

INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE

Minutes of the 1st Meeting of the 2023 Interim

August 1, 2023

Call to Order and Roll Call

The 1st meeting of the Interim Joint Committee on Banking and Insurance was held on Tuesday, August 1, 2023, at 9:30 AM, in Room 149 of the Capitol Annex. Representative Michael Meredith, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Michael Meredith, Co-Chair; Senators Julie Raque Adams, Donald Douglas, Jason Howell, John Schickel, Johnnie Turner, and David Yates; Representatives Chad Aull, Josh Bray, Robert Duvall, Deanna Frazier Gordon, Jim Gooch Jr., Derek Lewis, Matt Lockett, Shawn McPherson, Michael Sarge Pollock, Rachel Roberts, Tom Smith, and Cherlynn Stevenson.

Guests: Justin M. Burse, Acting Commissioner, Department of Financial Institutions; Ballard Cassady Jr., President and CEO, Kentucky Bankers Association; Dr. Charles "Skip" Hageboeck, President and CEO, City National Bank; Jim Fuchs, Vice President, Federal Reserve Bank of St. Louis; Edna Hughes, Vice President, Bluegrass Community Bankers Association; Dr. Jeffery Talbert, Professor and Division Chief for Biomedical Informatics in the UK College of Medicine, Associate Director for the Center for Clinical and Translational Science, University of Kentucky; Dr. John R. Langefeld, Principal, Insights4Health; Jenny Goins, President and CEO, Kentuckiana Health Collaborative; Abigail Gall, Executive Advisor, Department of Insurance; and Jim Musser, Kentucky Hospital Association.

LRC Staff: Jessica Sharpe, Breanna Patterson, and Elizabeth Hardy.

Consideration of Referred Administrative Regulations

806 KAR 006:072 Proposed

An amendment for proposed administrative regulation 806 KAR 006:072 was filed by the Department of Insurance on May 22, 2023. Abigail Gall briefly explained the proposed amendment. A motion was made by Senator Schickel and seconded by Representative Lewis to adopt the amendment for the proposed administrative regulation.

808 KAR 016:010 Proposed

An amendment for proposed administrative regulation 808 KAR 016:010 was filed by the Department of Financial Institutions on June 27, 2023. Commissioner Burse briefly explained the proposed amendment. A motion was made by Representative Lockett and seconded by Representative McPherson to adopt the amendment for the proposed administrative regulation.

What the failure of Silicon Valley Bank means for Kentucky Banks

Ballard Cassady provided a brief introduction. Dr. Hageboeck discussed recent bank failures and how those highlight the challenges facing the banking industry. While these particular failures were outliers, the factors that contributed to them are impacting Kentucky and will likely worsen in the coming year. He explained how community banks work, risks that banks face, and how various conditions caused by the COVID pandemic, congressional actions, and the Federal Reserve resulted in harm to banks.

Dr. Hageboeck stated that every bank in Kentucky is struggling with the same challenges as the three failed banks, but to a lesser degree. These challenges include locked in low-rate loans and investments, deposit loss, decreased capital values, and a slowing economy due to Federal Reserve measures to reduce inflation. So far, Kentucky banks are in good condition, but stresses will continue. Bank stock analysts expect bank profitability to decrease throughout 2024.

In Dr. Hageboeck's opinion, the legislature can provide assistance to Kentucky banks by understanding the unique role that banks play within the economy, especially community banks operating in rural areas, avoiding excessive or unfair regulation, and proactively supporting smaller banking organizations.

In response to Representative Lockett, Dr. Hageboeck stated that banks did not initially need to raise deposit rates because they were flush with deposits. Each bank must balance the need to raise deposit rates, while also watching their bottom line. The customer base for community banks is not as rate sensitive as the customer base for other banks. He also stated that bank customers today demand more technological savvy, which is harder for community banks to implement.

In response to Representative Aull, Dr. Hageboeck stated that there is an uninsured deposit database. He would guess that Kentucky banks do not have large amounts of uninsured deposits. Dr. Hageboeck is not aware of legislation enacted in other states that puts a cap or restriction on uninsured bank deposits.

In response to Chairman Meredith, Mr. Cassidy explained that excess money from the federal Paycheck Protection Program went into the system in the form of unneeded bank deposits, so banks had to make long-term investments with the money. Banks have an excess of money and are left deciding who to lend it to. Chairman Meredith responded that his bank experienced an accelerated increase in its deposit and asset bases due to

organic growth in the system resulting from an influx of federal dollars and that this is not uncommon among most banks. Dr. Hageboeck explained that almost all small loans are done through community banks because larger banks do not grow earnings on small loans. Small banks are disappearing and governments can make a difference by proactively looking for ways to help. Mr. Cassidy discussed the Federal 1071 rule and how it can negatively impact banks.

In response to Representative McPherson, Dr. Hageboeck stated that most loans are paid off well before 30 years. However, rising interest rates are preventing people from putting their houses on the market unless there is a life event. Most banks book five and seven year adjustable-rate mortgages (ARMs), which is a long time for bankers to worry about what deposits costs are going to do. Representative McPherson commented that he is still seeing employee retention money, which is another influx of dollars flowing into banks. Mr. Cassidy stated that the federal Consumer Financial Protection Bureau (CFPB) is looking to take location out of the algorithm for house appraisals. Representative McPherson responded that this will not work in rural areas and that the currently available data is not sufficient to replace physical inspection.

In response to Representative Lewis, Dr. Hageboeck stated that on a national level, he has asked Congressman Andy Barr to consider a federal law that sets a \$10 billion limit for CFPB regulation and for debit card revenue. Mr. Cassidy believes that tailoring bank regulations to the size of the bank is very important.

In response to Senator Howell, Dr. Hageboeck stated that only a small portion of loans are ARMs, about one in seven, but these loans end up being held by community banks. Because the longer-term rates are lower than the shorter-term rates, there is an incentive for customers to opt for the 30-year mortgage. However, if the yield curve becomes steep again, then ARMs will increase. In addition to cybersecurity and building an online presence, Dr. Hageboeck added that smaller banks are also addressing fraud issues and banking through cell phone applications. He further stated that banking through cell phone applications is not really increasing fraud and security problems and that he is not aware of efforts to change how money is wired to avoid fraud. Mr. Cassidy stated that the Federal Reserve's FedNow Service will probably help because it provides people with immediate access to their funds.

Representative Smith commented that federal money is continuing to be injected into communities and that the community banking industry could benefit from public-private partnership legislation, called P3, which was enacted some time ago. Chairman Meredith replied that the government rates on P3 loans are below market, which makes it difficult for banks to compete.

Economic Update

Mr. Fuchs provided an economic, financial, and banking conditions update. He first discussed his areas of responsibility and provided information about Federal Reserve liquidity programs. Mr. Fuchs discussed economic conditions, explaining that there is a cause for both optimism and concern. Economic growth, gross domestic product (GDP), and housing affordability are seeing improvement, but as the price index decreases, challenges remain.

Mr. Fuchs is seeing strong financial markets, but the stress index is increasing and there are signs of a pending recession. With regard to banking conditions, the Community Bank Sentiment Index indicates that community bankers are not optimistic about the economy. There is an increase in the delinquency and charge-off rates for consumer loans. For business loans, the charge-off rates have increased, but the delinquency rates are trending in the right direction. Delinquencies and charge-offs in real estate and agriculture remain low.

Mr. Fuchs discussed the Bank Term Funding Program, which banks are continuing to use, "Buy Now Pay Later" products, which are not necessarily viewed as a benefit to consumers, and a center in St. Louis studying competition and competitive factors in banking. Lastly, the St. Louis Federal Reserve hosts an annual Community Bank Research Conference and has made a commitment to attract academic research on community banking.

Chairman Meredith commented that he appreciated the information about the liquidity program, which is vital right now in this environment. He also saw good news for the industry in some of the graphs presented.

Community Banking Update

Ms. Hughes introduced herself and provided a brief description of her small bank in Logan County, which is almost 130 years old, and of the Bluegrass Community Bankers Association. She discussed the definition of a community bank and her experience working in a community bank. There are very few bank failures in Kentucky, which is due to the conservative nature of Kentucky banks and high-quality regulators, especially the Kentucky Department of Financial Institutions (KDFI). She stated that KDFI needs more money for staffing and technology. She also thanked Chairman Meredith for his leadership.

Ms. Hughes explained that community banks are a necessity. They financially support local events and nonprofits as well as physically working these events. They know their customer base and develop personal relationships, which is important in rural and underserved counties. Community banks coach and work with their customers to improve their credit and obtain good loans. Community banks also do small business lending very well, making 60 percent of all small business loans. Finally, community banks are disappearing due to several factors.

Creation of a Kentucky All-payer Claims Database

Dr. Langefeld stated that the vision for establishing an all-payer claims database (APCD) in Kentucky is to improve the overall health. An APCD seeks to achieve value by optimizing quality against cost. Kentucky has not improved its health ranking in 30 years. The APCD will attempt to create a "single source of truth" by coalescing data from many different sources. The uses and users of an APCD is a growing list, which is determined by the committee that helps control the database.

Ms. Goins talked about APCDs from an employer perspective. She provided a brief description of the Kentuckiana Health Collaborative and her background. Ms. Goins stated that APCDs can help improve the health of employees while also controlling costs. In the last year, the federal government has layered another requirement on employers, which is to pay a fair price for their employee's healthcare. How can an employer know if they are paying a fair price if they don't understand the data? She also discussed state health rankings and noted that the 10 highest-ranked states have APCDs. Kentucky is ranked forty-third and does not have an APCD. Private insurance spending is high in Kentucky and increasing faster than Medicare and Medicaid spending, which is a concern for employers and employees.

Dr. Talbert, speaking as a health services researcher, discussed myths and misunderstandings with APCDs. Although there is existing data in various sources, the data is not linked together to allow for a comprehensive picture. APCDs are not a partisan issue, as both blue and red states have adopted them to achieve various goals, and they don't cap prices, rather they only provide data and information. APCDs have comprehensive data governance requirements that determine how the data is used. APCDs do not put private data at risk because they follow rigorous data protection procedures, comply with data protection standards, and don't contain personal identifiers. They report accurate data, give submitting organizations the opportunity to correct errors, and use standard data reporting formats. Lastly, Dr. Talbert discussed the elements of good APCD legislation. Dr. Langefeld stated that the journey to creating an APCD in Kentucky has been in process for at least five years and they are now at a point where they are asking the legislature to implement it.

Mr. Musser explained the Kentucky Hospital Association's opposition to bringing an APCD to Kentucky. The database is a solution looking for a problem. There is plenty of data and transparency measures already available. The Cabinet for Health and Family Services has been collecting data, pursuant to KRS 216.2920, in collaboration with hospitals for 20 years. Having polled on this issue, constituents do not want their information turned over to a government agency. There are additional costs involved in implementing an APCD, no direct correlation between the healthiest states and having an APCD, and this will add another layer of bureaucracy. Lastly, there is not an incentive for insureds to participate in shoppable services programs because the savings go to the insurance company.

In response to Representative Bray, Dr. Langefeld stated that an APCD should not place additional burden on providers. The governance mechanism determined by the legislature will determine who has access to the information, who would maintain the database, and who is responsible for reporting the information. He does not anticipate a cost increase on the provider or the system, but there will be costs associated with operational duties, which will be included in the APCD structure itself. Dr. Talbert explained that most other states have a standardized process that comes from the APCD Council that determines how data is submitted, validated, and checked. Ms. Goins stated that while there is existing data that reflects the reasons for Kentucky ranking so low in health rankings, the data is not aligned and they are not able to look at it holistically. Dr. Talbert stated that an APCD will allow for programs seeking to address the problems to be tested. Dr. Langefeld stated that there are gaps in the existing data.

Representative Roberts stated that the National Conference of Insurance Legislators (NCOIL) has a model act on this subject and that Colorado is the gold standard in this area. In response to Representative Roberts, Dr. Talbert stated that APCDs have pricing and quality systems that provide tools to help people better understand the healthcare marketplace, obtain higher quality care, and lower costs.

In response to Representative Aull, Dr. Langefeld explained that while APCD data does not come from an HL7 data feed, HL7 data could be linked to the data sets feeding an APCD. Representative Aull commented that he does not envision submitting organizations filling out paperwork, but rather the data would automatically be pulled via an electronic feed. Dr. Talbert stated that there are some focused studies using an APCD that have seen success.

Representative Lewis commented that he would like to look further into APCDs with regard to pharmacy benefit managers, spread pricing, drug rebates, and real costs. In response to Representative Lewis, Ms. Gall stated that the Department of Insurance (DOI) has met with all stakeholders, expressed their concerns, raised questions, and gave answers for pieces that concerned the department. The department feels that the claims data would be beneficial for the department as well.

Representative Roberts commented that insureds are incentivized to shop when they have deductibles and copays. Mr. Musser responded that the issue is really a matter of who gets the savings from the shopping.

Chairman Meredith commented that one of the keys to an APCD is filling gaps in the data and getting the data all in one place. Mr. Musser responded that the state does not spend as much money on Medicare and private insurance as it does on Medicaid. Medicaid also covers many elderly people as dual eligibles.

There being no further business, the meeting was adjourned.