INTRODUCTION

Holding company[1] regulation is an increasingly significant part of our supervision of the thrift industry. At the time of publication, there were 530 holding company enterprises that controlled 543 thrifts. These thrift institutions represented over 50 percent of the industry and controlled over 92 percent of the industry's assets.

A preponderance of thrift holding companies are "shell" organizations that do not engage in any significant activities beyond the ownership of the thrift. However, a substantial number are large businesses or major complexes having more than one holding company along with numerous non-insured subsidiary companies. Companies that currently own thrifts include:

- Securities broker/dealers
- Insurance underwriters and agents
- Manufacturing firms
- Retail companies.

Up until the mid 1990s, the relatively few commercial firms and insurance companies that owned thrifts generally operated these entities independently from the operations in other parts of the organization. Many of these firms looked at their thrift investment as a means of diversifying their operations, not as a critical component of their main business.

During the mid 1990s, however, many financial firms, especially insurance companies and securities firms, determined that it would be in their best interest to offer customers a complete array of proprietary financial products – insurance policies, savings accounts, mortgage loans, credit cards and trust services – all under one roof. Unlike bank holding companies, unitary thrift holding companies could engage in a broad range of activities, including commercial, retail, and financial activities. The passage of the Gramm-Leach-Bliley Act in 1999 restricted commercial firms from owning thrifts; however, existing organizations were grandfathered.[2] The legislation also provided a process by which bank holding companies could elect to become "financial holding companies" that can engage in expanded financial activities, including insurance and securities.

This Handbook outlines our current approach to holding company supervision. This approach is flexible enough to apply to the most complex structures as well as the shell structures, the grandfathered and the nongrandfathered, the low risk as well as the high risk, and the healthy as well as the troubled holding company structures. In other words, this approach allows you to recognize the unique issues presented by any holding company enterprise, meaning the entire corporate structure or "family" associated with the holding company.

More importantly, this Handbook also provides guidance to assess the risks that holding company enterprises pose. It considers the combined risk profile, financial health and stability of the consolidated enterprise, as well as the degree of interdependence between the thrift and its affiliates. Examination conclusions are based on the current and prospective effect holding company enterprises have on their subsidiary insured thrifts.

SUPERVISORY STRATEGY

The Application Process

Prior to organizing or acquiring a thrift, a company is required to undergo a rigorous application process during which OTS intensively scrutinizes its proposed business plan for the insured thrift.

[1] When referring to "holding company" in this Handbook, you should assume it to mean "savings and loan holding company" unless specifically noted otherwise. Similarly, the term "thrift" should be read literally as "savings association."

[2] For more details on the different type of holding companies and activities restrictions, refer to Organizational Structure Section 400.

This rigorous review encompasses the capital structure, managerial expertise and overall integrity of the company. The objective of this process is to ensure that the applicant has the financial and managerial resources to assure the thrift will be operated in a safe and sound manner without jeopardizing the thrift or the deposit insurance funds.[3]

During the application process we address specific concerns we may have with the applicant's proposal. For example:

- If we believe the thrift does not have its own separate corporate identity and may have difficulty operating successfully on a stand-alone basis, we may require the thrift to hire more qualified full-time individuals in key positions, and to perform core business functions within the thrift itself. We seek to strike a balance between allowing holding companies to leverage the synergies of the overall organization and independence on the part of the thrift.
- If the applicant plans to rely on a network of agents or brokers for referral business, we make sure that proper controls are in place and that these representatives will receive comprehensive training.
- If we believe there is a risk that key decision makers working at both the thrift and the holding company could encounter conflicts of interest, we may require the thrift to appoint independent directors.
- If the thrift is heavily reliant on affiliates for funding, we may require the holding company to establish a segregated ear-marked deposit with the thrift, or that the thrift diversify its funding sources.
- If the proposal involves an elevated degree of risk, such as Internet banking or subprime lending, we may require the thrift to hold more capital than the minimum required under our regulations or diversify operations.

[3] Section 500 of the Applications Processing Handbook provides detailed holding company acquisition guidelines. The Applications Processing Handbook is available on the OTS website at www.ots.treas.gov.

Categorizing Holding Company Enterprises

Once the application is approved, and the thrift is formed or acquired, the resulting holding company enterprise is subject to our risk-focused approach to supervision and examination. Based on our analysis of the application, we first assign the holding company enterprise to one of the following two categories:

Category I	Noncomplex or relatively low risk thrift holding company enterprises.
Category II	Complex or higher risk holding company enterprises.

Dividing the holding company population in this manner helps us to more efficiently allocate examination resources, and assists managers in examination scheduling and planning. We expect that Category II holding company enterprises will, in most cases, require a more intense examination.

We will determine the complexity and level of risk by considering all of the following:

- Types of activities and assets of the holding company and its significant affiliates;
- Thrift's dependence on the holding company and other affiliates to perform core functions;
- Thrift's funding method, especially reliance on intercompany borrowings;
- Type and character of intercompany transactions;
- Thrift's significance within the holding company enterprise;
- Financial strength and stability of the holding company; and
- Examination or other supervisory findings at the holding company or subsidiary thrift.

A detailed checklist is contained in the Administrative Program, Section 710 to help determine which category a holding company enterprise should be given. The checklist is used not only at the conclusion of the application analysis, it is also used in preexamination analysis, as more fully explained in Administration Section 200. The category designation directs you to the appropriate holding company examination program.

The Off-site Monitoring Process

Off-site monitoring of the holding company enterprise is conducted between regularly scheduled examinations, and includes a review of reports filed by holding companies. These reports provide detailed information about the structure, activities, management and financial condition of the holding company and its subsidiaries.

In March 2001, we began collecting electronic financial data on holding companies. This data is filed quarterly by the subsidiary thrift along with its Thrift Financial Report. For most holding company enterprises, we have designated one holding company to provide this financial information. In some cases, where more than one distinct ownership path exists, there may be more than one designated filer.[4] Additionally, holding companies file H(b)-11 reports quarterly with the regional office.

Off-site monitoring also relies heavily on private sector information to supplement our own analysis, such as stock analysts' reports and ratings, securities filings, as well as the actual volume and prices of various holding company securities on the public markets. Such information will help identify issues to discuss with management. In addition, in enterprises that have another primary regulator, we will leverage off their information and resources.

Reviewing public reports and key financial data provide us an effective means to identify, and sometimes mitigate, potential problems, without being overly intrusive in the day-to-day operations of the holding company. Communication with management between examinations enhances our supervisory efforts, and keeps us informed of any changes in strategic direction or significant transactions that have the potential to adversely impact the thrift. Section 800 provides an overview of the information collected by OTS. Specific ratios are suggested for monitoring financial trends. By using this information, we are better poised to identify outliers and shifts in trends that will often prompt an informal inquiry.

The On-site Examination Process

On-site holding company examinations are conducted concurrently with the lead insured thrift on a 12 or 18-month cycle, depending on the size and rating of the thrift. The cost of examinations of holding companies, including their other subsidiaries, is assessed against, and paid by, the holding companies. The bill is generally sent to the top-tier[5] holding company, however, you can designate the appropriate company for billing in the Examination Data System (EDS).

The holding company examination focuses on the entire holding company enterprise as opposed to individual registered holding companies. This is the case even if most of your review is devoted to one company within the structure. You must at least consider the organizational structure of the holding company enterprise to determine where the risks lie and where you will devote examination resources. This approach is not meant to imply that you will conduct an in-depth review of every company within the structure. Instead, as noted under the Risk-Focused Approach discussion below, you will determine the scope based on the unique circumstances of each holding company enterprise.

In most cases you will perform one holding company examination, even if multiple tiers of indirect ownership exist. For ease of reference, this examination is electronically stored under the docket number of what is referred to as the "top-

[4] The line items reported on Schedule HC of the Thrift Financial Report and detailed instructions are contained in the Thrift Financial Report Instruction Manual. This manual is available on the OTS website at www.ots.treas.gov.

[5] The top-tier company is the highest level of ownership by a registered holding company.

tier" holding company. Only in situations where the thrift is controlled by more than one holding company that are in distinct ownership paths, may you need to conduct a separate examination for each ownership path.

You will document the examination in a report and assign a composite rating for each examination conducted. In addition, you will assign specific component ratings for complex or higher risk holding company enterprises (Category II).

More specific instructions on these aspects of the holding company examination are contained in Administration Section 200.

RISK-FOCUSED APPROACH

Determining Scope

OTS has the responsibility to identify and control risks that threaten a thrift's safety and soundness. Holding company examinations are risk-focused, meaning that the primary objective is to examine the holding company enterprise in the areas that pose the greatest risk to the thrift subsidiary.

An initial examination scope should target the areas of the holding company/thrift relationship that have higher than normal risk characteristics. A risk-focused philosophy implies that:

- Circumstances will determine the scope of the examination on a case-by-case basis;
- Minimum scope will consist of procedures that are sufficient to assess the significant risks to the subsidiary thrift; and
- Examination procedures will not incorporate every possible aspect of a full-scope examination.

You must ensure that each examination is carefully focused and tailored to the risks posed to the subsidiary thrift by the holding company and other affiliates. This risk-focused approach should enable you to efficiently manage available time and resources. **You are not required to perform every procedure in the holding company examination program**. Instead, you should use judgment to determine the level of review, testing, and analysis necessary to determine the effect of the holding company enterprise on the thrift.

There is no predetermined limit on the examination scope. As additional information indicates a greater degree of risk, the scope may be expanded. For example, the scope of an examination may be expanded if:

- Inadequate, inaccurate, or misleading information is reported in regulatory filings or if filings are frequently revised;
- Numerous affiliate or insider transactions occur between the thrift and its affiliates or insiders, or between the holding company and other affiliates or insiders;
- Substantial changes in holding company management, corporate structure, or ownership occur;
- Substantial changes in operations and financial condition are noted in the holding company enterprise;
- Poor financial condition, inadequate cash flow, or high leverage is found in the holding company enterprise;
- The holding company is perceived to adversely influence the thrift's operations or the thrift's operations are highly integrated with the corporate enterprise;
- The holding company enterprise is adversely affecting the thrift's financial resources through management fees, cash dividends, excessive tax payments, or affiliated transactions;
- The prior holding company or thrift examination revealed other significant concerns that need to be reassessed;
- The current thrift subsidiary examination is raising significant issues related to the holding company enterprise;

- The credit rating of the holding company's debt, if any, is downgraded by a national credit rating service, especially to a noninvestment grade; or
- The stock price of a publicly traded holding company declines substantially more than anticipated relative to a general stock market index.

EXAMINATION COMPONENTS

This Handbook contains detailed guidance and examination procedures for each of the primary areas of review in a holding company examination. There are three generic holding company examination programs, these are:

- Administrative Program, Section 710;
- Abbreviated Holding Company Examination Program; Section 720; and
- CORE Holding Company Examination Program, Section 730.

For all holding company enterprises, you start with the Administrative Program Section 710. This program contains procedures for determining the scope of the examination and the Risk Classification Checklist. You should use the Abbreviated Holding Company Examination Program Section 720 for low risk holding company enterprises (Category I), recognizing that you may need to consult the CORE Holding Company Examination Program Section 730 to address specific areas of risk. You should use the CORE Holding Company Examination Program, Section 730, for all higher risk or complex holding company enterprises (Category II). In addition, there may be specific issues that relate to certain holding company populations contained in Section 900.

The remaining sections of this Handbook are structured to parallel the primary areas of review in a holding company examination. These areas of review also parallel the component rating factors. Component rating factors are assigned for all Category II holding company enterprises, and may be assigned to Category I holding company enterprises at your discretion. Those factors are referred to by the acronym "CORE":

C	Capital
O	Organizational Structure
R	Relationship
E	Earnings

Capital

The first component of a holding company examination is an evaluation of ***Capital***. OTS does not employ a standardized capital requirement that applies to all holding companies. The population of thrift holding companies is far too diverse to develop a single, meaningful capital requirement. Instead, we take a case-by-case approach that considers the overall risk profile of the consolidated entity. This would involve assessing such traditional analytical measures as the overall leverage, the level of short-term debt and liquidity, cash flow and reliance on thrift earnings, interest coverage, quality of earnings, and level of consolidated tangible and equity capital. Our overall objective is to ensure that an appropriate equity buffer exists to shield the thrift from unexpected problems at the parent. Individualized capital requirements can be used as a tool to ratchet the capital level up or down to achieve this goal.

Organizational Structure

The ***Organizational Structure*** section gives an overview of the various types of holding companies. This component of the holding company examination requires you to identify the organizational structure and ownership and assess any changes. Additionally, in this aspect of the holding company examination, you will review the activities of the holding company and other affiliates in the structure to determine not only regulatory permissibility, but also what risks these activities may pose to the thrift.

Relationship

In the ***Relationship*** component, you will assess the interaction of the holding company's board of directors and executive management with the thrift. In doing this, you will reach conclusions about:

- The materiality of the thrift to the holding company or its controlling shareholders;
- The degree of influence the holding company has over the thrift and how this influence affects the thrift's operations;
- Whether the board of directors provides adequate oversight over the affairs of the holding company and its subsidiaries;
- How actively the holding company is involved in the management of the thrift;
- The degree of interdependence of the thrift and other entities within the holding company structure; and
- Whether the board has implemented effective policies and procedures to ensure that separate corporate identities are maintained and conflicts of interest avoided.

Earnings

In the ***Earnings*** component you will assess the holding company's operations and financial condition and their current and prospective effect on the subsidiary thrift. You will pay close attention to the holding company's earnings trends and capacity as well as cash flow. You will also evaluate the relative contributions and dividend payout ratios of significant subsidiaries of the holding company.

SUMMARY

Examination and supervision of holding companies has become more significant commensurate with the growth in size and diversity of the industry. Our philosophy is to assess the condition of the holding company enterprise and ensure that the thrift is not harmed by the operations of the holding company. We proceed with a risk-focused analysis with the objective of not only determining the current effect of holding company performance on the thrift, but also what the potential future impact might be. Additionally, to make as precise conclusions as possible, our approach is to allocate greater resources to the examinations of holding company enterprises that are complex or otherwise indicate that they possess a higher degree of operating risk.

The following Administration Section 200 details the procedures to be performed to implement this approach along with other examination elements. Other sections of this Handbook provide guidance to help you assess the CORE holding company examination areas.

REFERENCES

United States Code (12 USC)

§ 1467a	Home Owners' Loan Act
§ 1817(j)	Change in Bank Control Act

Code of Federal Regulations (12 CFR)

Part 574	Acquisition of Control of Savings Associations
Part 583	Definitions
Part 584	Regulated Activities