

Program Guidance: Examiners should complete only those sections of the program that the EIC deems necessary to evaluate this area and to support the overall examination conclusions.

Examination Objective

To ensure that the scope of the examination of the holding company structure is appropriate to adequately assess the risks presented.

Wkp. Ref.

Preexamination Procedures

1. Determine if any entity in the holding company structure is functionally regulated by the SEC, CFTC or various state insurance agencies. If so, you must consider the additional “Functionally Regulated” procedures which are italicized in the program. Also, note the functionally regulated entity and its primary regulator in the Regulatory Profile System, as well as the address and phone number of a contact person responsible for its supervision.

[Click&type]

[Click&type]

2. Forward the PERK to the top-tier holding company approximately one month prior to the joint examination of the “lead” association and the holding company. (In certain situations it may be appropriate to forward the PERK to another tier in the complex; however, in most cases, the top tier will be the starting point for a holding company examination.)

Functionally Regulated-Review the PERK to determine if any of the information request can be supplied by reports submitted to other regulators. After ensuring that the PERK does not request duplicative or publicly available information, direct any information requests that apply to a functionally regulated entity to that entity’s other regulator approximately six weeks prior to the examination of the lead association. Request the other regulatory body to gather the information and return it to the regional office.

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3. Review the institution overview in the regulatory profile system. (The institution overview can be found in the electronic continuing examination file (ECEP) on the OTS intranet). Verify the accuracy of the structure data in the holding company enterprise summary. Make any noted corrections to the structural data prior to creating an examination shell. (If you need to correct structure data after the shell is created, you must delete the shell, create the new shell, and inform the TARS administrator to bill hours to the new exam.)

[Click&type]

[Click&type]

4. Perform preexamination/scoping analysis. (Suggested scoping materials below.)

- Reports submitted to the OTS (H-(b)11 Annual/Current Report, H-(b)10 Registration Statement).
- Reports filed with the Securities and Exchange Commission (submitted as attachments to the H-(b)11).
- Statements of financial condition and operations.
- Most recent audit reports (including the Management Representation letter to the external auditor detailing pending and threatened litigation that may have a material effect on the holding company).
- Previous OTS examination report and supporting workpapers.
- Supervisory correspondence.
- Recent applications, including conditions of approval.
- Examination reports from other regulatory agencies, including self-regulatory bodies such as NASD.
- Other correspondence and data supplied by other regulators.
- Public sources: credit ratings by major rating agencies, newspaper or magazine articles, Reuters/AP internet reports.
- Holding company and affiliate web sites.
- Holding company board minutes.
- PERK.
- Subsidiary thrift's regulatory profile.

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5. Re-evaluate the holding company categorization by considering the questions in the Risk Classification Checklist to identify higher risk factors.

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[Click&type]

Examination Procedures-Overall Guidance

(For detailed procedures on component areas, see Sections 720 or 730)

6. Verify compliance with supervisory directives and enforcements actions.

- Verify compliance with:
 - Conditions of approval
 - Outstanding enforcement actions
 - Supervisory agreements and directives.
- Verify correction of violations or exceptions from previous examination.

Functionally Regulated-Coordinate findings and recommended actions with any regulator that has an interest.

[Click&type]

[Click&type]

Postexamination Procedures

7. Prepare examination report.

[Click&type]

[Click&type]

8. Assign overall rating to the holding company complex.

[Click&type]

[Click&type]

9. Conduct meeting with board of directors or senior management to review examination findings.

Functionally Regulated - Coordinate with the other regulators on all such meetings. Invite other functional regulators of the holding company to participate.

[Click&type]

[Click&type]

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10. Complete all Holding Company Examination Data System entries.

[Click&type]

[Click&type]

11. Update and make corrections as appropriate to Regulatory Profile System and other OTS databases.

[Click&type]

[Click&type]

12. Transmit examination report to the holding company.

Functionally Regulated - You should follow the information sharing procedures outlined in the agreements OTS has executed with the primary regulators of functionally regulated affiliates. As a general rule, copies of the examination report and any other confidential information will be provided to the functionally regulated entity's primary regulator upon receipt of a written request that demonstrates a justifiable need for the information. You should coordinate with your region's functional regulation contact.

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Risk Classification Checklist

In answering these questions, you should interpret the term “holding company” broadly, so as to include all affiliates within a holding company family.

DETERMINING LOW RISK/NONCOMPLEX SHELL HOLDING COMPANIES

- | | <u>Yes</u> | <u>No</u> |
|---|--------------|--------------|
| a) Is the holding company a shell? | | |
| If Yes, go to Question b. | | |
| If no, skip to Question e in the next section. | [Click&type] | [Click&type] |
| b) Is the shell only engaged in investing cash from dividends or proceeds from stock sales? | | |
| If Yes, go to Question c. | | |
| If no, skip to Question e in the next section. | [Click&type] | [Click&type] |
| c) Does the shell have only minimal debt that can easily be serviced by its own resources? | | |
| If Yes, go to Question d. | | |
| If no, skip to Question e in the next section. | [Click&type] | [Click&type] |
| d) In its cash management, does the shell invest solely in US government securities or other liquid nonleveraged cash instruments such as bankers acceptances or high grade commercial debt, or does it invest in high risk, highly leveraged instruments like options or futures that could lead to significant cash flow needs? | | |
| — Liquid interest bearing instruments | [Click&type] | [Click&type] |
| — Highly leveraged instruments | [Click&type] | [Click&type] |

If you answered “Yes” to questions a, b, and c, and the answer to question d is liquid interest bearing instruments GO NO FURTHER. The holding company you are reviewing is a low risk, noncomplex shell. You do not need to complete the remainder of this checklist. Refer to the Abbreviated Holding Company Examination Program, Section 720.

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Yes

No

If the answer is highly leveraged interest bearing instruments, please continue. These holding companies and all other nonshell holding companies present at least a moderate risk. The remaining questions will help you determine the nature of those risks. A YES answer to any of the following questions could indicate that the holding company is complex and may present a higher than normal degree of risk. You should weigh the importance of each question based on the holding company's specific circumstances.

FINANCIAL CONDITION

- e) Does the holding company lack a consistent source of reliable cash flow and stable earnings from operations other than proceeds from the thrift?

If Yes, review Earnings section of Program 730

[Click&type]

[Click&type]

- f) Is the holding company significantly leveraged, either with high debt levels, other hybrid instruments with debt-like features, or highly volatile investments, such as futures, options, IOs, or residuals?

If Yes, review Capital and Earnings sections of Program 730

[Click&type]

[Click&type]

- g) Does the holding company have major investments that can rapidly require significant cash expenditures, such as futures, short options or financing construction?

If Yes, review Capital and Earnings sections of Program 730

[Click&type]

[Click&type]

- h) Even if the holding company currently has low levels of debt and conservative investments, is it in a cyclical industry that is distressed or clearly experiencing adverse trends?

If Yes, review Capital section of Program 730

[Click&type]

[Click&type]

- i) Does the holding company have a history of volatile operating earnings?

If Yes, review Earnings section of Program 730

[Click&type]

[Click&type]

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Yes

No

- j) Has the holding company or any of its affiliates recently had a downgrade in debt ratings by a major debt rating agency, such as Moody’s or Standard and Poor’s?

If yes, review Capital section of Program 730

[Click&type]

[Click&type]

FINANCIAL INDEPENDENCE

- k) Is the thrift dependent on the holding company for access to the capital markets?

If Yes, review Capital section of Program 730

[Click&type]

[Click&type]

- l) Is the thrift unlikely to survive the financial collapse of the holding company or a major affiliate?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

OPERATIONAL INDEPENDENCE

- m) Do the thrift’s management and BOD consistently act in a manner beholden to the holding company?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- n) Are the thrift’s operational systems dependent upon the holding company or any of its affiliates?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- o) Is the *thrift* basically a “shell” with no or few full time employees dedicated only to the thrift’s well-being, as opposed to having a distinct management team devoted to the thrift?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- p) Are the thrift’s audit functions consolidated within the holding company, as opposed to having a separate, distinct audit department?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

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Yes

No

- q) Are most, if not all, key functions of the thrift, such as risk management, underwriting, investment advice, trading, and other banking or lending functions, being performed by the holding company or any of its affiliates?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- r) Is the compensation of thrift employees, either directly or indirectly through stock options, tied to the performance of the holding company?

If Yes, review Relationship section of Program 730, and review Thrift Activities Handbook Section 330.

[Click&type]

[Click&type]

- s) Are there significant or abusive intercompany or insider transactions such as loans, guarantees, asset purchases/sales, or service contracts?

If Yes, review Relationship section of Program 730, and review Thrift Activities Handbook Section 380.

[Click&type]

[Click&type]

REPUTATION RISK

- t) Is the thrift’s public identity linked with the holding company, such as a similar name and marketing strategies?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- u) Is there significant cross-selling of proprietary products, like trusts, insurance policies, mutual funds and the like?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- v) Is the thrift limited purpose in that it serves only to facilitate the sale of services and products of the holding company, for example trusts or mutual funds, as opposed to being a full service community association?

If Yes, review Organizational Structure section of Program 730

[Click&type]

[Click&type]

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Yes

No

- w) Do virtually all the thrift’s assets or liabilities come, directly or indirectly, from the holding company or any of its affiliates, as opposed to a widely diverse community deposit base with independent franchise value?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

MANAGEMENT EXPERIENCE

- x) Is the holding company inexperienced in running a federally insured entity, as opposed to a history of managing banks and thrifts?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- y) Is the thrift a de novo, as opposed to a thrift with existing management that has a proven track record?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- z) Is the holding company itself relatively new, as opposed to a well established business with many years of successful operations?

If Yes, review Relationship section of Program 730

[Click&type]

[Click&type]

- aa) Is the holding company in a significantly different business than financial services, such as manufacturing, with different auditing and accounting practices?

If Yes, review Capital and Earnings sections of Program 730

[Click&type]

[Click&type]

HOLDING COMPANY CLASSIFICATION

After completing the checklist, check the appropriate holding company categorization below. There is no hard and fast rule that indicates how many Yes answers are needed to deem a holding company as Category II. For instance, even if the thrift has its own distinct existence, staff and systems, a Yes answer to questions “e” through “j” could lead to determining that the holding company is complex, since the holding company’s financial condition means there is a greater incentive to try to boost earnings or cash flow via the thrift.

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You must make considered judgments as to the current and prospective risks that a holding company poses to its insured subsidiary. In general, if the thrift does have substantial insured deposits from outside the holding company, but is predominately beholden to the holding company for operational support, you should consider it Category II and focus heavily on the relevant procedures cross-referenced in the checklist. In such a case, a failure of the holding company would lead to the failure of the thrift.

You also need to consider consumer issues as well. Even if the thrift has virtually no insured deposits, making the prospect of a loss to the insurance fund unlikely, you still need to ensure the thrift is operating in a manner that it can survive the collapse of its parent. Even if no insured deposits are at risk, consumer *assets*, such as trusts, will be at risk if the thrift fails due to financial distress at its parent. Although nothing can be done to protect customers from market losses due to declines in the stock, bond or real estate markets, the thrift should still be able to ensure that the actual trust *accounts* are managed in an appropriate manner should the holding company fail.

Thus, even in those cases where the thrift has independent management, systems and identity, you should still consider it Category II if it is financially troubled. Similarly, any holding company with an unsatisfactory “U” rating should be classified as Category II. Although we have successfully insulated insured institutions from the bankruptcy of its parent, it is a difficult and time consuming process. Regional staff must be on alert whenever a holding company suffers crippling financial reverses.

(Please Check One)

The Holding Company is Noncomplex and not High Risk - Category I [Click&type]

The Holding Company is Complex or somewhat Higher Risk - Category II [Click&type]

Summarize the basis for your conclusion in your workpapers.

Examiner’s Summary, Recommendations, and Comments

[Click & type]

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