TESTIMONY OF

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Before the

U. S. SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

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I. Introduction

Chairman Crapo, Ranking Member Brown, and members of the Committee, thank you for the opportunity to appear before you this morning. I am Chairman and CEO of Zions Bancorporation, a $65 billion dollar (total assets) bank holding company headquartered in Salt Lake City, Utah. We primarily operate in eleven western states, with local management teams and brand names, from Texas to the West Coast, including the Chairman's home state of Idaho, where we are the third largest bank in the market, and where we have consistently been the largest SBA lender. Indeed, we have 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 consistently recognized by small and middle-market businesses as one of the best banks in the nation in providing banking services to such clients, as measured by the number of Excellence Awards conferred through Greenwich Research Associates' survey of approximately 30,000 small and middle market businesses across the country each year. Virtually all 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. We provide approximately one-third as much credit to businesses, in loan sizes between $100,000 and $1,000,000, as Bank of America does in aggregate - underscoring our focus on serving smaller businesses in the markets we serve. And we do so without presenting the type of systemic risk that is characteristic of the very largest banking organizations. Together with other regional banks, we are highly focused on delivering credit and depository services to the small and mid-sized businesses that have been America's engine of economic growth.

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, and other regional banks, 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. Regional Banks Have Simpler Business Models that Fundamentally Pose Less Risk than the Nation's Largest Money Center Banks

Regional banks overwhelmingly operate with straightforward, traditional business models that focus on receiving deposits and making loans. In my own bank's case, only 4.8% of our total assets are financed with short-term non-deposit liabilities. And the great majority of our loans are secured with various forms of collateral, providing a secondary means of repayment. Like community banks, regional banks focus on providing credit not only to consumers, but to small and mid-sized businesses. For example, in the case of Zions Bancorporation, business loans between $100,000 and $1 million in size comprise 19% of our entire commercial loan portfolio, as compared to approximately 2% for Citigroup and 7% for JPMorgan Chase.

The revenue streams of regional banks are primarily generated through lending spread income and the provision of ancillary services to customers with long-term relationships with the bank. There is much less focus on "transactional" income from trading and capital markets activities. Indeed, approximately 90% of the banking industry's total trading income last year was generated by five of the

[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.

industry's largest banks, each of which is considered by regulators to be a Global Systemically Important Bank ("G-SIB"), and none of which was a regional institution.

Using a more fulsome measure of risk than sheer asset size, two years ago the Treasury Department's Office of Financial Research ("OFR") published a report on the relative systemic risk posed by 33 U.S. bank holding companies.[2] The methodology employed was a systemic risk scorecard developed by the Basel Committee on Bank Supervision ("Basel Committee") and published by the Financial Stability Board ("FSB"), using data provided by bank holding companies on Federal Reserve Form Y-15 with regard to an institution's size, interconnectedness, substitutability, complexity and cross-jurisdictional activities. The highest score, denoted as a percentage, belonged to JPMorgan Chase & Co., with a score of 5.05%, followed by Citigroup at 4.27%. Applying the OFR/Basel Committee methodology to the two dozen regional banks with assets of over $50 billion, and thus designated as Systemically Important Financial Institutions ("SIFIs") under provisions of the Dodd-Frank Act, the *aggregate* risk score of the regionals as a group (including banks as large as U.S. Bancorp and PNC Financial Services Group, Inc.) is less than the score of *either* JPMorgan Chase or Citigroup. The very largest banks, which pose the type of systemic risk to the economy that Section 165 of the Dodd-Frank Act was meant to circumscribe, are characterized by not only substantially larger nominal asset exposures than those presented by regional banks, but also by complex - and often global - organizational structures, substantial off-balance sheet and market-making activities, and a high degree of interconnectedness throughout the financial sector and in the larger economy. For example, while JPMorgan Chase & Co.'s balance sheet is 39 times the size of Zions Bancorporation's, it's total payments activity last year was *616* times larger than Zions' levels, and its total derivatives exposures are *5,253*

[2] Office of Financial Research Brief Series, 15-01, February 12, 2015

times larger than ours. The same general relative risk exposures characterize the entire regional bank group.

III. The Dodd-Frank Act's Arbitrary Asset Thresholds are Stifling Our Ability to Serve Customers and Foster Economic Growth

a. 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, and the resulting impact on capital levels, 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.

Each of the 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 a quantitative assessment of its capital levels.[3] Zions Bancorporation has been a participant in the CCAR process for the past several years. We have spent well over $25 million in outside consulting feels, and many thousands of hours of management and board time focused on CCAR. We annually submit the equivalent of approximately 12,500 pages of detailed mathematical models, analysis and narrative to the Federal Reserve incorporating our CCAR projections and capital plans. We also complete a 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 less complex regional banking institutions. There are diminishing returns from this exercise for both the banking institutions and the regulators. Former Federal Reserve Governor Daniel K. Tarullo has noted that "...the

[3] The Federal Reserve also provides large, complex banking organizations (which it generally defines as those with over $250 billion in assets) with a qualitative assessment of stress testing and capital planning processes. Regional banks have previously been given such qualitative assessments; however, the Federal Reserve announced on January 30, 2017 that it would discontinue that practice, while at the same time tightening regulations regarding capital distributions to shareholders without seeking Federal Reserve Board approval.

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."[4]

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 has posed no material objection to Zions Bancorporation's qualitative processes in recent CCAR cycles, its own modeled measures of my firm's capital ratios after nine quarters of severely adverse economic conditions have been consistently and materially below our own projected outcomes. Such variances in outcomes beg 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 argue that "transparency around the stress testing exercise improves the credibility of the exercise and creates accountability both for firms and supervisors,"[5] 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 –

[4] Former Federal Reserve Board Governor Daniel K. Tarullo, in remarks to the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.
[5] Federal Reserve Board Vice Chairman Stanley Fischer, speaking at the Riksbank Macroprudential Conference, June 24, 2015

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 most 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 former 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."[6] Federal Reserve Governor Jerome Powell, Chairman of the Fed's Committee on Supervision and Regulation, recently indicated in a televised interview his desire to have the Fed provide "much more granular information about our expectations for loss rates on particular portfolios, of corporate loans and other types of loans." [7] While any improvement in communicating outcomes is welcomed, real transparency will only be attained when the Federal Reserve publishes details about the actual content and mechanics of the models it uses to effectively govern banks' capital levels, opening them to the kind of outside scrutiny and debate which would inevitably result in stronger modeling processes.

In the absence of such transparency, banks are left to guess what level of capital is required for each type of loan, and indeed for each *individual* loan, since every loan has a unique blend of borrower strength, collateral support and other characteristics that define risk.

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[6] Former Federal Reserve Governor Daniel K. Tarullo – before the U.S. Senate Committee on Banking, Housing and Urban Affairs, March 19, 2015.
[7] CNBC, June 1, 2017 Steve Liesman interview with Governor Jerome Powell

The uncertainty surrounding the Fed's modeling processes in CCAR can cause banks to withdraw or limit certain types of lending. 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.[8] 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 estate loans, the combination of which comprises a substantial portion 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, resulting in uncertainty in terms of how much credit of this type we can afford to grant, and at what price, in order to reduce the risk of a quantitative "miss" in the Federal Reserve's calculation of our required capital.

b. <u>Liquidity Management</u>

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

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[8] 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.

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 is 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. In times of liquidity stress, 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. As noted earlier. 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.

c. Other Consequences of SIFI Designation

Since the financial crisis, Zions Bancorporation has more than doubled its staffing 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. 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 which are in the hundreds of millions of dollars in size. 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 for 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 spent millions of dollars on the annual production of resolution plans, or "living wills," in accordance with requirements of the Dodd-Frank Act. This is despite the fact that, like other regional banks, we have a simple organizational structure, with a total of 20 (mostly very small) subsidiaries, as compared to an *average* of 1,670 subsidiaries for each of the nation’s six largest banks.

IV. 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 risk. Indeed, there is a lack of consistency in applying the Enhanced Prudential Standards of Section 165 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 with $147 billion in assets, and whose federally-insured USAA Federal Savings Bank subsidiary has over $70 billion in assets, is not subject to the requirements of section 165, since USAA is not a bank holding company. Likewise, the nation's largest credit union, Navy Federal Credit Union, with $81 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 not only an institution’s size, but its complexity, interconnectedness with the domestic and international financial system, substitutability, cross-jurisdictional activities and any other factors the Congress or regulators may deem relevant. We believe that any such analysis would find that Zions Bancorporation and most, if not all, 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.

V. Other Regulations that Retard the Ability of Regional Banks to Serve Customers and Foster Economic Growth

There are numerous other regulations as well as instances of regulatory guidance, that hamper (or threaten to impair) the ability of regional banks to serve the credit and depository needs of their customers. These include greatly heightened requirements for compliance with Bank Secrecy Act/Anti-Money Laundering regulations and the policing of "our customers' customers"; ambiguous and ever-changing rules with respect to Fair Lending and other anti-discrimination laws; and, highly prescriptive and evolving rules with respect to the governance and oversight of third-party vendor relationships. Two areas seem to me to be especially worthy of concern.

The first pertains to the incredible thicket of regulations that has developed around the issuance of residential mortgages. Mortgage lending has long been subject to a host of laws and regulations. But the additional layers of regulation emanating from the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 ("SAFE Act"), tighter appraisal standards at a time when there is a nationwide shortage of qualified appraisers, Dodd-Frank's Ability to Repay and Qualified Mortgage Standards, and others, has stifled the ability of many banks to conduct straightforward mortgage operations with traditional mortgage products – even when the resulting mortgage is held in a bank's loan portfolio. These issues have been particularly challenging for self-employed borrowers. In our own case, the cumulative effect of these many rules has dramatically retarded our ability to originate mortgage loans in our smaller branches, resulting in a substantial reduction in the origination of straightforward fixed rate, fully amortizing mortgages in our branch network in recent years.

A second prospective issue which I believe is deserving of Congressional focus arises from outside the traditional bank regulatory establishment, in the form of a new accounting standard on the horizon. Under the Financial Accounting Standards Board's "Current Expected Credit Loss" impairment standard, slated to take effect in 2020, banks and other SEC registrants will be required to set aside loss reserves not only for incurred losses inherent in a loan portfolio, but for all expected future losses, as well. This will be a challenging accounting standard for all lenders to implement, not least because it requires well-documented prognostication about an uncertain future. But the impact on the economy, and on borrowers in particular, is likely to arise from the fact that this accounting standard may be expected to produce the result that lenders will be incentivized to shorten the tenor of loans, such that the period over which losses must be estimated is shortened, and required reserves are accordingly reduced. This would, I believe, provide banks with incrementally more liquid balance sheets, and lower reserve requirements. But this will not be a good outcome for borrowers, who will become *less* liquid with shorter maturities or face the alternative of higher borrowing costs for longer-duration loans. This will not be a positive outcome for capital formation, which is critical to economic growth.

Thank you very much for allowing me the opportunity to present my institution's views on these important subjects.