INTRODUCTION

OTS conducts routine off-site monitoring of holding companies. The primary purpose of off-site holding company monitoring is the early identification of material concerns or risks that may adversely impact the thrift. The monitoring process will also help you:

- Identify holding companies that need to be examined ahead of schedule.
- Identify specific areas to review at the next examination.
- Assess compliance with supervisory directives to correct problems uncovered in prior examinations.
- Evaluate whether the holding company adheres to conditions of approval and business plans.
- Determine whether it is necessary to modify a holding company's rating or risk classification category.
- Assemble data, information, and analysis to support examinations.

Monitoring provides you an effective means to identify and address potential problems, without being overly intrusive in the day-to-day operations of the holding company. Nevertheless, you are encouraged to communicate with the holding company between examinations.

Ongoing communication enhances our supervisory efforts and keeps us informed of any changes in strategic direction or significant transactions that may adversely impact the thrift. You must not underestimate the need for ongoing dialogue with the management of the holding company. Such communication becomes particularly important when it comes to holding companies involved in industries that are either highly cyclical or rapidly evolving.

Periodic face-to-face meetings are appropriate for holding companies categorized as high risk or complex (Category II). Such meetings enable you to have the benefit of more up-to-date information about major business initiatives.

PRIORITIZING AND SCOPING MONITORING REVIEWS

You have broad discretion in determining the priority and scope of each monitoring review. Regional monitoring reviews should be risk-focused. *Ideally, you should complete holding company monitoring in conjunction with thrift monitoring to ensure a complete understanding of the relationships and interdependence between the parent and its thrift subsidiary.*

Prioritizing Monitoring Reviews

In prioritizing the monitoring of the holding companies in your caseload, you should consider:

- The holding company's relationship with the thrift and any potential burden that it places on the thrift (for example dividends, tax or expense payments).
- Any significant deterioration in the financial condition or performance of the holding company that may adversely impact the thrift.
- The significance of the thrift in the consolidated holding company organization.
- The holding company risk classification category.
- The holding company enterprise's composite rating and CORE component ratings, when available.
- Examination ratings assigned or concerns noted with regard to the subsidiary thrift.
- The asset size of both the holding company and the subsidiary thrift.
- Any significant events such as a proposed merger or acquisition.

For shell holding companies that have no debt, your monitoring activities should focus on the thrift condition/performance and any intercompany transactions or payments. For complex and diversified holding companies and shell holding company with outstanding debt, your review must address any significant deterioration in the financial condition or performance of the holding company that may result in an adverse impact on the thrift. By giving you an indication of the level of diversification and leverage, the following ratios may assist you in prioritizing your monitoring reviews.

Level of Diversification:

$$\frac{\text{Holding Company Assets}}{\text{Thrift Assets}}$$

This ratio will be higher for holding companies that have more holdings in nonthrift operations or investments. A ratio of 100% indicates that the holding company has no other assets besides the thrift (for example, a shell holding company), whereas a ratio of 200% would indicate that the thrift's assets represent one half of the holding company's consolidated assets. Higher ratios indicate a greater diversification from thrift assets and, perhaps, a more complex holding company structure.

$$\frac{\text{Holding Company Net Income}}{\text{Thrift Net Income}}$$

A ratio of 100% indicates that the holding company may have no other source of income besides the thrift. A ratio of greater than 100% indicates that the holding company has income from nonthrift sources (the higher the ratio, the more income from nonthrift sources). Conversely, a ratio of less than 100% indicates that the holding company's nonthrift operations are experiencing net losses (the lower the ratio, the greater the level of nonthrift losses).

Capital Evaluation:

Total Capital Ratio

$$\frac{\text{Holding Company Total Capital}}{\text{Holding Company Total Assets}}$$

This ratio will provide you with an indication of the overall leverage within the consolidated organization. A negative or low total capital ratio would generally indicate that the holding company has limited capital resources. You should consider the composition of total capital when evaluating the adequacy of holding company capital. Holding companies that have significant balances of intangible assets or other volatile assets relative to capital may not have the same capital stability as one with a comparable total capital ratio and little or no intangible assets. Intangible assets can include goodwill, core deposit intangibles, mortgage servicing rights and other intangible assets. You should consider the characteristics of these assets, particularly where the assets generate predicable cash flows that can be relied upon to fund operations.

Tangible Capital Ratio

$$\frac{\text{Holding Company Total Capital} - \text{Holding Company Intangible Assets}}{\text{Holding Company Total Assets} - \text{Holding Company Intangible Assets}}$$

This ratio provides you with another measure of the leverage in the consolidated organization. A low or negative tangible capital ratio may indicate that the holding company has limited capital resources, however, some intangible assets generate cash flows that could support operational funding. For example, GAAP characterizes mortgage-servicing assets as intangible assets, therefore, you should consider the impact of this component in entities with significant mortgage banking operations.

The tangible capital ratio should not be confused with the regulatory capital requirements imposed by the Federal Reserve Board on bank holding companies. OTS evaluates the adequacy of a holding company's capital on a case-by-case basis, and tangible capital is one consideration (see Section 300).

You should also consider that deferred policy acquisition costs (DPAC) are currently reported on TFR line HC510 with intangible assets. You should closely evaluate the composition of HC510 to understand the strength of the holding company capital structure.

Intangible Assets/DPAC Ratio:

$$\frac{\text{Intangible Assets and DPAC}}{\text{Total Capital}}$$

This ratio will assist you in evaluating the composition of total capital. When the amount of intangible assets or DPAC represent a large percentage of total capital, you should evaluate the attributes of these assets to determine whether the assets provide financial benefits to support operations.

Double Leverage Ratio

$$\frac{\text{Thrift \$ Equity}}{\text{Holding Company \$ Equity}}$$

This ratio can provide you with an indication of double leverage in the consolidated organization, however, the ratio is generally ineffective in identifying double leverage in holding company organizations that have other nonthrift subsidiaries. A higher double leverage ratio could indicate more significant holding company reliance on debt to fund its equity investments in the thrift. Generally, the more double leverage in the consolidated organization, the larger the holding company's cash flow demands will be to service interest payments and debt retirements. In a shell holding company, high double leverage may cause the holding company to seek significant capital distributions or other cash payments from the thrift.

Dividend Payout Ratio

$$\frac{\text{Thrift Cash Dividends to Holding Company}}{\text{Thrift Net Income}}$$

Dividends paid to the holding company may diminish the thrift's ability to augment capital and support the thrift's risk profile. Thrifts that have higher dividend payout ratios may be less capable of supporting their own risk profile from internally generated funds. You should closely evaluate the organization's capital management practices in situations where the thrift distributes a significant share of its net income to the holding company, particularly when the thrift net income represents the major source of the holding company's consolidated net income.

Scope of Monitoring Reviews

The scope of your review should be broad enough to obtain an understanding of the following three broad areas:

- An overview of the holding company, including its organizational structure, primary activities and business plans.
- The holding company's relationship with the thrift, especially its dependence on the thrift or the thrift's dependence on the holding company.
- The holding company's financial condition and performance.

There are a variety of information sources that can help you monitor these three areas. These informational sources include:

- Thrift Financial Report (TFR) Holding Company Schedule (Schedule HC), other TFR schedules, and relevant peer or trend ratios;
- Company or competitor press releases;
- Filings with the Securities and Exchange Commission (SEC);
- Equity and debt market or company analysis;
- Stock price/market data;
- Shareholder reports;
- H (b)–11 Annual/Current Report;

- Annual audit reports;
- Holding company examination reports;
- Subsidiary thrift examination report(s);
- Input from both the thrift and holding company EICs;
- Application approval orders and conditions;
- Pending application materials;
- Consumer complaints;
- Data supplied by other regulators, including examination reports;
- Thrift, holding company and other affiliate websites; and
- Industry websites.

As you conduct your routine monitoring, you should, at a minimum:

- Analyze the quarterly Schedule HC and ratio reports available on OTS national systems.
- Review periodic reports such as the Annual/Current H-(b)11 Reports, annual audit reports, SEC filings, as well as other information provided by a holding company's functional regulator.
- Review industry or publicly available information, including equity and credit analysis.
- Monitor compliance with major application approval conditions.

Analyzing Schedule HC and Internally Generated Reports. Schedule HC is filed quarterly by the subsidiary thrift. For most holding company enterprises, there is one holding company designated to provide this financial information. In some cases, where more than one distinct ownership path exists, there may be more than one designated filer. As you analyze this information, you should test the accuracy of the financial data reported. In addition, you must realize that even though the information is provided on a consolidated basis for the designated filer, there may be upper tier holding companies that are not reflected in the data. Therefore, you may want to coordinate your review of Schedule HC with your review of the holding company's comprehensive audited financial statements. These statements are usually filed as an attachment to the Annual/Current H-(b)11 Report.

The collection of the limited data on Schedule HC can provide an indication of the holding company's financial condition and useful trend information. As noted above, the holding company data and ratios generated from Schedule HC are most effective for holding companies with limited activities beyond the thrift investment. The ratios produced from Schedule HC for more diversified holding company structures are often less effective at providing clear indications of risk. For more diversified holding companies, your monitoring efforts should focus on analyzing SEC filings or other comprehensive financials provided in the H-(b)11 filing, and other publicly available financial information or analysis.

As you analyze Schedule HC, you should review the Evaluating Capital on a Case-By-Case Basis discussion in Section 300, Capital and the Ratio Analysis discussion in Section 600, Earnings. In these discussions, we describe ratios that can be used to analyze and spot trends regarding the holding company or consolidated group's capital adequacy, leveraging, earnings, liquidity, cash flow and reliance on subsidiary dividends. They can also be used to evaluate various financial aspects of the holding company enterprise's relationship with the thrift.

Please note, however, the ratios outlined in Sections 300 and 600 are only indicators that closer scrutiny is warranted; they should not automatically be assumed as indicative of a problem.

Periodic Reports. Holding companies must file periodic reports as defined by OTS. Current OTS requirements for periodic reports are outlined in the instructions to form H-(b)11 Annual/Current Report. This report must be filed by holding companies within 90 days of their fiscal year end. In addition, quarterly updates must be filed within 45 days of the end of each quarter during which there has been a material change in any of the information reported. If no changes have occurred, the holding company must file a statement certifying such.

The H-(b)11 provides important data on:

- The corporate structure
- The relationship with the thrift
- Dividends from the thrift
- Intercompany tax sharing
- Debt/securities

The holding company also files audited financial statements and copies of its SEC filings under cover of the H-(b)11.

Industry/Publicly-Available Information. As companies get larger and more complex, we cannot rely exclusively upon our own systems. Therefore, your offsite monitoring must also make effective use of market information, including analyst and rating agency reports, press reports and stock price and volume movements. These types of public information will help you identify issues to discuss with management. For holding companies with:

- Banking as their primary business, see www.fitchratings.com (FITCH IBCA, DUFF & PHELPS).
- Insurance as their primary business, see www.ambest.com (AM BEST).
- Diversified activities, see www.standardpoor.com (STANDARD & POORS). The Forum section includes "Ratings Commentary" on industries including Financial Institutions and Insurance. In addition, the "Ratings Actions" section includes ratings news.

In enterprises that have another primary regulator, you should leverage off of the other regulator's information and resources. In particular, you should review any examination reports, and any financial reports that the enterprise submitted. For further information on reviewing enterprises with functionally regulated entities, see the functional regulation discussion in Section 200, Administration.

Monitoring of Major Application Approval Conditions. OTS approves applications subject to the applicant thrifts and/or holding companies agreeing to maintain compliance with application approval conditions. Major applications will generally include those applications that are likely to substantially increase the risk profile of the thrift or holding company; involve novel or complex transactions; or that propose a significant shift in business strategy. All complex holding company and de novo applications are considered major applications.

Each OTS Region is responsible for monitoring and documenting a thrift or holding company's compliance with:

- All written application approval conditions.
- Any other written representations made to OTS either in the application or during the application process which were important considerations in the approval of the application, but which were not memorialized in a condition. These include issues requiring follow-up that may be found in departmental clearance memos or the supervision digest.
- Business plan projections. This includes performing a quarterly review of the thrift or holding company's adherence to the financial projections furnished by the applicant and accepted by the region. This review should assess both the volume and type of business activities in order to evaluate the riskiness of actual versus proposed operations.

If the thrift or holding company is not in material compliance with a significant approval condition or application issue, or if there are material variances from its business plan projections, areas of noncompliance must be identified and routed through the supervisory chain to the attention of the Regional Director. Supervisory corrective action will be implemented based upon regional evaluation of the severity of the noncompliance.

The monitoring requirements for major applications sunsets three years from the later of: (i) the date of approval of the application; (ii) the date of commencement of operations for de novos; or, (iii) the date of the Regional Director's approval of any major revision of the business plan.

MONITORING DOCUMENTATION

You should document your quarterly HC monitoring findings for any areas where you identify significant financial deterioration or supervisory concerns. Your review comments should be presented in a simple bullet point, exception-based, format. For each area of significant deterioration or concern, you should:

- Explain the cause and impact of the deterioration or concern; and
- Detail any planned corrective actions or necessary supervisory follow-up.

If your analysis does not reveal any significant deterioration in the financial condition or performance of the holding company, and does not reveal any new information that would be a cause for supervisory concern or supervisory action, a single sentence indicating such findings will suffice.