INTRODUCTION

The risk-based capital matrix is a tool to use when evaluating a bank's capital for the purpose of proposed enforcement actions. For example, an examiner may use the matrix to determine how much capital to require in a bank's enforcement action such as a formal agreement or consent order. The matrix helps to establish the tier 1 capital to risk-weighted assets ratio, since that is the ratio required in enforcement action articles. The matrix should be completed using the companion examiner guidance, Assessing Capital Adequacy.

The risk-based capital matrix is an internal guideline for the Office of the Comptroller of the Currency and does not create any substantive or procedural rights enforceable at law or in any administrative hearing.

Please note that some provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 require amendments to capital regulations and corresponding changes to this matrix. In addition, numerous national and international efforts are underway currently that will affect how the OCC quantifies interest rate risk. As new regulations, guidance, or examination tools become available, the matrix will be revised and redistributed.

QUESTIONS

Questions about the risk-based capital matrix should be directed to the Chief National Bank Examiner's Office at 202-874-5170 or the Special Supervision Division at 202-874-4450.

BACKGROUND

Although 12 CFR 3 contains the minimum capital ratios applicable to all banks, Subpart C provides for the establishment of higher minimum capital ratios for individual banks. 12 CFR 3.10 lists the circumstances or categories to consider in establishing those ratios.

Examiners can use the attached risk-based capital matrix to quantify a bank's capital needs when preparing an administrative action, such as a capital directive, formal agreement, or an order to cease and desist. The examiner must use his or her judgment when using the matrix and must understand the resulting figure is only a starting point for analyzing a bank's capital level.

PROCEDURE

To use the matrix, the examiner must evaluate the applicability of each numbered circumstance using the listed factors. The examiner also must determine whether a particular factor merits a different score than is suggested by the matrix. The examiner should fully support and document the use of this matrix and any other determinations of capital adequacy in the work papers.

Examiners should assess only circumstances that apply to the bank. In many categories, a management factor is also scored that either adds to or subtracts from the risk factor score. The matrix should be applied as though the fully phased-in 1993 rules were operative. The following instructions should be used in conjunction with the examiner guidance on Assessing Capital Adequacy, that provides additional information focussing on risk management.

EVALUATING THE CIRCUMSTANCES

1. **NEWLY CHARTERED BANK.** A capital score is assigned only if the bank is less than five years old. No score should be assigned in this category because of a change in control or merger within the prior five years.

2. **SPECIAL SUPERVISION BANK.** Any bank for which an enforcement action is contemplated should receive a score here. Remember the matrix is intended for use only in banks when an enforcement action is being considered.

3. **RISK OF CAPITAL INADEQUACY DUE TO LOSSES.** The degree to which the bank's capital is or could be impaired by losses is rated in this category. The bank's probable performance over the next year at least should be rated. Situations that could cause capital impairment include, but are not limited to: operating losses, pending litigation, trading losses, writing down assets, or losing the ability to book deferred tax credits.

   No score is assigned for banks that are expected to be profitable. Banks expected to suffer only minor losses are given the lowest score. Capital in those banks is not likely to become inadequate in the next year. Banks expected to have losses that will reduce capital below minimums receive the medium score. Banks that currently fall below minimums or are expected to become nearly insolvent score the highest.

4a. **SIGNIFICANT EXPOSURE TO INTEREST RATE RISK.** Evaluation of interest rate risk is explained in the examiner guidance paper, Assessing Capital Adequacy. The risk a bank incurs by taking foreign exchange positions should also be considered. Both the level of risk and the offsetting or compounding effect of management are rated.

4b. **SIGNIFICANT EXPOSURE TO FIDUCIARY RISK.** The results of an examination of a bank's trust department operations affects the score in this category. If a bank has no trust activities, no score is assigned. Both the level of risk and the offsetting or compounding effect of management are rated.

4c. SIGNIFICANT EXPOSURE TO OPERATIONAL RISK. Planning for and implementing new products and services involves operational risk. The contribution of the bank's written policies, procedures, contingency plans, and backup systems to that risk must all be considered. Additional assistance is provided in the examiner guidance paper, Assessing Capital Adequacy. Both the level of risk and the effect of management are rated.

4d. SIGNIFICANT EXPOSURE TO CREDIT CONCENTRATION RISK. The extent and nature of any concentrations must be assessed to determine their impact on capital. Additional guidance in this area is provided in the examiner guidance paper, Assessing Capital Adequacy. Both the level of risk and the effect of management are rated.

5. LEVEL OF LIQUIDITY. All aspects of the bank's liquidity, including current and projected position; primary and secondary sources; planning; and management, are rated in this category. The examiner must determine if the bank's liquidity is good, adequate, or poor. Thorough consideration of volatile liability dependence, sale or purchase of federal funds, concentrations among funds providers, reliance on brokered funds, asset appreciation or depreciation, liquid asset levels, potential access to unused markets, and the bank's credit service rating is needed to make this determination. A bank's off-balance sheet commitments may contribute to or detract from its level of liquidity.

A bank with no funding concerns is rated good. A bank with some funding problems or potential funding concerns is rated adequate. A bank that relies totally upon volatile or high cost funding sources has poor liquidity. Banks that are generally wholesale funded score highest in this category, even though their management of the funding is excellent. The assessment of management's ability in this area provides either a mitigating or an exacerbating score. Both the level of risk and the effect of management are rated.

6. BANK WITH A HIGH VOLUME OF OR SEVERE PROBLEM LOANS. The level of problem assets, especially high levels of severely criticized assets, is scored in this category. If management of the loan portfolio needs improvement or is inadequate, the score is increased. If management is good, the risk score is mitigated. Both the level of risk and the effect of management are rated.

7. **BANK GROWING RAPIDLY.** Acquisition growth and internal growth are scored separately since they represent differing levels of risk. Once again the ability of management is scored as well.

8. **BANK ADVERSELY AFFECTED BY AFFILIATES.** Any harm to the bank by affiliates, including a holding company or majority owner, must be assessed and scored. This includes a bank with undercapitalized affiliates that may be subject to FDIC cross-guarantees.

9. **OPTIONAL OTHER RISK FACTORS.** The examiner may add any other risk factors that cause concern. Additional mitigating factors may also be considered when arriving at a bank's final score. Any factors scored in this category should be fully supported by explanation and documentation.

SUMMARY

Add the scores for each category together to determine the capital (above the four percent minimum) needed by the bank. This score can be used as a starting point for discussions with management about the bank's capital level required in an enforcement action. You should fully discuss all risk factors with management to ensure that you have fully considered any mitigating factors in your determination.

This matrix and any supporting documentation must be included in work papers when the matrix is used.