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respect to SLHCs and their nondepository subsidiaries will be enforceable until modified, terminated, set aside, or superseded.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

[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

---

[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]

Patrick M. Parkinson
Director
Division of Banking Supervision
and Regulation

Sandra F. Braunstein
Director
Division of Consumer
and Community Affairs

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"
- 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"

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.