



## **Basel Pillar 3 Disclosures**

March 31, 2021

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## INTRODUCTION

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### Overview

Capital One Financial Corporation, a Delaware corporation established in 1994 and headquartered in McLean, Virginia, is a diversified financial services holding company with banking and non-banking subsidiaries. Capital One Financial Corporation and its subsidiaries (the “Company” or “Capital One”) offer a broad array of financial products and services to consumers, small businesses and commercial clients through digital channels, branches, Cafés and other distribution channels.

As of March 31, 2021, our principal subsidiaries included:

- Capital One Bank (USA), National Association (“COBNA”), which offers credit and debit card products, other lending products and deposit products; and
- Capital One, National Association (“CONA”), which offers a broad spectrum of banking products and financial services to consumers, small businesses and commercial clients.

The Company is hereafter collectively referred to as “we,” “us” or “our.” COBNA and CONA are collectively referred to as the “Banks.” Certain business terms used in this document are defined in the “Glossary and Acronyms” section of this Pillar 3 Disclosure (this “Report”).

### Regulatory Framework

#### *Basel III Capital Rules*

The Company and the Banks are subject to the regulatory capital requirements established by the Federal Reserve and the OCC respectively (the “Basel III Capital Rules”). The Basel III Capital Rules implement certain capital and liquidity requirements published by the Basel Committee on Banking Supervision (“Basel Committee”), along with certain Dodd-Frank Act and other capital provisions. Moreover, as insured depository institutions, the Banks are subject to Prompt Corrective Action (“PCA”) capital regulations.

The Basel III Capital Rules include requirements for quarterly public disclosures of qualitative and quantitative information regarding capital, capital adequacy and risk. These disclosures fall under the third Pillar of the Basel III capital framework (the “Pillar 3 Disclosures”), and are intended to allow market participants to assess key information about a bank’s risk profile and its associated level of capital. For additional information about the capital adequacy guidelines we are subject to, see “Part I—Item 1. Business—Supervision and Regulation” and “MD&A—Capital Management” in our Annual Report on Form 10-K for the year ended December 31, 2020 (the “2020 Form 10-K”) and in our quarterly report on Form 10-Q for Quarterly Period ended March 31, 2021 (the “Q1 2021 Form 10-Q”).

Under the Basel III Capital Rules, we must maintain a minimum common equity Tier 1 (“CET1”) capital ratio of 4.5%, a Tier 1 capital ratio of 6.0%, and a total capital ratio of 8.0%, in each case in relation to risk-weighted assets. In addition, we must maintain a minimum leverage ratio of 4.0% and a minimum supplementary leverage ratio of 3.0%. We are also subject to the capital conservation buffer and countercyclical capital buffer requirements, as described below.

In October 2019, the Federal Reserve, OCC and Federal Deposit Insurance Corporation (the “FDIC,” and collectively, the Federal Banking Agencies”) amended the Basel III Capital Rules to provide for tailored application of certain capital requirements across different categories of banking institutions (the “Tailoring Rules”). These categories are determined primarily by an institution’s asset size, with adjustments to a more stringent category possible if the institution exceeds certain risk-based thresholds. As a bank holding company (“BHC”) with total consolidated assets of at least \$250 billion that does not exceed any of the applicable risk-based thresholds, we are a Category III institution under the Tailoring Rules. Therefore, effective January 1, 2020, we are no longer subject to the Basel III “Advanced Approaches” framework and certain associated capital requirements, and we have elected to exclude certain elements of accumulated other comprehensive income (“AOCI”) from our regulatory capital as permitted by the Tailoring Rules. We remain subject to the countercyclical capital buffer requirement (which is currently set at 0%) and supplementary leverage ratio requirement, which were previously required only for Basel III Advanced Approaches institutions.

Global systemically important banks (“G-SIBs”) that are based in the U.S. are subject to an additional CET1 capital requirement known as the G-SIB Surcharge. We are not a G-SIB based on the most recent available data and thus we are not subject to a G-SIB Surcharge.

### ***Stress Capital Buffer Rule***

The Basel III Capital Rules require banking institutions to maintain a capital conservation buffer, composed of CET1 capital, above the regulatory minimum ratios. The capital conservation buffer for BHCs was previously fixed at 2.5%. In March 2020, the Federal Reserve issued a final rule to implement the stress capital buffer requirement (the “Stress Capital Buffer Rule”). The stress capital buffer requirement is institution-specific and replaces the fixed 2.5% capital conservation buffer for BHCs.

Pursuant to the Stress Capital Buffer Rule, the Federal Reserve will use the results of its supervisory stress test to determine the size of a BHC’s stress capital buffer requirement. In particular, a BHC’s stress capital buffer requirement will equal, subject to a floor of 2.5%, the sum of (i) the difference between the BHC’s starting CET1 capital ratio and its lowest projected CET1 capital ratio under the severely adverse scenario of the Federal Reserve’s supervisory stress test plus (ii) the ratio of the BHC’s projected four quarters of common stock dividends (for the fourth to seventh quarters of the planning horizon) to the projected risk-weighted assets for the quarter in which the BHC’s projected CET1 capital ratio reaches its minimum under the supervisory stress test.

Under the Stress Capital Buffer Rule framework, the Company’s new “standardized approach capital conservation buffer” includes its stress capital buffer requirement (which will be recalibrated every year based on the Company’s supervisory stress test results), any G-SIB surcharge (which is not applicable to us) and the countercyclical capital buffer requirement (which is currently set at 0%). Any determination to increase the countercyclical capital buffer generally would be effective twelve months after the announcement of such an increase, unless the Federal Banking Agencies set an earlier effective date.

The Company’s stress capital buffer requirement is 5.6% for the period from October 1, 2020 through September 30, 2021, at which point a revised stress capital buffer requirement will be applicable to the Company based on the Company’s 2021 stress testing results. Therefore, the Company’s minimum capital requirements plus the standardized approach capital conservation buffer for CET1 capital, Tier 1 capital and total capital ratios under the stress capital buffer framework are 10.1%, 11.6% and 13.6%, respectively, for the period from October 1, 2020 through September 30, 2021.

The Stress Capital Buffer Rule does not apply to the Banks. The capital conservation buffer for the Banks continues to be fixed at 2.5%. Accordingly, each Bank’s minimum capital requirements plus its capital conservation buffer for CET1 capital, Tier 1 capital and total capital ratios remain at 7.0%, 8.5% and 10.5% respectively.

If we fail to maintain our capital ratios above the minimum capital requirements plus the applicable buffer requirements, we will face increasingly strict automatic limitations on capital distributions and discretionary bonus payments to certain executive officers. Under the Basel III Capital Rules, if a banking institution’s capital ratios fall within its buffer requirements, the maximum amount of capital distributions and discretionary bonus payments it can make is a function of its Eligible Retained Income.

In March 2020, the Federal Banking Agencies revised the definition of Eligible Retained Income in their respective capital rules. Under the revised definition, any such automatic limitations on capital distributions would apply in a less severe and more gradual manner than would otherwise have occurred under the previous definition of that term. This change was made in response to the COVID-19 pandemic to support banking organizations that choose to use their capital and liquidity buffers to lend and undertake other actions that support economic activity in a safe and sound manner.

As of March 31, 2021, each of the Company and the Banks exceeded the minimum capital requirements and the buffer requirements applicable to them, and each of the Banks was “well capitalized” under PCA requirements.

### **Market Risk Rule**

The “Market Risk Rule” supplements the Basel III Capital Rules by requiring institutions subject to the rule to adjust their risk-based capital ratios to reflect the market risk in their trading portfolios. The Market Risk Rule generally applies to institutions with aggregate trading assets and liabilities equal to 10% or more of total assets or \$1 billion or more. As of March 31, 2021, the Company and CONA are subject to the Market Risk Rule. See “MD&A—Market Risk Profile” in our Q1 2021 Form 10-Q.

### **CECL Transition Rule**

As part of their response to the COVID-19 pandemic, the Federal Banking Agencies adopted a final rule (the “2020 CECL Transition Rule”) that provides banking institutions an optional five-year transition period to phase in the impact of the CECL standard on their regulatory capital (the “2020 CECL Transition Election”).

Pursuant to the 2020 CECL Transition Rule, a banking institution may elect to delay the estimated impact of adopting CECL on its regulatory capital through December 31, 2021 and then phase in the estimated cumulative impact from January 1, 2022 through December 31, 2024. For the “day 2” ongoing impact of CECL during the initial two years, the Federal Banking Agencies use a uniform “scaling factor” of 25% as an approximation of the increase in the allowance under the CECL standard compared to the prior incurred loss methodology. Accordingly, from January 1, 2020 through December 31, 2021, electing banking institutions are permitted to add back to their regulatory capital an amount equal to the sum of the after-tax “day 1” CECL adoption impact and 25% of the increase in the allowance since the adoption of the CECL standard. Beginning January 1, 2022 through December 31, 2024, the after-tax “day 1” CECL adoption impact and the cumulative “day 2” ongoing impact will be phased in to regulatory capital at 25% per year. The following table summarizes the capital impact delay and phase in period on our regulatory capital from years 2020 to 2025.

	<b>Capital Impact Delayed</b>		<b>Phase In Period</b>			
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>
“Day 1” CECL adoption impact	Capital impact delayed to 2022					
Cumulative “day 2” ongoing impact	25% scaling factor as an approximation of the increase in allowance under CECL		25% Phased In	50% Phased In	75% Phased In	Fully Phased In

We adopted the CECL standard (for accounting purposes) as of January 1, 2020, and made the 2020 CECL Transition Election (for regulatory capital purposes) in the first quarter of 2020. Therefore, the applicable amounts presented in this Report reflect such election.

### **Temporary Exclusions for Supplementary Leverage Ratio**

In April 2020, as part of the response to the COVID-19 pandemic, the Federal Reserve issued an interim final rule that temporarily excludes U.S. Treasury securities and deposits at Federal Reserve Banks from the calculation of the supplementary leverage ratio for BHCs. These temporary exclusions remained in effect through March 31, 2021 and expired as scheduled thereafter. The Company’s supplementary leverage ratio as of March 31, 2021 reflected these temporary exclusions. Without these temporary exclusions, we would have remained substantially in excess of the 3% regulatory minimum as of March 31, 2021.

In May 2020, the Federal Banking Agencies issued an interim final rule that provides an option for depository institutions to make similar exclusions to the calculation of the supplementary leverage ratio. If a depository institution elects to make such exclusions, it must request prior approval from its primary federal banking regulator before making capital distributions, such as paying dividends to its parent company, for as long as the exclusions are in effect. These temporary exclusions remained in effect for electing institutions through March 31, 2021 and expired as scheduled thereafter. Neither CONA nor COBNA elected to make such exclusions.

**Basis of Preparation**

This document contains Pillar 3 Disclosures as of and for the three months ended March 31, 2021, and has been prepared in accordance with the regulatory guidance prescribed by the Basel III Standardized Approach. The basis of consolidation that we use for regulatory reporting is consistent with the basis that we use for reporting under generally accepted accounting principles in the U.S. ("U.S. GAAP") as established by the Financial Accounting Standards Board. The regulatory instructions, however, do not in all cases follow U.S. GAAP. As a result of these differences, information in this Report may not be directly comparable to our disclosures in our Q1 2021 Form 10-Q or 2020 Form 10-K.

This Report contains information that is based on our interpretations, expectations and assumptions under the Basel III Capital Rule, as well as interpretations provided by our regulators, and is subject to change based on changes to regulations and interpretations. Our most recent Pillar 3 Disclosures report is available on our website ([www.capitalone.com](http://www.capitalone.com)) under "Investors/Financials/Basel Pillar 3 Disclosures" and it contains references to, and should be read in conjunction with our Q1 2021 Form 10-Q, 2020 Form 10-K, our Consolidated Financial Statements for Bank Holding Company ("FR Y-9C") and our Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework ("FFIEC 101") (also available on our website).

**Forward-Looking Statements**

Certain statements in this Report are forward-looking statements, which involve a number of risks and uncertainties. We caution readers that any forward-looking information is not a guarantee of future performance and that actual results could differ materially from those contained in the forward-looking information due to a number of factors, including those listed from time to time in reports that we file with the Securities and Exchange Commission, including, but not limited to the Q1 2021 Form 10-Q and 2020 Form 10-K.

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## CAPITAL

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### Capital Management

The prudent management of capital is one of our highest priorities. Capital must be sufficient to support the business plans and risk profiles of our business activities and to absorb adverse shocks (both systemic and idiosyncratic). Capital is central to our continuing operations and ability to lend to credit worthy businesses and consumers amidst normal and stressed environments.

The level and composition of our capital are determined by multiple factors, including our consolidated regulatory capital requirements and internal risk-based capital assessments such as internal stress testing and economic capital. The level and composition of our capital may also be influenced by rating agency guidelines, subsidiary capital requirements, business environment, conditions in the financial markets and assessments of potential future losses due to adverse changes in our business and market environments.

Our capital adequacy framework describes how we plan to ensure that we maintain the appropriate level and composition of our capital and remain resilient to potential uncertainties, consistent with the risk appetite and capital targets established by our Board of Directors. It includes clearly defined roles and responsibilities, a formal governance structure, and processes related to the overall implementation and oversight of our capital policy. Governance structures are designed to provide sound internal controls and to facilitate the Board of Directors' oversight and senior management's execution of the capital policy.

The Federal Reserve requires BHCs to submit a comprehensive capital plan that includes planned capital actions on an annual basis, consistent with their Comprehensive Capital Analysis and Review ("CCAR") requirements. The Federal Reserve uses the CCAR process to ensure that large BHCs have adequate capital and robust processes for managing their capital resources.

For additional information on capital management, see "MD&A—Capital Management" in our Q1 2021 Form 10-Q.

### Regulatory Capital and Capital Adequacy

Our regulatory capital structure consists of the following capital instruments:

#### *Common Stock*

Our common stock has par value of \$0.01 per share. As of March 31, 2021, we had approximately 457 million shares outstanding. For more information, see "Part I—Item 1. Financial Statements and Notes—Consolidated Balance Sheets" in our Q1 2021 Form 10-Q.

#### *Preferred Stock*

For information on our non-cumulative perpetual preferred stock, see "Note 9—Stockholders' Equity—Table 9.1: Preferred Stock Outstanding" in our Q1 2021 Form 10-Q.

#### *Unsecured Subordinated Debt*

For information on our unsecured subordinated debt, see "Note 7—Deposits and Borrowings—Table 7.1: Components of Deposits, Short-Term Borrowings and Long-Term Debt" in our Q1 2021 Form 10-Q.

The Basel III Capital Rule defines three categories of risk-based capital (CET1 capital, Tier 1 capital and Tier 2 capital) based on the capital elements' degree of permanency and capacity to absorb losses. CET1 capital primarily includes qualifying common shareholders' equity, retained earnings and certain AOCI amounts less certain deductions for goodwill, intangible assets, and certain deferred tax assets. Tier 1 capital consists of CET1 capital in addition to capital instruments that qualify as Tier 1 capital such as non-cumulative perpetual preferred stock. Tier 2 capital includes qualifying allowance for credit losses and subordinated debt.

Table 1 summarizes our regulatory capital structure as of March 31, 2021.

**Table 1: Regulatory Capital Under Basel III Standardized Approach**

<i>(Dollars in millions)</i>	<b>March 31, 2021</b>
Common equity excluding AOCI <sup>(1)</sup>	\$ 57,607
Adjustments:	
AOCI, net of tax <sup>(2)</sup>	(13)
Goodwill, net of related deferred tax liabilities	(14,444)
Intangible assets, net of related deferred tax liabilities	(81)
Other <sup>(3)</sup>	(18)
Common equity Tier 1 capital	43,051
Tier 1 capital instruments	4,847
Tier 1 capital	47,898
Tier 2 capital instruments	3,110
Qualifying allowance for credit losses	3,772
Tier 2 capital	6,882
Total capital	<u>\$ 54,780</u>

<sup>(1)</sup> Includes the impact of the 2020 CECL Transition Election

<sup>(2)</sup> Excludes certain components of AOCI as permitted under the Tailoring Rules.

<sup>(3)</sup> Includes deferred tax assets deducted from regulatory capital.



## Risk-Weighted Asset (“RWA”) Measurement

The Basel III Standardized Approach RWA is calculated based on the Basel III Capital Rule. Table 2 provides a distribution of our RWA by exposure categories prescribed by applicable regulations as of March 31, 2021. For a distribution of our RWA by balance sheet categories, see Schedule HC-R in our FR Y-9C as of March 31, 2021.

**Table 2: RWA by Basel Exposure Categories under Basel III Standardized Approach**

<i>(Dollars in millions)</i>	<b>March 31, 2021</b>
<b>RWA by Basel exposure categories:</b>	
Exposures to sovereign entities	\$ —
Exposures to supranational entities	—
Exposures to depository institutions, foreign banks and credit unions	574
Exposures to public-sector entities	16,263
Corporate exposures <sup>(1)</sup>	64,784
Residential mortgage exposures	212
Statutory multifamily mortgage exposures	2,338
High-volatility commercial real estate loans	356
Delinquent and past due loans	3,567
Other loans <sup>(1)(2)</sup>	159,952
Securitization exposures	4,890
Equity exposures	6,256
Other assets	19,204
<b>RWA by balance sheet asset categories (excluding derivatives)</b>	<b>278,396</b>
Off-balance sheet items	20,793
Over-the-counter derivatives	2,516
Centrally cleared derivatives	94
Market risk	95
<b>Total RWA before excess allowance for credit losses</b>	<b>301,894</b>
Excess allowance for credit losses	(6,685)
<b>Total RWA</b>	<b>\$ 295,209</b>

<sup>(1)</sup> Excludes 90+ day delinquent and non-accrual loans which are reported separately as delinquent and past due loans.

<sup>(2)</sup> Includes credit card, auto and other loans that are not classified in any other exposure categories in the above table.

### Capital Ratios under Basel III Standardized Approach

The table below provides regulatory capital ratios under the Basel III Standardized Approach, the regulatory minimum capital adequacy ratios and the PCA well-capitalized level for each ratio (where applicable) as of March 31, 2021.

**Table 3: Capital Ratios<sup>(1)</sup>**

	March 31, 2021		
	Ratio	Minimum Capital Adequacy	Well-Capitalized
<b>Capital One Financial Corp:</b>			
Common equity Tier 1 capital <sup>(2)</sup>	14.6 %	4.5 %	N/A
Tier 1 capital <sup>(3)</sup>	16.2	6.0	6.0%
Total capital <sup>(4)</sup>	18.6	8.0	10.0
Tier 1 leverage <sup>(5)</sup>	11.7	4.0	N/A
Supplementary leverage <sup>(6)(7)</sup>	11.3	3.0	N/A
<b>COBNA:</b>			
Common equity Tier 1 capital <sup>(2)</sup>	23.9	4.5	6.5
Tier 1 capital <sup>(3)</sup>	23.9	6.0	8.0
Total capital <sup>(4)</sup>	25.6	8.0	10.0
Tier 1 leverage <sup>(5)</sup>	19.8	4.0	5.0
Supplementary leverage <sup>(6)</sup>	15.9	3.0	N/A
<b>CONA:</b>			
Common equity Tier 1 capital <sup>(2)</sup>	13.1	4.5	6.5
Tier 1 capital <sup>(3)</sup>	13.1	6.0	8.0
Total capital <sup>(4)</sup>	14.3	8.0	10.0
Tier 1 leverage <sup>(5)</sup>	8.0	4.0	5.0
Supplementary leverage <sup>(6)</sup>	7.2	3.0	N/A

<sup>(1)</sup> Capital ratios are calculated based on the Basel III Standardized Approach framework. Capital requirements that are not applicable are denoted by "N/A."

<sup>(2)</sup> Common equity Tier 1 capital ratio is a regulatory capital measure under the Basel III Capital Rule calculated based on CET1 capital divided by risk-weighted assets.

<sup>(3)</sup> Tier 1 capital ratio is a regulatory capital measure calculated based on Tier 1 capital divided by risk-weighted assets.

<sup>(4)</sup> Total capital ratio is a regulatory capital measure calculated based on total capital divided by risk-weighted assets.

<sup>(5)</sup> Tier 1 leverage ratio is a regulatory capital measure calculated based on Tier 1 capital divided by adjusted average assets.

<sup>(6)</sup> Supplementary leverage ratio is a regulatory capital measure calculated based on Tier 1 capital divided by total leverage exposure.

<sup>(7)</sup> Supplementary leverage ratio for the Company as of March 31, 2021 excludes U.S. Treasury securities and deposits with the Federal Reserve Banks pursuant to an interim final rule issued by the Federal Reserve, see "Regulatory Framework" for more details.

As of March 31, 2021, each of the Company and the Banks exceeded the minimum capital requirements and the buffer requirements applicable to them, and each of the Banks was "well capitalized" under PCA requirements. The Eligible Retained Income for the Company as of March 31, 2021 is reported in Form FR Y-9C.

## Supplementary Leverage Ratio

Table 4 provides the supplementary leverage ratio, Tier 1 capital and total leverage exposure and related components under the Basel III Standardized Approach as of March 31, 2021. For additional information on the Supplementary Leverage Ratio and related components, refer to Schedule A of our March 31, 2021 FFIEC 101.

**Table 4: Supplementary Leverage Ratio**

<i>(Dollars in millions, except as noted)</i>	<b>March 31, 2021</b>
<b>Summary Comparison of Accounting Assets and Total Leverage Exposure</b>	
Total consolidated assets <sup>(1)</sup>	\$ 428,224
Adjustment for derivative exposures	6,300
Adjustment for repo-style exposures	23
Adjustment for off-balance sheet exposures	59,117
Other adjustments <sup>(2)</sup>	\$ (69,275)
Total leverage exposure <sup>(3)</sup>	<u>\$ 424,389</u>
Tier 1 capital under the Basel III Standardized Approach	\$ 47,898
Supplementary leverage ratio	11.3 %

<sup>(1)</sup> Includes the impact of the 2020 CECL Transition Election

<sup>(2)</sup> Includes adjustments to Tier 1 capital, adjustments for frequency calculations and temporary exclusion of U.S. Treasury Securities and Deposits at the Federal Reserve Banks pursuant to an interim final rule issued by the Federal Reserve. See "Regulatory Framework" for more details.

<sup>(3)</sup> Reflects on- and off-balance sheet amounts based on the Basel III Capital Rule for supplementary leverage ratio.

As of March 31, 2021, the supplementary leverage ratio, Tier 1 capital and total leverage exposure were 15.9%, \$21.8 billion and \$136.8 billion, respectively for COBNA; and were 7.2%, \$27.9 billion and \$387.7 billion, respectively for CONA. COBNA and CONA did not elect to exclude U.S. Treasury securities and deposits at the Federal Reserve Banks from their supplementary leverage ratio calculations, see "Regulatory Framework" for more information.

### ***Funds and Capital Transfer Restrictions***

The Banks are subject to regulatory restrictions that limit their ability to transfer funds to the Company. As of March 31, 2021, funds available for dividend payments from COBNA and CONA were \$4.5 billion and \$1.3 billion, respectively. Certain provisions in our borrowing agreements or the borrowing agreements of our subsidiaries may limit our subsidiaries' ability to pay dividends to us or our ability to pay dividends to our stockholders. For additional information on regulatory restrictions on transfer of funds or capital distributions between the Banks and the Company, see "MD&A—Capital Management—Dividend Policy and Stock Purchases" in our Q1 2021 Form 10-Q.

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## RISK MANAGEMENT

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### Risk Management Framework

Our Risk Management Framework (the “Framework”) sets consistent expectations for risk management across the Company. It also sets expectations for our “Three Lines of Defense” model, which defines the roles, responsibilities and accountabilities for taking and managing risk across the Company. Accountability for overseeing an effective Framework resides with our Board of Directors either directly or through its committees.

The “First Line of Defense” consists of any line of business or function that is accountable for risk taking and is responsible for: (i) engaging in activities designed to generate revenue or reduce expenses; (ii) providing operational support or servicing to any business function for the delivery of products or services to customers; or (iii) providing technology services in direct support of first line business areas. Each line of business or first line function is responsible for managing the risks associated with their activities, including identifying, assessing, measuring, monitoring, controlling and reporting the risks within its business activities, consistent with the risk framework. The “Second Line of Defense” consists of two types of functions: Independent Risk Management (“IRM”) and Support Functions. IRM oversees risk-taking activities and assesses risks and issues independent from the first line of defense. Support Functions are centers of specialized expertise (e.g., Human Resources, Accounting, Legal) that provide support services to the Company. The “Third Line of Defense” is comprised of the Internal Audit and Credit Review functions. The third line provides independent and objective assurance to senior management and to the Board of Directors that the first and second lines of defense have systems and governance processes which are well-designed and working as intended, and that the Framework is appropriate for our size, complexity and risk profile.

Our Framework consists of the following nine elements:



We provide additional discussion of our risk management principles, roles and responsibilities, framework and risk appetite under “MD&A—Risk Management” in our 2020 Form 10-K and Q1 2021 Form 10-Q .

### Risk Appetite

Risk appetite defines the parameters for taking and accepting risks and are used by management and our Board of Directors to make business decisions. Risk appetite refers to the level of risk our business is willing to take in pursuit of our corporate business objectives. The Board of Directors approves our risk appetite including risk appetite statements and associated metrics,

Board Notification Thresholds, and Board Limits for each of our nine risk categories. We communicate risk appetite statements, limits and thresholds to the appropriate levels in the organization and monitor adherence. While first line executives manage risk on a day-to-day basis, the Chief Risk Officer provides effective challenge and independent oversight to ensure that risks are within the appetite and specific limits established by the Board of Directors. The Chief Risk Officer regularly reports to the Board of Directors on the nature and level of risk across all nine risk categories. In addition to his broader management responsibilities, our Chief Executive Officer is responsible for developing the strategy and mission of our organization, determining and leading our culture, and reviewing and providing input into our risk appetite.

For further information on our risk framework and structure and organization of the risk management function, see “MD&A—Risk Management” in our 2020 Form 10-K and Q1 2021 Form 10-Q.

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## CREDIT RISK

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### Credit Risk Management

Credit risk is the risk to current or projected financial condition and resilience arising from an obligor’s failure to meet the terms of any contract with the Company or otherwise perform as agreed. We try to ensure that our credit portfolio is resilient to economic downturns. Our most important tool in this endeavor is sound underwriting. In unsecured consumer loan underwriting, we generally assume that loans will be subject to an environment in which losses are higher than those prevailing at the time of underwriting. In commercial underwriting, we generally require strong cash flow, collateral, covenants and guarantees. In addition to sound underwriting, we continually monitor our portfolio and take steps to collect or work out distressed loans. For further information on our loan underwriting standards, see “MD&A—Credit Risk Profile—Primary Loan Products” in our 2020 Form 10-K.

The Chief Risk Officer, in conjunction with the Consumer and Commercial Chief Credit Officers, is responsible for establishing credit risk policies and procedures, including underwriting and hold guidelines and credit approval authority, and monitoring credit exposure and performance of our lending related transactions. Our Consumer and Commercial Chief Credit Officers are responsible for evaluating the risk implications of credit strategy and the oversight of credit for both the existing portfolio and any new credit investments. They also have formal approval authority for various types and levels of credit decisions, including individual commercial loan transactions. Division Presidents within each segment are responsible for managing the credit risk within their divisions and maintaining processes to control credit risk and comply with credit policies and guidelines. In addition, the Chief Risk Officer establishes policies, delegates approval authority and monitors performance for non-loan credit exposure entered into with financial counterparties or through the purchase of credit sensitive securities in our investment portfolio.

Our credit policies establish standards in five areas: customer selection, underwriting, monitoring, remediation and portfolio management. The standards in each area provide a framework comprising specific objectives and control processes. These standards are supported by detailed policies and procedures for each component of the credit process. Starting with customer selection, our goal is to generally provide credit on terms that generate above hurdle returns. We use a number of quantitative and qualitative factors to manage credit risk, including setting credit risk limits and guidelines for each of our lines of business. We monitor performance relative to these guidelines and report results and any required mitigating actions to appropriate senior management committees and our Board of Directors.

### Credit Risk Profile

Our loan portfolio accounts for the substantial majority of our credit risk exposure. Our lending activities are governed under our credit policy and are subject to independent review and approval. Our primary loan products include credit card loans, auto loans and commercial loans which we generate through our Credit Card, Consumer Banking and Commercial Banking businesses. For a more detailed description of the composition of our loan portfolio, including an industry classification of our commercial loans and for information on our unfunded lending commitments related to our loan portfolio, see “MD&A—Credit Risk Profile” and “Note 3—Loans” in our 2020 Form 10-K and Q1 2021 Form 10-Q .

We market our products primarily in the United States (“U.S.”) as well as in the United Kingdom and Canada, and actively manage our risk from concentration within certain geographic areas. For a detailed description of the geographic distribution of our loan portfolio and our loan maturity classification, see “MD&A—Credit Risk Profile” in our 2020 Form 10-K.

We also engage in certain non-lending activities that may give rise to ongoing credit and counterparty settlement risk, including purchasing securities for our investment securities portfolio, entering into derivative transactions to manage our market risk exposure and to accommodate customers, extending short-term advances on syndication activity including bridge financing transactions we have underwritten, depositing certain operational cash balances in other financial institutions, executing certain foreign exchange transactions and extending customer overdrafts. In executing our non-lending activities, we comply with limits and guidelines approved by our Board of Directors that reflect our risk appetite and strategic goals. Our investment securities portfolio is concentrated in securities that generally have high credit ratings and low exposure to credit risk, such as securities issued and guaranteed by U.S. Treasury and U.S. government-sponsored enterprises or agencies. Our investment securities portfolio also includes non-agency residential mortgage-backed securities (“RMBS”) and other asset-backed securities (“ABS”) which are considered securitization exposures under the Basel III Capital Rule. For information about the credit risk related to our investment portfolio, see “MD&A—Consolidated Balance Sheets Analysis—Investment Securities” in Q1 2021 Form 10-Q and “Note 2—Investment Securities” in our Q1 2021 Form 10-Q for a maturity distribution of our investment securities.

In the normal course of our business, we enter into certain derivative transactions that give rise to counterparty credit exposure to counterparties and derivative clearinghouses. For information on credit risk related to our derivative transactions, see “Note 8—Derivative Instruments and Hedging Activities” in our Q1 2021 Form 10-Q. For information on risk management practices and policies related to our derivative transactions, see “Counterparty Credit Risk” discussion in this Report.

For the average balances of our credit risk exposures, see “MD&A—Consolidated Results of Operations—Table 2: Average Balances, Net Interest Income and Net Interest Margin” in our Q1 2021 Form 10-Q. For a comprehensive view of our credit risk exposure by balance sheet categories, see Schedule HC-R in our FR Y-9C as of March 31, 2021.

### **Credit Risk Measurement**

We closely monitor economic conditions and credit performance trends to assess and manage our exposure to credit risk. Trends in delinquency rates are the key credit quality indicator for our credit card and retail banking loan portfolios as changes in delinquency rates can provide an early warning of changes in potential future credit losses. The key indicator we monitor when assessing the credit quality and risk of our auto loan portfolio is borrower credit scores as they provide insight into borrower risk profiles, which give indications of potential future credit losses. The key credit quality indicator for our commercial loan portfolios is our internal risk ratings as we generally classify loans that have been delinquent for an extended period of time and other loans with significant risk of loss as nonperforming. In addition to these credit quality indicators, we also manage and monitor other credit quality metrics such as level of nonperforming loans and net charge-off rates. For further information regarding our credit risk associated with our loan and investment portfolios, see “MD&A—Credit Risk Profile”, “Note 3—Loans”, “MD&A—Consolidated Balance Sheets Analysis—Investment Securities” and “Note 2—Investment Securities” in our Q1 2021 Form 10-Q.

#### ***Allowance for Credit Losses and Reserve for Unfunded Lending Commitments***

We maintain an allowance for credit losses that represents management’s current estimate of expected credit losses over the contractual terms of our loans held for investment as of each balance sheet date. We also separately estimate expected credit losses related to unfunded lending commitments that are not unconditionally cancellable by us, such as letters of credit and financial guarantees. For a summary of changes in our allowance for credit losses and reserve for unfunded lending commitments, and components of the allowance for credit losses by portfolio, see “MD&A—Credit Risk Profile—Allowance for Credit Losses and Reserve for Unfunded Lending Commitments” and “Note 4—Allowance for Credit Losses and Reserve for Unfunded Lending Commitments” in our Q1 2021 Form 10-Q.

#### ***Delinquent and Nonperforming Loans***

For a quantitative summary of our delinquent and nonperforming loans, and geographic concentration, see “MD&A—Credit Risk Profile—Credit Risk Measurement” and “Note 3—Loans” in our Q1 2021 Form 10-Q.

## ***Investment Securities***

We evaluate our investment securities for impairment including credit losses on a regular basis in accordance with applicable accounting guidance, see “Note 2—Investment Securities” in our Q1 2021 Form 10-Q.

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## **COUNTERPARTY CREDIT RISK**

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Counterparty credit risk is the risk arising from the possibility that a counterparty may fail to fulfill contractual obligations, resulting in the termination or replacement of the transaction at a loss to us. We engage in certain non-lending activities that may give rise to ongoing credit and counterparty settlement risk, including purchasing securities for our investment securities portfolio, entering into derivative transactions to manage our market risk exposure and to accommodate customers, extending short-term advances on syndication activity including bridge financing transactions we have underwritten, depositing certain operational cash balances in other financial institutions, executing certain foreign exchange transactions and extending customer overdrafts. For further information regarding our credit risk associated with our investment securities portfolio see “MD&A—Credit Risk Profile” and “MD&A—Consolidated Balance Sheets Analysis—Investment Securities” and credit risk related to derivative transactions in “Note 8—Derivative Instruments and Hedging Activities” in our Q1 2021 Form 10-Q.

### **Counterparty Credit Risk Management**

The primary responsibilities of counterparty credit risk management are the approval of new counterparty relationships and the subsequent ongoing review of the creditworthiness of the counterparties. We seek to proactively manage counterparty credit risk by selecting a well-diversified set of counterparties with low risk of default. The counterparty exposure arising from financial instruments such as, but not limited to, derivatives, syndication activity and investment securities is aggregated with all other borrower exposures for counterparty risk management purposes.

For financial instruments, we establish exposure limits for counterparty relationships based on our risk appetite. Credit limits are commensurate with the financial capacity and credit quality of the counterparty by reference to our internal credit rating, the capital position of the counterparty and product specific factors.

### **Derivatives Counterparty Credit Risk**

Derivative instruments contain an element of credit risk that arises from the potential failure of a counterparty to perform according to the terms of the contract, including making payments due upon maturity of certain derivative instruments. We execute our derivative contracts primarily in over-the-counter (“OTC”) markets. We also execute interest rate and commodity futures in the exchange-traded derivative markets. Our OTC derivatives consist of both trades cleared through central counterparty clearinghouses (“CCPs”) and uncleared bilateral contracts. The Chicago Mercantile Exchange (“CME”) and the LCH Group (“LCH”) are our CCPs for our centrally cleared contracts. In our uncleared bilateral contracts, we enter into agreements directly with our derivative counterparties.

We manage the counterparty credit risk associated with derivative instruments by entering into legally enforceable master netting arrangements, where possible, and exchanging collateral with our counterparties, typically in the form of cash or high-quality liquid securities. The amount of collateral exchanged is dependent upon the fair value of the derivative instruments as well as the fair value of the pledged collateral and will vary over time as market variables change. When valuing collateral, an estimate of the variation in price and liquidity over time is subtracted in the form of a “haircut” to discount the value of the collateral pledged. Our exposure to derivative counterparty credit risk, at any point in time, is equal to the amount reported as a derivative asset on our balance sheet. The fair value of our derivatives is adjusted on an aggregate basis to take into consideration the effects of legally enforceable master netting agreements and any associated cash collateral received or pledged.

The terms under which we collateralize our exposures differ between cleared exposures and uncleared bilateral exposures.

- **CCPs:** We clear eligible OTC derivatives with CCPs as part of our regulatory requirements. Futures commission merchants (“FCMs”) serve as the intermediary between CCPs and us. CCPs require that we post initial and variation margin through our FCMs to mitigate the risk of non-payment or default. Initial margin is required upfront by CCPs as

collateral against potential losses on our cleared derivative contracts and variation margin is exchanged on a daily basis to account for mark-to-market changes in those derivative contracts. For CME and LCH-cleared OTC derivatives, we characterize variation margin cash payments as settlements. Our FCM agreements governing these derivative transactions include provisions that may require us to post additional collateral under certain circumstances.

- *Bilateral Counterparties:* We enter into legally enforceable master netting agreements and collateral agreements, where possible, with bilateral derivative counterparties to mitigate the risk of default. We review our collateral positions on a daily basis and exchange collateral with our counterparties in accordance with these agreements. These bilateral agreements typically provide the right to offset exposure with the same counterparty and require the party in a net liability position to post collateral. Agreements with certain bilateral counterparties require both parties to maintain collateral in the event the fair values of derivative instruments exceed established exposure thresholds. Certain of these bilateral agreements include provisions requiring that our debt maintain a credit rating of investment grade or above by each of the major credit rating agencies. In the event of a downgrade of our debt credit rating below investment grade, some of our counterparties would have the right to terminate their derivative contract and close out existing positions.

For a summary of our counterparty credit risk exposure, including the impact of netting and collateral as of March 31, 2021, see “Note 8—Derivative Instruments and Hedging Activities—Table 8.3: Offsetting of Financial Assets and Financial Liabilities” in our Q1 2021 Form 10-Q.

#### ***Counterparty Credit Risk Valuation Adjustment***

We record counterparty credit valuation adjustments (“CVAs”) on our derivative assets to reflect the credit quality of our counterparties. We consider collateral and legally enforceable master netting agreements that mitigate our credit exposure to each counterparty in determining CVAs, which may be adjusted due to changes in the fair values of the derivative contracts, collateral, and creditworthiness of the counterparty. We also record debit valuation adjustments (“DVAs”) to adjust the fair values of our derivative liabilities to reflect the impact of our own credit quality.

For information on policies that we use to manage our derivatives portfolio, see “Note 1—Summary of Significant Accounting Policies—Derivative Instruments and Hedging Activities” in our 2020 Form 10-K.

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## **CREDIT RISK MITIGATION**

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Credit risk mitigation is an essential component of our credit risk management. We use various risk mitigation techniques designed to reduce risk and minimize our losses in the event an obligor defaults. The most common mitigants that we use in our operations include collateral in the form of cash, investment grade securities, commercial property and other financial agreements such as loss sharing agreements, netting arrangements and third-party guarantees. The quality standards outlined in our underwriting policies remain the foundation for credit risk management and credit risk mitigation techniques supplement them by providing an alternative source of repayment.

In our secured loan portfolio, we have recourse to pledged collateral such as physical property or other financial assets that enable us to recover a portion of the contractual amount due in the event of a default. Assets that qualify as collateral include cash, securities, personal property such as vehicles and commercial real estate property. We also have certain credit card partnership arrangements that contain loss sharing provisions. The loss severity and the amount of credit reserves that are attributable to these portfolios are reduced based on the loss sharing amount due from the partners.

Our primary risk mitigation techniques for our derivatives portfolio are master netting agreements and collateral agreements as discussed in “Counterparty Credit Risk Management” in this Report.



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## SECURITIZATION

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The securitization framework of the Basel III Capital Rules apply to on- and off-balance sheet credit exposures that arise from a securitization transaction, or exposures that directly or indirectly reference a securitization exposure. Under the Basel III Capital Rules, a securitization is a transaction in which credit risk of one or more underlying exposures (substantially all of which need to be financial in nature) has been transferred to one or more third parties, where the credit risk associated with these underlying exposures has been separated into at least two tranches reflecting different levels of seniority and performance of the securitization transaction depends on the performance of these underlying exposures. We have exposure to securitizations that we have purchased, that we have originated, and that result from the tranching of credit risk in some of our commercial lending activities as discussed in more detail below.

In general, the Basel III Capital Rules allow a covered institution to hold capital against the portion of securitization exposures where the risk has been retained. If a covered institution consolidates the underlying assets, then it should hold capital for the entire risk associated with the underlying assets. This applies even if a portion of the risk may have been economically transferred to other investors. Accordingly, we hold capital for the entire portion of the underlying assets of our card and auto securitizations as we consolidate the underlying assets, and therefore do not consider them securitizations for regulatory capital purposes. This should be considered when comparing the information in this Report with the securitization information reported pursuant to U.S. GAAP in “Note 5—Variable Interest Entities and Securitizations” in our Q1 2021 Form 10-Q, which includes consolidated securitizations.

Securitization exposures give rise to multiple types of risks including, but not limited to, credit, liquidity and interest rate risk. Our approach to managing risk from securitization exposures is consistent with our overall risk management framework. The key processes of the framework ensure that the performance of our securitization exposures is monitored, conforms to our risk appetite and remains in compliance with the applicable legal requirements.

### **Roles and Objectives**

We are engaged in securitization activities as an investor, an originator and a servicer.

Our investment securities portfolio includes securitizations originated by third parties. These investments represent a majority of our securitization exposure and include predominantly agency RMBS and CMBS as well as non-agency RMBS and other ABS. These securities contribute to the overall portfolio strategies and objectives with regard to liquidity, interest rate risk, credit risk, return targets and other objectives, as appropriate. For additional information about our investment securities, see “Note 2—Investment Securities” in our Q1 2021 Form 10-Q.

As of March 31, 2021, our securitization exposures include commercial loans to special purpose entities secured by financial collateral with an outstanding balance of \$5.9 billion and total exposure of \$7.1 billion.

We had previously securitized mortgage loans by transferring these loans to securitization trusts that had issued mortgage-backed securities to investors. These mortgage trusts consist of option-adjustable rate mortgage (“option-ARM”) securitizations and securitizations of manufactured housing mortgage loans. For additional information about our involvement in securitization transactions as an originator and servicer, see “Note 5—Variable Interest Entities and Securitizations” in our Q1 2021 Form 10-Q.

For information on our accounting policies related to securitization exposure, see “Note 1—Summary of Significant Accounting Policies—Securitization of Loans” in our 2020 Form 10-K.

Table 5 summarizes our regulatory capital securitization exposure by type as of March 31, 2021.

**Table 5: Securitization Exposure by Underlying Exposure Type**

<i>(Dollars in millions)</i>	<b>March 31, 2021</b>	
Residential mortgage	\$	1,230
Asset-backed		2,136
Loans		7,142
Other <sup>(1)</sup>		76
<b>Total exposure</b>	<b>\$</b>	<b>10,584</b>

<sup>(1)</sup> Includes exposures from certain originated manufactured housing securitizations.

### Regulatory Capital Approach

We use the Simplified Supervisory Formula Approach (“SSFA”) under the Basel III Standardized Approach to assign risk weights to our securitization exposures. This approach is based on a formula that starts with a baseline derived from the capital requirements that apply to all exposures underlying the securitization and then assigns risk weights based on the subordination level of an exposure. As a result, the SSFA provides for risk sensitivity by applying relatively higher capital requirements to the more risky junior tranches of a securitization that are the first to absorb losses and relatively lower requirements to the more senior tranches. The approach also takes into account delinquencies on underlying assets and adjusts the capital requirement up or down as a function of these delinquencies.

Table 6 aggregates our securitization exposure and RWA by risk weight bands as of March 31, 2021.

**Table 6: Securitization Exposure and RWA by Risk Weight Bands**

<i>(Dollars in millions)</i>	<b>March 31, 2021</b>	
	<b>Exposure</b>	<b>RWA</b>
20% to ≤ 100%	\$ 9,366	\$ 2,089
> 100% to ≤ 250%	782	1,226
> 250% to ≤ 500%	308	816
> 500% to ≤ 1250%	128	759
<b>Total</b>	<b>\$ 10,584</b>	<b>\$ 4,890</b>

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**EQUITIES**

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Equity exposure refers to a security or instrument that represents a direct or an indirect ownership interest in, and is a residual claim on, the assets and income of a company. Our equity exposures consist primarily of non-publicly traded investments in entities or funds that support community development initiatives, restricted equity investments in Federal Reserve Bank (“FRB”) and Federal Home Loan Bank (“FHLB”) stock, and other miscellaneous investments. In addition, under the Basel III Capital Rule, our investment in fixed income funds related to our separate account Bank-Owned Life Insurance (“BOLI”) is treated as equity exposure. We invest in equity holdings primarily for business and strategic reasons and manage our exposure within our risk management framework.

For a discussion of the policies that determine the valuation and accounting for our equity holdings, see “Note 1—Summary of Significant Accounting Policies—Principles of Consolidation” and “Note 1—Summary of Significant Accounting Policies—Restricted Equity Investments” in our 2020 Form 10-K.

**Regulatory Capital Approach**

We use the Simple Risk Weight Approach (“SRWA”) for equity exposures excluding investment funds. Under the SRWA, we apply the risk weights assigned by applicable regulations to the equity exposures. The SRWA sets a maximum risk weight of 100%, provided that the non-significant equity exposure does not exceed 10% of our Tier 1 plus Tier 2 capital. Our non-significant equity exposure did not exceed the 10% threshold for the three months ended March 31, 2021 and therefore the maximum risk weight we applied was 100%. Our investment funds are primarily related to our BOLI program and money market funds. We have elected to utilize the Full Look-through approach for our BOLI program program, which will allow us to compute a risk-weighted asset amount for each exposure in the program. We will continue to use the Alternative Modified Look-Through Approach (“AMLT”) to calculate RWA for money market funds. Under the AMLT, the equity exposures are allocated on a pro rata basis depending on the investment fund limits in the fund prospectus and assigned a risk weight that corresponds to the investment type.

Table 7 provides a summary of our equity exposure and RWA as of March 31, 2021.

**Table 7: Capital Requirements by Risk Weight for Equity Investments**

<i>(Dollars in millions)</i>	March 31, 2021		
	Exposure	Risk Weight	RWA
FRB stock	\$ 1,316	— %	\$ —
FHLB stock	33	20	7
BOLI and other investment funds	677	86	580
Community development entities	4,562	100	4,562
Other	1,107	100	1,107
Total	<u>\$ 7,695</u>		<u>\$ 6,256</u>

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**MARKET RISK**

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**Overview**

The Market Risk Rule applies to assets and liabilities that meet the Federal Banking Agencies' definition of "covered positions." Covered positions include trading assets and liabilities, foreign exchange and commodity positions, with certain exceptions, and positions used to hedge covered positions. A trading position is defined as a position that is held (i) for the purpose of short-term resale, (ii) with the intent of benefiting from actual or expected short-term price movements, or (iii) to lock in arbitrage profits. Exposures excluded from the Market Risk Rule are subject to the other applicable provisions of the Basel III Standardized Approach described herein. The classification of an exposure as a trading asset or liability under U.S. GAAP does not determine its treatment under the Market Risk Rule.

Our covered positions are comprised primarily of various interest rate, foreign exchange rate and commodity derivatives offered as an accommodation to our customers within our Commercial Banking business and structural foreign exchange exposures related to certain of our international operations. We offset the majority of the market risk exposure of our customer accommodation derivatives through derivative transactions with other counterparties and hedge the majority of our structural foreign exchange exposures.

**Market Risk Management**

Our Board of Directors approves our overall market risk objectives, which include market risk management strategies, policies, and procedures. The Chief Financial Officer and the Chief Risk Officer are responsible for the establishment of market risk management policies and standards for the governance and monitoring of market risk at a corporate level.

The market risk positions for the Company and each of the Banks are calculated separately and in aggregate, and analyzed against pre-established limits. Results are reported to the Asset Liability Committee monthly and to the Risk Committee of the Board of Directors no less than quarterly. Management is authorized to utilize financial instruments as outlined in our policies to manage market risk exposure. For further information on our market risk management and structure of the organization, see "MD&A—Risk Management" in our 2020 Form 10-K and Q1 2021 Form 10-Q.

**Valuation Policies, Procedures and Methodologies**

We apply fair value methodologies specified under U.S. GAAP to determine the fair value of our covered positions. Fair value is defined as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. For additional information on our valuation policies, procedures and methodologies, refer to "MD&A—Critical Accounting Policies and Estimates—Fair Value," and "Note 16—Fair Value Measurement" in our 2020 Form 10-K.

**Measures in Market Risk RWA**

The following table presents Regulatory RWA by components and market risk-based capital as of March 31, 2021.

**Table 8: Regulatory Market Risk RWA and Capital**

<i>(Dollars in millions)</i>	<b>March 31, 2021</b>	
	<b>RWA<sup>(1)</sup></b>	<b>Capital</b>
Regulatory Value-at-Risk ("VaR") 10-day holding period <sup>(2)</sup>	\$ 27	\$ 2
Regulatory Stressed Value-at-Risk ("SVaR") 10-day holding period <sup>(2)</sup>	68	5
Total market risk	<u>\$ 95</u>	<u>\$ 7</u>

<sup>(1)</sup> Regulatory VaR-Based capital times 12.5.

<sup>(2)</sup> Regulatory VaR times a capital multiplier of 3.

## Regulatory Value-at-Risk

Regulatory VaR is a statistical risk measure used to estimate the potential loss from movements in the recent market environment. We use internal models to produce a daily Regulatory VaR measure of the general market risk of all covered positions. We employ a historical simulation approach using the most recent 500 business days and use a 99 percent confidence level and a holding period of 10 business days.

Due to the nature of our covered positions, we are not subject to the incremental risk or comprehensive risk capital requirement. Equity securities and options in our trading portfolio are treated as de minimis, which requires capital to be held dollar-for-dollar against these exposures. Our covered positions currently do not have exposure to credit spreads.

## Regulatory Stressed Value-at-Risk

Regulatory SVaR represents the level of risk contained in a bank's covered positions during a period of significant market instability. Similar to Regulatory VaR, we compute Regulatory SVaR daily, using a 10-day holding period and a 99 percent confidence level. We calculate Regulatory SVaR using the same internal models as Regulatory VaR, but apply historical data from a continuous 250 business day period of financial stress instead of the most recent 500 business days. We recalculate the stressed period monthly to ensure that the Regulatory SVaR produced by our model is representative of the worst case Regulatory VaR during the historical period.

The following table shows our period end, minimum, maximum, and mean Regulatory VaR by risk category and Regulatory SVaR values for the three months ended March 31, 2021.

**Table 9: 10-Day Regulatory VaR (By Risk Category) and Regulatory SVaR**

<i>(Dollars in millions)</i>	<b>Three Months Ended March 31, 2021</b>			
	<b>Period End</b>	<b>Min</b>	<b>Max</b>	<b>Mean</b>
<b>VaR</b> .....	\$ 0.6	\$ 0.5	\$ 1.0	\$ 0.7
Interest rate .....	0.1	0.1	0.1	0.1
Foreign exchange .....	0.3	0.2	0.4	0.3
Commodities .....	0.3	0.1	0.6	0.4
<b>SVaR</b> .....	1.6	1.3	2.6	1.8

## Model Validation

Our Model Risk Office validates the models that we employ to assess and analyze our market risk exposures as well as the related model documentation to ensure the appropriate use of the models. The Model Validation Group, a part of the Model Risk Office, validates and monitors our VaR and SVaR models. For additional information, refer to "MD&A—Critical Accounting Policies and Estimates—Fair Value" in our 2020 Form 10-K.

## Stress Testing

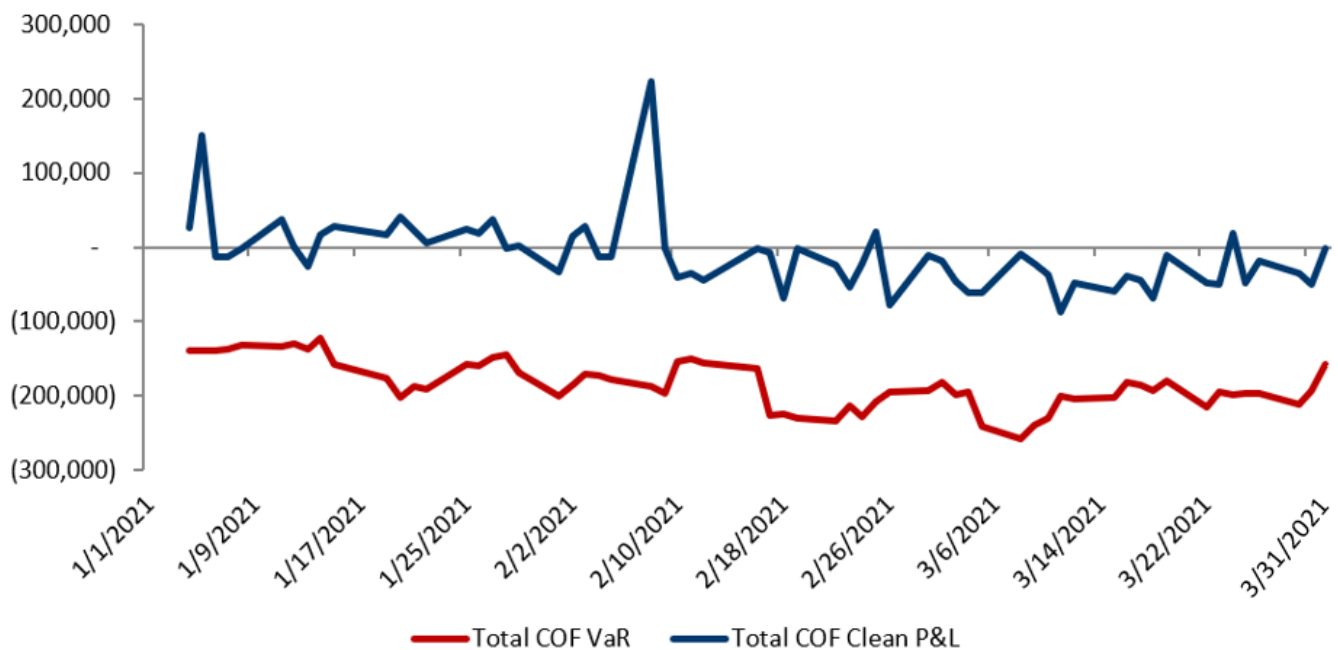
We conduct stress tests quarterly on our covered positions as part of our internal risk management process. Stress testing is a form of scenario analysis in which historical and hypothetical scenarios are applied to a portfolio in order to assess the impact of various stressed market conditions.

We employ both historical and hypothetical scenarios in our stress testing. We use historical scenarios to measure the market risk exposure under adverse and unexpected interest rate, foreign exchange, and commodity market movements. We use hypothetical scenarios in our stress testing to capture multiple potential interest rate shock scenarios that could cause financial stress.

## Back Testing

We use back testing to validate our internal VaR model and assess its accuracy. We perform back testing daily to compare actual returns on our covered positions with estimated VaR-based measures. We calculate actual returns as the changes in value of our covered positions that would have occurred if end-of-day positions were to remain unchanged (excluding fees, commissions, reserves, net interest income and intraday trading). We compare our actual returns with the corresponding daily VaR-based measure over a one business day holding period and a confidence level of 99 percent. An instance where the actual loss in our covered positions on a day exceeds the VaR for that day, it is labeled as a breach. If breaches occur more frequently than the assumed confidence level, the VaR model would undergo further evaluation to identify the potential drivers of the unexpected breaches. The model is subject to periodic adjustments to remain consistent with market conditions and portfolio composition. The following graph shows the daily VaR estimates against the daily actual returns in our covered positions for the three months ended March 31, 2021. We observed no breaches in our back testing during the First quarter of 2021.

### COF VaR Back Testing



## Securitization Positions

As of March 31, 2021, we had no securitization positions that were covered positions under the Market Risk Rule.

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## INTEREST RATE RISK

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We consider the impact on both net interest income and economic value of equity in measuring and managing our interest rate risk. For a discussion around the nature, key assumptions and frequency of measurement of interest rate risk and the sensitivity of net interest income and economic value of equity to interest rate movements, see “MD&A—Market Risk Profile” in our Q1 2021 Form 10-Q.

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## ***Glossary and Acronyms***

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**Basel III Capital Rule:** The regulatory capital requirements established by the Federal Banking Agencies in July 2013 to implement the Basel III capital framework developed by the Basel Committee as well as certain Dodd-Frank Act and other capital provisions.

**CECL:** In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-13, Financial Instruments—Credit Losses (Topic 326): *Measurement of Credit Losses on Financial Instruments*. This ASU requires an impairment model (known as the current expected credit loss (“CECL”) model) that is based on expected rather than incurred losses, with an anticipated result of more timely loss recognition. This guidance was effective for us on January 1, 2020.

**COBNA:** Capital One Bank (USA), National Association, one of our fully owned subsidiaries, which offers credit and debit card products, other lending products and deposit products.

**Company:** Capital One Financial Corporation and its subsidiaries.

**CONA:** Capital One, National Association, one of our fully owned subsidiaries, which offers a broad spectrum of banking products and financial services to consumers, small businesses and commercial clients.

**Corporate exposure:** Exposure that is not an exposure to a sovereign, a depository institution, a foreign bank, a credit union, a public-sector entity, a government-sponsored entity, certain multilateral banks and supranational entities, multilateral development bank, a residential mortgage exposure, a pre-sold construction loan, a statutory multifamily mortgage, a high volatility commercial real estate exposure, a cleared transaction, a default fund contribution, a securitization exposure, an equity exposure, or an unsettled transaction, a policy loan, a separate account or a PPP covered loan.

**Delinquent or past due exposures:** An exposure that is not guaranteed or not secured (and that is not a sovereign exposure or a residential mortgage exposure) if it is 90 days or more past due or on nonaccrual.

**Dodd-Frank Act:** Dodd-Frank Wall Street Reform and Consumer Protection Act.

**Eligible retained income:** The greater of (a) a banking organization's net income for the four preceding calendar quarters, net of any distributions and associated tax effects not already reflected in net income, or (b) the average of a banking organization's net income over the preceding four quarters.

**Excess allowance for credit losses:** Portion of the allowance for credit losses that exceeds the 1.25% threshold of risk-weighted assets and is therefore not eligible to be included in Tier 2 capital. Excess allowance is deducted from risk-weighted assets for regulatory capital calculation.

**Federal Banking Agencies:** The Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Issuance Corporation.

**Federal Reserve:** The Board of Governors of the Federal Reserve System.

**High Volatility Commercial Real Estate:** Classification of a credit facility secured by real property that primarily finances or has financed the acquisition, development, or construction of real property; has the purpose of providing financing to acquire, develop, or improve such real property into income-producing real property; and is dependent upon future income or sales proceeds from, or refinancing of, such real property for the repayment of such credit facility.

**Master netting agreement:** An agreement between two counterparties that have multiple contracts with each other that provides for the net settlement of all contracts through a single payment in the event of default or termination of any one contract.

**Policy loan:** A loan by an insurance company to a policy holder pursuant to the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract.

**PPP covered loan:** A Paycheck Protection Program covered loan as defined in section 7(a)(36) of the Small Business Act (15 U.S.C. 636(a)(36)).

**Public sector entity:** A state, local authority, or other governmental subdivision below the level of a sovereign, including U.S. states and municipalities.

**Residential mortgage exposure:** An exposure that is primarily secured by a first or subsequent lien on a one-to-four family residential property, or an exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family.

**Risk-weighted assets:** Risk-weighted assets consist of on and off-balance sheet assets that are assigned to one of several broad risk categories and weighted by factors representing their risk and potential for default.

**Separate account:** A legally segregated pool of assets owned and held by an insurance company and maintained separately from the insurance company's general account assets for the benefit of an individual contract holder.

**Sovereign exposure:** An exposure directly and unconditionally backed by the full faith and credit of a central government or an agency, department, ministry, or central bank of a central government.

**Statutory multifamily mortgage:** A loan secured by a multifamily residential property that meets the requirements under the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

**Tailoring Rules:** In October 2019, the Federal Banking Agencies released final rules that provide for tailored application of certain capital, liquidity, and stress testing requirements across different categories of banking institutions. As a bank holding company with total consolidated assets of at least \$250 billion that does not exceed any of the applicable risk-based thresholds, we are a Category III institution under the Tailoring Rules.



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## ***Acronyms***

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**ABS:** Asset-backed security  
**AMLTA:** Alternative Modified Look-Through Approach  
**AOCI:** Accumulated other comprehensive income  
**BHCs:** Bank holding companies  
**BOLI:** Bank-Owned Life Insurance  
**CCAR:** Comprehensive Capital Analysis and Review  
**CCP:** Central Counterparty Clearinghouse, or Central Clearinghouse  
**CECL:** Current expected credit loss  
**CET1:** Common equity Tier 1  
**COF:** Capital One Financial Corporation  
**FCM:** Futures commission merchant  
**FHLB:** Federal Home Loan Banks  
**FRB:** Federal Reserve Bank  
**OCC:** Office of the Comptroller of the Currency  
**OTC:** Over-the-counter  
**PCA:** Prompt corrective action  
**RMBS:** Residential mortgage-backed securities  
**RWA:** Risk-weighted assets  
**SRWA:** Simple Risk Weight Approach  
**SSFA:** Simplified Supervisory Formula Approach

## DISCLOSURE MAP

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	Valuation policies	18		69-70,193
	Measures in market risk RWA	18		
	Regulatory Value-at-Risk and Stressed Value-at-Risk	18-19		
	Model validation	19		69-70
	Stress testing	19		
	Back testing	20		
	Securitization positions	20		
Interest rate risk	Nature, assumptions, frequency of measurement	20	50-53	100-101
	Earnings sensitivity to rate shocks	20	52	100