

# Dodd-Frank Act Stress Test 2017 Results Disclosure

Webster Financial Corporation  
and Webster Bank, N.A.

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## I. Overview and Requirements

Webster Financial Corporation (“Webster” or the “Holding Company”) is the holding company for Webster Bank, N.A. (“Webster Bank” or the “Bank”). With \$26.2 billion in assets at June 30, 2017, Webster provides business and consumer banking, mortgage lending, financial planning, and trust and investment services through 167 banking centers, 343 ATMs, mobile banking, and online banking through [www.websteronline.com](http://www.websteronline.com). Webster Bank provides health savings account trustee and administrative services through HSA Bank, a division of Webster Bank, and also owns the asset-based lending firm Webster Business Credit Corporation and the equipment finance firm Webster Capital Finance Corporation.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), financial companies that have total consolidated assets of more than \$10 billion and are regulated by a primary federal financial regulatory agency shall conduct an annual stress test. The final Dodd-Frank Act Stress Test (“DFAST”) rule requires that covered institutions conduct the annual stress test using a nine-quarter forward-looking planning horizon, beginning with financial data as of December 31, 2016, and assess the potential impact to capital, applying three hypothetical economic scenarios provided by the Office of the Comptroller of the Currency (“OCC”) and the Federal Reserve Board (“FRB”): baseline, adverse, and severely adverse.

The Dodd-Frank Act also requires a covered institution to submit a report to its Board of Directors and its primary financial regulatory agency at such time, in such form, and containing such information as the primary financial regulatory agency shall require. Additionally, the Dodd-Frank Act instructs the primary financial regulatory agency to require a covered institution to publish a summary of its severely adverse stress test results.

This document summarizes the results of the severely adverse Dodd-Frank Act Stress Test for Webster Financial Corporation and Webster Bank, N.A., and provides a forward-looking perspective on potential impacts to capital under the severely adverse scenario. Results contained in this document are based on a hypothetical economic scenario constructed by Webster’s primary federal regulator and should not be interpreted as a forecast. Due to variations in methodologies between institutions, Webster’s stress test results may not be directly comparable to the results of other institutions.

The stress test results demonstrate that both Webster Financial Corporation and Webster Bank maintain excess capital to exceed both minimum and well-capitalized regulatory standards throughout the projected periods in the severely adverse stress scenario. This document also discusses the types of risks included in the stress test, provides an overview of the methodologies used, and explains significant changes in regulatory capital ratios.

## II. Severely Adverse Scenario Overview

The severely adverse scenario is characterized by a severe global recession that is accompanied by a period of heightened stress in corporate loan markets and commercial real estate markets. It is important to note this is a hypothetical scenario designed to assess the strength of banking

organizations and their resilience to unfavorable economic conditions. This scenario does not represent a forecast of the OCC or Federal Reserve.

In the severely adverse scenario, the level of U.S. real GDP begins to decline in Q1 2017 and reaches a trough in Q2 2018 that is about 6.5% below the pre-recession peak. The unemployment rate increases to a peak of 10%, in Q3 2018, from 4.7% in Q4 2016, a 5.3% increase. The consumer price inflation rate falls to 1.3% by Q2 2017 and then rises to 1.9% by the end of 2018.

As a result of the severe decline in real activity, short-term Treasury rates fall and remain near zero through the end of the scenario period. The 10-year Treasury yield drops to 0.8% in Q1 2017, rising gradually thereafter to 1.5% by Q1 2019 and to 1.8% by Q1 2020. Financial conditions in corporate and real estate lending markets are stressed severely. The spread between yields on investment-grade corporate bonds and yields on long-term Treasury securities widens to 5.4% by the end of 2017, an increase of 3.5% relative to Q4 2016. The spread between mortgage rates and 10-year Treasury yields widens to 3.6% over the same time period.

Asset prices drop sharply in the scenario. Equity prices fall by 50% through the end of 2017, accompanied by a surge in equity market volatility, which approaches the levels attained in 2008. House prices and commercial real estate prices also experience large declines, with house prices and commercial real estate prices falling by 25% and 35%, respectively, through Q1 2019.

### III. Risks

A key component of Webster's stress test process is the identification and measurement of risks and vulnerabilities specific to Webster. This section describes risks considered in the stress test results and the methodologies applied to translate risk measures into estimates of potential losses over the nine-quarter DFAST planning horizon. Among the key risks considered are credit risk, interest rate risk, liquidity risk, and operational risk.

**Credit risk** stems from a borrower or counterparty's potential inability to meet contractual obligations to the Bank. It represents the largest potential risk to earnings and capital. The stress test process incorporates specific credit risk models for each of eleven different loan asset classes required for regulatory reporting, as well as specific asset classes related to securities. Webster utilizes both portfolio-level and loan-level models to estimate net charge-offs using relevant macroeconomic variables provided by the regulators in the supervisory scenarios. The portfolio-level net charge-off models predict the net charge-off rates for each given portfolio based on the historical relationship between net charge-offs and the macroeconomic variables. The loan-level net charge-off models predict losses at a loan level based on historical relationships between net charge-offs, individual loan characteristics, and the macroeconomic variables, then aggregate the net charge-offs at a portfolio level. The losses associated with the loan portfolio impact the provision for loan and lease losses through maintenance of an adequate reserve.

A portion of Webster's securities holdings is also subject to credit risk and potential credit losses. Estimates of the potential losses are reflected in other-than-temporary impairment charges.

**Interest rate risk** is defined as the potential reduction in pretax, pre-provision net revenue (“PPNR”) due to changes in interest rates or spreads. It is managed and monitored on an ongoing basis with the primary goal of maximizing future earnings and net economic value in changing interest rate environments, while remaining within the established risk appetite. The Asset/Liability Management (“ALM”) simulation model provides detailed projections of net interest income using the supervisory interest rate scenarios and dynamic balance sheet assumptions. The projections are adjusted for the impact of nonperforming loans, liquidity costs, and changes to equity funding due to credit and operational losses.

**Liquidity risk** refers to Webster’s ability to meet a demand for funds by converting assets into cash and by increasing liabilities at a reasonable cost. For stress test purposes, management also estimates the cost of liquidity, particularly short-term liquidity, and incorporates this cost of liquidity in each scenario.

**Operational risk** results from inadequate or failed internal processes, people, and systems or from external events. It includes the risks stemming from failure to comply with applicable laws, regulations, and ethical standards, as well as the lack of required risk identification or mitigation pertaining to business processes and systems of operation. Operational risk is captured both as a standalone model component and in the various components modeling the impacts to noninterest income and expense.

**Other risks** not directly identified as part of DFAST include reputational risk and other strategic risks such as changes in competition, changes in consumer preferences, and technological innovation.

## IV. Stress Test Methodology

The stress test process utilizes the macroeconomic variables provided by the OCC and FRB and incorporates historical data, modeling, management judgment, and enterprise-wide expertise from Treasury, Business Line Management, Accounting, Credit Risk, Operational Risk, Financial Analytics, Finance, and Executive Management. The company relies on various quantitative and qualitative analyses as follows:

- Ordinary least square (“OLS”) regression-based modeling and expected loss loan-level modeling
- Other modeling techniques that utilize historical macroeconomic data and hypothetical future scenarios
- Historical trend analysis of Webster’s financial results and those of banking industry peers
- Where statistical correlations to macroeconomic variables are weak or nonexistent, management documents qualitative and quantitative support for management judgment conclusions

The stress test is an integral component of the risk management practices at Webster and is an important tool for evaluating capital adequacy and establishing capital targets. Engagement of Senior Management and the Board of Directors is essential to the process. The stress test program is governed by a Stress Test Committee, which reports up to the Capital Management Committee, Enterprise Risk Management Committee, and Board of Directors. The hierarchy is designed to ensure multiple layers of review and challenge throughout the process and to capture multiple perspectives from across the

organization. Prior to submission, Webster's stress test process and models were reviewed by Internal Audit and independently validated.

## V. Holding Company and Bank Stress Test Results

The following section summarizes results for Webster Financial Corporation and Webster Bank for the severely adverse scenario. As required, results are projected over a nine-quarter DFAST planning horizon beginning on January 1, 2017 and ending on March 31, 2019.

### Capital Ratios

Exhibit V.1 below summarizes the results for Webster Financial Corporation after applying the DFAST severely adverse scenario over the nine-quarter planning horizon. Q1 2019 represents the last period in the stress test, while, depending on the ratio, the lowest ratios occur in various periods during the nine-quarters. As highlighted, Webster's capital ratios exceed the regulatory minimums during all nine projected quarters. Additionally, Webster exceeds its tightest capital ratio, the total risk-based capital ratio, by \$576.7 million of excess capital over the regulatory minimum.

#### Exhibit V.1

Webster Financial Corporation				
	Actual	Severely Adverse Scenario		
	Q4 2016	Q1 2019	9 Quarter Lowest Ratio	Regulatory Minimum Basel III
Common equity tier 1 capital ratio	10.52%	9.06%	8.86%	4.50%
Tier 1 risk-based capital ratio	11.19%	9.74%	9.55%	6.00%
Total risk-based capital ratio	12.68%	11.42%	11.24%	8.00%
Tier 1 leverage ratio	8.13%	6.87%	6.74%	4.00%

Exhibit V.2 below summarizes the results for the Bank after applying the DFAST severely adverse scenario over the nine-quarter planning horizon. As highlighted, the Bank's capital ratios exceed the regulatory minimums during all nine projected quarters. Additionally, the Bank exceeds its tightest capital ratio, the total risk-based capital ratio, by \$489.5 million of excess capital over the regulatory minimum.

**Exhibit V.2**

Webster Bank				
	Actual	Severely Adverse Scenario		Regulatory Minimum Basel III
	Q4 2016	Q1 2019	9 Quarter Lowest Ratio	
Common equity tier 1 capital ratio	10.61%	9.88%	9.50%	4.50%
Tier 1 risk-based capital ratio	10.61%	9.88%	9.50%	6.00%
Total risk-based capital ratio	11.68%	11.13%	10.75%	8.00%
Tier 1 leverage ratio	7.70%	6.97%	6.71%	4.00%

### Pretax, Pre-Provision Net Revenue, Provision, & Net Income before Taxes

Exhibit V.3 summarizes cumulative PPNR, provision for loan losses, securities losses, and net income before taxes for Webster Financial Corporation over the nine-quarter planning horizon in the severely adverse scenario.

**Exhibit V.3**

Webster Financial Corporation		PPNR & Net Income	
\$ in millions			
	Severely Adverse	% of Average Assets (1)	
Pretax, pre-provision net revenue	\$ 324.6	1.28%	
Provisions for Loan Losses	(577.0)		
Realized Gain/(Loss) on Securities (AFS/HTM)	(39.4)		
Net Income/(Loss) Before Taxes	\$ (291.8)	-1.15%	

(1) 9-quarter average total assets for Severely Adverse w as \$25.3 billion.

Exhibit V.4 summarizes cumulative PPNR, provision for loan losses, securities losses, and net income before taxes for the Bank over the nine-quarter planning horizon in the severely adverse scenario.

**Exhibit V.4**

Webster Bank		PPNR & Net Income	
\$ in millions			
	Severely Adverse	% of Average Assets (1)	
Pretax, pre-provision net revenue	\$ 386.2	1.53%	
Provisions for Loan Losses	(577.0)		
Realized Gain/(Loss) on Securities (AFS/HTM)	(39.4)		
Net Income/(Loss) Before Taxes	\$ (230.2)	-0.91%	

(1) 9-quarter average total assets for Severely Adverse w as \$25.3 billion.

## Cumulative Loan Losses

Exhibit V.5 below provides the position of the loan portfolio for the Holding Company and Bank as of Q4 2016 and the cumulative net charge-off projection for the next nine quarters given the severely adverse scenario. A Dynamic Balance Sheet was used to develop the severely adverse loan and lease portfolio forecasts. Portfolio loss rates were calculated using the average nine-quarter balance of each portfolio.

### Exhibit V.5

Webster Financial Corporation & Webster Bank			
Projected Loan and Lease Losses			
\$ in millions	Actual	Severely Adverse Scenario	
	Loans Outstanding 12/31/16	Losses (Cumulative 9-Quarters)	Portfolio Loss Rate (1)
Total Loans and Lease Losses	\$ 17,094.2	\$ 503.2	3.00%

(1) Calculated using the nine-quarter average of loans outstanding of \$16.8 billion.

## VI. Significant Drivers of Stress Test Results

The most significant drivers affecting Webster's regulatory capital ratios were the deterioration in pretax, pre-provision net revenue and the increase in provision for loan and lease losses.

- **Decreased pretax, pre-provision net revenue** in the severely adverse scenario created a significant negative impact to capital levels. Key contributors to the decrease in PPNR included a lower level of interest-earning assets, a challenging interest rate environment due to declining long-term rates, foregone interest due to higher nonperforming loans, lower fee revenue, and higher operating costs. Additionally, loan origination volumes declined over the nine-quarter planning horizon.
- **An increase in provisions for loan and lease losses** was primarily a function of increased net charge-offs. During the nine-quarter planning horizon, the peak allowance for loan losses as a percentage of total loans reached a level slightly higher than the peak Webster experienced during the Great Recession.

### Forward-Looking Statements

*The capital ratios presented herein are calculated using capital action assumptions provided within the Dodd-Frank Act Stress Test rules. These projections represent hypothetical estimates that involve economic outcomes that are more adverse than expected by management. These estimates are not forecasts of actual expected losses, revenues, net income before taxes, or capital ratios. The results of the scenario are not intended to be a forecast of Webster's expected future economic or financial conditions. The results reflect theoretical performance under the prescribed hypothetical scenario. Webster's future financial results will be influenced by actual economic and financial conditions and various other factors as described in its reports filed with the Securities and Exchange Commission and available at [www.sec.gov](http://www.sec.gov).*



*This report contains certain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements may address issues that involve significant risks, uncertainties, estimates and assumptions made by management. Actual results may differ materially from current projections. Please refer to Webster's filings with the Securities and Exchange Commission for a summary of other important factors that may affect Webster's forward-looking statements. Webster undertakes no obligation to revise these statements following the date of this report.*