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Shedding the Status of Bank Holding Company

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On July 17, 2018, the Financial Stability Oversight Council ("FSOC") issued a proposed decision that would, if finalized, approve a transaction (the "Transaction") through which Zions Bancorporation, a bank holding company ("BHC"), would be eliminated through a merger into its national bank subsidiary, Zions Bank, N.A. ("ZB," and, collectively with Zions Bancorporation, "Zions"), such that ZB would be the surviving entity.

Currently, Zions is a $66 billion banking organization, headquartered in Utah. It operates 433 branches in the western United States under eight brand names, and 99.7% of Zions Bancorporation's assets and revenues come from ZB.

Zions is the largest banking organization to date to shed its BHC. Its situation is unique, since, as a participant in the Treasury's crisis-era Troubled Asset Relief Program ("TARP"), it is required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or "Dodd-Frank") to receive FSOC approval to shed its status as a systemically important financial institution ("SIFI") in order to shed its BHC and BHC regulation. Nonetheless, it is significant that Zions' motivation for the Transaction was not to eliminate only SIFI regulation; rather, similarly to other recent BHC-shedding transactions, it seeks to eliminate all BHC regulation generally.[1]

Motivation for Transaction: Reducing BHC Regulatory Burden

The Transaction would streamline Zions' corporate structure and reduce its regulatory burden by eliminating the costs and redundancies associated with having two federal banking regulators and related regulatory compliance burdens, at the holding company and bank levels, respectively.[2] Zions' SEC filings announcing the transaction note that the Transaction would result in Zions no longer being examined by the Board of Governors of the Federal Reserve (the

[1] *See* V. Gerard Comizio and Nathan S. Brownback, Bank Holding Company Shedding Transactions 34 Rev. of Banking and Fin. Services 61 (June 2018) (discussing recent BHC elimination transactions by Bank of the Ozarks and Bancorp South).

[2] *See id.*; *see also* V. Gerard Comizio, Revisiting the Bank Holding Company Structure: Do Community and Regional Banks Still Need A Holding Company? 5 Am. U. Bus. L. Rev. 189 (2016).

"Board") because it would no longer have a BHC (which are generally regulated by the Board) or be subject to BHC regulation.[3]

For Zions to achieve this result, the FSOC had to conclude that ZB, post-Transaction, would not be classified as a nonbank SIFI supervised by the Board under Section 117 of Dodd-Frank. Pursuant to Section 117, any BHC that had at least $50 billion in assets as of January 1, 2010 and that received financial assistance under or participated in TARP and, importantly, any successor to such a BHC, is a SIFI. Pursuant to Section 113 of Dodd-Frank, the Board can determine that a "nonbank financial company" should be categorized as a SIFI, even if not a BHC (such SIFIs, "nonbank SIFIs").[4] Section 117 permits the Board to approve a request by a nonbank SIFI that is a successor to a BHC SIFI to shed such status.

On May 24, 2018, the President signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act, which, among other things, raised Dodd-Frank's minimum asset thresholds for BHCs to be subjected to enhanced prudential standards ("EPS") as SIFIs. However, the legislation did not change Section 117. In other words, absent FSOC's approval, Zions would continue to be subject to Board examination, even if it did not have a BHC.

FSOC's Proposed Decision

The FSOC determined that it has the statutory authority under Section 117 to approve the Transaction. In issuing its decision, the FSOC is required by Section 113 to consider whether material financial distress at the "nonbank financial company" (i.e., ZB), or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities, could pose a threat to U.S. financial stability.

In evaluating these considerations, the FSOC focused on Zions' size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity, as well as on three primary "transmission channels" by which material financial distress at ZB could potentially impact U.S. financial stability post-Transaction: (1) the exposures of ZB's creditors, counterparties, investors, and others to ZB; (2) the effects of a rapid liquidation of ZB's assets on the markets for those assets;[5] and (3) the extent to which ZB offers critical functions or services to market participants for which there are no ready substitutes.[6] In summary, on all of these considerations, the FSOC concluded that the small size of Zions' position in the U.S. market made financial instability unlikely in the event of Zions' failure.[7]

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[3] Of course, Zions will still be examined and supervised, as now, by its primary federal regulator as a national bank, the OCC.

[4] It is perhaps textually incongruous that by becoming a bank without a BHC, Zions would become a [non]{.underline}bank SIFI, but, absent a favorable determination from FSOC, that would be the result under Dodd-Frank.

[5] To evaluate the consequences of a rapid liquidation of ZB's assets, the FSOC compared deposit run rates and risks to ZB's short-term wholesale funding to the size and liquidity profile of ZB's assets. Given the high degree of liquidity of many ZB assets and the generally small shares they represent in relevant markets, the FSOC concluded that even a rapid liquidation in distressed conditions would be unlikely to disrupt such markets.

[6] To insure provision of critical services, the FSOC evaluated market shares and concentrations of Zions in markets for deposits, loans, payment, clearing, and settlement services, and credit provision to state and local government and low- and moderate-income, minority, and underserved communities, concluding that Zions represents too small a share to cause disruption if Zions were unable to provide the services.

[7] The FSOC cited the large amounts, good credit quality, and liquidity of posted collateral with respect to Zions' short-term wholesale funding items as a mitigating factor in the event of failure. It also noted that more than 47% of ZB's deposits are uninsured, but suggested the risk of financial instability as a result of a Zions failure that caused depositor losses is low because few large financial institutions are Zions depositors.

The FSOC also noted that Zions is primarily deposit-funded, does not operate outside the United States, has a simple entity structure[8] and a straightforward method of resolution in case of failure,[9] and is and will remain a "highly supervised and regulated institution" post-Transaction.[10]

The FSOC is required to hold a written hearing regarding the proposed decision and to submit its proposed decision to the Senate and House committees that have jurisdiction over financial services. If neither committee schedules a hearing on the proposed decision, the FSOC intends to finalize its decision within 60 days of submitting the proposed decision to the committees.

OCC Approval

Unlike the FSOC's proposed decision, which is focused on the effects of the Transaction on U.S. financial stability, the OCC is more narrowly focused on ZB itself. The OCC is the primary federal regulator of ZB, and would remain so if the Transaction is completed.[11] The OCC considered a number of issues in its letter approving the Transaction, including:

- Confirming the legal permissibility of the Transaction under federal and Utah law;
- Granting permission for ZB to issue the preferred stock contemplated by the Transaction through its national bank charter;
- Approving the proposed acquisition by ZB of one operating subsidiary of Zions Bancorporation;
- Requiring the divestiture of certain equity and investment fund holdings of Zions Bancorporation by ZB within specified timeframes after the Transaction;[12] and
- Evaluating the permissibility of the merger under the Federal Reserve Act and Regulation W.[13]

Conclusion

Despite recent financial regulatory relief raising the SIFI threshold such that Zions is no longer subject to EPS as a SIFI, it is notable that Zions' apparent goal is to further reduce its regulatory burden by shedding its BHC. Given Zions' size—the largest bank to date to seek to shed its BHC—this is a significant development. As such, community and regional banking institutions should seriously consider the relative costs and benefits of entering into BHC-shedding transactions. Given the willingness of the OCC to approve the Zions transaction, and of the FDIC to approve similar BHC-shedding transactions for Bank of the Ozarks and BancorpSouth, which

[8] ZB itself is the only legal entity Zions identified as a "material entity" in its latest resolution plan, or "living will."

[9] If ZB failed, its resolution by the Federal Deposit Insurance Corporation ("FDIC") would be straightforward under the Federal Deposit Insurance Act. The FSOC does note that ZB's failure would be among the largest bank failures in U.S. history, however.

[10] The Office of the Comptroller of the Currency ("OCC") is and will remain ZB's primarily regulator; ZB would also continue to undergo additional supervision by the FDIC and the CFPB.

[11] Zions was required to seek, and has sought, the approval of the FDIC as well. According to the FSOC's proposed decision, the FDIC granted its approval.

[12] Zions holds several classes of shares in the Federal Agricultural Mortgage Corporation; the OCC determined that some but not all classes represented permissible national bank investments under prior OCC guidance. The impermissible classes must be conformed or divested within two years of the Transaction. Zions also holds directly ownership interests in 21 investment funds. The OCC determined that: (1) four of the investments are permissible for national banks, and may be retained; (2) 14 are illiquid covered funds pursuant to the Volcker Rule, held by Zions under a Board extension, and may be retained until 2022 pursuant to the extension; and (3) three are otherwise impermissible for national banks, and must be conformed or divested within two years of the Transaction.

[13] Under Regulation W, the merger of an affiliate into a Federal Reserve member bank is a "covered transaction," subject to certain quantitative and qualitative limitations.

were completed last year, each BHC should evaluate—and indeed, has a fiduciary duty to evaluate—[14] its structure to consider whether having a BHC justifies the regulatory burden that comes along with it, or if it could benefit from shedding its BHC.

[14] *See* Comizio and Brownback, *supra* note 1; V. Gerard Comizio, Do Banks Have a Fiduciary Duty to Shed Their BHC Status? Harvard Law School Forum on Corporate Governance and Financial