



Valley National Bancorp

2017 Annual
Dodd-Frank Act
Stress Test Disclosure

October 2017

2017 Annual Dodd-Frank Act Stress Test Disclosure for Valley National Bancorp and Valley National Bank

Introduction

Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and related regulations requires national banks and federal savings associations with consolidated assets of more than \$10 billion, including Valley National Bancorp (referred to herein as “we”, “us”, “our” or “Valley”), to conduct annual stress tests. In the Dodd-Frank Act stress test (“DFAST”) conducted annually and completed in July of this year, we are required to perform stress tests using a set of macroeconomic scenarios (supervisory baseline, supervisory adverse and supervisory severely adverse) developed by the Board of Governors of the Federal Reserve System (“Federal Reserve Board”). The results of the stress tests are submitted to the Office of the Comptroller of the Currency (“OCC”) and the Federal Reserve Board.

Stress testing is an integral component of our internal capital adequacy assessment. We incorporate DFAST into our internal processes to assess our capital adequacy to ensure that Valley holds an appropriate amount of capital based on the risk associated with our businesses and consistent with Valley’s Board of Director’s Risk Appetite Statement.

The DFAST rules require us to publish a summary of the stress test results based on the Federal Reserve Board’s severely adverse scenario in October of this year. Our planning horizon for the 2017 stress test is the first quarter of 2017 through the first quarter of 2019.

Basel III-Based Capital Rules (“Basel III”)

Valley is required to compute its capital ratios for each quarter of the planning horizon. The Common Equity Tier I, Tier I Risk Based Capital, Total Risk Based Capital and Leverage ratios are calculated utilizing the Basel III-based capital rules.

Standardized Capital Rules

We are required to calculate capital ratios under the Standardized Capital Rules. Risk weighted assets and capital are calculated under the Standardized Capital Rules that utilize the Revised Capital Framework definition of capital. The new definitions of capital include changes to certain limitations on the instruments that can be included in regulatory capital and the items that must be deducted.

Severely Adverse Scenario

The severely adverse scenario is developed and prescribed by the Federal Reserve Board. For the 2017 DFAST, the scenarios include 28 variables, 16 domestic and 12 international. This included six measures of economic activity and prices; four aggregate measures of asset prices or financial conditions; six measures of interest rates; and twelve measures of international conditions.

GDP and Unemployment

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. In this scenario, the level of U.S. real GDP begins to decline in the first quarter of 2017 and reaches a trough in the second quarter of 2018 that is about 6½ percent below the pre-recession peak. The unemployment rate increases by about 5¼ percentage points, to 10 percent, by the third quarter of 2018. Headline consumer price inflation falls to about 1¼ percent at an annual rate by the second quarter of 2017 and then rises to about 1¾ percent at an annual rate by the middle of 2018.

U.S. Interest Rates and Credit Spreads

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 ¾ percent in the first quarter of 2017, rising gradually thereafter to around 1½ percent by the first quarter of 2019 and to about 1¾ percent by the first quarter of 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 about 5½ percentage points by the end of 2017, an increase of 3½ percentage points relative to the fourth quarter of 2016. The spread between mortgage rates and 10-year Treasury yields widens to over 3½ percentage points over the same time period.

Equity Markets & Other Prices

Asset prices drop sharply in this scenario. Equity prices fall by 50 percent 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 percent and 35 percent, respectively, through the first quarter of 2019.

Summary of Results

The following table summarizes the results of Valley's calculations under the Federal Reserve Board's severely adverse scenario over the planning horizon. The results incorporate the following capital action assumptions that are consistent with the Federal Reserve Board's DFAST rules for each of the quarters in the planning horizon:

- common stock dividends equal to the quarterly average dollar amount of common stock dividends that were paid in the first quarter of 2016 through the fourth quarter of 2016;
- common stock cash dividends were paid in accordance with regulatory requirements;
- payments on any other instrument eligible for inclusion in the numerator of a regulatory capital ratio equal to the stated dividend, interest or principal due on such instrument; and
- no redemption or repurchase of any capital instrument eligible for inclusion in the numerator of a regulatory capital ratio.

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**Projected Capital Ratios, Pre-Provision Net Revenues (“PPNR”), Aggregate Losses and Net Income
Valley National Bancorp Projections Under the Federal Reserve Board’s Severely Adverse Scenario**

These results are calculated using capital action assumptions required by the DFAST rules. All projections represent hypothetical estimates that involve an economic outcome that is more adverse than expected. These estimates are not forecasts.

Actual and Projected Capital Ratios through Q1 2019 under the Federal Reserve Board’s Severely Adverse Scenario			
	Actual Q4 2016	Stressed	
		Ending	Lowest
Common equity tier 1 ratio (%)	9.27%	9.72%	9.47%
Tier 1 risk based capital ratio (%)	9.90%	10.42%	10.14%
Total risk based capital ratio (%)	12.15%	13.33%	12.43%
Tier 1 leverage ratio (%)	7.74%	8.86%	7.80%
*Ratios reflect impairment of approximately \$16.6 million related to our purchase credit impaired portfolio			

Projected Loan Losses by Type of Loan from Q1 2017 through Q1 2019 under the Federal Reserve Board’s Severely Adverse Scenario		
	in millions	Portfolio Loss Rates ¹
Total Loan and Lease Losses	121.8	0.82%
First Lien Mortgages	2.7	0.11%
Junior Liens and HELOCs	1.5	0.32%
Commercial and Industrial	40.0	2.00%
Commercial Real Estate	41.0	0.53%
1-4 Family and Other Construction	12.3	4.10%
Credit Cards	0.8	10.74%
Other Consumer	14.0	2.34%
Other Loans	9.6	3.22%
¹ Average balances used to calculate portfolio loss rates exclude purchase credit impaired loans		

Projected PPNR, Losses and Net(Loss)/Income After Taxes from Q1 2017 through Q1 2019 under the Federal Reserve Board’s Severely Adverse Scenario		
	in millions	Percentage of Average Assets
PPNR	351.5	1.69%
Other Revenue	-	-
Less		
Provision for Loan Losses	209.5	1.01%
Realized Losses/(Gains) on Securities	-	-
Equals		
Net (Loss)/Income Before Taxes	141.9	0.68%
*Figures may not total due to rounding		

2017 Annual DFAST Results | Valley National Bank

Projected Capital Ratios, Pre-Provision Net Revenues (“PPNR”), Aggregate Losses and Net Income

Valley National Bank Projections Under the Federal Reserve Board’s Severely Adverse Scenario

These results are calculated using capital action assumptions required by the DFAST rules. All projections represent hypothetical estimates that involve an economic outcome that is more adverse than expected. These estimates are not forecasts.

Actual and Projected Capital Ratios through Q1 2019 under the Federal Reserve Board’s Severely Adverse Scenario			
	Actual Q4 2016	Stressed Ending	Lowest
Common equity tier 1 ratio (%)	10.55%	10.88%	10.76%
Tier 1 risk based capital ratio (%)	10.55%	10.88%	10.76%
Total risk based capital ratio (%)	11.82%	12.75%	12.12%
Tier 1 leverage ratio (%)	8.25%	9.19%	8.30%

*Ratios reflect impairment of approximately \$16.6 million related to our purchase credit impaired portfolio

Projected Loan Losses by Type of Loan from Q1 2017 through Q1 2019 under the Federal Reserve Board’s Severely Adverse Scenario		
	in millions	Portfolio Loss Rates ¹
Total Loan and Lease Losses	121.8	0.82%
First Lien Mortgages	2.7	0.11%
Junior Liens and HELOCs	1.5	0.32%
Commercial and Industrial	40.0	2.00%
Commercial Real Estate	41.0	0.53%
1-4 Family and Other Construction	12.3	4.10%
Credit Cards	0.8	10.74%
Other Consumer	14.0	2.34%
Other Loans	9.6	3.22%

¹ Average balances used to calculate portfolio loss rates exclude purchase credit impaired loans

Projected PPNR, Losses and Net(Loss)/Income After Taxes from Q1 2017 through Q1 2019 under the Federal Reserve Board’s Severely Adverse Scenario		
	in millions	Percentage of Average Assets
PPNR	419.2	2.02%
Other Revenue	-	-
Less		
Provision for Loan Losses	209.5	1.01%
Realized Losses/(Gains) on Securities	-	-
Equals		
Net (Loss)/Income Before Taxes	209.7	1.01%

*Figures may not total due to rounding

Based on the Federal Reserve Board's severely adverse scenario, the most significant drivers of the changes in Valley's regulatory capital ratios over the planning horizon when compared with actual regulatory capital ratios as of the fourth quarter of 2016 are:

- decreased risk weighted assets resulting from modest loan and investment contraction over the planning horizon;
- loan losses which are included in our net (loss)/income projections and increased allowance for loans and lease losses;
- impairment of approximately \$16.6 million associated with our purchase credit impaired loan portfolio which represents the loss we may incur over the life of the portfolio which extends well beyond the planning horizon;
- increased retained earnings due to lower distributions to shareholders; and
- lower PPNR over the planning horizon resulting in decreased net (loss)/income.

Material Risk Captured in the Stress Test

Credit Risk

Credit risk represents the principal loss we would incur if a borrower or counterparty based on its inability or unwillingness failed to perform on an obligation. Valley's exposure to credit risk is principally in the form of lending.

Credit risk is incorporated into our 2017 DFAST results via the severely adverse macroeconomic scenario. The significant drop in economic output, home prices and equity prices as well as a rise in the unemployment rate resulted in increased credit risk which is reflected in our provision for loan losses.

Liquidity Risk

Liquidity risk is the risk to earnings or capital arising from a bank's inability to meet its obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources. Liquidity risk also arises from the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Our 2017 DFAST results account for liquidity risk by projecting funding balances based on the severely adverse scenario and assessing the impact of any outflows on our balance sheet.

Interest Rate Risk

Interest rate risk is the risk to earnings or capital arising from movements in market interest rates. Interest rate risk arises from the impact of movements in interest rates and the timing of cash flows (repricing risk), from changing rate relationships among different yield curves affecting bank activities (basis risk), from changing rate relationships across the spectrum of maturities (yield curve risk), and from interest-related options embedded in bank products (options risk).

Interest rate risk is incorporated into our 2017 DFAST results based on an initial decline of both short-term and long-term treasury rates early in the planning horizon. While long-term rates rose steadily

through the planning horizon, the short end of the curve remained at zero. Credit spreads widened as do mortgage spreads, although to a lesser degree.

Operational Risk

Operational risk is the risk to earnings or capital arising from inadequate or failed internal processes or systems, the misconduct or errors of people, and adverse external events. Operational losses result from internal fraud; external fraud; employment practices and workplace safety; clients, products, and business practices; damage to physical assets; business disruption and systems failures; and execution, delivery, and process management. For capital stress testing purposes, compliance risk has been considered as part of operational risk.

Operational risk losses are assessed based on the assumed conditions of the severely adverse scenario. The estimates may include judgements based on Valley's historical operational risk experience, internal factors and industry trends. The 2017 DFAST results incorporate operational risk losses within the non-interest expense projections over the planning horizon.

Acquisition Risk

Acquisition risk can potentially impact enterprise-wide risk indicators. Risk exposures arise from expanding the geographic reach of the combined entity and broadening of the customer base potentially through new products or services. An acquisition may result in greater concentration of counterparty credit risk or exposure to financial instruments. Identifying potential changes in enterprise risks, creating an action plan to address them, and assessing changes to risk management strategies post-acquisition are critical to managing acquisition risk.

Description of Our Stress Testing Methodologies

Our stress testing projections are primarily estimated using quantitative methodologies. Management judgement is also a critical component of the process and therefore some estimates are conveyed based on a qualitative approach. We use econometric models to estimate pre-provision net revenue and credit losses to assess our capital levels for each quarter over the planning horizon.

On whole, line items determined to be material to the balance sheet or income statements are projected using quantitative models. However, in certain situations where statistical correlations to macroeconomic variables are weak or in cases where sufficient historical data are not available, we use qualitative estimations to determine the projections over the planning horizon. Typically, qualitative estimations are more conservative in nature, in that the results are more adverse to capital.

We largely utilize the variables developed and prescribed by the Federal Reserve Board in our econometric models. In certain circumstances we may utilize variables that are extrapolated based on what was provided by the Federal Reserve Board.

Our stress testing methodologies are subject to a rigorous effective challenge and validation process that is critical to achieving accurate and credible results. The effective challenge process engages our subject matter experts at various levels to provide a thorough analysis and review of the results. The validation process incorporates an additional level of review by assessing the appropriateness of the models utilized in the stress test, including the suitability of each model's purpose, assumptions, and performance.

Valley National Bancorp's wholly owned subsidiary, Valley National Bank represents 99.9 percent of the consolidated Company's assets; therefore, we apply the same methodologies when conducting stress tests at the bank level.

Supplementary Information

Additional information on DFAST is available on the Federal Reserve Board's website at <https://www.federalreserve.gov/publications/2017-june-dodd-frank-act-stress-test-preface.htm>.