

Citizens Financial Group, Inc.

Dodd-Frank Act Mid-Cycle Company-Run Stress Test Disclosure



Published October 5, 2017 to disclose estimated impacts for Citizens Financial Group, Inc.

Table of Contents

I. Introduction	3
I.A. Risks Considered by Citizens	4
I.B. Citizens Methodologies	4
I.B.1. Pre-provision Net Revenue	4
I.B.2. Losses	5
I.B.3. Provision for Loan and Lease Losses	5
I.B.4. Changes in Capital Position	6
I.C. CFG Results under the CFG Severely Adverse Scenario	6
I.C.1. Impacts of Stress on Net Income, Losses and Risk-Weighted Assets	6
I.C.2. Impacts of Stress and Supervisory-Prescribed Capital Actions on Capital Ratios	8

I. Introduction

Citizens Financial Group, Inc. (CFG) is a financial and bank holding company headquartered in Providence, Rhode Island. The primary subsidiaries of CFG are its two insured depository institutions, Citizens Bank, N.A. (CBNA), a national banking association, and Citizens Bank of Pennsylvania (CBPA), a Pennsylvania-chartered savings bank. "Citizens" is used throughout this document to refer collectively to all three legal entities. Citizens provides traditional banking products and services to consumer and commercial customers across an 11-state branch banking footprint in New England, the Mid-Atlantic and the Midwest. Citizens maintains more than 100 retail and commercial non-branch offices located both in its banking footprint and in other states and the District of Columbia largely contiguous to its footprint. Citizens has approximately 1,200 branches, 3,200 ATMs and 17,700 employees (as of June 30, 2017).

This document discloses the mid-cycle company-run stress test results for CFG as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act company-run stress testing (DFAST) regulations¹ require that covered companies disclose the following information for a CFG-designed severely adverse scenario over a nine-quarter planning horizon (planning horizon) beginning with the third quarter of 2017 and ending with the third quarter of 2019 (July 1, 2017 – September 30, 2019):

- A description of the types of risk included in the stress tests.
- A description of the methodologies used in the stress test, including those used to estimate losses, revenues, provision for loan and lease losses and changes in capital positions over the planning horizon.
- The estimates of projected revenue, losses and net income before taxes; loan losses in aggregate and by sub-portfolio; pro forma regulatory capital ratios and an explanation of the most significant causes for the changes in regulatory capital ratios.

The FRB defines a stress test as “a process to assess the potential impact of a scenario (hypothetical economic conditions) on the consolidated earnings, losses, and capital of a covered company over the planning horizon (a set period of time), taking into account its current condition, risks, exposures, strategies, and activities.” The disclosed outcomes represent a hypothetical estimate and do not represent Citizens’ expected performance under current business strategies.

Estimated impacts of stress are one of many inputs to Citizens’ capital adequacy process. Citizens maintains a comprehensive capital adequacy process that incorporates an end-to-end view of risk-taking, risk management, risk-based capital adequacy assessment and capital planning. The Finance and Risk organizations lead this capital adequacy process with participation from the lines of business and Audit. The Citizens capital adequacy process is fully supported by internal policies and practices used by Citizens to ensure that the amount and composition of capital is adequate given the company’s risk exposures and the regulatory requirements and expectations.

¹ Reference 12 CFR Part 252.

I.A. Risks Considered by Citizens

Citizens' Enterprise Risk Management Framework provides for the identification, assessment, monitoring and control of material risks that affect or have a potential to affect Citizens' value for its customers, colleagues, communities, shareholders and regulators. These material risks are evaluated to ensure they are appropriately accounted for when assessing capital needs through stress testing and are summarized in *Exhibit 1*.

Exhibit 1: Citizens Material Risks

Level 1 Risks	Risk Definition
Credit risk	Credit risk is the risk to current or anticipated earnings or capital arising from an obligor's failure to meet the terms of any contract with the bank or otherwise perform as agreed.
Interest rate risk	Interest rate risk is the risk to current or anticipated earnings or capital arising from movements in interest rates.
Reputation risk	Reputational risk is the risk of loss resulting from damages to a firm's reputation, in lost revenue; increased operating, capital or regulatory costs; or destruction of shareholder value.
Strategic risk	Strategic risk is the risk to current or anticipated earnings, capital, or franchise or enterprise value arising from adverse business decisions, poor implementation of business decisions, or lack of responsiveness to changes in the banking industry and operating environment.
Operational risk	Operational risk is the risk to current or anticipated earnings or capital arising from inadequate or failed internal processes or systems, human errors or misconduct, or adverse external events.
Compliance risk	Compliance risk is the risk to current or anticipated earnings or capital arising from violations of laws, rules or regulations, or from nonconformance with prescribed practices, internal policies and procedures, or ethical standards.
Market/price risk	Market/price risk is the risk to earnings or capital arising from adverse changes in the value of portfolios of trading instruments.
Liquidity risk	Liquidity risk is the risk that the consolidated enterprise and/or any of its material entities are unable to meet current or projected payment obligations in a timely manner.

I.B. Citizens Methodologies

The Integrated Stress Testing Policy governs activities under Citizens' stress testing framework, specifically scenario generation, aggregation and reporting. The stress testing approach is built upon the distributed development of business activity assumptions to maximize line of business input, review and challenge; and the centralized calculation of results to ensure a consistent and logical relationship among balances, income and capital calculations.

I.B.1. Pre-provision Net Revenue

Citizens develops projected balances and yields by rolling the balance sheet forward through the planning horizon. Citizens starts with the current portfolio position and forecasts a dynamic balance sheet driven by changes in the macroeconomic variables. The process includes the use of various combinations of internal analytics, business activity macroeconomic models with expert judgment overlays as needed, historical data and prior stress test results with business unit expert judgment to develop the possible outcomes under assumed stress conditions.

I.B.1.1. Net Interest Income

Citizens determines the net interest income for a given period based on the pricing characteristics of starting position balances and the pricing characteristics of any new asset or liability balance. More specifically, Citizens calculates net interest income as the interest revenue on performing assets less the interest expense on liabilities based upon the scenario-specific interest rates. Projections are derived from a combination of macroeconomic models and pricing characteristics associated with existing portfolios, new business, and renewals.

I.B.1.2. Noninterest Income

Citizens captures fees and other income in order to create a complete income statement. The businesses forecast fees and other income generally based on the level of business activity (e.g., mortgage servicing fees, credit card interchange fees, etc.) for a given scenario using modeled and nonmodeled approaches supported by expert judgment and historical data.

I.B.1.3. Noninterest Expenses

Citizens projects noninterest expenses primarily through nonmodeled approaches that are supported by expert judgment and historical data. Starting with the most recent expense structure, each forecast takes into account scenario-specific economic conditions and the planned levels of business activity to determine the projected expenses over the planning horizon. In addition, Citizens projects expenses for operational risk losses for the scenarios using an internally developed model. Legal expenses and idiosyncratic events using expert judgment are also considered and included when appropriate.

I.B.2. Losses

This section provides a summary of the methodologies used to model credit and other-than-temporary impairment (OTTI) losses.

I.B.2.1. Credit Losses

Citizens uses credit loss forecasting models, with expert judgment overlays as needed, to project charge-offs for a given scenario. The credit loss forecasting models use historically observed losses from Citizens' portfolios and take into account the macroeconomic conditions and interest rate environment defined in the scenario. The credit modeling team uses forecast balances generated as part of the PPNR methodology described above to forecast charge-offs through the planning horizon.

I.B.2.2. Other-Than-Temporary-Impairment Losses

Citizens uses a model to project OTTI exposures for the non-agency (private-label) residential mortgage-backed securities portfolio. Citizens includes projected OTTI in the recognition of unrealized losses on securities (available-for-sale and held-to-maturity) for the period in which the impairment is estimated to be realized under stress.

I.B.3. Provision for Loan and Lease Losses

Citizens generates projected provision expense as a function of net charge-offs for each quarter and the quarter-over-quarter change in the allowance for credit loss. Net charge-offs are determined by the Commercial and Consumer loss forecasting models and processes.

Allowance for credit loss is determined in alignment with U.S. Generally Accepted Accounting Principles.

I.B.4. Changes in Capital Position

CFG and its subsidiary banks calculate and assess capital adequacy under the standardized approach. On January 1, 2015, CFG began to assess and report regulatory capital and capital ratios based on the Basel III standardized risk weighted assets (RWA) methodology and Basel III capital definitions² that will continue to phase in by January 1, 2019.

Within this disclosure, Citizens uses the outputs of the integrated stress testing process to assess projected capital ratios for the CFG severely adverse scenario. Citizens' estimated financial performance and changes in the size and credit characteristics of Citizens' underlying risk portfolios under stress are the key drivers in determining both its projected level of capital and projected RWA requirement at the end of each quarter in the planning horizon. These projected sources and uses of capital drive the change in capital ratios under the CFG severely adverse scenario.

I.C. CFG Results under the CFG Severely Adverse Scenario

I.C.1. Impacts of Stress on Net Income, Losses and Risk-Weighted Assets

The net loss before taxes under the CFG severely adverse scenario, as shown in *Exhibit 2* below, is primarily driven by an impairment to goodwill and higher provision expense resulting from higher nonperforming loans and charge-offs. Additionally, the scenario results in a reduction in business activity causing a decline in earning assets and noninterest income. The lower interest rate environment causes compression to the net interest margin further reducing CFG's earning under this scenario.

The increase in provision expense is largely driven by the effect of higher unemployment rates and reduction in real estate values. Higher unemployment reduces many customers' ability to repay, resulting in higher loss rates across all retail and small business portfolios. The increase in unemployment also causes reduced demand in Commercial lending; in addition, the decrease in GDP results in higher losses and higher provisions in the Commercial portfolios. The reduction in real estate values lowers collateral values, further increasing charge-offs in the real estate-secured portfolios due to an increase in loss severities.

² CFG has "opted-out" of the Basel III requirement to include in Common Equity Tier 1 Capital all components of Accumulated Other Comprehensive Income (AOCI) except net gains and losses on cash flow hedges related to items that are not fair-valued on the balance sheet. Consistent with this "AOCI opt-out," CFG calculates Basel III ratios in which its regulatory capital position is not affected by certain transactions that are otherwise included in AOCI under GAAP accounting, such as the mark-to-market of securities held as available for sale or any amount recorded in AOCI in relation to defined benefit pension plan assets.

Exhibit 2: CFG Net Income under CFG Severely Adverse Scenario

	Q3 2017 - Q3 2019 (\$ billions)	Percent of Average Assets ¹
Pre-provision net revenue ²	\$3.8	2.6%
Other revenue ³	—	—
less		
Provisions	5.2	3.6
Realized losses/gains on securities (AFS/HTM)	—	—
Trading and counterparty losses ⁴	—	—
Other losses/(gains) ⁵	6.9	4.8
equals		
Net income/(loss) before taxes ⁶	\$(8.3)	(5.8)%

¹ Average assets is the nine-quarter average of total assets.

² Pre-provision net revenue includes losses from operational risk events, mortgage repurchase expenses and other real estate owned (OREO) costs.

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 and credit valuation adjustments (CVA) losses and losses arising from the counterparty default scenario component applied to derivatives, securities lending and repurchase agreement activities.

⁵ Other losses/gains include projected change in fair value of loans held for sale and loans held for investment measured under the fair-value option and goodwill impairment losses.

⁶ Numbers may not foot due to rounding.

Projected macroeconomic conditions under the CFG severely adverse scenario negatively affect the portfolio performance across all loan types as shown in *Exhibit 3*. The Commercial loss rate is driven primarily by falling corporate profits, as a result of the weakening economy. The Consumer loss rate is mainly driven by the general weakness in the economy, resulting in higher unemployment and depressed housing prices affecting the ability to recapture unpaid principal balance on foreclosed properties. In addition, less disposable income leads to increasing student loan losses, while a depressed auto market is reflected in a lower value recapture on repossessed vehicles, due to declining used car values, which impacts auto losses. The size of the loan book declines as a result of reduced loan originations in the weaker economy; loan originations are not sufficient to offset large increases in losses and prepayment activity in the CFG severely adverse scenario.

Exhibit 3: CFG Loan Losses under CFG Severely Adverse Scenario

Loan type	Q3 2017 - Q3 2019 (\$ billions)	Nine-Quarter Cumulative Portfolio Loss Rates (%) ¹
First lien mortgages, domestic	\$0.2	1.3%
Junior liens and HELOCs, domestic	0.3	2.3
Commercial and industrial ²	1.4	4.4
Commercial real estate, domestic	0.8	5.6
Credit cards	0.2	16.5
Other consumer ³	0.9	4.1
Other loans	0.3	4.0
Total projected loan losses ⁴	\$4.2	3.9%

¹ Average loan balances used to calculate portfolio loss rates exclude loans held for sale and loans held for investment under the fair-value option, and are calculated over nine quarters.

² Commercial and industrial loans include small- and medium-enterprise loans and corporate cards.

³ Other consumer loans include student loans and automobile loans.

⁴ Numbers may not foot due to rounding.

CFG's total balance sheet contracts over the nine quarters of stress, resulting in a decline in RWA as noted below in *Exhibit 4*. Loan growth is projected in the first two quarters as CFG continues to grow loan originations consistent with baseline plans. As the macroeconomic environment deteriorates, a combination of lower consumer demand and tightened underwriting results in lower loan originations at the back-end of the planning horizon. The balance sheet is affected by credit losses and weaker loan demand, which reduce balances and resulting RWAs. This trend is partly offset by a higher proportion of nonperforming loans and higher risk-weighted assets in residual loan portfolios.

Exhibit 4: CFG RWAs under CFG Severely Adverse Scenario

(\$ billions)	Actual Q2 2017	Projected Q3 2019
Risk-weighted assets	\$125.8	\$120.5

I.C.2. Impacts of Stress and Supervisory-Prescribed Capital Actions on Capital Ratios

CFG is well-positioned to withstand stress due to the strength of its balance sheet, risk profile and capital base. In alignment with FRB requirements, CFG projected regulatory capital ratios under the CFG severely adverse scenario using supervisory-prescribed capital actions. *Exhibit 5* summarizes the DFAST capital action requirements defined by FRB regulation.

Exhibit 5: Capital Actions Assumptions

DFAST Capital Action	Q3 2017	Each Quarter Q4 2017 - Q3 2019
Quarterly common dividends	Actual	Equal to the quarterly average dollar amount of dividends paid in Q4 2016-Q3 2017 plus dividends associated with stock issuance related to expensed employee compensation and with funding a planned merger or acquisition
Payments on additional tier 1 and on tier 2 capital instruments ¹	Actual	Equal to the stated dividend, interest, or principal due on such instrument
Redemption/repurchase of Capital Instruments	Actual	None
Issuance of common or preferred stock	Actual	None, except for issuances related to expensed employee compensation or in connection with a planned merger or acquisition

¹ Additional tier 1 and tier 2 capital instruments include noncumulative preferred equity and qualifying subordinated debt.

Supervisory-prescribed capital actions do not reflect CFG's planned capital actions, nor do they necessarily reflect the capital actions that CFG would execute in a stressed environment. CFG's internal controls and regulatory expectations would halt or significantly reduce capital distributions if losses such as those implied by the CFG severely adverse scenario were to occur.

Exhibit 6 summarizes the starting, ending and minimum capital ratios for CFG over the planning horizon for the CFG severely adverse scenario using the methodologies described in section I.B and the capital action assumptions described above.

Exhibit 6: CFG Capital Ratios under CFG Severely Adverse Scenario

(%)	Actual Q2 2017	Projected Stressed Capital Ratios ¹			Required Regulatory Minimum under Stress
		Ending	Minimum	Quarter of Minimum	
Common equity tier 1 capital ratio	11.2	10.4	10.0	Q2 2018	4.5
Tier 1 risk-based capital ratio	11.4	10.6	10.2	Q2 2018	6.0
Total risk-based capital ratio	14.0	13.2	12.9	Q2 2018	8.0
Tier 1 leverage ratio	9.9	9.2	8.8	Q2 2018	4.0

¹ The capital ratios are calculated using capital action assumptions provided within the Dodd-Frank Act stress testing rule. 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 minimum capital ratio presented is for the period Q3 2017 to Q3 2019.

Although all of CFG's capital ratios decline over the planning horizon under the CFG severely adverse scenario, all ratios continue to exceed the required regulatory minimum.

- The common equity tier 1 (CET1) ratio ends the scenario at 10.4%, 80 bps lower than the starting position of 11.2%, reaching a minimum of 10.0% in Q2 2018.
- The tier 1 risk-based ratio ends the scenario at 10.6%, 80 bps lower than the starting position of 11.4%, reaching a minimum of 10.2% in Q2 2018.
- The total risk-based capital ratio ends the scenario at 13.2%, 80 bps lower than the starting position of 14.0%, reaching a minimum of 12.9% in Q2 2018.

- The tier 1 leverage ratio ends the scenario at 9.2%, 70 bps lower than the starting position of 9.9%, reaching a minimum of 8.8% in Q2 2018.

In all instances, over the planning horizon, CFG's capital ratios decline primarily due to an increase in projected net losses and the assumed supervisory-prescribed capital actions, which are partially offset by pre-provision net revenue generation and a decrease in risk-weighted assets.