should be streamlined where possible and, at a minimum, modified in two material ways.

    - The NYDFS should not require "mirror voting" or granting management power to vote shares in excess ("Excess Shares") of the amount that would trigger a presumption of control (as contemplated in sample passivity commitment #1). Mirror voting can distort the shareholder vote. Granting management voting power over Excess Shares also creates myriad practical problems. For these reasons, mirror voting no longer is included among similar passivity commitments imposed by the Federal Reserve Board ("FRB").[2]

    - The NYDFS also should not limit arms' length business dealings between a Managed Fund, its investment adviser and an investee Regulated Entity (as contemplated in passivity commitment #4). Such limits may needlessly harm Regulated Entities, which may rely on the expertise of advisers and their Managed Funds to provide various services, including to help manage employee benefit plan assets. So long as such business is at arms' length, it does not raise the same control concerns as other types of relationships.

- Third, the NYDFS should explain the process by which any passivity commitments will be entered into and acted on by the NYDFS. Specifically, the NYDFS should allow an adviser to Managed Funds to submit the passivity commitments outlined in

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[2] *See* Letter from FRB General Counsel to Robert J. Rhatigan (May 6, 2021), available here; Letter from FRB General Counsel to William J. Sweet, Jr. (Dec. 3, 2020), available here; and Letter from FRB General Counsel to Anne E. Robinson (Nov. 26, 2019) (*hereinafter,* "Vanguard Letter"), available here.

the final Guidance and set a reasonable timeframe within which the NYDFS will respond. We believe the Guidance should establish that, if the NYDFS does not object to submitted passivity commitments within a reasonable period of time (say, 30 or 45 days), the Managed Funds should be allowed to assume that the applicable presumption has been rebutted and act accordingly.

- Finally, the NYDFS should make clear that once control is rebutted (whether by way of entry into appropriate passivity commitments or by other means), an adviser's Managed Funds may acquire, in the aggregate, up to 25% of any class of voting stock of a Regulated Entity.

I. Background on Regulated Fund Structures

Regulated Funds, as noted above, are registered under the Investment Company Act and include mutual funds, ETFs and closed-end funds. The investment adviser to a Regulated Fund must be registered with the Securities and Exchange Commission ("SEC") under the Investment Advisers Act of 1940 ("Advisers Act"). Regulated Funds are one type of client served by investment advisers.

Each Regulated Fund is a separate legal entity, organized under state law usually as a corporation or a business trust (in some states, a "statutory trust"). Regulated Funds have officers and directors (if the fund is a corporation) or trustees (if the fund is a trust), including a minimum percentage of independent directors. The Regulated Fund's board oversees the management and operations of the fund and has mandated responsibilities under the Investment Company Act. Unlike traditional operating companies, a Regulated Fund is externally managed and typically has no employees in the traditional sense. Instead, a Regulated Fund relies on service providers, including its investment adviser, to invest fund assets and carry out other business activities.

There is a broad range of Regulated Funds with a variety of investment objectives and strategies. Regulated Funds, including those that share a common investment adviser or other service providers, invest in a wide variety of securities as well as other assets to meet their investment objectives.

Regulated Funds are subject to a comprehensive regulatory scheme under federal securities and other laws.[3] The Investment Company Act and other laws impose substantive requirements on the management and operations of Regulated Funds as well as extensive disclosure and reporting requirements. For example, in their capacity as shareholders in portfolio companies, Regulated Funds must provide disclosure about their proxy voting policies and procedures and publicly report their proxy votes.

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[3] A Regulated Fund is regulated under all four of the major federal securities laws: the Securities Act of 1933, which requires registration of the fund's shares and the delivery of a prospectus; the Exchange Act, which regulates the trading, purchase and sale of fund shares and establishes antifraud standards governing such trading; the Advisers Act, which regulates the conduct of the fund's investment adviser and requires the adviser to register with the SEC; and, most importantly, the Investment Company Act, which requires the fund to register with the SEC and meet certain operating conditions and standards.

A number of Regulated Funds, and other investors, may each engage a single investment adviser, but each fund and investor maintains its own agreement with the investment advisor, with its own investment objectives and strategies. The adviser acts as a fiduciary to each client and, in this capacity, owes *each client* a duty of care and a duty of loyalty. The adviser's duty is to manage a client's assets pursuant to both the separate investment management agreement signed with that client and other ancillary documents that set forth the adviser's obligations and other information related to the adviser's management of a client's assets (e.g., fund prospectus and fund shareholder reports).

II. The NYDFS Should Adopt an Approach to Aggregation that Aligns with the SEC's Approach under the Federal Securities Laws

We appreciate the NYDFS's considered and careful approach to aggregation of different Managed Fund interests in a Regulated Entity. We recommend that, rather than crafting a bespoke approach to aggregation, the NYDFS borrow from and align with the existing framework under the federal securities laws that guides how an investment adviser managing the assets of multiple Regulated Funds and other clients determines when investor positions should be aggregated for purposes of measuring beneficial ownership.

Specifically, under Section 13 of the Exchange Act, any person acquiring beneficial ownership of an equity security registered under the Exchange Act and directly or indirectly the "beneficial owner" of more than five percent of such class of securities must file (publicly) with the SEC certain information. The information and the type of filing required differ based on certain factors, including the person's purpose or effect of changing or influencing control of the issuer. Section 13(g) permits certain investors to file a Schedule 13G rather than the more onerous Schedule 13D. In order to file Schedule 13G, an investor must have acquired the securities with no purpose or effect of changing or influencing the control of the issuer, and not in connection with or as a participant in any transaction having such purpose or effect.[4] Further, specific types of investors are eligible to file on Schedule 13G, such as Regulated Funds and registered investment advisers.[5] Often such investors filing on Schedule 13G are referred to as passive investors.

Advisers with discretionary voting and/or investment authority are generally deemed to be beneficial owners of securities held in discretionary accounts.[6] As passive investors, advisers to Regulated Funds typically file Schedule 13Gs. Thus, funds that are managed by a single investment adviser may have their positions aggregated in a Schedule 13G, but the existing

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4 17 C.F.R. §§ 240.13d-1(b)(1) and (c).

5 *See* id.

6 A Regulated Fund or adviser may be deemed to be a "beneficial owner" of an equity security, for purposes of Section 13(d) or 13(g) of the Exchange Act, if the fund or adviser, directly or indirectly, has or shares (1) voting power, including the power to vote, or direct the voting of, such security; and/or (2) investment power, including the power to dispose or direct the disposition of such security. *See, e.g., Adoption of Beneficial Ownership Disclosure Requirements, Exchange Act Rel. No. 13,291 (Feb. 24, 1977)*; *In re* William R. Grant, Exchange Act Release No. 26,339 (Dec. 5, 1988).

federal framework typically will not require all of the funds within a single complex to aggregate positions that are managed by different investment advisers.

The NYDFS should adopt the same position. In fact, we know of no compelling reason for the NYDFS to adopt a different approach. Aggregating funds that are independently advised or sub-advised is not required by statute or by policy and, instead, would create new compliance complexities and challenges for advisers, which are accustomed to, and currently operate, compliance and reporting systems based on the federal securities' law aggregation requirements.

III. The NYDFS's Proposed Passivity Commitments Should Be Modified in Certain Respects from What Has Been Proposed and Their Use Should Be Clarified

As noted above, when an investment adviser has filed a Schedule 13G with respect to the holdings of its Managed Funds, the adviser has indicated that it is investing with no intent to change or influence control of the issuer. We recommend that NYDFS account for this passive investment posture in considering whether it will require passivity commitments at all. If the NYDFS determines that passivity commitments are warranted, we recommend streamlining and simplifying those commitments wherever possible. We request at least two specific changes.

First, passivity commitment #1, the mirror voting requirement, should be removed. The NYDFS should not require mirror voting of Excess Shares because, given the other commitments, the ability to vote such share positions does not create any risk of control of Regulated Entities. Voting decisions by advisers to Managed Funds that have entered into passivity commitments with the NYDFS and/or filed Schedule 13Gs are not made to control the policies or management of any Regulated Entity.

In addition, mirror voting may have detrimental consequences. Mirror voting dilutes the voting power of an adviser's Managed Funds, resulting in each having less than "one share, one vote." In contested and close votes, mirror voting could hamper a Managed Fund's ability to promote long-term value for its shareholders. Mirror voting also amplifies the voting power of other large shareholders, which in effect gain additional voting power without acquiring additional shares. These shareholders may not be passive and, instead, may be focused on seeking control. Further, in practice, mirror voting almost always fails to replicate the "non-mirror" voted results because it omits votes cast immediately prior to or at the shareholder meeting.[7] Finally, mirror voting is a manual process involving numerous third parties, which introduces the risk of operational mistakes and costs to the proxy voting process.

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[7] In administering the proxy voting process, a Regulated Fund complex typically engages a third-party service provider to coordinate manually with a company's proxy tabulator to vote the Regulated Funds' Excess Shares based on votes cast. As a practical matter, this initial tabulation must be conducted prior to the shareholder meeting. As a result, votes cast after this cut-off date, which can be substantial or even decisive, do not factor into how mirror votes are cast.

For these reasons, the FRB has dispensed with previously mandated mirror voting requirements under the federal change in bank control regime.[8] The FRB explained that eliminating mirror voting, which it had previously required of advisers to Managed Funds, "more closely align[s] … commitments with traditional passivity commitments, and . . . have the potential to improve the corporate governance of [banking organizations]."[9] We hope that the NYDFS will take note of the lessons learned by the FRB in this regard. Alternatively, if the NYDFS does require mirror voting, it should allow flexibility in the process, including by, for example, allowing the use of a proxy vendor.

Second, passivity commitment #4, limiting business dealings between a Managed Fund or its manager and a Regulated Entity should be revised to allow all arms' length business dealings. Without this change, this passivity commitment could have negative impacts on Regulated Entities. For example, Regulated Entities may rely on Managed Funds and their investment advisers for asset management services, particularly in support of 401(k) plans and other retirement plans. It is important to ensure that such services, provided at arm's length, are not restricted, as that could have needless negative consequences for Regulated Entities and their employees (which may be denied necessary asset management and related services on the most cost-effective basis). These arms' length services are not apt to pose a risk of undue influence over a Regulated Entity. In this regard, we note that the FRB does not limit arms' length business dealings with regulated banks in its parallel passivity commitments.[10]

Finally, advisers should be able to enter into one set of passivity commitments with the NYDFS that rebut any presumption under each of the applicable regulations/statutes with respect to all NYDFS Regulated Entities. We also believe that advisers should be able to submit whatever commitments are outlined in the final Guidance and, unless the NYDFS objects within a reasonable period (30 or 45 days), assume that the applicable presumption is rebutted. Extensive delays in the process can be costly, forcing Managed Funds to use alternative means (such as purchasing costly derivative positions) to acquire the economic exposure to issuers as directed by their clients while keeping aggregate holdings under applicable thresholds pending action by the NYDFS.

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[8] *Compare* letters cited in *supra* n. 2 *with*, *e.g.*, Letter from FRB General Counsel to Satish Kini (Apr. 11, 2013) (requiring mirror voting), available here.

[9] *See* Vanguard Letter, *supra* n. 2, at 4.

[10] *See supra* n. 2.

IV. The NYDFS' Control Presumption Should Be Rebutted up to 25% of a Regulated Entity's Voting Stock

Finally, once the NYDFS is satisfied that an investment adviser and its Managed Funds have appropriately rebutted the presumption of control, whether by entering into passivity agreements or by other means, the NYDFS should allow the adviser, on behalf of its Managed Funds, to invest in up to 25% of the voting stock of a Regulated Entity.

Once the adviser and Managed Funds have demonstrated that the funds are passive investors, it is in the best interest of both the funds and their shareholders to permit ownership up to a 25% threshold without a determination of control. This will provide maximum flexibility for the funds to fulfill their investment purposes without undue cost and burden and, given the assurances of passivity, without impermissible involvement in the management of the Regulated Entities.

This approach also is taken by the federal banking agencies, such as the FRB, under the federal Change in Bank Control Act.[11]

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We appreciate the opportunity to comment on this significant proposal. If you have any questions, please contact me (202-326-5813 or solson@ici.org) or Rachel Graham, Associate General Counsel (202-657-7931 or rgraham@ici.org).

Regards,

/s/ Susan M. Olson

Susan M. Olson
General Counsel

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[11] 12 C.F.R. § 225.41(c).