TESTIMONY OF

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Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HOUSE COMMITTEE ON FINANCIAL SERVICES

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I. Introduction

Chairman Neugebauer, Ranking Member Clay, and members of the Subcommittee, thank you for the opportunity to appear before you this afternoon. I am Chairman and CEO of Zions Bancorporation, a $58 billion dollar (total assets) bank holding company headquartered in Salt Lake City, Utah. We operate seven community banks, with local management teams and brand names, in eleven states from Texas to the West Coast. Indeed, we consider ourselves to be a "Collection of Great Banks," with a particular focus on serving small and mid-sized businesses and municipalities throughout the West. We believe we are very good at serving such customers, and are proud to have been awarded 24 Excellence Awards (placing us second among more than 750 U.S. Banks surveyed) in Greenwich Research Associates' survey of approximately 30,000 small and middle market businesses across the country in a variety of product and service categories in 2014.

Virtually all of our banking activities are very traditional in nature, with a straightforward business model that is highly focused on taking deposits, making loans, and providing our customers with a high degree of service. We are primarily a commercial lender, which is to say that we are especially focused on lending to businesses. And notably, roughly half of our total commercial loan commitments consist of loans of less than $5 million in size, underscoring our focus on serving smaller businesses throughout the West.

Zions Bancorporation has the distinction of currently being the smallest of the Systemically Important Financial Institutions – or "SIFIs" – in accordance with the $50 billion asset threshold for the determination of systemic importance as defined in section 165 of the Dodd-Frank Act. And while we are proud of the services we provide to our customers, and believe we incrementally make a real difference in the local markets in which we operate, we certainly do not consider ourselves to be systemically important to the United States economy. We in fact half-jokingly refer to our company as

an "Itty Bitty SIFI," and we see evidence that an increasing number of thoughtful observers, including our own regulators, are of the opinion that we are of neither the size, complexity nor critical importance to the workings of the U.S. economy to warrant the scope, intensity and cost of additional regulation that the automatic designation as a SIFI carries with it.[1]

II. Stress Testing and Capital Planning

As a covered institution, or SIFI, under section 165 of the Dodd-Frank Act, Zions Bancorporation is subject not only to the Act's rigorous stress testing (Dodd-Frank Act Stress Test, or "DFAST") requirements, but to the annual Comprehensive Capital Analysis and Review ("CCAR") conducted in conjunction with the annual DFAST exercise.

The DFAST process is intensive, time-consuming and costly. It involves the development and continual maintenance of sophisticated statistical models designed to project a bank's performance over the course of a hypothetical nine-quarter period of severe economic stress, using scenarios incorporating a variety of macroeconomic variables supplied annually by the Federal Reserve, and supplemented by a bank holding company's own variables and assumptions reflecting any of its idiosyncratic risk exposures. These statistical models are expected to be capable of projecting the likely outcomes and interrelated effects of each line item on a bank holding company's income statement and balance sheet based on a granular analysis of a bank's individual assets and liabilities. They must be developed based on historical performance, back-tested, validated, audited and documented. So-called "challenger" models must also be developed to identify potential weaknesses inherent in the more material primary models. And the entire process must be conducted under a rigorous governance process involving both the bank's management and board of directors.

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[1] See, *e.g.*, remarks of Federal Reserve Board Governor Daniel K. Tarullo in his testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.

Each of the (currently) 31 bank holding companies required to participate in the Federal Reserve's supervisory stress test exercise furnishes the Federal Reserve with millions of data elements derived from individual loans and other balance sheet items on Form FR Y-14. This data is used both in the banks' internal stress tests and in the Federal Reserve's own models to project risk-weighted assets and capital levels during and at the conclusion of the hypothetical period of severe stress in an attempt to ensure that capital levels under stress will not breach minimum regulatory standards.

The CCAR exercise builds on the DFAST process by incorporating a firm's projected capital actions over the nine-quarter projection period. The objective is to determine that a bank holding company's projected capital actions would not, during a period of stress such as that reflected in the stress test, impair capital levels below required regulatory capital thresholds. After evaluating the results of its own and the banks' stress tests and capital plans, the Federal Reserve provides each covered institution with both a qualitative and a quantitative assessment of its stress testing and capital planning processes.

Zions Bancorporation has been a participant in the CCAR process for the past two years, after the Federal Reserve expanded the number of covered institutions from 18 to the current group of 31 participating bank holding companies. In preparing throughout 2014 for our participation in "CCAR 2015" – an exercise covering a planning period from September, 2014 through December, 2016, with our internal stress testing results and capital plan submitted in January of this year – we incurred approximately $20 million in direct expense, much of it with outside consultants. We also spent many thousands of hours of management and board time focused on CCAR. Our board of directors met twenty times in 2014; CCAR was a significant agenda item in seventeen of those meetings. During the first week of January, 2015, we submitted approximately 12,500 pages of detailed mathematical models, analysis and narrative to the Federal Reserve incorporating our CCAR 2015 product. We have

recently been completing our mid-year stress test exercise to complement the more intensive annual submission.

I view stress testing as a fundamentally important tool in the management of a bank's risk and the assessment of its capital adequacy. The value of the insights it yields, however, does not increase in linear proportion to the investment made in the exercise, and this is particularly true for the smaller and less complex regional banking institutions. There are diminishing returns from this exercise for both the banking institutions and the regulators. Federal Reserve Governor Daniel K. Tarullo recently noted that "...the basic requirements for the aggregation and reporting of data conforming to our supervisory model and for firms to run our scenarios through their own models do entail substantial expenditures of out-of-pocket and human resources. This can be a considerable challenge for a $60 billion or $70 billion bank. On the other side of the ledger, while we do derive some supervisory benefits from inclusion of these banks toward the lower end of the range in the supervisory stress tests, those benefits are relatively modest, and we believe we could probably realize them through other supervisory means."[2]

Ideally, the stress testing process should inform management's and the board's thinking about managing credit concentrations, interest rate risk, underwriting standards, pricing, and maintaining an appropriate balance of risks in its portfolio. In our own experience, these objectives are largely thwarted by the reality that the results of the Federal Reserve's internal models trump our own internally modeled results. Although the Federal Reserve posed no material objection to Zions Bancorporation's qualitative processes in CCAR 2015, its own modeled measure of the firm's tier 1 common equity ratio after nine quarters of severely adverse economic conditions was *40%* below our own projected outcome. Such a variance in outcomes begs a reconciliation of the models used by each organization if the results are to be truly useful in the management of the company. And while Federal Reserve officials

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[2]Federal Reserve Board Governor Daniel K. Tarullo, in remarks to the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.

argue that “transparency around the stress testing exercise improves the credibility of the exercise and creates accountability both for firms and supervisors,”[3] they continue to maintain that it is important not to disclose details of their models, lest firms “manage to the test.” Certainly it is not difficult to understand a regulator’s perspective about this, but the notion that the rules – which are effectively incorporated into those models’ algorithms – governing banks’ capital distributions to the firms' owners should be kept secret finds little if any parallel in our legal and regulatory system.

This lack of transparency has the effect of creating uncertainty, and because the Federal Reserve’s modeled capital results become the “binding constraint” for capital planning by some banks, including my own, we are *necessarily* led to attempt to “manage to the test” - even if it’s not clear how the test works. This uncertainty echoes recent comments by Federal Reserve Governor Daniel K. Tarullo, who noted that “while enhanced prudential standards are important to ensure that larger banks can continue to provide credit even in periods of stress, some of those same enhancements could actually inhibit credit extension by rendering the reasonable business models of middle-sized and smaller banks unprofitable.”[4] In our own case, we’ve in particular established limits on construction and term commercial real estate lending that are significantly more conservative than those incorporated in current interagency guidelines on commercial real estate risk management.[5]

Another example of the uncertainty around the Federal Reserve's models involves small business loans. The detailed FR Y-14 data templates used for the Federal Reserve’s models to capture granular data on collateral values and other factors useful in evaluating potential loss exposures for commercial loans expressly exclude loans of less than $1 million and credit-scored owner-occupied commercial real

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[3] Federal Reserve Board Vice Chairman Stanley Fischer, speaking at the Riksbank Macroprudential Conference, June 24, 2015

[4] Federal Reserve Governor Daniel K. Tarullo – before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.

[5] Office of the Comptroller of the Currency, FDIC and Board of Governors of the Federal Reserve System: *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices,* December, 2006.

estate loans, the combination of which amounts to nearly 15% of our total loan portfolio. Rather, such loans are reported on a supplemental schedule that includes only the loan balances. We can therefore only suppose that such loans are treated relatively more harshly in the Federal Reserve's models, and consider whether this is another area where we should exercise restraint in extending credit in order to reduce the risk of a quantitative "miss" in the Federal Reserve's calculation of our required capital.

III. Liquidity Management

Having been designated as a Systemically Important Financial Institution, Zions Bancorporation is also subject to the Modified Liquidity Coverage Ratio. The three primary federal banking regulatory agencies, in implementing the Basel III liquidity framework, jointly adopted the Liquidity Coverage Ratio ("LCR") rule in September, 2014. The rule is applicable to internationally active banking organizations, generally those with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposure. At the same time, the Federal Reserve went beyond the Basel Committee's LCR framework, and adopted a somewhat less stringent rule, the Modified Liquidity Coverage Ratio ("MLCR"), applicable to bank holding companies with $50 billion or more in consolidated assets but that are not internationally active. This quantitative measurement supplements a qualitative liquidity management framework introduced in early 2014 to fulfill Enhanced Prudential Standards requirements, including liquidity standards, required by section 165 of the Dodd-Frank Act. The MLCR requires a bank holding company to hold a narrowly defined portfolio of "High Quality Liquid Assets" ("HQLA") equal to or greater than expected net cash outflows over a 21-day period, in accordance with a prescribed set of run-off calculations established in the rule. The qualitative liquidity management framework requires, among other things, monthly internal liquidity stress tests to supplement the prescriptive MLCR in determining the size of the institution's required minimum liquidity buffer.

The full extent of the impact of the liquidity rules on SIFIs is almost certainly not fully apparent in the current economic environment. We have experienced a prolonged period of low interest rates without precedent, and liquidity in the banking system has been abundant by virtually any historical measure. But liquidity comes at a cost, and the true cost of these rules will become manifest as interest rates and liquidity levels eventually normalize. While it is important for every depository institution to maintain appropriate levels of reserves to deal with normal fluctuations in cash flows, maintaining additional liquidity buffers as an insurance policy against times of extreme stress will almost certainly be a costly exercise for banks and for the economy at large. Every dollar invested in high quality liquid assets is a dollar that cannot be loaned out and put to more productive use. The impact will likely be most particularly acute for smaller and middle-market businesses that do not have ready access to the capital markets, and for whom bank credit is their financial lifeblood. Regional banks subject to the MLCR and the additional enhanced prudential liquidity standards imposed by the Dodd-Frank Act provide a disproportionate share of credit to such businesses.

IV. Other Consequences of SIFI Designation

Since the financial crisis, Zions Bancorporation has added nearly 500 additional full-time equivalent staff in areas such as compliance, internal audit, credit administration and enterprise risk management. In an effort to manage costs, these increases have been accompanied by offsetting reductions in other areas of the organization, including many customer-facing functions. Many, though not all, of these increases in risk management staffing are directly attributable to the Enhanced Prudential Standards requirements of the Dodd-Frank Act and other regulatory requirements that have arisen in the wake of the financial crisis.

We have also embarked on an ambitious program to replace core software systems, revamp our chart of accounts and establish a data governance framework and organization in order to ensure our

ability to meet the substantial data requirements necessary to fully comply with the stress testing and liquidity management protocols applied to SIFIs. We expect to spend well over $200 million on these projects, making this the most substantial investment in systems in our history. While we will derive ancillary benefits from modernizing our systems, ensuring regulatory compliance has been a significant factor in our decision to make these investments. Additional investments have been made in software systems directly related to compliance with the Enhanced Prudential Standards. An example is the expenditure of approximately $3 million in software that facilitates compliance with incentive compensation governance requirements. In addition to the software investment, thousands of hours have been spent redesigning incentive plans and validating their compliance with regulatory requirements.

We have also begun the annual production of resolution plans, or "living wills," in accordance with requirements of the Dodd-Frank Act. In the coming year, we expect to spend approximately $2 million in outside legal and consulting fees, and a great deal of additional time, effort and cost for the preparation of our resolution plan. Though not directly related to the requirements of section 165 of the Dodd-Frank Act, a recent advanced notice of proposed rulemaking from the FDIC that would require institutions with two million or more deposits accounts to calculate insured deposit coverage for each account on a daily basis will require additional substantial investment in systems by Zions Bancorporation and the other approximately 36 institutions the FDIC anticipates would be covered under the new rule - a group that roughly approximates the SIFI universe of bank holding companies.

V. Alternative Means of Designating Systemic Importance

There is no apparent analytical foundation for the Dodd-Frank Act's establishment of a $50 billion asset size threshold for the determination of an institution's systemic financial importance. Indeed, there is a lack of consistency in applying the Enhanced Prudential Standards of section 165 of the Dodd-

Frank Act to all insured depository institutions with over $50 billion in assets, with the result that some federally insured depository institutions with total assets greater than those of my own bank holding company are not automatically subject to these rules. For example, USAA, a diversified financial services company whose USAA Federal Savings Bank subsidiary has over $70 billion in assets, is not subject to the requirements of section 165 inasmuch as USAA is not a bank holding company. Likewise, the nation's largest credit union, Navy Federal Credit Union, with $67 billion in assets, is not subject to these requirements.

We are supportive of an approach to the determination of systemic importance that removes the hard-coded $50 billion asset threshold currently incorporated in the Dodd-Frank Act, and that substitutes banking regulators' thoughtful and transparent analysis, consistently applied, taking into account an institution's complexity, interconnectedness with the domestic and international financial system, funding structure, asset risk profile and other such factors. We believe that any such analysis would find that Zions Bancorporation and a number of other regional banking institutions would not be found to be systemically important using such an approach, and that the net benefit to the U.S. economy from redirecting the resources these institutions currently expend on compliance with section 165 requirements to the prudent extension of credit and other banking services to customers would be significant.

Thank you very much for allowing me the opportunity to present our institution's views on this important subject.