INTRODUCTION

Capital serves many purposes, and the level and composition of capital held by a company is an important measure of the company's overall financial health, as well as the health of its subsidiaries. Capital provides a holding company with a buffer in times of poor operating performance, can help maintain public confidence in the holding company, and supports reasonable growth.

The OTS does not impose either consolidated or unconsolidated regulatory capital requirements on thrift holding companies. Although there is no specific numerical requirement (ratio), OTS-regulated holding companies should have a prudential level of capital to support their risk profile. The lack of any specific capital requirement means that you have to consider all aspects of an organization's risk profile to determine if capital is adequate on a case-by-case basis. Your conclusions about the capital structure of a holding company will depend upon findings you make in other components of the holding company examination, including earnings, relationship, and the level of risk inherent in the holding company's activities.

The purpose of this Section is to assist you in evaluating capital at the holding company level and in evaluating its potential effect on the subsidiary thrift. In reaching your conclusions, you should take advantage of publicly available information, including industry analyst reports and ratings, as well as indicators of market trends and perceptions. You should also use peer analysis to compare the level of capital held by other companies engaged in similar lines of business.[1]

[1] Unless otherwise noted, you should assume all asset, debt and capital calculations in this section are based on Generally Accepted Accounting Principles (GAAP), which means all such figures will be calculated on a consolidated basis.

CAPITAL SUFFICIENCY/RISK ANALYSIS

High capital ratios are not necessarily indicative of overall capital sufficiency, especially when an organization is involved in risky activities or securitizations and other capital arbitrage techniques. The scope and complexity of today's banking business, particularly with respect to offering an expanded array of financial products, makes it even more important to evaluate capital based on a company's overall risk profile. Because thrift holding companies are so diverse, the adequacy of capital cannot be determined solely on the basis of a numeric formula or standard. Instead, capital management must be a dynamic process. Holding companies must ensure that they have sufficient capital to support their underlying risks.

Organizations are increasingly using internal processes to assess risks and to ensure that capital, liquidity, and other financial resources are sufficient in relation to an organization's overall risk profile. The sophistication and level of detail of a holding company's capital management techniques will vary based on the complexity and size of the enterprise. You should request the holding company's support and analysis for its capital management strategies as part of your preexamination response kit or during the course of the examination.

Assessing the Overall Risk Profile

The need to assess overall risk is inherent in each component of the holding company examination. This process starts by completing the Risk Classification Checklist in the Administrative Program, Section 710.

This preliminary risk assessment is then refined and updated as a better understanding of the holding company is gleaned during the course of the examination.

You will find that many of the conclusions that you will need to make in addressing the capital strength of a holding company will be dependent on findings made in other sections of the examination process. For example, the following questions will help you assess the overall risk profile of a holding company's capital structure. In many cases, you will need to review other sections of this handbook in order to properly address them:

Issues Addressed in the Organizational Structure Section

- How significant is the thrift in the holding company structure?
- What risks do the holding company activities and assets present?

Issues Addressed in the Relationship Section

- Has the holding company influenced the thrift to engage in riskier activities and if so, how?
- What is the direct or indirect impact of intercompany transactions and transactions with insiders (for example, loans, asset purchases or sales, guarantees, and service agreements)?
- What is the quality of management and risk management systems?

Issue Addressed in the Earnings Section

- Is the overall financial condition of the holding company deteriorating, stable, or improving?

Other Capital Related Issues

- Does the holding company or other affiliates have off-balance sheet contracts or activities (with explicit or implied recourse) that result in a higher degree of risk exposure than is apparent from its balance sheet?
- Are there any terms, conditions or covenants in the holding company's or other affiliate's securitization documents that could adversely impact the thrift, such as a supervisory action that could trigger early amortization or the transfer of servicing?
- How does the amount of capital held by the holding company compare to its peers?
- What significant risks does the thrift face?

In the normal course of business, companies encounter several types of risks. ***The following are examples*** *of how various types of risk can be present in a holding company enterprise and can adversely impact capital.*

<u>Credit Risk</u> – The risk that a counterparty will fail to perform.

A holding company has pronounced credit risk on a corporate-wide basis evidenced by a high volume of residuals and subordinate securities held at the parent, and subprime lending and securitization activities conducted by subsidiaries. Residual and subordinate holdings total more than half of capital. Further, management has been slow to incorporate actual default and prepayment data in valuing subordinate securities. Consequently, those asset values are overstated, as is reported capital. Thus, although this holding company boasts a capital ratio that would equate to "well capitalized," its capital level is insufficient.

<u>Market Risk</u> – This includes a wide range of scenarios and unexpected events resulting from adverse movements in market rates or prices. Such events may lead the holding company to influence the thrift to engage in riskier activities.

A holding company decides to quickly expand its business. Without a proportionate increase in capital, the holding company has lost flexibility, and is unable to react to adverse market conditions. Not only does this affect the holding company's ability to support the thrift, the holding company may pressure the thrift for additional financial resources and encourage the thrift to assume a higher risk profile to attempt to maximize returns.

Funding and Liquidity Risk - The risk that the entity will be unable to meet its payment obligations on settlement dates.

A holding company has massive debt service requirements due to a number of acquisitions. Its heavy reliance on borrowed funds, coupled with inadequate operating policies and procedures, have led to undue pressure at the thrift level to dividend funds to the parent for debt service.

A holding company's funding strategy should support maturing liabilities with liquid assets and avoid the over reliance on any single or volatile source of funds. Holding companies and their affiliates must maintain sufficient liquidity and capital to service outstanding debt obligations without adversely affecting the thrift.

Operational Risk - The risk that deficiencies in information systems or internal controls will result in unexpected loss. Such deficiencies generally are a function of the quality of management and information systems.

A holding company's poor capital management results from, among other things, inaccurate and misleading financial reporting, failure to implement corrective actions from the last exam, internal audit deficiencies, and the lack of corporate separateness. Although the quantitative measure of holding company capital appears high, poor reporting provides no comfort in the quality and accuracy of that number.

Interdependency of Systems and Operations Risk – The risk that the activities/operations of the holding company are so intermingled with the thrift that the cessation of a holding company operation negatively impacts the thrift.

A holding company is a mortgage banker that does securitizations, with the thrift providing the servicing. The servicing income represents a major component of the thrift's revenue. The holding company sells the mortgage banking operation. The sale has a detrimental effect on the thrift due to its reliance on the mortgage banking operation to provide a continuing source of servicing income to cover its operating expenses.

Higher Risk Holding Company Activities – The risk that the holding company will make investments or engage in activities, especially with respect to activities that the thrift itself cannot engage, that pose risk to the thrift or that could jeopardize the thrift's reputation.

A holding company forms a subsidiary to foreclose on a large real estate development project. The project is only partially complete, major capital expenditures are anticipated, and, although the holding company has a reasonable capital level, the debt service and operating expense requirements are substantial. The holding company's financial condition deteriorates to a point where it can no longer service the debt, and, as a result, pressures the thrift for additional dividends in order to fund the completion of the project. Later, the holding company attempts to convince the thrift to buy a portion of the REO, which is impermissible.

Legal Risk – The risk that contracts are not legally enforceable or properly documented.

A thrift has a note receivable from its holding company that is not properly recorded. No board minutes or journal entries have recorded the transaction. This is largely due to the fact that accounting and treasury personnel don't enforce corporate separateness of the holding company and the thrift. In actuality, this note does not legally exist, which means the thrift is overstating its capital by counting this nonexistent asset. Once the asset is written off, the capital of the thrift is below its regulatory requirement

EVALUATING CAPITAL ON A CASE-BY-CASE BASIS

OTS' approach to holding company supervision provides for the evaluation of capital on a case-by-case basis, considering the overall risk profile of each holding company enterprise. To do this, you will need to consider the following basic financial elements:

- **Debt** – the ratio of holding company debt as a percentage of tangible capital[2], the effect holding company debt has on the thrift, and the ability of the holding company to service debt or fulfill holding company obligations.
- **Quality and Availability of Capital** – the ratio of total capital to total assets and the ratio of tangible capital at the holding company as a percentage of tangible assets[3], the quality of that capital, and the ability of the holding company to raise new capital.
- **Dividends** – the ratio of the holding company's earnings being paid out in dividends, and whether the quality and level of holding company earnings is sufficient to support such dividends.

Debt

Financial leverage is the use of debt[4] to supplement the equity in a company's capital and funding structure. From the perspective of management and stockholders, debt can represent a favorable financial tool as the owners only need to provide a small portion of the total financing, and much of the financial risk will be borne by lenders. This allows the existing owners to maintain control with a limited investment at stake and, assuming the proceeds are reinvested at a positive spread, the earnings generated will increase the overall Return on Equity (ROE). Some companies use debt for the acquisition of other entities.

Although the judicious use of leverage is a favorable financial management technique, you should be alert to the following pitfalls:

- Leverage may pressure management to produce short-term revenues to service debt, and may result in greater risk taking.
- Firms with high levels of leverage are more susceptible to losses during periods of economic downturn, either in the economy at large or the specific industries in which they do business. This can have a compounding effect as the economic downturn may result in a declining financial condition, which in turn increases borrowing costs as debt matures and must be renewed, often at higher interest rates.
- The use of leverage reduces management's flexibility in making future decisions; lenders may impose the following types of debt covenants that could adversely impact the thrift:
  - Limits on future debt issues;
  - Provisions to accelerate repayment of the debt in the event certain covenants are violated;
  - Limits on dividend payments; or
  - Specific constraints on operating ratios.

You must assess both the role of leverage within the consolidated holding company operations/financial structure and the actual, and potential, impact such leverage may have on the operations of the thrift. Implicit in such analysis is the need to identify the extent to which the holding company utilizes debt to capitalize/fund the thrift's operations, and the degree to which the parent relies upon the thrift to provide cash flow for debt service.

Recently, debt or debt-like instruments such as trust preferred securities can be issued at such attractive rates that management feels compelled to raise such funds before having a clear idea of what to do with the proceeds. Holding company boards of directors are expected to develop prudent capital management plans prior to undertaking financing activities in the marketplace. Otherwise, they may be implementing a funding strategy that may place undue financial burdens on the thrift's operations. You should review the way the proceeds of such financings are deployed, and how such obligations are serviced. You will also need to determine whether

[2] Tangible Capital = Capital minus intangible assets.

[3] Tangible assets = Total assets minus intangible assets.

[4] Debt includes borrowings with specific terms and excludes deposits and transactional liabilities.

the holding company is, in general, overextended given its financial characteristics.

You should generally consider the following questions:

- What is the ratio of holding company debt as a percentage of tangible capital?[5]
- Is the level of debt rising?
- What investments or activities does the debt fund?
- Could the terms, conditions, or covenants of the debt have an adverse effect on the thrift?
- What is the maturity schedule for debt instruments' effect on liquidity?
- What is the level of interest expense?
- Is interest expense a significant percentage of recurring income?
- What debt ratings has the holding company received from nationally recognized credit organizations?

There are several ratios that you may use to assess these factors.

Calculate the parent company leverage by looking at the debt to capital ratio:

Debt to Capital Ratio =

$$\frac{\text{Long-Term Debt}}{\text{Tangible Capital}}$$

A holding company with a low debt to capital ratio will generally have greater access to the capital markets.

There are no "bright line" thresholds for categorizing highly leveraged operations and it is primarily the company's earnings power that dictates the acceptable level of debt. Accordingly, the focus of your review should be on the ability of the company to generate cash flow to meet its fixed debt service. However, as a general guideline, you should become increasingly vigilant as debt to capital ratios start to trend past 50 percent. It is presumed that a debt ratio significantly exceeding 50 percent will trigger intensive analysis of holding company cash flow needs and earnings power, and an appropriate comment in the holding company report of examination is most likely warranted. Regardless, you should be sensitive to long and short-term trends and management's future plans for using leverage.

Also, compute the total debt to equity ratio on a market value basis.

Total Debt to Equity Ratio at Market Value =

$$\frac{\text{Total Debt at Book Value}}{\text{Equity at Market Value}}$$

If the market value of equity is higher than the book value, the above ratio will be lower than the debt to equity ratio on a book value basis. This indicates a favorable market perception and the ability to raise capital at an attractive price. However, if the market value of equity is lower than the book value, the above ratio will exceed the ratio on a book value basis, indicating the market will only provide capital at a discount to book value.

Note: For holding companies with significant nonthrift operations, a more meaningful calculation might be the ratio of Debt to Total Assets. This would be especially true for holding companies involved in industries with a high percentage of fixed assets. (Such debt should be long-term to match the maturity of the assets acquired.) Follow-up may be required for ratios in excess of ten percent, but ratios should be compared to appropriate peers. For comparisons, utilize Robert Morris Associates (RMA) financial statement analysis.

Another important step in analyzing parent company leverage is calculating the leverage ratio:

[5] You should also include trust preferred securities, or similar hybrid instruments that possess both debt and equity characteristics, when assessing the holding company's overall use of leverage.

Leverage Ratio =

$$\frac{\text{Long-Term Debt}}{\text{Long-Term Debt plus Capital}}$$

The lower the ratio, the less exposure to loss when the company's performance is poor, but also a lower return on equity when performance is good.

The proceeds of parent company long-term debt may be advanced to the thrift either as debt or equity. The condition referred to as simple leverage exists when holding company debt proceeds are advanced to the subsidiary thrift as debt. Such debt should have repayment terms matching those imposed upon the holding company by its lender and should be serviced from the thrift's current earnings. The condition referred to as double leverage exists when funds obtained by the holding company from debt proceeds are invested into the thrift subsidiary as equity. Increasing the capital base of the thrift allows the thrift to increase its borrowings as well, thereby compounding the original holding company debt and resulting in higher consolidated leverage. In this situation, thrift revenues must be sufficient to service both levels of debt because typically the parent will rely upon dividends from the thrift subsidiary to fund its debt service requirements. [6] Such situations can generate substantial pressure on the thrift to maintain its earnings to support future dividend payments, thereby increasing the temptation for the thrift to engage in higher risk operations.

Within complex operations, double leverage will not always be readily evident, as parent level debt may not be directly allocated to provide equity in the thrift. One general measure that you can use as a proxy to help identify the role of double leverage is the following ratio:

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

Higher ratios, or a trend of increasing ratios, could indicate the existence or growth of double leverage in the holding company/thrift relationship. A ratio of 100% indicates that there is no double leverage in the organization, while a ratio of 125% indicates that 25% of the thrift's equity capital was derived from sources other than parent equity investments into the subsidiary or through subsidiary retained earnings.

Another situation you must watch for is when nonthrift subsidiaries of highly leveraged holding companies experience operating problems. Even when holding company debt is not advanced to the thrift, the parent may look to the thrift to be the primary or sole source of debt service cash flow due to weaknesses elsewhere in its organization. This too could result in the parent imposing a more aggressive or high risk operating philosophy upon the thrift to generate near term earnings to support higher dividends, management fees, or tax sharing payments.

If you determine that any further leveraging of the holding company poses a risk to the thrift, you must immediately advise the Regional Director. The Regional Director may deem it appropriate to require the holding company to provide specific information on its capital planning and allocation process or notice before incurring, renewing or rolling over any debt or hybrid securities with debt-like characteristics. Such action may be most appropriate for holding companies:

- Whose subsidiary thrift institution has a composite CAMELS rating of 3, 4 or 5;
- That are rated unsatisfactory; or
- That would be of supervisory concern if additional debt were issued.

Quality and Availability of Capital

Capital provides a secondary source of financial protection for the holding company if operating capacity proves insufficient. A holding company that has capital does not necessarily have sufficient cash flow to meet contractual obligations when they are due. Capital can provide cash only if selected assets can be sold, the capital is used to

[6] Capital distributions must be within the limits prescribed by 12 CFR 563, Subpart E (563.140 – 563.146).

secure new debt, or new equity can be issued. In addition, a particular capital position can also be a function of a company's accounting practices, and, thus, should not be solely viewed as a proxy of a company's financial health. Accounting standards are often assumption driven and aggressive accounting assumptions can overstate the value of assets and thus cloud a company's true capital position.

Before any relevant quantitative capital measures can be calculated, you must determine the GAAP capital of the holding company. GAAP capital represents the aggregate of holding company capital, including the capital of all subsidiaries, after the elimination of all intercompany items. Capital must be computed in accordance with GAAP, or some other approved regulatory accounting for functionally regulated affiliates. For affiliates that are regulated by another state or federal agency, determine if there are any agreements or conditions imposed that would require the holding company to devote financial resources (including capital contributions) to that entity. If such agreements or conditions exist, determine the extent to which they could ultimately have an adverse effect on the subsidiary thrift.

Once you determine the amount of GAAP capital, you must consider qualitative as well as quantitative factors. To determine the adequacy of a holding company's capital, you should answer the following questions:

- What is the ratio of total capital to total assets?
- What is the ratio of tangible capital to tangible assets?
- To what extent does the holding company rely on trust preferred securities or other hybrid equity securities as a source of financing? You should closely scrutinize any holding company that has trust preferred securities, or similar instruments with both debt and equity characteristics, that approach 25 percent of the holding company's tangible capital.
- Does the holding company have a high proportion of assets that a thrift would be unable to count as capital?
- Does the holding company have the ability to raise new equity capital or generate capital internally, through earnings other than from the thrift?
- Has the holding company's capital position deteriorated since the last examination, and if so, why?
- Have significant asset/liability restructurings, acquisitions, or divestitures occurred that might negatively affect the financial or managerial relationship between the thrift and the holding company?

As you review capital, keep in mind that there are some positive factors that enhance capital protection. These include:

- Strong management that has a record of superior capital management;
- Sound asset quality; and
- A history of strong (recurring) and consistent (stable) operating earnings and cash flow.

Similarly, potential adverse factors that detract from the holding company's capital condition include:

- Demonstrably weak or ineffective management;
- Low liquidity, high interest rate risk exposure, or high foreign exchange exposure;
- Significant levels of off-balance sheet activities, including asset securitization activities, which can result in the retention of substantial recourse;
- Reliance on wholesale and short-term funding sources, or a significant amount of longer-term debt that will mature soon;
- Engaging in activities viewed as being high risk, unless adequately hedged and well-managed;

- Internal inability to generate sufficient capital because asset growth exceeds sustainable equity capital formation;
- No, or limited, access to capital markets; and
- Excessive capital distributions paid to, or the divestiture of subsidiaries to, stockholders.

One analytical approach that you should consider is how the holding company's capital position would look if it were a thrift or a bank holding company. This approach becomes less helpful if the holding company is predominately a commercial company, which has a much different balance sheet than financial companies. Nevertheless, such an analysis can lead to important findings.

For instance, the presence of assets at the holding company level that could not be counted as capital at the thrift level would lead to questions about the quality of the holding company's capital. Even though the thrift may be better off if such assets are not at the thrift level, the presence of the assets on the consolidated balance sheet will still affect the health of the overall holding company enterprise.

The following are some examples of the types of assets that either could not be counted as thrift capital, or have limitations as to how much could be counted as thrift capital:

- Direct investments in real estate ventures.
- Hybrid instruments that possess debt characteristics, like trust preferred securities.
- A high ratio of assets, such as IO strip securities, to capital, in which a thrift would have to hold dollar-for-dollar capital.

Similarly, assets that are not considered tangible under GAAP may, nonetheless, produce revenues or otherwise have creditable value. Such assets might include, for example, assets (such as mortgage servicing rights) that the thrift may include in computing core and tangible capital.[7] You should factor such assets into your assessment of whether capital is sufficient.

[7] See 12 CFR 567.12.

Another approach you may wish to consider is to regard the holding company as a new applicant for a savings and loan charter. Given its current financial condition, and types of activities, would you feel comfortable approving this company as a savings and loan holding company?

Dividends

The dividend practices of the holding company may affect the financial position of its thrift and other subsidiaries. Dividend policy influences the sustainable growth rate of any organization based on its effect on retained internal capital.

If the level of a holding company's dividends poses an actual or potential burden on the thrift subsidiary, then you should determine if the holding company's dividend payout and prospective rate of earnings retention are consistent with its capital needs, asset quality, growth, cash flow, and overall financial condition. You may conclude that it is necessary to calculate the dividend payout ratios for the parent and all holding company subsidiaries using the following formula.

Dividend Payout Ratio =

$$\frac{\text{Dividends Paid}}{\text{Net Income}}$$

The holding company's dividend payout ratio should be reasonable and consistent with any existing business plan. You should compare the dividend payout ratio, net income, and asset growth of each significant affiliate of the holding company.

In general, the following statements apply to holding company dividends:

- Sustainable core earnings should suffice to pay the dividend over the long term.
- There should be adequate liquid assets on hand to make dividend payments.

- Generally, a holding company and its thrift should avoid borrowing funds to provide for the payment of dividends to shareholders of the holding company. (Such an action may be proposed in certain situations when management prefers not to cut the dividend to avoid a negative market reaction. Similarly, borrowing may be needed if the company's cash flows are predominantly achieved seasonally, such as a retailer heavily dependent on holiday sales.)
- Neither the holding company nor the thrift should have to sell assets to provide funds for the payment of dividends to the holding company's shareholders.

The inability to sustain or increase stockholders' dividends may demonstrate holding company weaknesses. Often times, the suspension of dividends is the result of the holding company facing a liquidity squeeze. Even the perception of the holding company running low on cash can lead to repercussions for the subsidiary thrift. When the thrift's public identity is linked to the holding company with a similar name, a crisis or loss of confidence in the holding company could adversely effect the thrift regardless of the thrift's own financial stability. For example, for members of the public not familiar with the distinction between the thrift and its parent, a run on the thrift may result from the perception that its holding company is running out of cash. To avoid loss of market confidence, a thrift may enter into a questionable transaction with its holding company or affiliate in an attempt to avoid a crisis.

CAPITAL MANAGEMENT AND OVERSIGHT

As noted above, one of the positive qualitative factors affecting the adequacy of capital is strong capital management. Managers and directors should attempt to anticipate capital needs and provide for the maintenance of adequate capitalization. Good practice dictates that holding company management should develop a capital management plan if the holding company's ratios are low relative to others with similar risk profiles in their industry, or are likely to fluctuate. A good plan sets forth specific strategies by which management intends to reach its established goals.

Most financial organizations consider several factors in evaluating their overall capital adequacy. These include:

- Comparing their own capital ratios with industry peers;
- Risk concentrations in credit and other activities;
- Current and desired credit-agency ratings; and
- Historical experiences, including severe adverse events in its past.

You may also want to consider these factors as you analyze capital.

Many holding companies and other financial organizations use stress testing, and scenario analysis, as a tool to estimate unexpected losses. This process helps organizations project the performance of their assets under conservative "stress test" scenarios. Stress testing can estimate the portfolio exposure to deteriorating economic, market and business conditions. It also allows for different assumptions to be input, thereby allowing management to foresee potential consequences.

Holding companies should be able to demonstrate that their approach to relating capital to risk is sound. One method for a holding company to determine if it holds a sufficient amount of capital is if it meets an objective measure of financial health, such as a target public-agency debt rating or even a statistically measured maximum probability of becoming insolvent over a given time horizon. This latter method is the foundation of the Basle Accord's treatment of capital requirements for market and foreign-exchange risk. Risk assessment must address all relevant risks, including, but not limited to: credit risk, market risk, liquidity risk, interest rate risk, operational risks, and legal risk.

Holding companies without adequate procedures to estimate and document the level of capital necessary to support their activities should be criticized.

You should interview holding company management to identify their plans for ensuring a safe cushion of capital. Specifically, you should inquire whether they have plans for:

- New debt issues or sales of equity;
- Additional capital contributions;
- Loans, transfers, or distributions of holding company assets within the holding company structure; or
- Acquisitions.

During your conversations, you also should emphasize that the holding company's level of capital is a major consideration in the overall examination rating.

RATING THE CAPITAL COMPONENT

To properly assess risk at the holding company, you must consider the thrift subsidiary, the nonbank subsidiaries, the parent only and the consolidated entity. You should consider capital on a consolidated basis as holding company management has some discretion as to the allocation of capital within the organization. In some situations it may also be useful to consider capital after deducting thrift capital. For holding companies with functionally regulated subsidiaries, you should also analyze capital after deducting capital held within such functionally regulated subsidiaries.

Evaluate capital sufficiency, on a case-by-case basis, considering among other things, the holding company's own documented analysis of the capital needed to support its activities. You should expect capital levels to be risk sensitive.

Further, you need to remember that all the holding company examination components are integral to the overall examination process. For example, your findings about earnings will clearly have an impact on your final conclusions about capital adequacy.

You should assign a ***capital component of "1"*** if the holding company serves as a financial resource to the entire corporation. Such companies provide both a basis for growth and access to capital markets as needed.

You should assign a ***capital component rating of "2"*** if the holding company can support the volume and risk of its activities, as well as the activities of its subsidiaries. Such holding companies are also positioned to provide a cushion for unexpected losses, and support its level of borrowing, as well as that of its subsidiaries.

You should assign a ***capital component rating of "3"*** to any holding company that does not have sufficient capital to serve as a buffer for its own activities and activities of its other subsidiaries. Such companies present the risk of adverse effects on the thrift.

SUMMARY

The capital sufficiency of a holding company is a critical factor in the regulation of thrift holding companies. Your analysis should consider both the quantity and quality of capital and the effect that the holding company's operations may have on the thrift currently, and in the future. To do this properly, you must consider the:

- Capital needed based on the risk associated with each holding company and nonbank subsidiary activity;
- Relationship between debt and capital;
- Existence of long-term debt in the capital structure;
- Extent and use of debt at the parent to fund capital investments of subsidiaries;
- Trend of capital in comparison to peer groups;

- Management's ability to devise capital plans in the event of a capital deficiency or planned expansion;
- Ability to access the capital markets;
- Extent of concentration in any one asset or type of asset, including intangibles, interest only (I/O) strips, illiquid assets, deferred tax assets, and
- Extent of off-balance sheet exposure.