

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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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Wkp. Ref.

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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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Wkp. Ref.

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

[Click&type]

[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]

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Wkp. Ref.

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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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

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.

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

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]

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Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

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]

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

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]

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

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.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

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]

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

SECTION: Abbreviated Holding Company Examination Program

Section 720

Program Guidance: This Abbreviated Holding Company Examination Program should be used to examine low risk or noncomplex holding company enterprises. Also, be sure to consider the unique characteristics of the specialized holding company structures discussed in Section 900. You should complete only those sections of the program that the EIC deems necessary to evaluate each CORE examination area and to support the overall examination conclusions. You may consult the full CORE Holding Company Examination Program (Section 730) for more detailed steps for each procedure.

C – Capital

Examination Objectives

Determine the holding company’s financial resources and assess its current and prospective effect on the subsidiary thrift.

Evaluate the holding company’s level of debt and capital structure.

Examination Procedures

	<u>Wkp. Ref.</u>
1. Assess the holding company’s ability to service its outstanding debt and the degree the thrift is relied upon to upstream funds to service the debt. Determine whether double leveraging is occurring, and to what extent. [Click&type]	[Click&type]
2. Assess the holding company’s consolidated capital structure. Consider the quantity and composition of capital. Does the holding company have enough capital to protect the subsidiary thrift from risky activities or adverse events within the holding company enterprise? [Click&type]	[Click&type]
3. Consider the effect of the company’s dividend practices on its capital condition. [Click&type]	[Click&type]

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Wkp. Ref.

4. 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 (such as capital contributions) to that entity. If such an agreement exists, determine the extent to which it could ultimately have an adverse impact on the subsidiary thrift.

[Click&type]

[Click&type]

O – Organization Structure

Examination Objectives

Analyze ownership and control.

Determine if there is evidence that the holding company structure is designed to circumvent OTS policies.

Identify activities of the holding company and its noninsured subsidiaries to determine permissibility.

Assess what risks the activities of the holding company and its other affiliates pose to the thrift.

5. Analyze changes in the holding company’s organizational structure since acquisition or the previous examination. Obtain or prepare an organizational chart that identifies all holding company tiers and other affiliates of the thrift.

[Click&type]

[Click&type]

6. Determine whether any individual or entity – directly, indirectly, or by acting in concert – has acquired control.

[Click&type]

[Click&type]

7. Evaluate the risk that the activities of the holding company or other affiliates pose to the subsidiary thrift.

[Click&type]

[Click&type]

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Wkp. Ref.

R – Relationship

Examination Objectives

Assess the influence of the board of directors and management on the thrift.

Consider how integrated the thrift is in the holding company enterprise.

Consider the independence of the boards of directors of the thrift, holding company and other affiliates.

Determine if intercompany transactions are appropriate.

Examination Procedures

8. Assess the influence of the board of directors and management on the thrift. Consider the independence of the boards of directors of the thrift, holding company and other affiliates. Do any relationships appear to create a conflict of interest or usurpation of corporate opportunity?

[Click&type]

[Click&type]

9. Review management’s written strategic goals and objectives. Evaluate whether the organization’s goals have changed, and, if so, assess how they affect the risk-profile and financial condition of the company.

[Click&type]

[Click&type]

10. Assess the adequacy of internal controls, books, records and systems to ensure that the thrift maintains separate corporate identity.

[Click&type]

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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

SECTION: Abbreviated Holding Company Examination Program

Section 720

Wkp. Ref.

11. Determine the extent to which the operations of the thrift are integrated with the holding company and other affiliates. Assess the risks posed by integrated systems, common risk management practices, central decision making, joint marketing and delivery systems, linked market reputation, and the significance of the thrift within the structure. Evaluate whether the thrift can be insulated from adverse events within the holding company structure and carved out as a stand-alone operating entity.

[Click&type]

[Click&type]

12. Analyze the tax-sharing agreement and policies, tax payments paid by the subsidiary association to the holding company, and the income tax accounting and settlement practices where the thrift does not file a separate tax return.

[Click&type]

[Click&type]

13. Identify and assess the direct and indirect impact on the thrift of any significant inter-company or insider transactions such as asset purchases/sales, contracts for services, loans, or guarantees. If the transactions were conducted with the thrift, ensure that they were properly identified in the thrift's books and records and reviewed for compliance with the affiliate transaction regulations (12 CFR 563.41 and 563.42).

[Click&type]

[Click&type]

14. Verify compliance with statutory and regulatory requirements.

[Click&type]

[Click&type]

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Wkp. Ref.

E – Earnings and Liquidity

Examination Objectives

Assess the trends of the holding company’s earnings and cash flows.

Determine if the holding company’s earnings and cash flow trends may lead it to require the thrift to provide funds through dividends or other means.

Examination Procedures

15. Review the holding company’s financial statements, consolidated audit, management representation letter, and SEC filings. Identify financial trends, discussions of significant accounting practices and any material weaknesses identified in the most recent independent audit report, prior examination reports of OTS or any other regulator. Determine the relative strength of subsidiaries to holding company profitability and balance sheet strength.

[Click&type]

[Click&type]

16. Identify any changes to the bond ratings of the holding company or significant affiliates. Assess the causes for any changes.

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[Click&type]

Examiner’s Summary, Recommendations, and Comments

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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Program Guidance: This CORE Holding Company Program should be used to examine high risk or complex holding company enterprises. Also, be sure to consider the unique characteristics of the specialized holding company structures discussed in Section 900. This Program may also be used to supplement the Abbreviated Holding Company Examination Program (Section 720). You should complete only those sections of the program that the EIC deems necessary to evaluate each CORE examination area and to support the overall examination conclusions.

C – Capital

Examination Objectives

Determine the holding company's financial resources and assess its current and prospective effect on the subsidiary thrift.

Evaluate the holding company's level of debt and capital structure.

Examination Procedures

Wkp. Ref.

1. Assess the holding company's ability to service its outstanding debt and the degree the thrift is relied upon to upstream funds to service the debt. Determine whether double leveraging is occurring, and to what extent.
 - Determine if the level of consolidated debt is increasing and if interest expense is a significant portion of recurring income.
 - Calculate the ratio of *consolidated holding company debt to consolidated tangible capital*. (For holding companies with significant nonthrift operations, particularly in industries with large investments in fixed assets, calculate the *debt-to-total asset* ratio.)
 - Calculate the holding company's *leverage* ratio.
 - Compute the *debt-to-equity* ratio on a market value and book value basis to assess the market perception of the company.
 - Consider if the holding company is investing in leveraged instruments such as futures and options that can require volatile cash needs.
 - Determine to what degree the holding company has retained recourse (explicit or implicit) related to off-balance sheet funding activities such as asset securitizations.

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

- Consider whether the holding company is committed to investments with material cash needs, such as major construction projects and other capital intensive business activities.

[Click&type]

[Click&type]

2. Assess the holding company's consolidated capital structure. Consider the quantity and composition of capital. Does the holding company have enough capital to adequately protect the subsidiary thrift from risky activities or adverse events within the holding company enterprise? Consider the overall risk profile and all risk factors, including credit, market, operational, and legal risks.

- Determine if the holding company's capital position has deteriorated since the last examination. If so, cite the reasons.
- Analyze whether the holding company has significantly restructured its asset/liability portfolio or made significant acquisitions or divestitures.
- Review the composition of consolidated capital. How would capital be affected if thrift capital conventions, bank holding company capital conventions, or the capital conventions of other functional regulators are applied?
- Consider the extent to which the holding company uses debt-like instruments such as trust preferred stock for financing. Determine if management developed a sound plan for investing the proceeds of any such financing activities. Determine how interest or dividend obligations are financed, specifically, if the thrift is relied upon, in whole or in part, to service such obligations?
- Review the holding company's capital plans. Consider the effect of future transactions and major acquisitions on capital. Assess the holding company's access to capital markets.
- In cases where capital is considered inadequate, discuss with management any plans to access the capital markets or otherwise augment capital.

[Click&type]

[Click&type]

3. Consider the effect of the company's dividend practices on its capital condition.

- Identify situations where the company or thrift must borrow funds or sell assets to maintain dividend payments.
- Calculate the holding company's *dividend payout to earnings* ratio and determine if it is consistent with the business plan.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

- Compare the dividend payout ratios, net income, and asset size of significant affiliates to assess relative contributions.

[Click&type]

[Click&type]

4. 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 (such as capital contributions) to that entity. If such an agreement exists, determine the extent to which it could ultimately have an adverse impact on the subsidiary thrift.

[Click&type]

[Click&type]

O – Organizational Structure

Examination Objectives

Analyze ownership and control.

Determine if there is evidence that the holding company structure is designed to circumvent OTS policies.

Identify activities of the holding company and its noninsured subsidiaries to determine permissibility.

Assess what risks the activities of the holding company and its other affiliates pose to the thrift.

Examination Procedures

5. Analyze changes in the holding company enterprise since acquisition or the previous examination.

Compare the current organization chart with one at the time of acquisition or the previous examination.

- Review organizational data provided by any other regulatory agency.
- Identify all tiers of the holding company. Ensure that the OTS holding company database accurately reflects the current structure.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

- Determine if the holding company has acquired, formed, divested, or transferred any subsidiaries or significant portion of its consolidated assets.

[Click&type]

[Click&type]

6. Determine whether any individual or entity - directly, indirectly, or by acting in concert - has acquired control.

- Review a list of all significant shareholders to determine the number of shares owned and percentage of outstanding stock held. (Significant stockholders include any person or entity that owns ten percent or more of stock either individually or acting in concert.)
- Determine whether any changes in ownership have occurred since acquisition or previous examination.
- Determine whether the holding company repurchased a significant amount of its stock or if any new issuances of capital stock, capital notes, or subordinated debentures occurred.
- Consider exemptions contained in Section 10(a) of the Home Owners' Loan Act and 12 CFR Section 574.3.

[Click&type]

[Click&type]

7. Review the activities of the holding company and other affiliates.

- Evaluate the risk that the activities of the holding company or other affiliates pose to the thrift.
- Ensure that the holding company is not engaged in any acts or acquisitions prohibited by 12 CFR 584.4 or 584.9 regarding ownership interests in nonaffiliated companies or control of mutual thrifts, respectively.

[Click&type]

[Click&type]

R – Relationship

Examination Objectives

Assess the influence of the board of directors and management on the thrift.

Consider how integrated the thrift is in the holding company enterprise.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

Consider the independence of the boards of directors of the thrift, holding company and other affiliates.

Determine if intercompany and insider transactions are appropriate.

Examination Procedures

8. Assess the influence of the board of directors and management on the thrift. Consider the independence of the boards of directors of the thrift, holding company, and other affiliates. Determine whether any of the relationships appear to create a conflict of interest or usurpation of corporate opportunity.

- Identify the principal decision makers of the holding company, including major shareholders. Does the holding company share common officers with the thrift? If so, expand your review in the thrift examination to ensure they are fulfilling their fiduciary role to the thrift.
- Does the holding company have policies and procedures regarding conflicts of interest and intercompany and insider transactions. Evaluate whether such policies are adequate to protect the interests of the thrift and are being followed.
- Determine the thrift's line of reporting to the holding company.

[Click&type]

[Click&type]

9. Review management's written strategic goals and objectives. Evaluate whether the organization's goals have changed, and, if so, assess how they affect the risk-profile and financial condition of the company.

[Click&type]

[Click&type]

10. Assess the adequacy of internal controls, books, records and systems to ensure that the thrift maintains separate corporate identity.

- Determine whether the financial statements are complete, consistent, and accurate. Consider the materiality of the thrift to the overall corporate structure and the scope of the independent audit. Resolve any discrepancies.

Functionally Regulated-Determine if any discrepancies are due to different forms of regulatory accounting practices.

- Identify who performs the audit of the holding company and the thrift and whether there has been a change in auditing firms and the reason for such change.
- Identify who performs the internal audit work for the holding company and determine whether independence requirements have been met.

Exam Date: _____

Prepared By: _____

Reviewed By: _____

Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

- Determine the effect of accounting changes to the financial recordkeeping and reporting processes.
- Review the audit committee minutes and any correspondence between the holding company and the independent auditor to identify financial recordkeeping deficiencies disclosed to the directors.
- Identify any recommendations, criticisms, or comments related to financial recordkeeping and reporting in the most recent independent audit report and prior examination reports of OTS and any other regulatory agency.

[Click&type]

[Click&type]

11. Determine the extent to which the operations of the thrift are integrated with the holding company and other affiliates.

- Assess the risk posed by integrated systems, common risk management practices, central decision making, joint marketing and delivery systems, linked market reputation, size of the thrift in relation to the holding company, and common controls.
- Assess the risk posed by the thrift's public identity being linked with the holding company. In particular, review the Management Representation letter, or an attached attorney's letter, to the external auditor detailing pending or threatened litigation that could harm the holding company, and pose reputational risks for the thrift.
- Evaluate whether the thrift can be insulated from adverse events within the holding company structure and carved out as a stand-alone operating entity, if necessary. Ensure that separate corporate identity is maintained.
- Review policies and procedures concerning the operation of the association.
- Review any plans for the thrift.

[Click&type]

[Click&type]

12. Identify and assess the direct and indirect impact on the thrift of any significant inter-company or insider transactions such as loans, guarantees, asset purchases/sales or service contracts. If the transaction is with the thrift, ensure that it is properly reflected in the thrift's books and records and reviewed for compliance with the affiliate transaction regulations (12 CFR 563.41 and 563.42).

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Exam Date: _____

Prepared By: _____

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Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

13. Analyze the tax-sharing agreement and policies, tax payments paid by the thrift to the holding company, and the income tax accounting and settlement practices where the thrift does not file a separate tax return.
- Determine whether the agreement conforms to the OTS policy, particularly with regard to timing, amount, refunds, and treatment of deferred taxes.
 - Determine whether the agreement is governing the current practices of the consolidated group.
 - Determine that taxes collected by the parent holding company from the thrift are not in excess of the amount that the thrift would have paid if it had filed a separate return.
 - Determine that tax payments made by the thrift do not significantly precede the time that a consolidated estimated tax liability would be due and payable by the holding company to the taxing authorities.
 - Determine that the amount and timing of payment of taxes and receipt of refunds by the thrift is no less favorable to the thrift than if it had filed separate returns or made separate estimated payments to the taxing authority.
 - Determine that the deferred tax accounts of the thrift are maintained on its own books and are not transferred to the books of the holding company.
 - Determine if the Internal Revenue Service (IRS) or other taxing authorities have assessed any additional tax payments on the consolidated group.
 - Determine that the holding company has allocated any such additional assessments in accordance with the tax-sharing agreement.
 - If there is a conflict between the tax sharing policies of OTS and the policies of another regulatory agency, contact regional management.
 - Analyze the income tax accounting and settlement practices where the thrift does not file a separate tax return.
 - Review consolidating schedules supporting financial reporting and determine the reasonableness of income tax expense (benefit) to the thrift compared with other members of the group. Timing differences between book income and taxable income may affect the analysis.
 - Determine if any IRS examinations are ongoing and whether any material additional tax obligations are anticipated as a result.
 - Determine if there are outstanding refunds from amended or net operating loss carrybacks that should be allocated to the thrift, or filings of questionable

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

recoverability (from the holding company) that could result in chargebacks to the thrift.

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14. Verify compliance with statutory and regulatory requirements.

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E – Earnings

Examination Objectives

Assess the trends of the holding company's earnings and cash flows.

Determine if the holding company's earnings and cash flow trends may lead it to require the thrift to provide funds through dividends or other means.

Examination Procedures

15. Review the holding company's financial statements, consolidated audit, management representation letter, and SEC filings. Identify financial trends, discussions of significant accounting practices and any material weaknesses identified in the most recent independent audit report, prior examination reports of OTS or any other regulator.

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16. Determine the relative strength of subsidiaries to holding company profitability and balance sheet strength.

- Calculate the following ratios to identify financial trends: cash position, current ratio, operating cash flow, debt ratio and return on equity.
- Using trend and peer analysis, evaluate the earnings of the company's nonthrift operations/subsidiaries over the prior three years and determine the causes for weak or deteriorating performance.
- Evaluate the quality of earnings. Determine whether the sources of earnings of pre-tax income are recurring.
- Assess whether the holding company is in a highly cyclical business.

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Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

SECTION: CORE Holding Company Examination Program Section 730

Wkp. Ref.

17. Use external information to evaluate holding company's financial condition.
- Identify any changes to the bond ratings of the holding company or significant affiliates. Assess the causes for any changes.
 - Determine stock price. Compute the *market value to book value ratio* and *price/earnings ratio*. Compare results to the company's peers.

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18. Analyze the holding company's cash flow.
- Compare the holding company's parent only cash flow from operating and investing activities to the amount provided by the thrift through dividends.
 - Determine whether financial flexibility exists from nonthrift sources that would enable the holding company to service its short-term obligations.
 - Quantify the amount of cash flow provided to the holding company by the thrift and determine what the company's cash flow position would be without funds from the thrift.
 - Compare the amount of interest expense on the parent only borrowings to the amount of dividends received from the thrift.
 - Compute the *fixed charge coverage ratio* to determine whether the holding company can meet its contractual obligations from current earnings.
 - For those companies unable to fully meet cash flow needs from internal resources, identify the cause and level of the deficit and assess the three year trend.
 - In cases of worsening or deficit cash flow positions, obtain or prepare a maturity schedule comparing the levels of resources available to funding requirements over the short term (up to 90 days), intermediate term (91 days to 1 year), and long term (over 1 year).

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