August 5, 2011

SUPERVISION OF SAVINGS AND LOAN HOLDING COMPANIES (SLHC)

Attention: **Chief Executive Officer of Each Tenth District SLHC**

Subject: Supervision of SLHCs

In Brief: Effective July 21, 2011, Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) transferred to the Board of Governors of the Federal Reserve System (Board) the supervisory functions of the Office of Thrift Supervision (OTS) related to SLHCs and their nondepository subsidiaries. DFA also provides that all regulations, guidelines, and other advisory materials issued by the OTS on or before the transfer date with respect to SLHCs and their nondepository subsidiaries will be enforceable until modified, terminated, set aside or superseded.

On July 21, 2011, the Board issued Supervision and Regulation (SR) Letter 11-11 and Consumer Affairs (CA) Letter 11-5, which describes the supervisory approach the Board will use during the first supervisory cycle for SLHCs.

Highlights: In particular, the guidance states the Board's intentions to apply consolidated supervision in a manner consistent with the Board's established risk-based approach to bank holding company (BHC) supervision, holding SLHCs to the existing principles and standards of safety and soundness and consumer compliance risk management. The Board intends to supervise SLHCs in the designated supervisory portfolios of holding companies with similar characteristics and risk profiles. Information on the Board's supervisory approaches is contained in Attachments A and B.

The first supervisory cycle will be used by the Federal Reserve to learn more about the unique operational features of SLHCs and to acquaint SLHCs with the Board's supervisory policies, approaches, and expectations. The guidance describes the intended inspection and supervisory rating methods to be used by the Board to facilitate this transition, including the Board's plan for transitioning SLHCs from the CORE rating system to the Board's RFI/C(D) rating system.

Finally, the letter summarizes the key laws, regulations, and supervisory guidance that apply to SLHCs following the transition. The principles to be applied during the first supervisory cycle are set forth in previously issued supervisory guidance documents which are listed in the letter. In addition, Attachment C contains examination guidance for assessing the capital adequacy of SLHCs. The Board currently is reviewing OTS guidance and, as a general matter, has found that much of it is similar to that issued by the Board, or it was issued on an interagency basis. The Board intends to publish more detailed information about the application of supervisory guidance to SHLCs at a later date.

Contact: If you have questions or comments regarding SR 11-11/CA 11-5, please contact Assistant Vice President Rick Lay at (800) 333-1040, extension 45703.

Internet: A copy of the SR/CA Letter and its Attachments is available on the Board's web site at: http://www.federalreserve.gov/boarddocs/srletters/2011/sr1111.htm

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF BANKING SUPERVISION AND REGULATION

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS

SR 11-11

CA 11-5

July 21, 2011

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK AND TO SAVINGS AND LOAN HOLDING COMPANIES SUPERVISED BY THE FEDERAL RESERVE

SUBJECT: Supervision of Savings and Loan Holding Companies (SLHCs)

Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (Dodd-Frank Act) transfers to the Board of Governors of the Federal Reserve System (Board) the supervisory functions of the Office of Thrift Supervision (OTS) related to SLHCs and their nondepository subsidiaries beginning on July 21, 2011. The Dodd-Frank Act also provides that all regulations, guidelines, and other advisory materials issued by the OTS on or before the transfer date with respect to SLHCs and their nondepository subsidiaries will be enforceable until modified, terminated, set aside, or superseded. As a result of this change in law, approximately 430 SLHCs will be transferring to Board supervision on July 21, 2011.

The Board has approved a notice that will be published in the Federal Register shortly which outlines the OTS regulations that the Board intends to continue to enforce after the transfer date.[2] As discussed in that notice, the Board will publish an interim final rule that effectuates the transition of regulations as soon as practicable.

This letter describes the supervisory approach the Board will use during the first supervisory cycle[3] for SLHCs. As discussed in a notice of intent issued by the Board and published in the Federal Register in April 2011 (notice of intent), the Board believes that it is important that any company that owns and operates a depository institution be held to appropriate standards of capitalization, liquidity, and risk management consistent with the

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[1] Pub. L. 111-203, July 21, 2010; 124 Stat. 1376. See Section 312, Powers and Duties Transferred.

[2] See Federal Reserve Board press release, "Federal Reserve seeks comment on notice outlining regulations previously issued by the Office of Thrift Supervision," July 21, 2011.

[3] For purposes of this letter, the first supervisory cycle for an SLHC is the period of time between July 21, 2011, and the close of the first required inspection.

principles of safety and soundness.[4] The Board also believes that it is important that such companies be held to appropriate standards consistent with principles of consumer compliance risk management, including where nondepository subsidiaries are engaged in activities involving consumer financial products or services.

As a result, it is the Board's intention, to the greatest extent possible taking into account any unique characteristics of SLHCs and the requirements of the Home Owner's Loan Act (HOLA), to assess the condition, performance, and activities of SLHCs on a consolidated basis in a manner that is consistent with the Board's established risk-based approach regarding bank holding company (BHC) supervision. As with BHCs, the Board's objective will be to ensure that an SLHC and its nondepository subsidiaries are effectively supervised and can serve as a source of strength for, and do not threaten the soundness of, its subsidiary depository institution(s).

However, the Board is aware that it will take time for Federal Reserve supervisory staff to better understand an SLHC's operations and business model. The Board also is aware that SLHC management may need a period of time to make operational changes in response to the Federal Reserve's supervisory expectations, if necessary. The first cycle of SLHC inspections therefore will be instructive to both the Federal Reserve and SLHC management in terms of practical issues that arise in the supervision of an SLHC, particularly in the supervision of an SLHC that engages primarily in commercial, insurance, or broker-dealer activities.

As discussed in the notice of intent, the Board generally intends to transition SLHCs into the Board's designated supervisory portfolios of holding companies with similar characteristics and risk profiles. SLHCs that engage in significant commercial, insurance, and broker-dealer activities may be included in separate supervisory portfolios. The frequency and scope of supervisory activities for holding companies is discussed in detail in section 5000 of the Federal Reserve's *Bank Holding Company Supervision Manual* and in Board Supervision and Regulation (SR) letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less." For specific information about the supervisory approach during the first supervisory cycle for holding companies of varying size and complexity, see Attachments A and B of this letter.

Additionally, the notice of intent stated that the Board anticipated transitioning SLHCs to the Board's "RFI/C(D)" rating system (commonly referred to as "RFI").[5] The Board will issue a notice shortly outlining application of the RFI rating system to SLHCs and any modifications that the Board believes are necessary to accommodate SLHCs. That notice will provide the public with an additional opportunity to comment and will provide for a transition period before Federal Reserve examiners will assign final RFI ratings.

First-Cycle Inspections

The Federal Reserve plans to use the first inspections to learn more about the unique operational features of SLHCs and how its holding company supervision framework can most effectively be implemented at these companies. Accordingly, the focus of inspection activities during the first supervisory cycle will be on gaining an understanding of the structure and

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[4] See 76 FR 22662.

[5] See SR letter 04-18, "Bank Holding Company Rating System," and 69 FR 70444.

operations of each SLHC. Depending on the size and activities of the SLHC, Federal Reserve supervisory staff should use the first supervisory cycle to develop an understanding of the SLHC's business profile; prepare an institutional overview, risk assessment, and supervisory plan; and begin initial discovery reviews and assessments. A discovery review is an inspection activity designed to improve the Federal Reserve's understanding of a particular business activity or control process. For a larger and more complex company, the Reserve Bank will use a continuous monitoring program to supervise the SLHC.

In addition, during the first supervisory cycle, Federal Reserve supervisory staff should assess whether an SLHC conducts its operations in a safe and sound manner and in compliance with applicable laws and regulations, as well as whether an SLHC, its subsidiary depository institution(s), and nondepository subsidiaries are in compliance with any enforcement actions, applications commitments, or other supervisory directives (including citations in previous examinations or inspections). If Federal Reserve supervisory staff concludes that an SLHC is not conducting its operations in a safe and sound manner; is in violation of applicable law or regulations; or is not complying with any outstanding enforcement action, commitment, or supervisory directive, or if the primary regulator of a subsidiary savings association has determined that it is not in satisfactory condition, appropriate action should be taken against the SLHC, including possible formal or informal enforcement action.

As noted above, the Board understands that it will take time to acquaint SLHCs with the Board's supervisory policies and approach. To help facilitate this transition, examiners will be using this first supervisory cycle to inform SLHCs how their operations compare to the Board's supervisory expectations. As a result, the Board will not be issuing final RFI ratings to SLHCs during the first supervisory cycle.

Instead, during the first supervisory cycle, the Federal Reserve will be issuing an "indicative rating" that indicates to the SLHC how it would be rated if the RFI rating system was formally applied. Similar to a traditional inspection, the findings accompanying the indicative rating should include a detailed description of deficiencies that need to be addressed by management and/or the board of directors. Deficiencies that are correctable in the normal course of business; do not pose an immediate threat to the safety and soundness of the organization; or do not represent a violation of applicable law or regulation or failure to comply with any outstanding enforcement action, commitment, or supervisory directive generally should not result in formal or informal enforcement actions.

When communicating inspection findings, examiners should use standard Federal Reserve terminology to differentiate among matters requiring immediate attention (MRIAs), matters requiring attention (MRAs), and observations.[6] Examiners should discuss with management practices that are not consistent with the safety-and-soundness or consumer compliance risk management principles that are applied to BHCs to understand the business reasons for such practices and any controls surrounding the practices in question. When MRIAs and/or MRAs have been identified and communicated to the SLHC in a report of inspection, examiners should work with the SLHC to establish a plan and appropriate timetable for SLHC management to address these matters within a reasonable period. In determining the appropriate timetable for addressing deficiencies, examiners should refer to the priorities outlined in SR 08-1/CA 08-1 and should consider the nature, scope, complexity, and risk of the deficiency.

[6] See SR letter 08-1/CA letter 08-1, "Communication of Examination/Inspection Findings" (SR 08-1/CA 08-1).

Supervision staff at the Board will review MRIAs and MRAs periodically to ensure appropriate prioritization and consistent treatment across SLHCs.

Applicable Law, Regulations, and Guidance

The main governing statute for SLHCs is HOLA. Other statutes apply to both SLHCs and BHCs, such as the Change in Bank Control Act and the Management Interlocks Act. As noted above, the Board intends to issue an interim final rule that will codify all the rules that apply to SLHCs. Although the Board anticipates conforming certain portions of the OTS rules to those currently found in the Board's Regulation Y, Regulation Y will not apply to SLHCs. Although SLHCs are similar to BHCs, SLHCs are not subject to the Bank Holding Company Act. In particular, SLHCs may engage in a wider array of activities than those permissible for BHCs and may have concentrations in real estate lending that are not typical for BHCs. Moreover, unlike BHCs, SLHCs are currently not subject to regulatory consolidated capital requirements, nor have they previously been subject to a formal source-of-strength doctrine. Guidance for assessing the capital adequacy of SLHCs is included in this letter as Attachment C.

As discussed above, the Dodd-Frank Act transfers all supervisory guidance applicable to SLHCs to the Board on the transfer date. Both the Board's and the OTS's supervisory guidance is largely based on principles of safety and soundness. Accordingly, the majority of Board guidance for BHCs should be equally relevant for the operations of SLHCs. The Board currently is reviewing OTS guidance and, as a general matter, has found that much of it is similar to that of the Board or was issued on an interagency basis.[7] During the first supervisory cycle, examiners should evaluate an SLHC using the same safety-and-soundness and consumer compliance risk management principles that are applied to a BHC.

The principles to be applied during the first supervisory cycle are largely set forth in the following documents:

- SR letter 09-4, "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies"
- SR letter 08-9/CA letter 08-12, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations"
- SR letter 08-1/CA letter 08-1, "Communication of Examination/Inspection Findings"
- SR letter 04-18, "Bank Holding Company Rating System"
- SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less"
- SR letter 99-18, "Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles"
- SR letter 99-15, "Risk-Focused Supervision of Large Complex Banking Organizations"
- SR letter 97-24, "Risk-Focused Framework for Supervision of Large Complex Institutions"

[7] The Board intends to publish more detailed information about the application of supervisory guidance to SLHCs at a later date.

- Federal Reserve *Bank Holding Company Supervision Manual*:
    - Section 2010 (supervision of subsidiaries)
    - Section 2020 (intercompany transactions)
    - Section 4010 (parent company financial factors)
    - Section 4060 (consolidated earnings)
    - Section 4070 (BHC rating system)
    - Section 5000 (BHC inspection program)

SLHCs preparing for Federal Reserve inspections may find it helpful to become familiar with this guidance, in addition to the interim final rules setting forth regulations for SLHCs.

The Board will continue to review the OTS guidance to determine whether and how best to integrate it into the Board's supervisory system. If examiners have questions about the applicability of a particular safety and soundness or consumer compliance risk management principle, they should consult with Board staff.

Communication and Coordination

The Board understands that the transition to supervision of an SLHC by a new federal agency presents challenges for both the supervised institution and the agency. To address these challenges, the Federal Reserve has designated staff at each Reserve Bank to review, on an ongoing basis, the Federal Reserve's conduct of first-cycle inspections of SLHCs. Board staff will coordinate with those staff to periodically review inspection practices, promote a consistent supervisory approach across SLHCs, and clarify the application of policies and guidance for examiners and SLHCs as necessary.

Contacts

For questions regarding this guidance, please contact Kevin Bertsch, Associate Director, at (202) 452-5265, T. Kirk Odegard, Assistant Director, Policy Implementation & Effectiveness, at (202) 530-6225, or Michael Sexton, Assistant Director, Domestic Banking Acquisitions & Activities, at (202) 452-3009, in the Division of Banking Supervision and Regulation; or Suzanne Killian, Assistant Director, at (202) 452-2090, or Phyllis Harwell, Manager, LFI/LBO and Consumer Complaints, (202) 452-3658, in the Division of Consumer and Community Affairs. In addition, questions may be sent via the Board's public website.[8]

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Cross-References:

- SR letter 09-4, "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies"
- SR letter 08-9/CA letter 08-12, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations"
- SR letter 08-1 / CA letter 08-1, "Communication of Examination/Inspection Findings"
- SR letter 04-18, "Bank Holding Company Rating System"
- SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less"
- SR letter 99-18, "Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles"
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Attachments:

A. *First-Cycle Inspection of SLHCs Engaged Primarily in Depository Institution Activities*

B. *First-Cycle Inspection of Insurance SLHCs, Broker-Dealer SLHCs, and Commercial SLHCs*

C. *Assessing Capital Planning and Sufficiency*

[8] See http://www.federalreserve.gov/feedback.cfm.

Attachment A

First-Cycle Inspection of SLHCs Engaged Primarily in Depository Institution Activities

The Federal Reserve supervisory program for an SLHC engaged primarily in depository institution activities conducted through its savings association(s) will be determined by the Federal Reserve supervisory program for portfolios of BHCs of similar asset size and complexity (i.e., the company generally will be treated as a community, regional, or large banking organization).[1] When conducting inspection activities, examiners should take into account the unique characteristics of SLHCs and coordinate with primary supervisors of the savings association and functional regulators of the parent or its nondepository subsidiaries, if any.

In general, the first inspection and assignment of an indicative rating will follow the issuance of the primary federal or state banking regulator's report of examination of the lead savings association subsidiary. Giving consideration to the time required for the primary federal or state banking regulator to complete its examination and issue a report, it is expected that the first inspections of, and assignments of indicative ratings to, SLHCs are not likely to occur until late 2011 or early 2012.

SLHCs with Less Than $1 Billion in Assets

An inspection of a company with less than $1 billion in assets (small shell company) will be conducted according to small shell bank holding company guidance (as described in SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less"). In addition, the inspection should determine if the SLHC has nondepository subsidiaries that are engaged in activities involving consumer financial products or services. Key elements of this program for a small shell SLHC will include the following:

- Examiners should determine whether the SLHC is complex or noncomplex, including a determination of whether the SLHC conducts any activities that are not permissible for a BHC.[2]
- For a noncomplex small shell company where all subsidiary savings associations have satisfactory composite and management ratings, where no material outstanding or consolidated issues are otherwise indicated, and where there are no nondepository

[1] SLHCs with less than $10 billion in assets generally will be supervised in the community banking organization portfolio, with SLHCs with less than $1 billion in assets supervised as small shell companies. SLHCs with $10 billion but less than $50 billion in assets generally will be supervised as regional banking organizations, and SLHCs with $50 billion or more in assets generally will be supervised as large banking organizations. These should be viewed as guidelines rather than rigid thresholds, since assignment of SLHCs to these portfolios will depend on not only the consolidated asset size of the SLHC, but also on the activities of the consolidated SLHC and the size and complexity of savings association subsidiaries.

[2] The determination of whether a holding company is "complex" versus "noncomplex" is made at least annually on a case-by-case basis taking into account and weighing a number of considerations, such as the size and structure of the holding company; the extent of intercompany transactions between insured depository institution subsidiaries and the holding company or uninsured subsidiaries of the holding company; the nature and scale of any nonbank activities, including whether the activities are subject to review by another regulator and the extent to which the holding company is conducting Gramm-Leach-Bliley authorized activities (e.g., insurance, securities, merchant banking); whether risk management processes for the holding company are consolidated; and whether the holding company has material debt outstanding to the public.

subsidiaries that are engaged in activities involving consumer financial products or services, examiners generally will assign only indicative risk-management and composite ratings to the SLHC based on the ratings of the lead savings association. Typically, Federal Reserve examiners assign these ratings based on offsite analysis.

- For other noncomplex small shell companies, examiners generally will conduct an offsite review, with targeted onsite review as necessary, and will assign only indicative risk-management and composite ratings to the SLHC based on its analysis.
- For a complex small shell company, examiners generally will conduct an offsite review, with targeted onsite review as necessary, and will assign an indicative rating to the SLHC based on its analysis, addressing all components of the RFI rating system.
- If a determination is made that an SLHC nondepository subsidiary is engaged in activities involving consumer financial products or services, those activities and their risks should be factored into the consumer risk assessment for the SLHC and in the indicative rating.

SLHCs with Assets Between $1 - $5 Billion

An inspection of a company with assets between $1 billion and $5 billion will be conducted according to SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less." In addition, the inspection should determine if the SLHC has nondepository subsidiaries that are engaged in activities involving consumer financial products or services. Key elements of this program for these SLHCs will include the following:

- Examiners should determine whether the SLHC is complex or noncomplex, including a determination of whether the SLHC conducts any activities that are not permissible for a BHC.
- For a noncomplex SLHC with a satisfactory composite rating, a limited-scope onsite inspection--which may be satisfied with a targeted inspection--is required every two years.
- For a complex SLHC with a satisfactory composite rating, a full-scope onsite inspection is required annually. This requirement may be satisfied with a limited-scope or targeted review for the onsite portion of the inspection, supplemented by other information sources.
- For an SLHC with a less-than-satisfactory composite rating, irrespective of complexity, at least one full-scope onsite inspection and one limited-scope or targeted inspection are required annually. The requirement for an annual full-scope inspection may be satisfied with a limited-scope or targeted inspection for the onsite portion, supplemented by other information sources.
- Complete indicative ratings will be assigned to the SLHC in conjunction with inspection activities.
- If a determination is made that an SLHC nondepository subsidiary is engaged in activities involving consumer financial products or services, those activities and their risks should be factored into the consumer risk assessment for the SLHC and in the indicative rating.

- Additional limited-scope or targeted inspection activities may be conducted as needed.

SLHCs with Assets Between $5 - $10 Billion

An inspection of a company with assets between $5 billion and $10 billion will be conducted in accordance with section 5000 of the *Bank Holding Company Supervision Manual*. In addition, the inspection should determine if the SLHC has nondepository subsidiaries that are engaged in activities involving consumer financial products or services. Key elements of this program for these SLHCs will include the following:

- Examiners should determine whether the SLHC is complex or noncomplex, including a determination of whether the SLHC conducts any activities that are not permissible for a BHC.
- For a noncomplex SLHC with a satisfactory composite rating, a limited-scope onsite inspection is required every two years.
- For a complex SLHC with a satisfactory composite rating, a full-scope onsite inspection is required annually.
- For an SLHC with a less-than-satisfactory composite rating, irrespective of complexity, at least one full-scope onsite inspection and one limited-scope or targeted inspection are required annually.
- Complete indicative supervisory ratings will be assigned to the SLHC in conjunction with inspection activities.
- If a determination is made that an SLHC nondepository subsidiary is engaged in activities involving consumer financial products or services, those activities and their risks should be factored into the consumer risk assessment for the SLHC and in the indicative rating.
- Additional limited-scope or targeted inspection activities may be conducted as needed.

SLHCs with Assets of $10 Billion and Greater

During the first supervisory cycle, staff will engage in regular discovery activities of SLHCs with assets of $10 billion and greater that are engaged primarily in depository institution activities. These discovery activities will focus on gaining an understanding of the SLHC's financial condition, financial activities, corporate governance, and risk management processes.

- The first inspection activities at an SLHC with assets of $10 billion and greater will be conducted according to the principles set forth in consolidated supervision guidance contained in SR letter 08-9/CA letter 08-12, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations." In addition, due to the unique nature of many SLHC activities, discovery review activities will be part of inspection activities, particularly during the first inspection cycle. The inspection generally will not be completed, and the indicative ratings assigned, until issuance of the primary federal banking regulator's report of examination of the lead savings association subsidiary.

- While most SLHCs engaged primarily in depository institution activities operate in a manner that is similar to that of BHCs (i.e., the majority of operations are conducted through depository institution subsidiaries and nondepository subsidiaries engaged in activities that are primarily financial in nature), some companies in this group may conduct activities that normally are not encountered in BHCs. Therefore, examiners should develop an understanding of these operations, the manner in which the company monitors and manages these activities, and risks to the safety and soundness of the company or its depository institution subsidiaries, as well as any potential consumer compliance risks, that could arise from these activities.

Attachment B

First-Cycle Inspection of Insurance SLHCs, Broker-Dealer SLHCs, and Commercial SLHCs

A limited number of SLHCs have been identified as being primarily engaged in insurance or broker-dealer activities, primarily engaged in commercial activities through the exemption in section 10(c)(9)(C) of HOLA, or primarily engaged in activities that were authorized by regulation on March 5, 1987 for SLHCs to engage in directly, and have savings association subsidiaries that account for only a small percentage of the total consolidated assets of the SLHC. Commercial SLHCs are principally engaged either in commercial activities (such as manufacturing or merchandising) or in activities not specifically permissible for financial holding companies (such as real estate development).[1] Given the distinct nature of these entities, the Board may elect to supervise these entities in portfolios separate from the traditional holding company portfolios, which are based largely upon asset size.

During the first supervisory cycle, examination staff should focus on gaining an understanding of the structure of the consolidated organization, intercompany financial transactions, and overall financial condition, and should conduct reviews of corporate governance, risk management, and internal audit at each SLHC.

At SLHCs focused on insurance and broker-dealer lines of business, examiners will also identify and conduct reviews of key financial activities and associated risk management practices.

At commercial SLHCs, while examiners should seek to gain an understanding of the structure and operations of the consolidated organization, the focus of first inspection cycle activities should be on the financial, not the commercial, activities of the company. However, the segregation of the financial business lines of these companies will vary and some or all corporate functions may integrate both commercial and financial business lines. An inspection of a company in this category should include all functions that directly relate to financial activities, such as risk management, corporate governance, and internal financial activities (e.g., treasury functions, derivative/hedging transactions, or lending). Examiners should assess commercial activities only to the extent that these activities may impact the savings association subsidiary(ies), including the holding company's ability to serve as source of strength to them.

During the initial supervisory cycle for SLHCs primarily engaged in insurance, broker-dealer, or commercial activities, supervision staff should, by the fourth quarter of 2011, initiate several activities:

- communicate with the OCC, FDIC, state banking supervisors, state insurance regulators, the U.S. Securities and Exchange Commission, and any other functional regulators (as relevant);

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[1] Section 10(c)(9)(C) of HOLA permitted certain SLHCs, referred to as grandfathered unitary SLHCs or GUSLHCs, to retain their authority to engage in nonfinancial activities. Only a subset of all GUSLHCs primarily engages in commercial activities. That subset, along with other SLHCs that engage in activities that were authorized by regulation on March 5, 1987 for SLHCs to engage in directly, and have savings association subsidiaries that account for only a small percentage of the total consolidated assets of the SLHC are referred to herein as "commercial SLHCs."

- develop an initial supervisory profile (institutional overview and risk assessment)[2] for each company, including any potential consumer compliance risks arising from financial activities outside of the savings association subsidiary(ies); and
- develop an initial financial assessment for each company.

Subsequently, supervisory staff should leverage information gained through the above activities to:

- develop and implement supervisory plans, in coordination with other regulators as appropriate;
- conduct targeted discovery reviews; and
- compile financial data to support horizontal and peer analyses.

Federal Reserve examination staff plan to complete these first supervisory cycle activities by July 2012. At that point, it is anticipated that staff will have gained sufficient knowledge of the risk profiles of each organization to inspect and provide indicative ratings to these companies in line with the Federal Reserve supervisory process for bank holding companies.

[2] See SR letter 99-15, "Risk-Focused Supervision of Large Complex Banking Organizations," and SR letter 97-24, "Risk-Focused Framework for Supervision of Large Complex Institutions."

Attachment C

Assessing Capital Planning and Sufficiency

SLHCs currently are not subject to consolidated regulatory leverage or risk-based capital requirements. However, in accordance with both Federal Reserve and OTS guidance, an SLHC should have sufficient capital and an effective capital planning process, consistent with its overall risk profile and considering the size, scope, and complexity of its operations, to ensure the safe and sound operation of the company.

Examiners should evaluate capital planning and sufficiency following relevant BHC supervisory guidance, which is very similar to the supervisory methods formerly used by the OTS. This guidance includes:

- SR letter 09-4, "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies"
- SR letter 04-18, "Bank Holding Company Rating System"
- SR letter 02-1, "Revisions to Bank Holding Company Supervision Procedures for Organizations with Total Consolidated Assets of $5 Billion or Less"
- SR letter 99-18, "Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles"
- Sections 4060.3.10, 4060.3.11.3, 4060.7, and 4060.9 of the Federal Reserve's *Bank Holding Company Supervision Manual*

Qualitative Capital Assessment

The OCC, FDIC, or state regulator will assess capital at the savings association level. If capital planning is conducted at the thrift level and the SLHC is a noncomplex shell SLHC, examiners should rely to the extent possible on the federal or state regulator's work to evaluate capital planning and sufficiency, following the guidance in SR 02-1, SR 04-18, SR 09-4, and the *Bank Holding Company Supervision Manual.*

If capital planning is conducted at the SLHC level or if the SLHC is large, complex, or primarily conducts nonbanking activities, examiners should independently assess capital planning and sufficiency at the SLHC, following the guidance in SR 99-18, SR 04-18, SR 09-4, and the *Bank Holding Company Supervision Manual.*

Examiners should assess whether capital planning processes are sufficient for the institution's size, complexity, and risk profile. For example, when assessing capital planning processes at the SLHC, examiners should inquire as to how the SLHC's management and board:

- identify the consolidated risk profile, considering organizational structure and risk management
- determine the level of consolidated capital to maintain commensurate with those risks, including assessment of capital sources (internal and external), capital levels, and trends

- conduct formal capital planning, including stress testing under various degrees of stress
- consider the appropriate level and mix of various capital instruments
- consider the appropriate level of dividends
- factor industry-specific capital requirements established by a federal, state, or other regulatory body in the capital assessment (if applicable)
- factor peer analysis and ratings agency analysis in the capital assessment
- incorporate the above assessments in strategic and tactical planning
- document the above assessments in board and committee meeting minutes

Examiners also should understand how the SLHC's management and board:

- identify risks within the savings association subsidiary(ies)
- assess the capital needs at the savings association subsidiary(ies)
- consider the appropriate level of dividends from the savings association subsidiary(ies) to the parent

Finally, examiners should consider how the SLHC historically has served as a source of capital for the savings association subsidiary(ies) and its ability to do so in the future.

Quantitative Capital Assessment

In addition, examiners may find it useful to calculate the ratios described in section 300 of the OTS *Holding Companies Handbook* to aid in identifying trends in capital levels and sufficiency when compared to prior periods and prior OTS holding company reports of examination.

Assigning a Rating to Capital

When assigning an indicative or final rating to the Capital Adequacy subcomponent of the RFI Financial Condition component, examiners should utilize the descriptions of the ratings in the attachment to SR 04-18, which do not refer to specific regulatory capital requirements. Examiners should also utilize the inspection procedures set forth in section 4060.3.11.3, "Overall Assessment of Capital Adequacy," of the *Bank Holding Company Supervision Manual*, excluding any procedures (such as #1) related to minimum regulatory capital standards.