[HPS] LEADING THINKING

The 2014 Federal Reserve Stress Tests

March 21, 2014

Hamilton Place Strategies provides communications, policy, and advocacy solutions at the intersection of business, government, and media.

Executive Summary

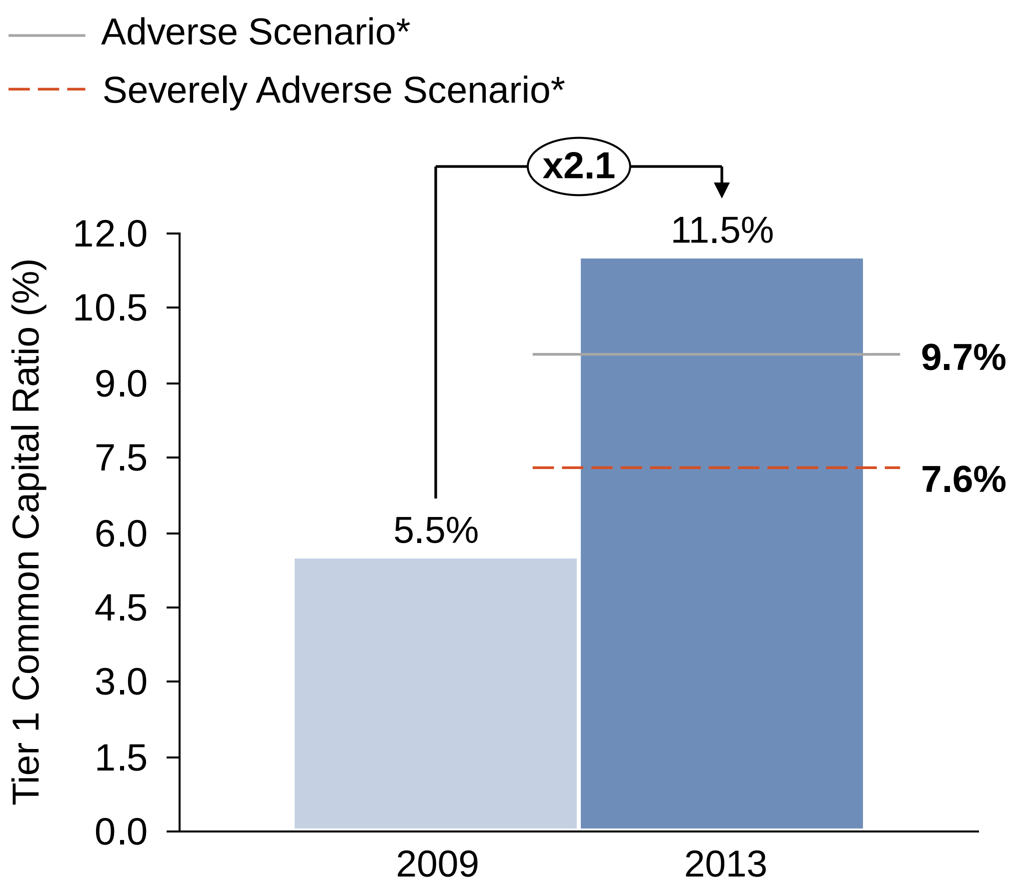
On March 20th, the Federal Reserve released the results of the 2014 stress tests, of which 29 out of 30 banks passed.* This document outlines the results, improvements from prior tests, and the domestic and international scenarios the Federal Reserve tested against. Key highlights are:

- **With a capital ratio that more than doubles the 2009 ratio, the 30 largest bank holding companies (BHC's) maintained an average capital ratio of 7.6 percent under the most severely adverse scenario.** This is well above the regulatory minimum of 5.0 percent with only one BHC falling below the minimum.
- **The 2014 stress tests added several new features compared to 2013**, including:
  - An independent balance sheet and risk-weighted asset (RWA) projections for individual BHC's, improving comparability;
  - The use of Basel III's phase-in requirements for calculating capital ratios;
  - The disclosure of individual BHC performance under both the adverse and severely adverse scenarios;
  - The testing of 30 BHC's – which account for nearly 80 percent of U.S. banking assets – as opposed to 18 BHC's, which were tests the previous year;
  - The default of the six largest BHC's largest counterparty in derivative and swap trades; and,
  - A global market shock affecting a broad range of risk factors.
- **The domestic severely adverse scenario includes a decline in real GDP of nearly 4.75 percent between Q3'13 and Q4'14.** Additionally, there is an increase in the unemployment rate to 11.25 percent, a 50 percent drop in equity prices, and housing price decline of 25 percent.
- **Internationally, the severely adverse scenario features recessions in the Euro area, the United Kingdom, and Japan.** There is also below-trend growth in developing Asia.

*Zion Bancorporation did not pass

By More Than Doubling Their Capital Ratio, U.S. Banks Are Able To Withstand The Fed's Worst-Case Scenario

The Aggregate Tier 1 Common Capital Ratio For The 29 Largest Bank Holding Companies



What This Means:

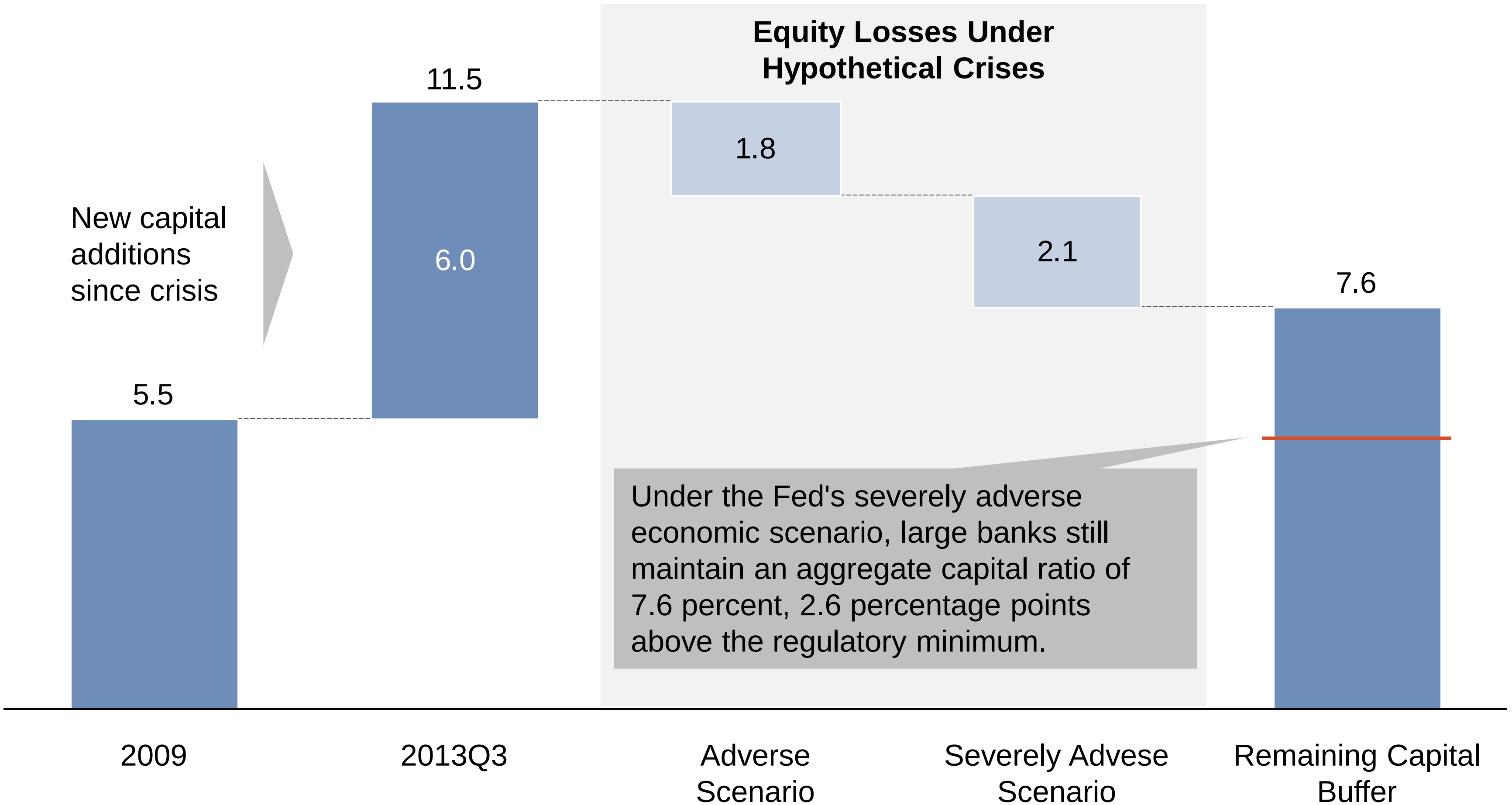
- The tier 1 common capital ratio measures a firm's highest quality of capital to its assets on a risk-weighted basis.
- This is an indicator of financial strength and the ability to withstand losses.
- Going in to the stress tests, the aggregate tier 1 common capital ratio was 11.5%.
- Under the Fed's most severe economic contraction scenario U.S. financial institutions' ratio fell to minimum level of 7.6%, which is 2.1 percentage points higher than it was during the financial crisis.

*Lowest estimate of ratios under each hypothetical scenario

Source: Federal Reserve

With More Capital, U.S. Banks Withstand Both Of The Fed's Hypothetical Adverse Scenarios

The Aggregate Tier 1 Common Capital Ratio For The 29 Largest Bank Holding Companies



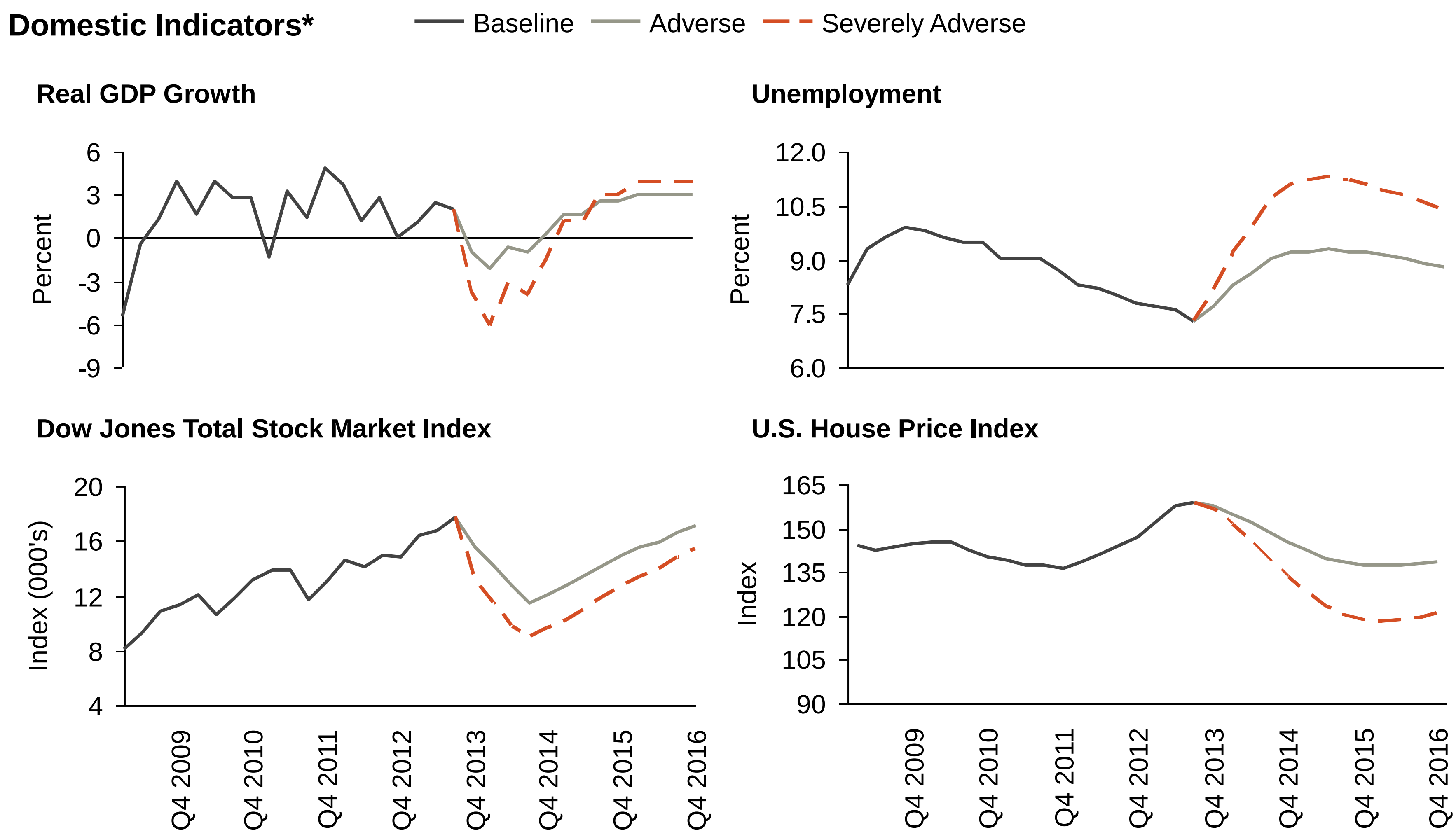
*Lowest estimate of ratios under each hypothetical scenario

Source: Federal Reserve

In 2014, The Fed Continued To Make Changes That Improve Stress Tests While Addressing Past Criticisms

From…	To…
Stress tests relied on individual bank's balance sheet and RWA projections	The Fed is independently projecting balance sheet and RWAs, which improves comparability of the stress tests across BHC's
The Fed used Basel II regulations to calculate capital levels	The Fed 's calculation now reflects the phase-in of the revised capital framework under Basel III
The Fed only disclosed individual bank performance under the severely adverse scenario	The Fed now discloses individual BHC performance for the severely adverse and adverse scenarios, providing more information to the market
Some suggest the Fed did not fully account for counterparty risk	The Fed incorporated a counterparty default scenario that involves the default of the BHC's largest counterparty in trading of swaps and derivatives
Additionally, some suggested global shocks may have been underappreciated in tests	The Fed included a "Global Market Shock" component which includes a set of one-time, hypothetical shock to a broad range of risk factors
The Fed tested 18 BHC's	In 2014, the Fed tested 30 BHC's, which account for nearly 80 percent of U.S. bank assets

Under The Fed's Severely Adverse Scenario, The U.S. Unemployment Rate Rises To 11.25 Percent



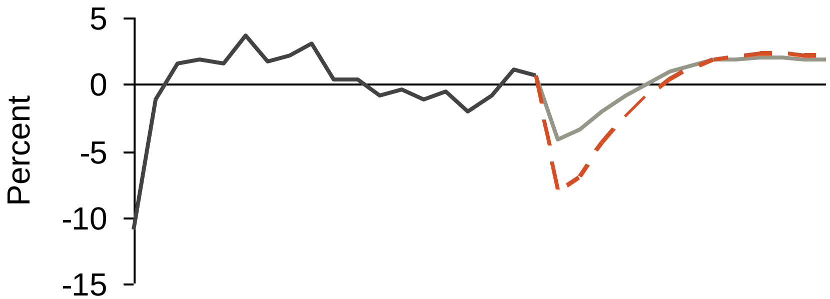
*Shows four of the 16 domestic indicators used in the Fed's two hypothetical scenarios

Source: Federal Reserve

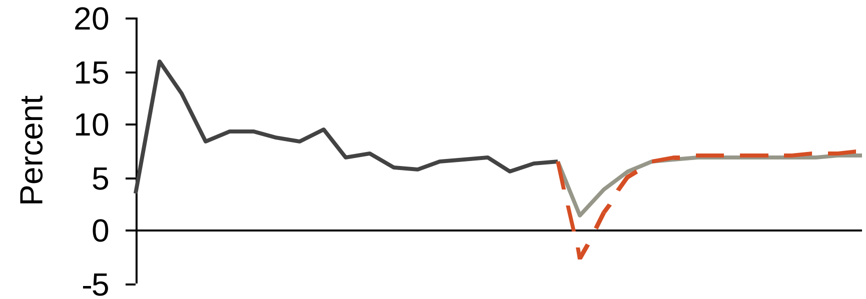
Globally, The Severely Adverse Scenario Features Recessions In Euro Area, UK, And Japan

International Indicators* Baseline Adverse Severely Adverse

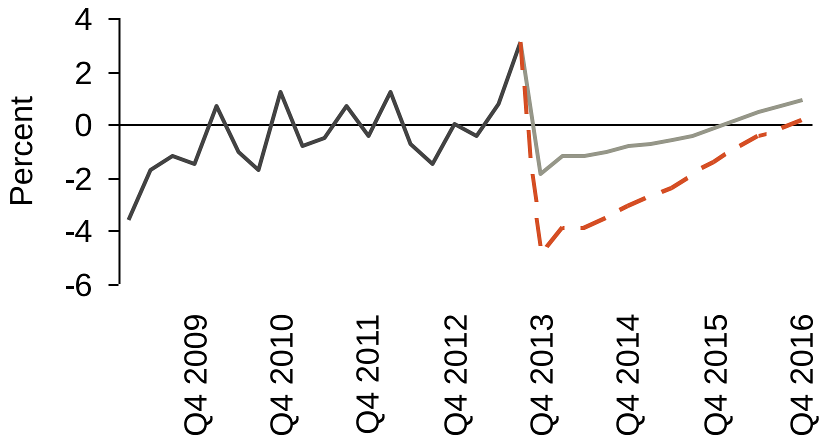
Euro Area Real GDP Growth



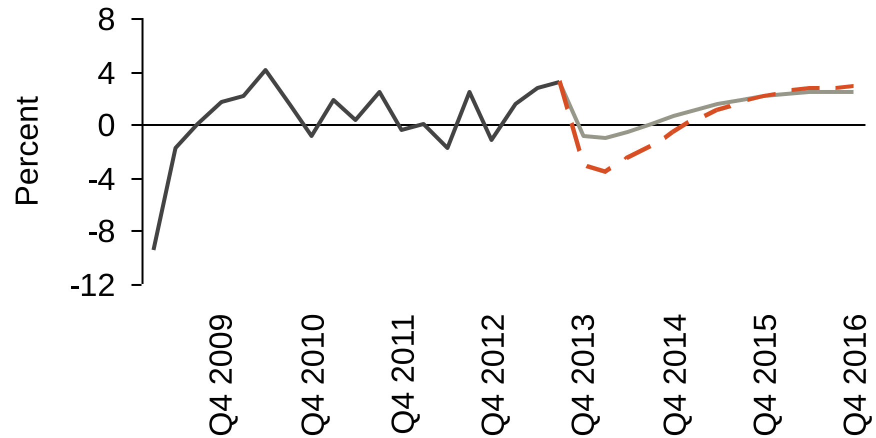
Developing Asia Real GDP Growth



Japan Real GDP Growth



UK Real GDP Growth



*Shows four of the 12 international indicators used in the Fed's two hypothetical scenarios

Source: Federal Reserve