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COF.N - Capital One Financial Corp at Goldman Sachs Financial Services Conference (Virtual)

EVENT DATE/TIME: DECEMBER 08, 2020 / 7:20PM GMT

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PRESENTATION

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Right. Up next, we are pleased to once again have Capital One join us. Capital One has come into the pandemic position better than most as it had managed credit in a tight manner, built out industry-leading technology and was on a journey to see significant efficiency improvement. While it's built significant amounts of reserves in the downturn, we don't think much of that has changed, and we expect it to leverage the significant investments it's made to drive efficiency gains over time and has built a significant excess capital position, which we think will position the company to return it over time.

Here to tell us more about where we go from here is Chairman and CEO, Rich Fairbank. Today's discussion is going to be a fireside chat. Rich, Danielle, thank you once again for joining us, as always.

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

Thank you, Ryan. It's great to be here. And yes, Danielle Dietz is with me here as well.

QUESTIONS AND ANSWERS

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Awesome. So Rich, maybe just to start off, can you give us a sense of what you're seeing in -- from the U.S. consumer? You recently noted that this has been the biggest disconnect in the 30 years you've been doing this between the economy and the performance of the consumer but that could reverse itself in a significant way if things went in a certain direction. So based on what you know as of today, what you're seeing, where do you think we go from here? And how important do you think further stimulus is to the ultimate outcome for the consumer?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

So thanks, Ryan. And Ryan, I don't know how many years you and I have been doing these together. It's our first that's not in person.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

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Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

11? Wow, we'll keep our streak going in that. Thanks, everyone, for joining us today. So this is certainly an extraordinary thing that we are observing. And as someone that built a company or the founding idea that was so linked to how we can leverage technology and information to win at credit, we're seeing things we just haven't seen in all those years. So I think the U.S. consumer is demonstrating some really exceptional resilience. And it's important to remember that consumers went into this downturn in considerably better shape than last time with lower debt levels; lower payment obligations, thanks in part to lower interest rates; a higher savings rate; and not a lot of structural issues in the economy or the housing sector, things like that.

The thing that I so often point at is a defining sort of root cause of so many of the different things we're seeing this time around is the abruptness and intensity with which this downturn took off. And it took off for consumers, it took off -- the consumers, the government, the lenders all went in this down elevator all at the same time. And all the participants in that had some very dramatic reactions that came out of that, that have contributed to some of the unique things that we've seen. So we certainly saw consumers react quickly and cautiously when the pandemic began. And almost immediately, they went into the trilogy of behavior. We've seen this trilogy before, but the magnitude was so significant: spending less, saving more and paying down on debt, especially revolving debt. And for us, that shows up in lower purchase volumes, higher payment rates and more deposit inflows.

We, of course, also saw widespread forbearance programs across the banking industry and unprecedented consumer support through government stimulus. And the cumulative impact of the consumer balance sheet of lost wages, sort of offset by government support and lower spending, has been a pretty electrifying thing to look at and, by our tally, is a positive net consumer "savings" effect of well over $1 trillion or $10,000 per U.S. household. Now of course, the circumstances of individual consumers and the households are highly variable, and we're talking here about totals and, therefore, averages. But a significant part of the CARES Act stimulus expired after July and the rest runs out at year-end. And this, of course, is adversely impacting many, many unemployed Americans. If we don't see the renewed stimulus, especially strong unemployment benefits, some of these favorable effects that we've seen will likely wear off in the coming months, leaving a lot of consumers in an exposed position, and that risk is reflected in our allowance choices.

And the pandemic itself has been getting worse over the past few months, which also could have new adverse effects on the economy and consumer resilience. But if we pull way up, I think what makes this downturn so different from others is that unlike descending into the downturn on little cat feed over many, many months or even years, we all went into free fall sort of at the same time. All the parties had a really strong reaction. Governments were able to mobilize stimulus on a per month basis that's never been seen before. And we are seeing, therefore, the great disconnect. Our allowance reflects a resumption to things that are a lot more normal. Every month that we continue to enjoy the strong credit trends, we're getting closer to the other side of this and reducing the cumulative losses through the downturn rather than just delaying the impact.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Thanks for all the color there, Rich, and I'm going to come back to credit in a second. But if you just think about what you've seen now in the consumer, you talked about saving and paying down debt. At the bottom, purchase volume was down over 30%, and then it came all the way back to basically flat. Can you maybe just update us on the purchase volume trends you're seeing in your business? And has there been any fundamental shift in customer behaviors over a -- within the last couple of months as the pandemic has unfolded?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

So year-over-year purchase volume growth rebounded through the third quarter. You all could see that in our metrics. And the run rate sort of hit low single-digit growth by the end of the quarter, and customers have increased their spending from the very low levels of Q2. But even with that rebound, purchase volume growth is still well below the double-digit increases we saw earlier this year. So I think sometimes people, when they look at Capital One data, they then say purchase volume is back. It's flat year-over-year. We were running at double digit -- low double-digit increases so it's really not, in a sense, at least looking at Capital One data, fully back from that perspective.

You asked what's been happening lately, and we're all watching carefully the overall holiday spending trends, we've seen some noise and a little softness around Black Friday. But I think the noise is the bigger point I would make than the softness point. But if anything, it has been a little soft. And I think intuitively, it's logical that consumers might not spend as much as usual with nowhere to go and limited access to even family members and extended family members to see. So I think it's quite plausible that holiday spending will be light because of the pandemic. I don't think that would necessarily be a negative indicator about the health of the consumer, but it might be more of a byproduct of the quarantine life that we're all living. But if anything, the very earliest signs would be consistent with a little softness there.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Got it. And if you think about credit performance, which you highlighted before, in the card business, I would have never expected 9 months into a pandemic to see losses down almost 50 bps year-over-year last quarter and I think about 80 last month. Delinquency is down over 150 basis points year-over-year. And the auto business continues to put up extraordinary performance. But as you highlighted, with risk of further stimulus, the pandemic getting worse, there's still a lot of uncertainty there. So do you have a better sense, at least for the range of outcomes now that we've gotten these announcements regarding the vaccine, of what this will ultimately look like from a credit perspective?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

So the metaphor, after all these years, I would probably think by -- sometimes I find the most simple metaphors are the most telling. But I've used this metaphor, Ryan, of picture unemployment rate and the economy that's behind that as a mountain, and we go up to a big spike in the mountain, and then go down the other side of the mountain and return over time to normal. As you know, in general, over the decades that I've been in this business, industry credit card loss rates have not only sort of followed the unemployment rate by coincidence, they've been almost numerically the same.

And so it is really bizarre to see these diverging the way that they are. But the metaphor I use here is from a credit loss point of view, we're burrowing through the tunnel, we're burrowing a tunnel through this gigantic mountain of unemployment. And what's unclear is, do we continue to burrow horizontally through this with the extraordinary performance or do things turn and the consumer rapidly return to where they are on the mountain. I think one could argue any of those outcomes is plausible. The important thing is with every month that we burrow through this, we're, I think, lowering the cumulative impact. I think it's less likely that there's sort of a big retroactive impact from the parts of the mountain that we have avoided.

So I think the vaccine -- the interesting thing about the vaccine is the virus itself created an unusual and not seen before entry into the downturn. Interestingly, the vaccine on the other side may create a unique exit to the downturn because, usually, consumers have to pick themselves up by their bootstraps and get their confidence back and all this stuff. And you saw how long that took after the global financial crisis to sort of get all that mobilized. With a vaccine coming here, I think there is a chance for confidence returning in a more sudden way than you would typically have. By the way, none of that is reflected in our allowance because our allowance is reflective of the great uncertainty and the extraordinary pressures that the economy is suffering, and we'll just have to see over time how these things play out.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Got it. Well, we'll save the reserve release questions for the next earnings call. But maybe to just bring it home to Capital One, Rich, a big thing that you spent years talking about was the choices that you made heading into the downturn: avoiding high-balance revolvers, cautious on lines of credit, amongst other things. How do you think -- we obviously live in a relative world, how do you think these impacts -- these things will impact the ultimate outcome? And what do you think it means for Capital One's performance versus the industry?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

We can't really speak to the results of our competitors, although I will say that, over a lot of years in this journey, I've looked with skepticism at some of the underwriting that some of our competitors have done, and sometimes those things have come to roost in downturns. I think, and I've been saying for some years before the downturn, I think the industry, and if I calibrate versus the other credit markets that we're in, I think the major players in the card business are very rational. They have underwritten soundly and rationally. And so I think all of us are benefiting from some sound underwriting practices as well as the real assist from the government and from consumers.

Let me talk just a little bit about Capital One because you indicated we have taken some unique approaches. We've always believed that the choices you make during the good times are the most important drivers of how you perform in the bad times. And that's why we managed down our concentration of, we call them, high-balance revolvers. But another way to put it is just consumers with a lot of debt, with a lot of particularly revolving debt, they tend to perform very well. And one gives -- it leaves a lot on the table. They tend to perform very well in the good times. They just have a lot less resilience that we have found. And that's -- so we have continued to minimize our exposure to high-balance revolvers.

We've also done a unique thing to structure some partnership deals with loss sharing, and we have also been cautious with credit lines. And you may remember, Ryan, over the last couple of years, we have increased the amount of times we were mentioning we're being particularly cautious this deep into the credit cycle. So it reduced our asset growth but improved our resilience. So what we're finding right now -- and my dog is here agreeing with me, I better get us out there -- everybody's got a point of view on where we are right now. But what -- if you look at our metrics, we have had, sort of relative to other card issuers, the most year-over-year improvement, in fact, a bizarre thing, even up to the last month, showing some increased improvement over last year in certain credit metrics where, even seasonally, they're supposed to be turning the other way.

So I think some of this is just the benefits of some of the extra conservative choices that we have made. But we'll have to see how things play out in the rest of the downturn, but we feel very well about how we're positioned. And I think it puts us in a position to lean into some growth opportunities also, which I'm sure, at some point, you'll ask about.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

That was very good telegraphing because I was about to ask about it right now. Rich, if I kind of reflect back, you went from decisions that you made that led to growth that was probably a little bit slower than the industry at low single-digit shrinking, and now we're lapping some tougher comps with the Walmart addition and the portfolio shrinking low to mid-teens. So as you sit here today, while I know Capital One never targets specific amounts of growth, what do you need to see to open up underwriting for loan growth to return? And maybe can you just talk about -- you mentioned earlier about the rationality of competition, maybe just talk about what you are seeing on the competitive side. And are you and competitors starting to come back into the market for customer acquisition?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

Yes. So remember, I said all 3 parties went down the down elevator at the same time, not knowing where this elevator was going to stop, those parties being consumers, government and lenders. And the consumers have had sort of an unprecedented and immediate conservatism in their behavior. The government was able to mobilize, on a per month basis, an amount of stimulus never seen before and -- I'm just letting my dog back in here. And the lenders all pulled back pretty dramatically at the start of the downturn. We certainly did. I think what's happened in the marketplace is -- and each lender doing it in a different way and each lender is pursuing their -- each lender has a bit of a different strategy in targeted segments as well.

Everybody is starting to return more toward where things were before. I don't think anyone is fully there. But you see, after marketing spend was way down, it's starting to go up a little bit. Origination volumes, mail volumes, these various things are starting to turn. For us, it's not a binary thing like we're either in or we're out. What we have worked so hard to do, and we do this in every downturn, is look for unique opportunities, especially on the origination side of the business, that look safe but allow us to really keep the origination machine going. Our conservatism is mostly on the credit lines that we grant and the choice of line increases, but we tried to keep the origination machine going as prudently as we can.

And as the pandemic and downturn have unfolded, we have increasingly found some safe areas for growth, especially in originations. And that's why we've also signaled the significant increase in marketing. Now these originations don't show up immediately in outstandings growth because that's really more about when the option value of those originations shows up in future line increases. But really important to us is keeping the underlying machine going. And I think we've been able to do that off the really strong credit base that we have, been able to increasingly lean into that and that will be very helpful down the road.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Rich, you just noted the expectation for a pickup in marketing in the fourth quarter, I think you said a significant sequential increase that is driven by both seasonality and the full quarter effects of increases in domestic card marketing, which is consistent with what we just talked about. Can you maybe just dig in a little bit further and talk about what some of the drivers are, what decisions you're making right now to determine the ultimate magnitude of that? And are we beginning -- well, you're not expecting to see balances accelerate because that could come over time given the low and grow strategy, but could we begin to see an acceleration in customer acquisition that could drive growth over an intermediate time frame?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

Yes. So the original drop in the economy and the extremeness of the pandemic led us to pull back on pretty much everything, tightening credit policy, pulling back even a lot on the origination machine. So there was quite a brownout period for a number of months as we took stock on how things were going to settle out. Since then, we have been working really, really hard to identify those opportunities for growth, and we look at the business in many, many segments but by pulling out a magnifying glass and looking at the nature of whether we're getting positive or adverse selection in a particular segment over the transom with the new business, looking at the competitive environment.

And also, at the same time, another factor, Ryan, that is increasingly helpful is as we are getting farther in our tech journey, the ability for more big data, real-time driven underwriting has -- is kind of coming into the fore right now as well. And out of all of this, we found a growing number of origination opportunities even while still other parts were tighter than usual. But we're leaning into those opportunities, and the marketing is also a reflection of that.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Got it. So to shift gears a little bit, Rich, during the first half of 2019, you set an operating efficiency target to highlight the progress you've made in a lot of these digital and tech journey to improve the profitability. And this improvement, which I think you dubbed as 42% in '21 was withdrawn during the onset of the pandemic, but then you brought it back a quarter later with no timetable attached to it. So maybe a 2-part question, first, with the Walmart revenue step-up and the transition out of data centers set to happen this quarter, can you talk about the drivers of reaching the goals from here, revenue versus expense? And then second, I know at this point, there's no public timetable on the goal, but given the backdrop, like, can you give us sort of a framework to think about a realistic goal in terms of timing? Or what will we need to see to reach that goal?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

Yes. So our journey of improving operating efficiency has been an ongoing journey of 5 or 6 years. We had a bit of a setback. The pandemic set us back a bit on that journey. But let's pull up and talk about what are the drivers of the operating efficiency improvements we've been able to enjoy over the last 5 or 6 years. And powered by the tech transformation and the continued improvements in underwriting and innovations at Capital One, we saw a growing -- we have found continued growth opportunities, and the revenue side of the business has been a very important driver of the efficiency. And essentially, we've been able to grow costs slower and the revenue has grown sort of year after year.

As we -- around the time of when we were talking about 42% by '21, we were looking ahead to, really, an increase in some of the growth opportunities that we were looking at, unlocking some of the credit lines that we had held back and capitalizing on some opportunities that were very real and tangible to us. And so on the revenue side, and that was the particularly larger driver of the significant projection of efficiency improvement, we were counting on quite a bit of revenue growth. At the same time, we also had things in the works that would help on the efficiency side, most notably, the data center exit. So those drivers, like the data center exit, the Walmart step-up on the revenue sharing, that has proceeded sort of just as we had expected.

The elephant in the room is the revenue is not, right now, what it was projected to be. But I look at this, and while we have pulled back on the timing of when we declare a certain destination, the underlying drivers of the ability to improve efficiency over time, the opportunity to drive growth, the ability of our technology transformation to drive both growth opportunities, revenue opportunities and the opportunities to be more efficient, all of that is still the way it was before. So the only question now is timing. But we feel very good about how value is created over time by this company, particularly on the shoulders of our tech transformation. And we're just going to have to see a little bit on the timing.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Got it. A couple more topics then, Rich, you rolled out a national banking campaign, I think it was last year, and it contributed to significant growth in customer deposits, although stimulus has clearly been a big chunk of that more recently. Do you have a sense for how much is being driven by stimulus versus company initiatives? And when you think about the strategic positioning of the bank, you referred to, I think, it was the bank in the middle: digital savvy but with a physical presence, has the pandemic changed your view of how that should look over the longer term?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

So we've had a tremendous growth in deposits, and a big driver of the success has been the government support and consumer savings. But I think our national banking strategy has also been a significant driver of growth, enabling us to reduce pricing while still generating a lot of volume. And for years, we have developed and scaled our hybrid model of digital direct banking with thin physical distribution. The pandemic has not altered the destination of where consumers are going. In fact, I think it's been strongly confirmatory of that. But the primary impact, I think it has accelerated their journey. So this is a favorable trend for Capital One, and we continue to go all-in on our strategy.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Got it. Rich, can we maybe talk a little bit about the auto business? This has been a major bright spot. I think you had 11% year-over-year growth. You've talked about some of the digital investments you've made there as well as some client segmentation you've done. How do you expect the performance, from a growth perspective, to evolve over the rest of the pandemic? Second, what are you seeing with auction prices? And how do you expect all the dislocation in the auto market to inevitably pan out for the health of the asset class over the intermediate term?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

Let me talk a little bit about the market and then talk about Capital One. The auto marketplace, from a lending point of view, has certainly been a positive one in this pandemic. You had manufacturers dialing back their volumes, so there was less pressure from the captives. The used car pricing has been celestial, really unbelievable. And the credit performance, auto has benefited from the credit performance of consumers that we've talked about earlier in this conversation. So that has been, I think, a good market for everybody in the auto business.

Now I think all the auto players, Capital One included, dialed back somewhat just as the pandemic unfolded. We have another thing going on in the auto business, though, that has been the continued traction of our digital strategy. We have invested heavily in real-time underwriting. We've built the Auto Navigator product that can underwrite any car in America on any lot in a fraction of a second. And both on the consumer side and with respect to dealers, this has been a beneficial thing for generating extra volume and high-quality volume. So it's hard for us to separate the effects of the positive marketplace, the competitive dial-backs and Capital One's increasing traction with technology. But we have, even as we've sort of dialed back our credit policy, been able to generate some outsized growth.

Here's what I observed now in the marketplace. Competitors are roaring back. I think we anticipate increased competition that will probably have -- that will make its way into impacting our growth metrics. But how this all plays out is hard to predict. But it is striking, if you just kind of pulled up and look at Capital One's Auto Finance metrics, since the pandemic began, you can barely see a pandemic because there's been a lot of strength in the marketplace and in our market position.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Maybe one last question, Rich. You've noted that capital return is an important part of the shareholder return. The Fed says that you need to run at about 10%. And clearly, once we get to the point of returning capital, you could be at 13%, 14%. I guess does this change the way at all you think about capital? And how should we think about managing that down over time?

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

So we have talked about an 11% target, and let me give you a few thoughts on this. The Fed set out our stress capital buffer at 5.6%. Combined with the 4.5% regulatory minimum, our capital requirement under the stress capital buffer framework is currently 10.1%, and we would expect to operate above that level in most environments. We also do our own stress modeling, which is a critical input into our capital targets. Pulling up, while our capital requirement under the SCB framework is 10.1%, we expect to manage the buffer above that in normal times and be running higher in the near term given the current capital distribution restrictions and overall heightened uncertainty.

In terms of managing down to that level over time, obviously, the restrictions on capital distribution implemented by the Fed will prevent us from share repurchases for the remainder of the year. That said, given that we're running at over 13% CET1 capital and have a strong desire to resume share repurchases once the economic and regulatory environments permit, we are looking forward to finding the opportunity to distribute capital to shareholders because that's a very central part of our thesis. Barring any additional Fed actions, the SCB framework should allow us the flexibility to manage our capital distributions, including dividends and share repurchases on an ongoing basis, beginning as soon as the first quarter of '21.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Great. Well, Rich, unfortunately, we are out of time. But on behalf of myself and investors, just wanted to say thank you, again, for all the thoughts. Have a nice holiday season, and we look forward to doing this, hopefully, again in person next year. Thanks again.

Richard D. Fairbank - *Capital One Financial Corporation - Founder, Chairman, CEO & President*

Ryan, I look forward to that. Thanks, everyone. And thanks for hosting this conference.

Ryan Matthew Nash - *Goldman Sachs Group, Inc., Research Division - MD*

Thanks again. Have a great holiday season, Rich. Take care.
