Capital One Financial Corporation

Dodd-Frank Act Company-Run Stress Test Disclosures

September 15, 2014

Explanatory Note

Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") requires that certain bank holding companies, including Capital One, conduct stress tests twice per year to assess the potential impact of certain scenarios on the consolidated earnings, losses, and capital of each bank holding company, taking into account its current condition, risks, exposures, strategies and activities.

Capital One conducted the mid-year Dodd-Frank Stress Test (DFAST) in the second quarter of 2014 using our actual performance through the first quarter of 2014 and information available at that time. Any results, events or financial performance after the first quarter of 2014 are not reflected in the stress test results. Capital One submitted the full results of its stress tests to the Federal Reserve on July 5, 2014.

The Dodd-Frank Act also requires that Capital One disclose a summary of the stress test results under Capital One's Severely Adverse Scenario. Capital One's Severely Adverse Scenario represents a hypothetical economic situation which includes assumptions of economic worsening that are at least as severe as the economic conditions experienced in the 2008 recession. The summary of Capital One's results must include estimates of the aggregate impact of the stressed economic scenario on certain financial metrics over the nine-quarter planning horizon. In addition, Capital One must provide estimates of its regulatory capital ratios including the Tier 1 common ratio as calculated using the Basel I framework and the common equity Tier 1 capital ratio under the Basel III Standardized Approach framework.

Certain statements and estimates below may be forward-looking, including those that discuss, among other things: loss projections, revenues, income, capital measures, accruals for litigation and other claims against Capital One, future financial and operating results, Capital One's plans, objectives, expectations and intentions, and the assumptions that underlie these matters. Capital One cautions readers that the results in the summary below are not forecasts, predictions of future performance, or measures of its solvency; actual results could differ materially from those contained in this summary. In addition, these results do not represent Capital One's current expectations regarding future results of operations or financial condition. They are based on hypothetical scenarios and other assumptions used for the sole purpose of conducting the required stress tests, and Capital One makes no assurances or predictions about the likelihood of any of these scenarios or assumptions actually occurring. Capital One does not undertake any obligation to update or revise any of the information contained herein whether as a result of new information, future events, or otherwise.

The stress test results below are expected to differ from the stress test results produced by the Federal Reserve in its annual Comprehensive Capital Assessment and Review (CCAR) process due to differences in methodologies and assumptions used to produce the results. Refer to the section below entitled *"Considerations in Assessing our DFAST Projections"* for more information.

Scenario Description

Capital One has a long-established process of monitoring the economic environment and its impact on our portfolios. As part of this process, senior management routinely reviews and approves baseline and stressed economic forecasts which are used for internal financial and business planning as well as for regulatory stress tests.

The Severely Adverse Scenario we developed for the mid-year DFAST assumes significant deterioration in economic conditions from current levels, creating large reductions in employment, home prices and GDP, among other factors. Under this scenario, the U.S. is assumed to fall into a severe recession, with the unemployment rate increasing five percentage points to a peak of 11.4% in the fourth quarter of 2015 and remaining elevated throughout the stress horizon. Our Severely Adverse Scenario also projects a significant drop in home prices. Home prices are assumed to decline 24.8% from the beginning level of the stress test to a low point in the fourth quarter of 2015.

In addition to the adverse economic assumptions, we have incorporated a number of idiosyncratic risks in our projections, including the risk of higher representation and warranty claims arising from mortgages that were originated principally by predecessor companies between 2005 and 2008, elevated levels of operating expenses and unexpected operational losses including potential cyber attacks, as well as idiosyncratic risks related to concentrations in our commercial and card portfolios.

While these other risks are not necessarily correlated with the economic conditions reflected in our Severely Adverse Scenario, we assume that they could manifest in an environment generally characterized by the types of conditions described in the scenario. Accordingly, we included the impact of all of these risks in our Severely Adverse Scenario concurrent with the impacts assumed to result as a direct consequence of the stressed economic environment.

Overview of Stress Test Methodology and Approach

Our stress test methodology considers a broad range of potential stresses to our balance sheet and capital levels, including potential impacts to our interest rate risk position, balance sheet composition, and levels of pre-provision net revenue (PPNR), charge-offs, allowance for loan and lease losses, and tax. The stress analysis and underlying assumptions are informed by a number of factors, including the performance we have observed in our portfolios through prior actual stress periods, including the 2008 recession. The analysis was conducted in the second quarter of 2014 using actual performance through the first quarter of 2014 and information available to us at that time.

In our Severely Adverse Scenario, the largest impact to our capital ratios comes from changes in credit performance. For our credit card, auto and home loans portfolios, we project stressed losses using account-level econometric models, which incorporate Metropolitan Statistical Area (MSA) level variables. In our commercial portfolios, most of our loss modeling estimates the impact of a given stress scenario at the borrower-level, capturing the effects of varying loan characteristics and collateral positions, among other factors. In select portfolios, we use more aggregated economic forecasting approaches that incorporate the specific macro-drivers relevant to each portfolio, including customer and relationship-level attributes.

Once credit has been modeled, we translate our overall credit outlook into projected allowance levels for each quarter. We also use our stressed views of losses to estimate second order impacts of credit worsening, such as the increase in operating costs related to collections and other loss-mitigation activities, the impact on finance charges and other fees (assessments, reversals and reserves), and the reduction in future revenue due to the inevitable reduction in outstandings from higher losses. The impacts on fees and operating costs are estimated based on historical data, modified as needed to reflect changes due to new legislation, regulations, or business practices.

We model PPNR based on the expected performance of our various businesses to estimate the impact that our Severely Adverse Scenario would have on our overall financial performance. The projected impacts are based on the characteristics of each asset and liability class and the related support costs for new originations, ongoing management, and underlying infrastructure for each business. Our revenue modeling is divided into net interest income and non-interest income, and our non-interest expense modeling is split between operating and marketing expenses.

In addition to modeling the income statement impact of our Severely Adverse Scenario, we capture the projected impact of the stressed environment on our balance sheet size and composition. The three main factors impacting our balance sheet projections are: (1) the impact to existing loan balances of higher charge-offs; (2) the impact to growth in loan balances due to changes in demand; and (3) the impact to loan growth from fewer lending opportunities meeting our profitability and resilience requirements as our models and underwriting scorecards systematically incorporate leading credit indicators to reflect the worsening credit conditions in the financial projections used in underwriting. As we have observed in prior stress periods, these three factors have the natural result of quickly reducing the size of our combined loan portfolio.

While all of these factors meaningfully influence our balance sheet during stress periods, the inevitable reduction in profitable and resilient lending opportunities as credit worsens has a particularly pronounced impact on us relative to peer banks given our concentration in credit card and auto loans, the balances of which naturally decline quickly absent a high level of new (and discretionary) account originations.

Additionally, because of the high volume of new originations required to maintain and grow our credit card portfolio balances, we incur much higher marketing costs as a percent of risk weighted assets than most banks. This distinction is important to note because these costs naturally drop in a worsening credit environment, as our underwriting models are recalibrated automatically resulting in fewer lending opportunities and less marketing spend.

Table 1: Results of Capital One Internal Modeling in the Capital One Severely Adverse Scenario under the DFAST Rules

Projected Stressed Capital Ratios through Q2 2016 under the DFAST rules in the Capital One Severely Adverse Scenario

	Consolidated Parent (COFC)[1]			
	Actual		Stressed Ratios[2]	
	Q1 2014	Q2 2014	Q2 2016	Minimum
Tier 1 common ratio (%)	13.0%	12.7%	11.8%	10.4%
Common equity tier 1 capital ratio (%)	13.0%	12.7%	12.1%	11.0%
Tier 1 risk based capital ratio (%)	13.4%	13.3%	12.5%	11.3%
Total risk-based capital ratio (%)	15.4%	15.4%	14.2%	13.3%
Tier 1 leverage ratio (%)	10.4%	10.7%	10.3%	9.2%

1) The Tier 1 common ratio is based on the Basel I capital framework throughout the forecast horizon. The common equity Tier 1 capital ratio is calculated based on the Basel III Standardized Approach framework including transition provisions that started in Q1 2014. The Tier 1 risk-based capital ratio, Total risk-based capital ratio, and Tier 1 leverage ratio are calculated based on provisions starting in Q1 2014. As an Advanced Approaches bank holding company (BHC) we are subject to the revised capital framework that the Federal Reserve adopted in connection with the implementation of the Basel III accord, including the framework's minimum regulatory capital ratios and transition arrangements starting in Q1 2014. For more details on the differences between Capital One's Basel I and Basel III Standardized Approach capital ratios, please refer to Capital One's 2013 Annual Report on Form 10-K, or other SEC filings.

2) The capital ratios are calculated using capital action assumptions provided within the DFAST rules. These projections represent hypothetical estimates that involve an economic outcome that is more adverse than expected. These estimates are not forecasts of expected losses, revenues, net income before taxes, or capital ratios. The capital ratios presented represent the minimum and the end of period ratios for the nine quarter forecast horizon from Q2 2014 to Q2 2016.

Actual Q1 2014, Q2 2014, and projected Q2 2016 risk-weighted assets under the Capital One Severely Adverse Scenario

	Consolidated Parent (COFC)			
	Actual		Projected Q2 2016	
	Q1 2014	Q2 2014	Current general approach	Basel III standardized approach
Risk Weighted Assets (billions of dollars)[1]	219.0	226.2	188.8	198.3

1) As per the final Basel III rules, Capital One has modeled capital levels under the Basel III Standardized Approach regime based on the stipulated transition provisions for numerator impacts effective in 2014 and the prescribed risk weightings for assets becoming effective in 2015 without transition provisions.

Projected Revenue, Losses, and Net Income Before Taxes for Q2 2014 through Q2 2016 under the Capital One Severely Adverse Scenario

	Consolidated Parent (COFC)	
	$ in Billions	% of Average Assets[1]
Pre-Provision Net Revenue[2]	17.1	6.2%
Other Revenue[3]	0.0	0.0%
Less		
Provisions	18.4	6.6%
Realized Losses/(Gains) on Securities	0.2	0.1%
Trading and Counterparty Losses[4]	0.0	0.0%
Other Losses/(Gains)	0.0	0.0%
Equals		
Net Income before Taxes	(1.5)	(0.5)%
<u>Memo items</u>		
Other comprehensive income[5]	(0.3)	(0.1)%
Other effects on capital	*<u>Q4 2014</u>*	*<u>Q4 2015</u>*
AOCI included in capital calculation[6]	(0.5)	(0.7)

1) Expressed on a 9-quarter cumulative basis as a percentage of average assets over the same time period.

2) Pre-provision net revenue includes stress adjustments for operational risk events, and expenses including mortgage representation and warranty and real estate held for sale.

3) Other revenue includes one-time income and expense items not included in pre-provision net revenue.

4) Trading and counterparty losses include mark-to-market losses, changes in credit valuation adjustments (CVA) and incremental default losses and losses arising from the counterparty default scenario component applied to derivatives, securities lending, and repurchase agreement activities.

5) As an Advanced Approaches BHC under the new capital framework, accumulated other comprehensive income (AOCI) is included in calculations of regulatory capital subject to the transition provisions. Other comprehensive income includes incremental unrealized losses/gains on Available For Sale securities.

6) 20 percent of AOCI is included in capital calculations for 2014, 40 percent of AOCI is included in capital calculations for 2015 and 60 percent of AOCI is included in capital calculations for 2016.

Projected Loan Losses by Type of Loan for Q2 2014 through Q2 2016 under the Capital One Severely Adverse Scenario

	Consolidated Parent (COFC)	
	$ in Billions	% of Avg. Portfolio Balance[1]
Loan Losses[2]		
First Lien Mortgages, Domestic	0.1	0.5%
Junior Liens and HELOCs, Domestic	0.1	3.9%
Commercial and Industrial	1.1	5.1%
Commercial Real Estate, Domestic	0.6	2.6%
Credit Cards	12.2	18.0%
Other Consumer	1.7	5.5%
Other Loans	0.2	1.8%
Total Loan Losses	16.0	8.7%

Note: Reflects loan classification under regulatory reporting FR Y9-C. This classification is different than how Capital One classifies loan product types for SEC reporting purposes. For example, FR Y9-C requires that Small Business Credit Card loans be reported under Commercial & Industrial, whereas these loans are reported under Credit Card for SEC reporting purposes.

1) Average loan balances used to calculate portfolio loss rates exclude loans held for sale, and are calculated over nine quarters.

2) Commercial and industrial loans include small and medium enterprise loans and corporate cards. Other consumer loans include automobile loans.

Description of Projections

We have calculated our regulatory capital ratios over the second quarter 2014 to second quarter 2016 stress horizon using the Basel I framework and the Basel III Standardized Approach. Projected capital ratios under the Basel I framework are provided because they continue to be the basis for the Federal Reserve's evaluation of capital adequacy in the stress test. Under the Basel I capital framework, we are required to maintain our Tier 1 common ratio above 5.0%. We also project our stressed capital ratios using the Basel III Standardized Approach because it reflects the capital rules currently in force. Under the Basel III Standardized Approach, we are required to maintain our common equity Tier 1 capital ratio above 4.5%.

In our modeling of our Severely Adverse Scenario, our capital ratios are projected to be lower than in our baseline, but would still remain well above current regulatory requirements. Our Tier 1 common ratio calculated under the Basel I capital framework is projected to be our most binding capital ratio and is projected to decline to a low point of 10.4% in the first quarter of 2015. This low point is driven primarily by reserve builds in our consumer lending businesses and a disallowed deferred tax asset position. We project capital accretion after the low point, beginning in the second quarter of 2015 through the end of the scenario.

We project our capital ratios under the Basel III Standardized Approach's common equity Tier 1 capital to be higher than the Basel I Tier 1 common ratio. In our projections, the net impact of the introduction of new elements in the Basel III Standardized Approach capital calculation such as AOCI in common equity Tier 1 capital, and the differential treatment of other elements that affect capital such as deferred tax assets to the extent that they are disallowed (inclusive of any applicable phase-in provisions) results in a higher absolute common equity Tier 1 capital ratio than the Tier 1 common ratio for the same period.

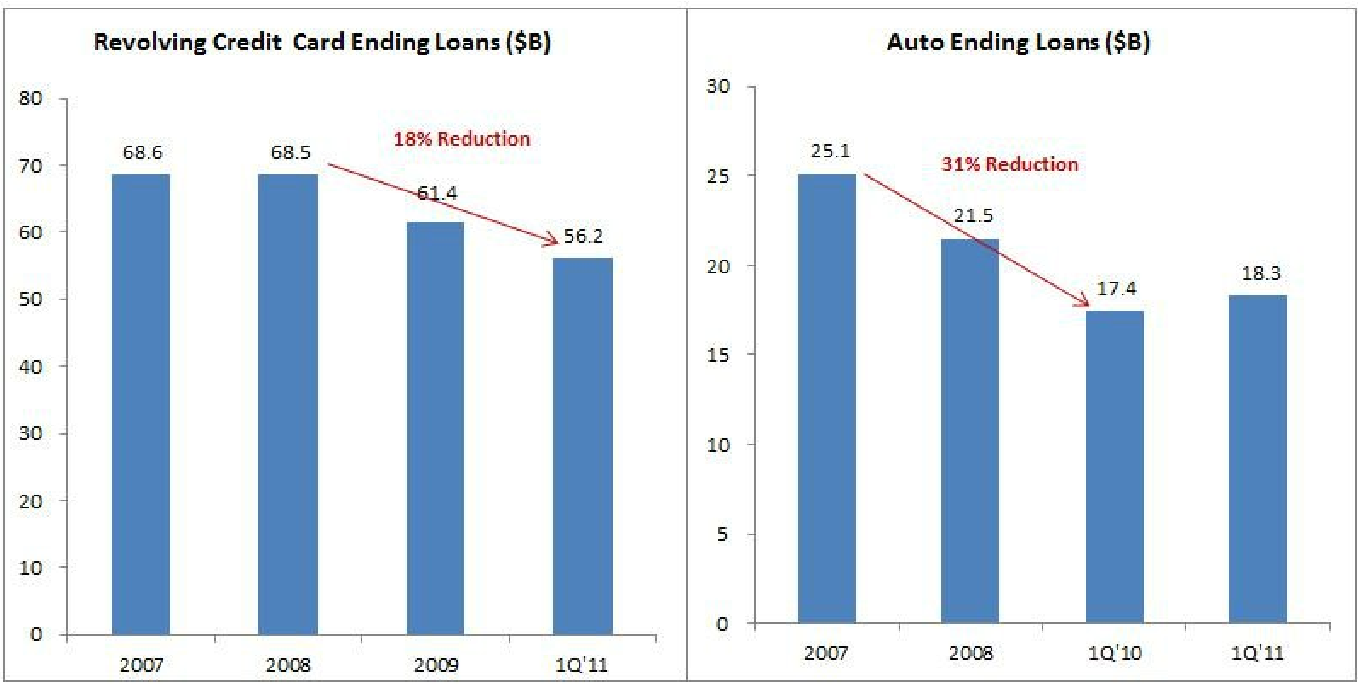
The largest impact to our projected income forecasts in our Severely Adverse Scenario is due to the provision for credit losses. This impact is most pronounced in our credit card and auto loan portfolios. Provision for credit losses is projected to increase, initially driven by allowance builds (in anticipation of credit deterioration) and later by elevated charge-offs (as the housing and labor markets deteriorate). Consistent with our experience in the last recession, as the economic stress dissipates and our loan balances decline due to elevated charge-offs and reduced new origination activity, we forecast allowance releases toward the end of the nine quarter period.

In addition to the provision impact described above, we project revenues to decline as our loan portfolio contracts and reversals of finance charges and past due fees increase with rising charge-offs. We incorporate modest rate cuts in deposits, along with other management actions, to reduce costs and to partially offset the decline in demand for credit and resulting lower funding needs. We also expect marketing expense to decline (primarily due to lower originations), while operating expenses would be reduced modestly as higher collections and recoveries costs and costs associated with the non-economic risks described above partially offset projected operating expense reductions due to lower originations and a smaller portfolio.

The largest impact to our balance sheet in our Severely Adverse Scenario is to the size of our loan portfolio. In addition to the direct impact of higher charge-offs, in a period of economic stress we typically experience reduced loan demand, and in response to deteriorating credit, our underwriting models systematically recalibrate using leading credit indicators and identify fewer lending opportunities, which naturally reduces marketing. These shifts immediately help to offset deterioration in both our earnings and capital ratios by reducing non-interest expense and by shrinking the balance sheet. The impact to balance sheet size driven by reduced loan demand and the natural reduction in lending opportunities that occur under economic stress is particularly pronounced for Capital One given the consumer-centric composition of our portfolio. Compared to most banks subject to stress testing under the Dodd-Frank Act, a much larger share of our loan portfolio is in asset classes that attrite quickly, specifically auto loans and credit cards.

Different factors drive the rapid attrition in these two asset types. Auto loans are amortizing loans with original terms typically ranging from four to six years. In addition to the relatively short contractual life of these loans, there is a significant amount of voluntary prepayment on auto loans as consumers pay off loans early, usually due to the sale or trade in of the vehicle. While credit cards are revolving products that do not have the contractual amortization characteristics of auto loans, the relatively high expected loss rate, voluntary pay down of balances, and the rate of account closures results in relatively rapid asset attrition. Due to this natural run-off, our card portfolio shrinks meaningfully absent a high level of new account originations.

As shown below, within nine quarters of tightening underwriting in 2008, our card portfolio contracted 18% from \$68.5B to \$56.2B. Credit quality and underwriting were impacted earlier in our auto portfolio than in our other portfolios. In the last recession, our auto portfolio contracted 31% from \$25.1B at the end of 2007 to \$17.4B at the end of the first quarter of 2010. The natural contraction of our loan portfolios as our underwriting models recalibrate when credit begins to worsen is a powerful and deeply embedded characteristic of our business model which helps us weather significant economic downturns.



As a result of our concentration in consumer lending, our marketing budget is disproportionately large compared to most other banks. For 2013, our marketing expense was \$1.4B which we expect to rise in 2014 dependent on our assessment of market and competitive opportunities. The natural reduction in our marketing as our underwriting models identify fewer lending opportunities that meet our profitability and resilience requirements is a meaningful lever for improving earnings and capital ratios under stress. The combination of lower loan demand that we expect to occur as the economy deteriorates, and fewer opportunities as our underwriting models systematically recalibrate to the worsening environment, immediately reduces our need for marketing. In our Severely Adverse Scenario we anticipate that marketing expense would naturally drop beginning in the fourth quarter of 2014, partially offsetting the negative impact on our earnings from the downturn.

We project that higher charge-offs and a natural reduction in profitable and resilient lending opportunities would reduce the size of our card portfolio by 17% and our auto portfolio by 25% over the nine quarter stress test horizon. Although not an exact comparison due to differences in seasonality and contributions from discrete discontinued portfolios, this level of reduction would be consistent with what we experienced in the last downturn, when our card portfolio contracted by 18% and our auto portfolio contracted by 31% in an economic environment that was not as severe as our Severely Adverse Scenario used in this stress test.

These assumptions are grounded in historical experience and the dynamics of our business. In addition to the direct impact to loan balances of higher charge-offs, we have observed the dynamics of reduced demand and tighter underwriting as our models systematically incorporate deteriorating credit conditions in past recessions and anticipate similar dynamics in future downturns. Importantly, these actions do not require us to form assumptions regarding competitor actions like changes in price; rather, they are rooted in our own lending choices, the direct consequence of charge-off-driven reduction in loan balances, and the natural tightening that occurs as fewer lending opportunities meet our profitability and resilience requirements.

In summary, the adverse impact to capital driven by income statement dynamics in the Supervisory Severely Adverse Scenario is projected to be partially offset by the capital benefits of a smaller balance sheet.

Considerations in Assessing our DFAST Projections:

1. **There are fundamental differences between our stress testing methodology and the Federal Reserve's approach.**

   As we indicated in our September 2013 and March 2014 Dodd-Frank Act Company-Run Stress Test disclosures, there are a number of important differences between our stress testing approach and the approach used by the Federal Reserve. Our stress testing models are customized to reflect the unique profile and business model of each of our portfolios. The models incorporate vast amounts of detailed, internal performance data as well as customer and loan characteristics that we have, for years, systematically captured and used for decision-making and ongoing financial management.

   While we do not have insight into the specific inputs or assumptions contained in the regulatory stress test models, the Federal Reserve appears to have made a choice to use industry-wide models without making adjustments for differences in business practices and results among banks. To the extent the Federal Reserve uses an "industry average" modeling approach, important differences in our portfolio composition or our business model and practices which are meaningfully different than industry average may not be fully captured. These differences have contributed to the divergence between our stress test projections and the projections developed by the Federal Reserve in past stress tests, and are likely to continue in future stress tests.

2. **Significant differences between Capital One and Federal Reserve projections are likely to persist and may increase in future stress tests.**

   The models we used for the mid-year 2014 DFAST are substantially similar to the models we used in prior stress test cycles. As was evident in the Federal Reserve's March 2013 and March 2014 disclosures of stress test results[1], a comparison of our DFAST projections to the projections calculated by the Federal Reserve revealed significant differences.

   Because the Federal Reserve's disclosure of its modeling methodologies is limited, we cannot with any certainty substantiate the specific causes of any differences in projections. However, the March 2014 stress test disclosures continue to show that one of the largest contributing factors to the difference in

[1]The 2013 and 2014 disclosures of stress test results are available on the Federal Reserve Board's website (http://www.federalreserve.gov/newsevents/default.htm)

overall projected results were significant differences in estimates of credit card loss rates. While we are confident in our models for estimating potential losses under stress in our various loan portfolios and have tested them against historical data where appropriate, we believe that the variation in future projected results - as exemplified by the difference in credit card loss rates between Capital One's models and the Federal Reserve's models - are likely to persist, and may increase.

Additionally, rather than reflecting the balance sheet projections submitted by banks, the Federal Reserve uses its own balance sheet assumptions. As noted by the Federal Reserve in a November 2013 release, their balance sheet modeling assumes loans would increase approximately 2% across all asset classes under stress, while most CCAR 2014 banks assume loans would decrease under stress. Notably, the Federal Reserve's modeling does not appear to include any differentiation between loan classes.

For Capital One, the Federal Reserve's approach to modeling the balance sheet, and the assumption that loan and total asset balances will grow during the stress horizon, appears to be another material driver of the difference between the Federal Reserve's projections and our own projections. As described above, in addition to the direct effect on loan balances from higher charge-offs, Capital One has consistently observed declining loan balances during prior recessions as our underwriting models systematically recalibrate to the worsening economic and credit conditions and identify fewer lending opportunities. This naturally reduces marketing and the origination of new loans. This reduction in new loan originations, combined with the relatively short duration of our credit card and auto loan portfolios, results in a contraction of our balance sheet and benefits our capital ratios under stress.

Importantly, the models of the Federal Reserve are proprietary, and our insights are limited only to the inputs or methodologies they have disclosed. Since the approval of any proposed capital distributions is ultimately determined by the Federal Reserve's own projections, our DFAST projections should not be interpreted as an accurate indicator of our ability to make future distributions of capital.

3. **Our performance in future stress periods may not be consistent with past stress periods.**

   Stress tests have been an important tool in our overall risk and capital management approach for many years. Over time, we have developed a robust methodology and comprehensive set of models to simulate Capital One's performance under a range of scenarios. While we have incorporated our observations from actual results over the course of past economic downturns - most notably those from the 2008 recession - into our methodologies and models, there can be no assurance that our methodologies and models will be accurate predictors of our performance or capital levels in future downturns. Similarly, while our stress tests include a range of hypothetical economic stress scenarios, there can be no assurance that future recessions will have the same severity or profile as the scenarios we have examined.