ZIONS BANCORPORATION

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May 31, 2011

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC 20551

Dear Ms. Johnson:

We are responding to the request by the Board of Governors of the Federal Reserve System and other regulatory agencies for comments on proposed rule on incentive-based compensation arrangements which would implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA"). We are a $51 billion holding company which owns eight separately chartered banks, ranging in size from $70 million to $16 billion in assets.

In general, we agree with the comments being submitted on this rule by the American Bankers Association. In this comment letter, however, we wish to highlight a number of points that are of particular concern to us, a "Main Street" banking organization that focuses on small- and medium-sized businesses and consumers within our local communities and that has historically maintained a balanced and relatively conservative compensation structure.

General Principles Are Compatible with Historic Practices. The general principles enunciated in the proposed rule are compatible with our historic compensation philosophy and practices and, accordingly, are principles that we generally would be comfortable following in the future. Historically, we have compensated our senior executives who have a policy-making role or are responsible for a material business line, that is, our executive officers or "Section 16 Officers", through four elements: annual salary, annual discretionary cash bonuses, multi-year formulaic performance plans (typically covering three-year periods) and stock option grants with multi-year vesting periods (typically three years).[1] Thus, a majority of the potential incentive compensation awarded to these executives is subject to diminution over a significant period of time, at least three years, because of subpar company performance or adverse outcomes on risks undertaken by our company. In addition, we are also able to reduce annual cash bonuses as a result of adverse risk outcomes or subpar company performance tied to prior year actions or decisions of our executives, as we have in fact done in recent years.

By tying the realization of value from incentive compensation awards to long-term company performance, our historic structure creates a very strong disincentive for our executives to cause the company to incur risks that could lead to material loss. For example, as demonstrated in the proxy statement for our 2009 annual meeting, the company's subpar performance resulting from the recent financial crisis had the result of eliminating virtually all potentially realizable value under outstanding incentive compensation awards held by our five "Named Executive Officers" in 2008. The lost potential value aggregated to $28.4 million in a year in which the actual total compensation of the five NEOs

[1] The compensation structure described above is similar to that used by our subsidiary banks to compensate their executive management teams.

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aggregated to only $8.4 million. In addition, annual discretionary bonuses of certain NEOs were eliminated because of the impact of prior year decisions that resulted in adverse outcomes in 2008. (The in-the-money value of outstanding options was $0 at 2008 year-end compared to $21.1 million at 2006 year-end. The payout under long-term performance plans was $0 in 2008 compared to $6.5 million in 2006, the next earliest comparable year; annual bonuses were $1.2 million in 2008 compared to $2.0 in 2006.)

In addition, our executive officers are expected to comply with stock ownership and retention guidelines. The holding of stock under these guidelines creates an additional disincentive for our executives to take on undue risk. Adherence to these guidelines created additional losses by our executives during the recent financial crisis, which we are not reflected in the figures noted above.

Although the risk- and performance-tied elements of our compensation structure did not enable us to avoid material losses, perhaps suggesting that compensation practices were not a significant cause of the recent financial crisis, we believe tying incentive compensation to long-term performance is prudent and helps focus executives on reducing risks that could hurt long-term performance.

Other aspects of the proposed rule are also compatible with our historic compensation structure. The proposed rule's guidance on the manner in which companies can assure that excessive incentive compensation is avoided – including reviewing the compensation history of an individual and other employees with comparable expertise, considering the financial results of the company and analyzing compensation practices and levels at comparable institutions – is consistent with the steps that our compensation committee and management have taken for over a decade. The four-pronged structure of our executive compensation package has typically resulted in a majority of an executive's realized incentive compensation being subject to adjustment based on financial performance, including losses, experienced by the company over a period of at least three years, which is consistent with what appears to be the basic principle enunciated in the proposed special 50% deferral rule for financial institutions with $50 billion or more of assets.

Thus, we believe that the basic principles enunciated in the rule are compatible with our historic compensation practices and are prudent principles. We suspect that the vast majority of banking institutions and virtually all of our mid-sized peer banking organizations have compensation practices that are, although divergent in details, similarly compatible with the proposed rule.

<u>Principles-Based Approach</u>. Except for the 50% deferral rule proposed to be imposed on financial institutions with assets of $50 billion or more, we note that the proposed rule follows an approach of setting forth general principles for the design of incentive-based compensation arrangements. We agree with this approach rather than an approach which would prescribe detailed rules and prohibitions (similar to the Treasury Department's TARP Standards for Compensation and Corporate Governance; Interim Final Rule), and believe it is essential that this approach be maintained. This is important because there are a wide variety of compensation practices among financial institutions, as a result of differing historic practices and different geographic and competitive environments, among other things. Even within a single financial institution, there are typically a large number of incentive compensation plans and arrangements designed to fit the competitive environment of different business lines or, importantly, to respond to ocassional needs to enter into special arrangements for hiring, retention and other purposes. In addition, the compensation plans used by an organization serve a variety of functions, including performance motivation, retention, internal pay equity and risk mitigation. Differing compensation plans require different ways of balancing these objectives.

Financial institutions and regulatory agencies need flexibility to design compensation structures and take compensation actions in a manner that is appropriate to their particular circumstances and exigencies. Indeed, we believe that this flexibility is essential to the continued vitality of the commercial banking industry, because rigid prescriptive rules and onerous compensation design limitations raise the very real risk of making careers in the banking industry much less attractive than careers with less regulated companies, such as hedge funds and unregulated financial companies. If this happens, the traditional commercial banking industry's ability to recruit and retain the best and brightest talents will be seriously damaged.

<u>Eliminate 50% Deferral Rule</u>. We believe the final rule should eliminate the special deferral rule proposed to be imposed on financial institutions with assets of $50 billion or more. It is one of the few detailed, prescriptive rules contained in the proposed rule and brings out the many problems associated with such rules in the context of incentive compensation.

First, the provision raises definitional problems, which are very problematic and could lead to unanticipated and unnecessary changes in compensation practices. For example, the proposed rule speaks of "deferral". Does this term only cover delaying the release of cash or shares for a period after payout, vesting or exercise? If so, banking organizations should eliminate long-term performance periods or vesting periods. Otherwise, employees would not be able to realize a substantial portion of incentive compensation for periods of time so great that the motivational and retentive benefits of the compensation to company interests would become largely worthless (for example, employees would not receive the value from our three-year performance plans until the lapse of six years). [2] If the term is intended to include performance and vesting periods, then, at a minimum, the rule must be clarified to make this clear. Moreover, the rule requires that 50% of incentive compensation be deferred, but what is the 50% to be measured against? If awards, the rule should indicate how awards are to be valued. For cash and standard equity awards, this would be relatively simple (although theoretic and model-based in the case of stock options), but for various performance-based and unique awards, it could be extremely difficult. If payouts and realized values, which will vary from forecasted amounts, the

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[2] If the rule is intended to require a three-year deferral period after a three-year performance period, the company would be advised to eliminate the performance period in its current form and instead make a cash award in year one in the maximum amount possible under the performance plan design, defer that amount for three years, and then make a payout at the end of the three-year deferral period in the amount calculated under the original performance plan design. This would amount to a lot of redrafting for no reason and with no benefit. It could, however, under the Securities and Exchange Commission's current compensation disclosure requirements, lead to a totally confusing and misleading portrayal of the company's actual compensation, if the maximum award were shown as actual compensation received by the executive in year one, even though it would not be realized until year three, and there would be little expectation in year one that the amount released in year three would be as much as the maximum amount. (This confusion results from the fact that the SEC's current compensation disclosure regime basically views compensation as a set value given to an executive in a given year, rather than an award of potential value made in a given year that will result in realized value at different times over a number of years. This shortcoming is currently most pronounced with respect to equity awards. During the recent financial crisis, for example, the lost potential value of equity awards held by financial institution executives was enormous, but probably largely because the SEC's current disclosure regime does not highlight disclosure of lost value of equity grants or equity held under stock ownership guidelines, the public was unaware of these losses and was left with the incorrect view that financial institution executives did not suffer financial losses and pain even though their institutions suffered losses and received public financial support.)

calculation could be very difficult, and in a sense arbitrary, when applied to a variety of awards reaching maturity in a given year.

Second, by focusing on deferral, the proposed rule creates a "one solution" approach to compensation risk mitigation and ignores numerous other effective methods, including stock ownership guidelines and compensation design features included in the proposed rule's general principles, including risk adjustment of payouts, longer term performance periods and reduced sensitivity to short-term performance.[3] Third, as a strict prescription it is likely to interfere with the effective solution of practical problems that a financial institution is likely to encounter from time to time, such as the need to grant incentive awards to key employees being recruited by competitors.

For these reasons we believe that the special 50% deferral rule should be eliminated in its entirety. We believe that the implementation of the proposed rule's general principles will be a sufficient means of mitigating compensation-related risk.

If the regulatory agencies believe that it is necessary to retain in the final rule the concept of a three-year deferral of 50% of incentive compensation, we strongly recommend that the concept be transformed from a rigid prescription to a general rule, which would indicate that approximately half of the incentive compensation awarded to an individual in a given year (determined by the accounting value in the case of equity awards or maximum payout under performance plans) be structured in a manner such that the ultimate payout or realization of value under the award be affected by negative financial and risk results occurring over a substantial period of time, such as three years and that this can be accomplished through vesting periods, performance periods, deferrals or similar methods, or a combination thereof.

If the special 50% deferral rule is retained in whatever form, we believe that it should be applied to all financial institutions covered by the incentive compensation rule. If the concept is so important that it is needed for larger institutions, it follows that it would be beneficial to smaller institutions as well.[4]

Risk-Based Approach. We find it difficult to tell how deeply the proposed rule's principles should be applied to a banking organization's employee base. This ambiguity arises mainly from the application of the term "covered employee" to groups of employees whose activities collectively give rise to the risk of material loss. Although it might be possible to answer this question through the supervisory process, we

[3] The proposed rule highlighted four methods by which incentive compensation can be designed to avoid risk of material financial loss. If the deferral rule is adopted, the other three risk mitigation methods would likely be avoided by larger financial institutions. This is because, for example, reducing incentive compensation payments to reflect risk would be onerous if the payment then had to be deferred for three years and further reduced for future losses. Such a compensation structure would surely make employment in the financial services industry unattractive.

[4] We would also recommend elimination of the special rule that the board of directors or a committee of the board of $50 billion financial institutions identify, and approve the compensation of, certain covered persons other than those subject to the 50% deferral rule, because we believe the board should have the flexibility to determine the scope of its review of executive compensation. If the final rule adopts some type of special standard for larger institutions, we also suggest that a dividing line other than $50 billion be used. We raise this point in light of the significant questioning of the appropriateness of the $50 billion threshold in other contexts (and not simply because we are an institution with $51 billion of assets). One alternative would be to give regulatory agencies the discretion to require $50 billion and greater institutions to comply with the special rule when deemed necessary, for example if an institution's governance and other requirements are found to be unsatisfactory.

believe it would be advisable for the final rule to provide better guidance. Doing so would reduce the risk of inconsistencies among regulators, which could become pronounced, and could help make the achievement of the rule's objectives more effective.

In this regard, we believe it would be beneficial for the final rule to adopt a risk-based approach to the application of the rule's design principles. Risk-based approaches are used extensively by banking organizations in their risk management, audit, compliance and other processes, as well as by regulators in their supervisory activities, and have proved to be very valuable. The principal utility of such an approach is that it enables the banking organization to focus its resources and attention on the areas and issues that matter the most, rather than diluting its effort on areas that are unlikely to give rise to material problems. Under risk-based programs used today, a banking organization typically is given the responsibility to review and risk rate its activities as a first step in the process. Regulators generally defer to the banking organization's determinations and risk ratings, if produced from a reasonably designed and operated process, but also provide guidance to the banking organization to help it improve its process, determinations and ratings. We believe the final rule should make it clear that the same process should be used in determining the scope of employees whose compensation should be subjected to the rule and subject to related internal reviews and reports.

<u>Materiality</u>. We note that the concept of material loss is a fundamental aspect of the rule, which prohibits incentive compensation arrangements that are excessive or could lead to material financial loss, but that the rule is silent on what "material financial loss" means. We believe this concept should be understood in the context of circumstances which gave rise to section 956 of the DFA: the widespread potential failure of banking organizations throughout the United States in from 2008 through 2010. Thus, we recommend that the term be understood in the context of the potential failure or capital inadequacy of a financial institution or in circumstances that materially threaten public confidence in the institution. Existing provisions of banking law use similar concepts, such as the following:

> "A bank that has, or is expected to have, losses resulting in capital inadequacy" (OCC Regs., 12 C.F.R. § 3.10(c); may provide a basis for the OCC's issuing an individual minimum capital requirement);
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> "[C]ontinued service or participation by such party posed, poses, or may pose a threat to the interests of the depositors of, or threatened, threatens, or may threaten to impair public confidence in, any relevant depository institution" (FDIC Regs., 12 C.F.R. § 308.163(b)(1); with other factors, may provide a ground for the FDIC's issuing a removal or prohibition order); and
>
> "undercapitalized, significantly undercapitalized, or critically undercapitalized within the meaning of section 38(b)(1) of the Federal Deposit Insurance Act, 12 U.S.C. § 1831o(b)(1)" (provides the basis for certain types of prompt corrective action).

We believe it is important to clarify the concept, and to indicate the severity level the rule is concerned about, for a number of reasons. First, without clarification, the term could be interpreted, in light of securities law disclosure practices, to mean a loss that could have a material impact on a banking organization's quarterly financial results. This would be a far too stringent standard, which would require the application of the rule to virtually all employees other than clerical staff.

Second, in order that regulators and banking organizations focus on eliminating compensation practices that truly matter, it is important that, as discussed above, a risk-based approach be employed. We believe that such a risk-based approach should be keyed to the risk that truly matters: the potential failure of financial institutions and the destabilizing effect that fear of failure has on the financial system systemically.

Third, a risk of failure or loss of confidence concept would ensure that regulators not be drawn into micro-managing compensation for reasons related not to safety and soundness concerns but to ordinary earnings and profitability concerns. The safety and soundness of financial institutions is a matter that regulators must be greatly concerned about and for which they must have the tools they need. Ordinary earnings and profitability is a concern best left to financial institutions and their shareholders and investors.

Simplification of Reviews and Reports -- Allow for Holding Company Consolidation. As a holding company with eight separately chartered banks, we are especially concerned with what appears to be an unnecessarily burdensome aspect of the proposed rule. It appears that the proposed rule applies to each financial institution of a particular size, even if the financial institution is a subsidiary of another financial institution subject to the rule. If this is the intent, it means that a holding company that operates through a single subsidiary bank, with numerous geographic and/or business line divisions would define materiality on a larger basis and would conduct a single review of compensation and make a single report to the board and to regulators. If that same holding company decided not to operate through divisions, but through subsidiary banks, it would be required to adopt a smaller standard of materiality and to conduct multiple reviews and prepare multiple reports – one for the holding company and one for each of its subsidiaries that was subject to the rule. We choose to operate through separate subsidiaries, in very large measure because we think it ties us better to the communities in which we operate, makes us more responsive to the needs of our customers in different localities and enables us to make a greater impact in our communities – in short, because we believe we are able to provide superior banking products and services by having separately chartered and headquartered subsidiaries. We can see no reason the rule should in effect penalize us for making the choice to operate out of local subsidiaries; if it is appropriate for a financial institution of our size operating through a single subsidiary to comply with the rule on a consolidated basis, it should also be appropriate for us, operating through multiple subsidiaries, to comply on a consolidated basis. Indeed, it is at the holding company, and not at the subsidiary bank level, where we have independent, consultant-assisted, board oversight of our compensation practices. It is at the holding company where we define and oversee organization-wide standards and practices. Thus, we strongly urge that the final rule allow for holding companies to apply the rule on a consolidated basis, such that materiality would assessed on a consolidated basis and a single consolidated review be conducted and a single consolidated report to the board and to the primary regulator be produced.

Simplification of Reviews and Reports – Adopt TARP Certification Approach. We concur with a recommendation being made by the American Bankers Association, that the detailed compensation report envisioned by the proposed rule be replaced with a certification approach similar to that required under the Treasury Department's Interim Final Rule. In fact, regardless of whether a detailed compensation report is prepared or not, a financial institution's compensation and risk officers will analyze the institution's compensation plans and practices and will report to the institution's board and, in the examination and supervisory context, regulatory personnel will review the financial institution's compensation information, analysis and practices and will discuss its compensation practices with the financial institution's officers. It is in these processes that the most meaningful actions will be taken and the most meaningful assessments made. It is understandable that there should be some documentation of these processes and assessments. But it seems to us that the certification approach used under the TARP rule would be sufficient and that the detailed report envisioned by the proposed rule would be unproductive make-work for institutions and for regulators. Unless the regulatory agencies can articulate how they intend to utilize the detailed reports and how those reports will benefit them, we would recommend a simpler, certification approach.

Sincerely,

Thomas E. Laursen
General Counsel, Executive Vice President and Secretary

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