ADVANTA®

Advanta Corporation
Government Relations Office
1301 Pennsylvania Ave, NW
Suite 500
Washington, DC 20004
(202) 347-1289
(202) 347-6876 (facsimile)

October 10, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Room 3060
550 17th Street, NW
Washington, D.C. 20429

Attention: Comments/Legal ESS

Dear Mr. Feldman:

Statement of Interest

This letter is filed on behalf of Advanta Corp. ("Advanta") in response to the Notice of and Request for Comment on issues related to industrial loan companies and industrial banks, 71 *Federal Register* 163 (August 23, 2006).

Advanta is the parent company of Advanta Bank Corp., an industrial bank chartered under the laws of the state of Utah and insured by the FDIC. Advanta Bank Corp. is one of the nation's leading issuers of MasterCards to small businesses. As such, Advanta has a keen interest in this issue.

Advanta appreciates this opportunity to share its views as the FDIC reviews issues dealing with the chartering, ownership, and supervision of industrial banks. We commend the FDIC for its timely examination of what has become a controversial issue.

General Comments

Advanta believes the current regime governing the chartering and examination of industrial banks both protects the safety and soundness of the financial system while allowing for new financial institutions to enter the marketplace.

While this Notice and Request for Public Comment raises a number of public policy questions, we are concerned that it will result in yet another organized out-pouring of "grass roots" letters from those who veil their anti-competitive positions behind a mask of concern about the financial system.

As former FDIC Chairman Powell put it:

> *"... ILCs today exist at the intersection of many developments in the financial system and raise a number of legitimate issues.* ***However, I believe that some opponents of ILCs may be blurring the facts in order to make their case.*** *For example, some ILC opponents have raised the issue of the complexity of ILCs and the ability of the FDIC and the states to adequately supervise them. We deal with complexity every day. It is our job."* (Remarks entitled "The ILC Debate: Regulatory and Supervisory Issues" before the Conference of State Bank Supervisors (CSBS), May 30, 2003, PR-52-2003, emphasis added).

Sharing these concerns, former Comptroller of the Currency Jerry Hawke put it this way:

> *"[There is] a virtual total lack of evidence in the U.S. that affiliations between banks and nonbank firms present serious threats to the banking system.* ***[Critics] are very frequently motivated less by philosophy than by a desire to segment markets in order to diminish competition."*** (See *American Banker,* November 17, 2005, emphasis added).

We believe that the FDIC itself has the expertise to dispassionately review and answer the questions posed herein. The FDIC has access to the business plans, exam reports, CAMELS ratings and data points of all industrial banks. They will show a healthy vibrant industry serving millions of customers.

This year, after a lengthy effort spanning the administrations of former FDIC Chairs Tanoue, Powell and Gruenberg, Congress enacted comprehensive deposit insurance reform.

This important legislation was based on the FDIC's exhaustive review of the deposit insurance system dealing with pricing, fund maintenance and coverage culminating, in April 2001, with the publication of a set of recommendations which formed the foundation for the legislation.

This multiple year effort encompassed the current period of growth of ILC charters. At no time did the FDIC, or Congress, make *any* finding that ILCs posed any unique risk to the fund or warranted any different regulatory treatment.

Absent any, as yet undiscovered, showing of systemic risk, we believe the current effective and efficient regulatory and supervisory structure should remain unchanged.

Current FDIC Regulatory Oversight

Before making specific comments, an overview of the FDIC's current regulatory authority over ILCs and their parent companies is useful.

12 U.S.C. Section 1820 (B) specifically authorizes the FDIC to examine bank affiliates and their holding companies. This allows the FDIC to determine the relationship of a depository institution to its holding company and affiliates and the effect of such relationships on the depository institution.

The FDIC routinely uses this authority to examine both owners and affiliates of ILCs. The FDIC's examiners are well aware of their authority to examine bank affiliates and have been specifically instructed to review pertinent transactions between industrial loan banks and owners that are not bank holding companies as part of the examination process (*See, e.g.*, FDIC Office of Inspector General Audit Report No. 00-022 (June 7, 2000), p.36.

Former FDIC Chairman Powell discussed this oversight in remarks at a May 2003 CSBS meeting. After describing the FDIC's examination of ILCs ("these organizations are rigorously and sufficiently supervised by the state supervisors and the FDIC on an ongoing basis"), he addressed concerns about the oversight of the banks' parent companies:

> "While I understand these concerns, ***the FDIC has - and often uses – a number of tools to manage both the holding company's involvement with the financial institution, and to manage transactions between the two entities.***
>
> We can and do visit the parent companies - and other affiliated entities for that matter - to look over issues or operations that could impact the insured institution. Congress has given us the power to protect the integrity of those relationships. We have exercised that power, and we have coordinated closely with you – the state regulators – in our work. We have found parent companies of ILCs to be acutely conscious of their responsibilities with respect to their ILC subsidiaries and the consequences of violating applicable laws and regulations.
>
> * * *
>
> We at the FDIC must all be vigilant in our supervisory role. But I will reiterate: ***The FDIC believes the ILC charter, per se, poses no greater safety and soundness risk than other charters.***
>
> ***Further, the firewalls and systems of governance safeguarding ILCs from misuse by their parent companies are, in many cases, more stringent than***

> ***what exists in many affiliates of bank holding companies.*** In part, the generally positive experience of the ILC charter in recent years is attributable to a continually evolving supervisory approach that considers each institution's purpose and placement within the organizational structure." (Emphasis added).

The "prompt corrective action" provisions of 12 U.S.C. 1831 (o) subjects ILC owners to regulatory oversight to prevent deterioration in the depository institution's capital adequacy.

It prohibits insured institutions from making capital distributions (or paying management fees) to their holding companies if such payments would cause the institution to become undercapitalized. It requires depository institutions (including ILCs) that become undercapitalized to prepare capital restoration plans that include a guarantee from the institution's holding company of the bank's compliance with the plan. And, in the event an insured institution (including an ILC) becomes significantly undercapitalized, they authorize regulators to order the bank's holding company to divest non-depository affiliates that pose a significant risk to the institution, or to divest the institution itself.

The FDIC exercises its authority in the course of visitations to industrial bank holding companies and affiliates (often in conjunction with examinations by the banks' state regulators). The financial strength of the holding company, and its ability to serve as a source of strength for the financial institution, is initially assessed through a review of the holding company's financial reports and financial statements, and of other documentation furnished at the request of FDIC or state examiners.

Examiners' on-site visits include reviews of the adequacy of holding company internal controls, and treasury, cash management, audit, credit, information technology and other functions. These examinations include an examination of loan transactions, a review of hedging activities, and an analysis of functions such as trading activities that holding company affiliates may perform for the bank.

The FDIC's authority over ILCs and their owners allows it to address concerns about conflicts of interest, concentrations of power, or expansion of the federal safety-net that are sometimes voiced (most often by competitors) about the relationship of industrial loan banks to their holding companies. Former Chairman Powell was clear that the FDIC has the regulatory authority it needs to prevent abuses:

> "In our view, Congress has given us good tools to manage the relationship between parents and insured subsidiaries. These are a great help in preventing the problems that have been identified with this sort of business arrangement – indeed the FDIC manages these relationships every day in the industrial loan company model with little or no risk to the deposit insurance funds – and no subsidy transferred to the nonbank parent." (Remarks of

Donald E. Powell before American Bankers Association Annual Meeting, October 8, 2002).

The questions posed herein also raise a number of, as yet undefined, issues. They speak of "commercial" versus "financial" owners of ILCs and discuss the role of consolidated supervision. Yet these issues are intertwined.

Some long-time parent companies of ILCs include the largest manufacturing companies in the world. Some of these are, because of their ownership of unitary thrifts, subject to consolidated supervision by the OTS. Others are not.

Some long-time parent companies of ILCs, like Advanta Corp., are financial companies without commercial affiliations; yet do not have consolidated supervision at the parent company. Other financial companies are subject to consolidated supervision by the OTS or the SEC.

It is precisely this diversity that has made the current FDIC model of bank-centric regulation so efficient and effective.

Again, absent any showing of systemic risk, disproportionate risk to the Deposit Insurance Fund, or lack of some necessary authority, we believe the current regulatory and supervisory structure should remain unchanged.

Specific Responses

1. *Have developments in the ILC industry in recent years altered the relative risk profile of ILCs compared to other insured depository institutions? What specific effects have there been on the ILC industry, safety and soundness, risks to the Deposit Insurance Fund, and other insured depository institutions? What modifications, if any, to its supervisory programs or regulations should the FDIC consider in light of the evolution of the ILC industry?*

Advanta is unaware of any difference in the risk profile of industrial banks *vis a vis* any other type of FDIC-insured bank charter.

2. *Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund differ based upon whether the owner is a financial entity or a commercial entity? If so, how and why? Should the FDIC apply its supervisory or regulatory authority differently based upon whether the owner is a financial entity or a commercial entity? If so, how should the FDIC determine when an entity is "financial" and in what way should it apply its authority differently?*

As outlined in our general comments and in our answer to the first question, we believe whether the owner of an ILC is a commercial or financial entity has no bearing on the risk to the fund.

3. Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund differ based on whether the owner is subject to some form of consolidated Federal supervision? If so, how and why? Should the FDIC assess differently the potential risks associated with ILCs owned by companies that (i) are subject to some form of consolidated Federal supervision, (ii) are financial in nature but not currently subject to some form of consolidated Federal supervision, or (iii) cannot qualify for some form of consolidated Federal supervision? How and why should the consideration of these factors be affected?

While the bulk of ILC assets are in banks whose parent companies are subject to OTS or SEC oversight at the parent, a number of ILCs, ours included, are owned by parent companies not subject to consolidated supervision.

Advanta is unaware of any empirical evidence suggesting that banks subject to consolidated supervision are any stronger or pose any lessened risk to the insurance fund than those without supervision at the parent company.

There are thousands of banks throughout the country that either do not have consolidated supervision or, in the case of single bank holding companies, have minimal supervision at the parent company. Other banks exempted from holding company supervision include financial institutions that do not offer a full range of banking services, such as credit card banks, Edge Act banks, grandfathered "nonbank banks," grandfathered "unitary thrifts," and trust banks.

4. What features or aspects of a parent of an ILC (not already discussed in Questions 2 and 3) should affect the FDIC's evaluation of applications for deposit insurance or other notices or applications? What would be the basis for the FDIC to consider those features or aspects?

The FDIC should continue to evaluate ILCs in the same manner as any other bank charter application with an emphasis on safety and soundness, and public need and convenience. The extent that a parent company impacts this or provides a potential source of strength in capital, management expertise, or product innovation, are factors the FDIC should continue to evaluate.

5. The FDIC must consider certain statutory factors when evaluating an application for deposit insurance (see 12 U.S.C. 1816), and certain largely similar statutory factors when evaluating a change in control notice (see 12 U.S.C. 1817(j) (7)). Are these the only factors FDIC may consider in making such evaluations? Should the consideration of these factors be affected based on the nature of the ILC's proposed owner? Where an ILC is to be owned by a company that is not subject to some form of consolidated Federal supervision, how would the consideration of these factors be affected?

12 U.S.C. 1816, entitled "Factors to be considered," contains no general grant of agency authority to decide eligibility for deposit insurance, instead, before again listing specific factors, stating:

> "**The factors that are required**, under 1814 of this title to be considered in connection with, and enumerated in, any certificate issued pursuant to section 1814 of this title and that are required, under section 1815 of this title, **to be considered by the Board of Directors** in connection with any determination by such Board pursuant to section 1815 of this title **are the following**..." (Emphasis added).

12 U.S.C. 1817 (j) (7) is equally specific stating the reasons that the appropriate Federal banking agency may disapprove a proposed acquisition of control. It contains no broad grant of authority to the FDIC, or, indeed, any other agency to create additional reasons.

The statute does not address the issue of whether the applicant is subject to consolidated supervision at the parent company level any more than if the applicant was an independent bank owned by an entrepreneur or family that own a host of other businesses.

While it is clear, from the public filings during the FDIC's extraordinary field hearings on the application for an ILC charter by a large retail chain, that some oppose that application and the charter in general, a public hue and cry does not justify ignoring the plain meaning of a statue.

The Supreme Court of the United States put in plainly: "Nothing is better settled than that statutes should receive a sensible construction, such as will effectuate the legislative intent, and, if possible, so as to avoid an unjust or absurd conclusion." See *Lau Ow Bew v. United States*, 144 U.S. 47, 59 (1892).

In this case, a sensible reading of the statute enumerates the factors to be considered by the FDIC.

6. Should the FDIC routinely place certain restrictions or requirements on all or certain categories of ILCs that would not necessarily be imposed on other institutions (for example, on the institution's growth, ability to establish branches and other offices, ability to implement changes in the business plan, or capital maintenance obligations)? If so, which restrictions or requirements should be imposed and why? Should the FDIC routinely place different restrictions or requirements on ILCs based on whether they are owned by commercial companies or companies not subject to some form of consolidated Federal supervision? If such conditions are believed appropriate, should the FDIC seek to establish the underlying requirements and restrictions through a regulation rather than relying upon conditions imposed in the order approving deposit insurance?

Along with the impediments to this described in our answer to Question 5, imposing different restrictions or requirements on different classes of applicants runs afoul of yet another, very specific, statutory provision in the FDIC's organic statute.

That provision, the nondiscrimination clause, 12 U.S.C. 1830, states, in relevant part:

> "It is the purpose of this chapter to provide **all** banks and savings associations with the same opportunity to obtain and enjoy the benefits of this chapter." (Emphasis added).

Absent a statutory change requiring disparate treatment for insured ILCs that are either commercially owned or do not a have consolidated supervisor at the parent company level, the FDIC lacks the authority to treat ILCs differently than any other applicants for deposit insurance.

It is difficult to see how this statutory hurdle can be overcome via a regulatory rulemaking.

7. Can there be conditions or regulations imposed on deposit insurance applications or changes of control of ILCs that are adequate to protect an ILC from any risks to safety and soundness or to the Deposit Insurance Fund that exist if an ILC is owned by a financial company or a commercial company? In the interest of safety and soundness, should the FDIC consider limiting ownership of ILCs to financial companies?

No commercially-owned ILC has ever failed. No commercially-owned ILC has caused any loss to the Deposit Insurance Fund. There is simply *no* empirical evidence to suggest that commercially-owned ILCs present any unique safety and soundness risk.

If the FDIC identifies specific characteristics or conduct at a specific bank, or identifies concerns about a specific commercial owner of an ILC, its already comprehensive application, examination, and enforcement powers should dispose of the matter.

8. Is there a greater likelihood that conflicts of interest or tying between an ILC, its parent, and affiliates will occur if the ILC parent is a commercial company or a company not subject to some form of consolidated Federal supervision? If so, please describe those conflicts of interest or tying and indicate whether or to what extent such conflicts of interest or tying are controllable under current laws and regulations. What regulatory or supervisory steps can reduce or eliminate such risks? Does the FDIC have authority to address such risks in acting on applications and notices? What additional regulatory or supervisory authority would help reduce or eliminate such risks?

The provisions of Sections 23A and 23B apply fully to ILCs. Compliance with these provisions, as well as any other covered transactions, is part of the regular safety and soundness examinations and, in the case of *de novo* or change of control applications, one of the metrics that are reviewed in the application process by both the FDIC *and* the appropriate state banking regulatory agency.

We believe that the business plan of any applicant should fully reflect the purpose and extent of transactions between affiliates as well as disclose any other relationships or proposed transactions that pose potential conflicts of interest.

9. Do ILCs owned by commercial entities have a competitive advantage over other insured depository institutions? If so, what factors account for that advantage? To what extent can or should the FDIC consider this competitive environment in acting on applications and notices? Can those elements be addressed through supervisory processes or regulatory authority? If so, how?

This question raises a disturbing issue: Does the FDIC believe that it, or indeed any banking agency, should be the arbiter of competition; or that it can or should decide, *sua sponte*, when a particular class of institution has an advantage?

There will be times when an ILC owned by a commercial company is advantaged when it leverages existing business relationships with customers. There will be times when a bank holding company with global reach may leverage its broad array of services to the disadvantage of a competing, more specialized, ILC to win customers.

There will be times where a community bank can use its local business and social relationships to take customers from an ILC or a large global bank holding company. In all the instances, it is the customer, acting through the free marketplace, who decides who has the competitive advantage.

In any case, it is difficult to see how ILCs have any systemic competitive advantage over other banks. Collectively, ILCs represent less than 1.4% of total bank assets and an infinitesimal amount of total bank branches. The deposits of the *entire* industry are just over $111 billion or, to put in perspective, approximately 1/5 of the insured deposits of Bank of America *alone.*

At the same time, no global financial holding company has chosen to surrender its charters, bid the Federal Reserve Board a fond farewell, and decamp to Nevada or Utah to avail itself of some real or perceived competitive advantage.

10. Are there potential public benefits when a bank is affiliated with a commercial concern? Could those benefits include, for example, providing greater access to banking services for consumers? To what extent can or should the FDIC consider those benefits if they exist?

All ILCs, whether owned by commercial manufacturing companies or nonbank financial services providers, meet the public needs and convenience test used by the FDIC when evaluating an application for a *de novo* charter or a change of control. To the extent that consumers, or indeed all types of customers, benefit from additional competition and innovation, commercially owned ILCs are beneficial.

Additionally, in the case of an ILC owned by a well-capitalized commercial firm, the parent company serves as a source of strength to the operating bank, thereby mitigating risk to the Deposit Insurance Fund.

11. In addition to the information requested by the above questions, are there other issues or facts that the FDIC should consider that might assist the FDIC in determining whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs?

We believe that the FDIC should carefully consider the role and the experience of its partner agencies in the regulation of ILCs, namely the state banking agencies. We also believe that the legislative and policy decisions made by the state legislatures in states which charter ILCs should receive consideration and deference.

For example, the parent companies of ILCs, like the banks they control, are subject to state regulation. In the case of Utah, where Advanta Bank Corp. is chartered, the Financial Institutions Act requires owners of ILCs to register with the Utah Department of Financial Institutions and provide statements of financial condition. Utah also mandates that a majority of the members of the board of directors of an ILC be outside directors, unaffiliated with the bank's parent company.

Lending to parent companies and affiliates is limited to 15% of bank capital unless a higher amount is allowed under Federal law. The Utah Commissioner is authorized by law to examine the books and records of financial institution holding companies, compel the furnishing of reports necessary to supervise the holding company's bank subsidiary, *and take any other action that is necessary to protect the bank,* its depositors, its customers or taxpayers (*See* Utah Code Annotated, Section 7-1-510).

State laws governing industrial loan banks also address the qualifications of businesses that own or control them.

While not the case in Nevada or Utah, Section 701.1 of California's Financial Code requires that companies seeking to control these institutions engage only in activities permissible under federal law for financial holding companies. This requirement makes a company engaged in commercial (or other) activities that are not "financial in nature" under the Gramm-Leach-Bliley Act ineligible to acquire an industrial loan bank in California.

California has made one policy choice. Nevada and Utah have chosen a different path. The fact that these three states which house the bulk of the ILCs have different legislative and regulatory structures reflects the diversity of the charter.

They have this in common: their *elected* state legislatures have made their policy decisions as to who can own ILCs. We believe the FDIC should consider the wishes of the states as it ponders the issues raised in these questions—especially in light of suggestions to limit the ownership of an entire class of legally chartered institutions by preempting state banking law.

Similarly, we recommend that the FDIC consider these questions, as well as the underlying moratorium, in the context of the decline of the state bank charter. Whether caused by the growing concentration of banking in the hands of a few mega-holding companies or by the appeal of a federal charter whose powers have grown through aggressive administrative preemptions, the state charter has been in decline.

Although the state system retains 71% of the bank charters, as of year end 2005 national banks and thrifts hold more than two-thirds of the total assets in the banking system, leaving the state system with approximately 33%. Compare that to 2003, when state banks' share of total assets was around 45%.

Although, as noted in our response to Question 9, a tiny part of the total banking system, the ILC charter is one of the few exceptions to this shift to the federal charter. The role ILCs play in maintaining a vibrant dual banking system is well recognized. For example, testifying before a 2003 House subcommittee hearing, then Assistant Secretary of the Treasury for Financial Institutions Wayne Abernathy put it this way:

> I think ILCs are a great example, emblematic of the strength of the constitutional federal system of government that we have. They are emblematic of the kind of variety that we have in financial institutions because of the innovation that our dual banking system allows. We have federal institutions, we have state institutions that offer different kinds of services to meet the needs of consumers, whether they are individuals or businesses. (*See* Testimony of Hon. Wayne Abernathy on the Business Checking Freedom Act of 2003 before the Subcommittee on Financial Institutions and Consumer Credit, March 5, 2003 at http://commdocs.house.gov/committees/bank/hba87234.000/hba87234_0.HTM.)

Again, we believe the FDIC should examine the ILC charter in the context of maintaining the dual banking system which has characterized our nation's banking system for more than 140 years.

12. Given that Congress has expressly excepted owners of ILCs from consolidated bank holding company regulation under the Bank Holding Company Act, what are the limits on the FDIC's authority to impose such regulation absent further Congressional action?

Since Congress specifically exempted the owners of ILCs from registering under the Bank Holding Company Act of 1956 and numerous amendments thereto (along with other bank charters enumerated in our answer to Question 3), we do not believe that consolidated supervision can be imposed via regulation or by rulemaking.

The FDIC has the ability, through its application, examination, and enforcement powers, to address any concerns about the viability or conduct of any insured bank—regardless of its specific form of charter. This has been and, we believe should be, sufficient to address any safety and soundness issues without additional holding company regulation.

Absent some specific statutory authority under the Bank Holding Company or FDI Acts, attempting to restrict ILC owners not subject to consolidated supervision goes beyond the intent of Congress *and* would effectively preempt the state legislatures which have enacted laws dealing with the chartering and ownership of ILCs. The latter would be yet another blow to the continued viability of the dual banking system.

Conclusion

The FDIC and the state banking agencies have a strong record of proactive, effective and efficient regulation of ILCs under current law. We believe this should remain unchanged.

We urge the agencies to carefully consider the comment letters filed on behalf of the trade associations which represent the interest of the ILC industry, namely the American Financial Services Association, the Securities Industry Association and the Utah Association of Financial Services.

Thank you for the opportunity to participate in this vital rulemaking.

Sincerely,

Frank M. Salinger
Vice President, Government Relations
fsalinger@advanta.com