

 TEXAS CAPITAL BANCSHARES, INC.®

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 TEXAS CAPITAL BANK®

**Dodd-Frank Act Company-Run Stress Test 2016 Public Disclosure**

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## 1. Introduction

Texas Capital Bancshares, Inc. (“Texas Capital” or the “Company” or “TCBI”), a Delaware corporation organized in 1996, is the parent of Texas Capital Bank, National Association (the “Bank” or “TCB”). The Company is a registered bank holding company and a financial holding company headquartered in Dallas, Texas, with primary banking offices in Austin, Dallas, Fort Worth, Houston, and San Antonio, the five largest metropolitan areas of Texas. Since inception the Company has focused on organic growth, maintenance of credit quality and recruiting and retaining experienced bankers with strong personal and professional relationships in their communities.

As a mid-size banking institution with consolidated assets between \$10 and \$50 billion, Texas Capital is required to implement the stress testing and disclosure requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank Act”). These tests include a series of regulatory derived, hypothetical economic scenarios (“Supervisory Scenarios”) which are intended to test the resiliency of a bank’s financial position under extremely adverse economic conditions.

This document summarizes the methodologies used to complete the 2016 Dodd Frank Act Stress Test (“DFAST”), and outlines select metrics indicative of financial performance under the most severe of the three Supervisory Scenarios, the “Supervisory Severely Adverse” scenario. **It is important to note that the Supervisory Severely Adverse scenario is not a forecast, but rather a hypothetical scenario with assumed financial and economic conditions designed by the Federal Reserve to assess the strength of banking organizations under extremely adverse conditions. As such, the quantitative output included herein should not be viewed as a forecast of expected outcomes or financial performance.**

## 2. Supervisory Severely Adverse Scenario

Similar to last year, the Supervisory Severely Adverse scenario published by the Federal Reserve is characterized by a deep and prolonged recession, comparable if not more severe than the Great Recession of 2008-2009. Forecast economic variables that drive TCBI performance are among the most severe in the last 40 years, in most instances reflecting a severity in the worst 5% of observed outcomes.

To augment the national variables promulgated by the Federal Reserve, the Company considers additional economic variables that are consistent with the scenario but more reflective of the Bank’s geographic footprint and unique business model.

## 3. Risks Accounted For in Stress Testing Results

TCBI categorizes its risk exposures under nine classifications for the purposes of risk identification. Full or partial inclusion of each risk in DFAST is predicated on multiple factors, including the correlation to economic factors and the applicability of capital stress testing as a tool to measure a particular risk.

## **Credit Risk**

Loans represent by far the largest asset category on the Bank's balance sheet, and their related credit risk is the most significant risk the Company assumes. Credit risk arises from the potential that a borrower or counterparty will fail to perform on an obligation. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance. It arises any time bank funds are exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

In DFAST, TCBI measures credit risk using quantitative credit loss models conditioned on historical performance and internally defined risk drivers. Losses are reflected in capital depletion through the erosion of the Allowance for Loan and Lease Losses ("ALLL") leading to additional provision expenses needed to "refill" the quarterly balance of the ALLL to adequate levels.

## **Interest Rate Risk**

Interest rate risk is the risk to earnings or capital arising from movements in interest rates. This economic perspective focuses on the value of the institution in today's interest rate environment and the sensitivity of that value to changes in interest rates.

The primary method of measuring interest rate risk in DFAST is through modeling net interest income. The Company's investments, loans, deposits and debt portfolios are all considered, with detailed data used to project the interest income and expense of existing and projected portfolios under specific scenario conditions.

## **Liquidity Risk**

Liquidity risk is the potential that an institution will be unable to meet its obligations as they come due. This could happen because of an inability to liquidate assets or obtain adequate funding, or because specific exposures cannot easily be unwound or offset without significantly lowering market prices because of inadequate market depth or market disruptions. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from a bank's failure to recognize or address changes in market conditions that affect its ability to liquidate assets quickly and with minimal loss in value.

Liquidity risk is measured through the evaluation of parent cash position, changes in anticipated funding mix, earnings impacts through pre-provision net revenue ("PPNR") projections and capital buffers established to allow for market access during recessions.

**Price Risk**

Price risk is the risk to earnings or capital arising from changes in the value of portfolios of financial instruments. The risk arises from market-making, dealing and position-taking activities for interest rate, foreign exchange, equity and commodity markets. Many banks use the terms "price risk" and "market risk" interchangeably.

As of December 31, 2015 TCBI had \$30 million of available for sale securities, and no pre-maturity sales were assumed, rendering the potential capital impacts of this risk *de minimus*. Given the portfolio size and materiality, the impacts of changing interest rates to the fair value of the existing securities portfolio across scenarios are not considered. TCBI believes this is appropriate, especially considering there is no risk of direct capital impacts and only extremely limited potential for indirect capital impacts.

**Operational Risk**

Operational risk is the risk of unexpected losses that can occur from inadequate information systems and reporting, operational problems, breaches in internal controls, fraud (both internal and external), or unforeseen catastrophes. It also includes staff competency, experience, technical expertise, compensation and benefits.

This risk is partially considered through non-interest expense modeling.

**Other Risks**

Other risks identified and monitored through the Company's Enterprise Risk Management framework but not explicitly included in the Company's DFAST results include:

- 1) Financial reporting risk;
- 2) Strategic risk;
- 3) Reputational risk; and,
- 4) Compliance risk

These risks, while difficult to quantify through capital stress testing, are considered when establishing the capital buffer the Company holds above regulatory minimums and when evaluating financial performance under the Supervisory Severely Adverse scenario.

**4. Methodologies Used and Resulting Estimates**

TCBI's DFAST framework is organized around specific process steps necessary to reliably measure the impact of conditions consistent with the Supervisory Scenarios on the risk factors described above. Capital Stress Testing models used in DFAST focus on defining the relationship between macroeconomic

variables and balance sheet volumes, revenues and losses in order to estimate outcomes that could arise under the evaluated scenarios.

In addition to quantitative modeling techniques, TCBI’s DFAST process also considers qualitative components guided by management’s knowledge of business performance resulting in the potential for conservative overlays to modeled outcomes.

Methodologies used are described below:

- 1) Estimates of credit loss are based on quantitative models developed from historical experience to predict the likely performance for loans with similar risk characteristics under hypothetical severely adverse economic conditions.
- 2) Balance sheet growth and composition projections are based on quantitative models developed from historical experience, known strategic initiatives and planned constraints.
- 3) Provision expense estimates draw upon established Company practices for assessing appropriate reserve levels across the forecast horizon.
- 4) PPNR is estimated using a series of quantitative models to assess the impact of changing economic conditions on loan balances, funding strategies, interest income, interest expense, non-interest income and non-interest expense.

Figure 1.1 summarizes the financial results for both TCB and TCBI under the Supervisory Severely Adverse scenario.

Figure 1.1 – 9-Quarter Financial Results

<i>9-Quarter Totals (\$000's)</i>	<b>Texas Capital Bank N.A.</b>	<b>Texas Capital Bancshares</b>
Pre-Provision Net Revenue	411,764	388,104
Provision for Loan and Lease Losses	312,394	312,394
Net Charge-Offs	222,529	222,529
Net Income Available to Common	40,197	26,517

## 5. Capital Ratios

Capital ratios are generated for each quarter of the forecast period consistent with applicable regulatory guidance outlined by the Basel III phase in schedule. Despite the effects of the significant and prolonged recession reflected in the Supervisory Severely Adverse scenario, regulatory capital ratios remain in line with internal Bank stress testing guidelines throughout the forecast horizon.

Figures 1.2 and 1.3 display both the ending regulatory capital ratios as well as the minimum levels reached during the 9 quarter forecast period for TCB and TCBI respectively.

Figure 1.2 – TCB Capital Ratios – Severely Adverse Scenario

Regulatory Ratio	Actual Q4 2015	Stress Capital Ratios	
		Ending Q1 2018	Minimum
Common Equity Tier 1 Capital Ratio (%)	7.82	7.59	7.46
Tier 1 Risk-Based Capital Ratio (%)	8.64	8.39	8.24
Total Risk-based Capital Ratio (%)	10.57	10.64	10.12
Tier 1 Leverage Ratio (%)	8.96	8.70	8.63

Figure 1.3 – TCBI Capital Ratios – Severely Adverse Scenario

Regulatory Ratio	Actual Q4 2015	Stress Capital Ratios	
		Ending Q1 2018	Minimum
Common Equity Tier 1 Capital Ratio (%)	7.47	7.19	7.11
Tier 1 Risk-Based Capital Ratio (%)	8.81	8.48	8.39
Total Risk-based Capital Ratio (%)	11.05	11.03	10.56
Tier 1 Leverage Ratio (%)	8.92	8.79	8.78

Importantly, the parent company also retains access to substantial unencumbered cash balances throughout the forecast horizon which could be contributed as capital to TCB if desired.

Given the proportional size of TCB in relation to the consolidated entity, the impact of the Supervisory Severely Adverse scenario on forecast capital ratios is similar at both TCB and TCBI. The significant drivers of changes in regulatory capital levels across the 9-quarter period are as follows:

- Forecast economic conditions in the Supervisory Severely Adverse scenario drive reductions in loan growth resulting in modestly higher period-end loan balances over the 9-quarter horizon.
- Consistent with historical experience, core earnings remain strong throughout the scenario resulting in sufficient internal capital generation to offset the heightened provision expense associated with elevated credit losses.
- Negative interest rates lead to continued margin compression.
- Increases in non-interest income resulting from elevated mortgage warehouse activity are partially offset by expenses associated with increases in other real estate owned and credit collection activities.

Summaries of the 9-quarter changes to Common Equity Tier 1 (“CET1”) Ratios are shown in Figure 1.4 and Figure 1.5 below:

Figure 1.4 – TCB CET1 Sources and Uses

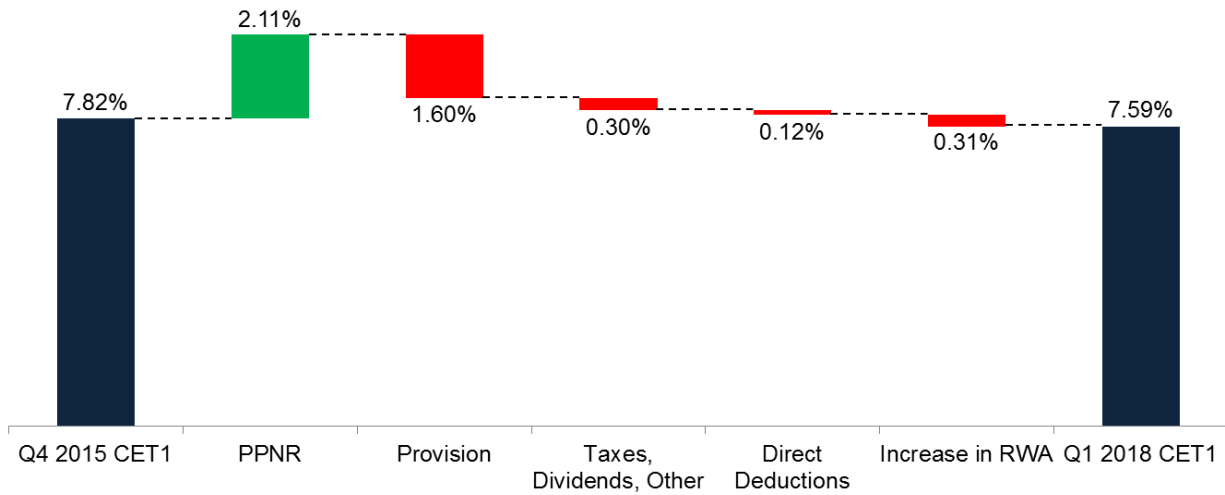
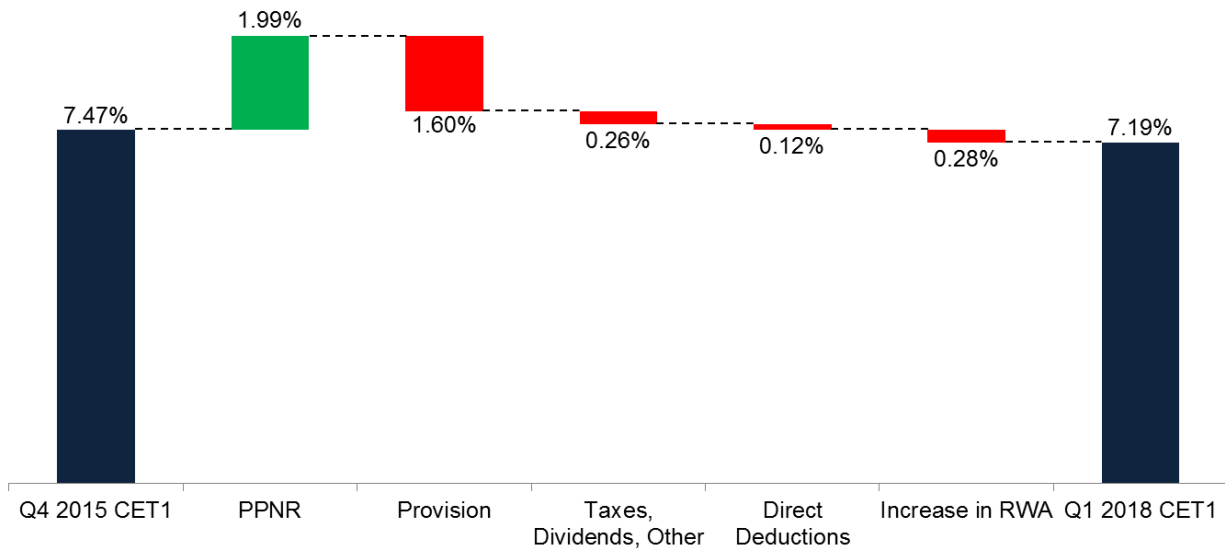


Figure 1.5 – TCBI CET1 Sources and Uses





*This disclosure may be deemed to include forward-looking statements which are based on management's current estimates or expectations of future events or future results. These statements are not historical in nature and can generally be identified by such words as "believe," "expect," "estimate," "anticipate," "plan," "may," "will," "intend" and similar expressions. The information contained in this disclosure speaks only as of its date. We are under no obligation, and expressly disclaim such obligation, to update, alter or revise our forward-looking statements, whether as a result of new information, future events, or otherwise. A number of factors, many of which are beyond our control, could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. These risks and uncertainties include, but are not limited to, deterioration of the credit quality of our loan portfolio, the effects of recent declines in oil and gas prices on our customers, increased defaults and loan losses, the risk of adverse impacts from general economic conditions, competition, interest rate sensitivity and exposure to regulatory and legislative changes. These and other factors that could cause results to differ materially from those described in the forward-looking statements can be found in our Annual Report on Form 10-K and in other filings we make with the Securities and Exchange Commission.*