

INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE

Minutes of the 2nd Meeting of the 2020 Interim

October 20, 2020

Call to Order and Roll Call

The 2nd meeting of the Interim Joint Committee on Banking and Insurance was held on Tuesday, October 20, 2020, at 8:30 AM, in Room 171 of the Capitol Annex. Representative Bart Rowland, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Bart Rowland, Co-Chair; Senators Tom Buford, Rick Girdler, Christian McDaniel, Morgan McGarvey, Dennis Parrett, John Schickel, Brandon Smith, and Reginald Thomas; Representatives Terri Branham Clark, Joseph M. Fischer, Deanna Frazier, Jim Glenn, Jim Gooch Jr., Kathy Hinkle, Adam Koenig, Derek Lewis, Michael Meredith, Sal Santoro, Dean Schamore, Wilson Stone, Ken Upchurch, and Rob Wiederstein.

Guests: Mark Treesh, Executive Director, Insurance Institute of Kentucky; Chris Nolan, Consultant, MML&K Government Solutions; Sharon P. Clark, Commissioner, Department of Insurance; DJ Wasson, Deputy Commissioner, Department of Insurance; Charles Vice, Commissioner, Department of Financial Institutions

LRC Staff: Jessica Sharpe, Breanna Miller, and Elizabeth Hardy

Approval of September Minutes

Representative Koenig moved to approve the September meeting minutes. The motion was seconded by Representative Santoro. The minutes were approved by voice vote.

Insurance Institute of Kentucky 2021 Legislative Priorities

Mark Treesh, Executive Director, Insurance Institute of Kentucky (IIK), explained that IIK is a state trade organization for property, casualty, and life insurance issues. Mr. Treesh noted that the IIK is presenting a pared-down list of legislative priorities due to the nature of the upcoming session. These priorities include bills relating to towing and distracted driving.

Mr. Treesh stated that IIK is working on a towing bill, which is based on a National Conference of Insurance Legislators (NCOIL) model act. With this bill, IIK is trying to

eliminate egregious practices some IIK members have observed relating to vehicle towing and storage businesses. These issues include inadequate rate transparency, differing rates for insurers and consumers, and expensive gate fees. He discussed some issues that the model act is intended to address.

According to Mr. Treesh, a towing bill was already passed about five years ago. The new legislation is going to incorporate the remaining model provisions that were not initially included. IIK has discussed the bill draft and received input from numerous stakeholders. Mr. Treesh gave a section by section summary of the bill, including provisions relating to definitions, emergency towing, private property towing, notice given to vehicle owners, rates, storage, release of vehicles, unfair and discriminatory fees, and representations made by towing companies.

Next, Mr. Treesh discussed legislation pertaining to distracted driving, which is also based on a proposed NCOIL model act. IIK members are seeing an increase in distracted driving and would like to be part of the solution to this problem. This bill would require hands-free cell phone usage while driving. Twenty-four states have adopted hands-free driving legislation, and 19 more are considering legislation. Mr. Treesh gave a section by section summary of the bill, including provisions relating to definitions, operation of vehicles, and penalties.

Chris Nolan, Consultant, MML&K Government Solutions, reiterated that distracted driving is a growing issue across the country. It is not only a business issue but a safety issue as well. From 2014 to 2018, there were almost 4,000 car-related fatalities in Kentucky and about 25 percent of those fatalities were related to distracted driving. The number could potentially be higher, because it can be challenging to determine what caused a car-related death.

Mr. Nolan also stated that IIK continues to have discussions about reforming the Personal Injury Protection (PIP) insurance laws in Kentucky. IIK has been working with the Kentucky Justice Association to come to some common ground. However, due to factors affecting the upcoming session, IIK will not pursue this issue in the 2021 legislative session.

In response to comments from Senator Schickel and Co-chair Rowland, Mr. Treesh responded that both bills were works in progress and that IIK will continue to work with stakeholders.

Department of Insurance Update

Sharon P. Clark, Commissioner, Department of Insurance (DOI) stated that the department implemented a three-fold plan of action to address the COVID-19 pandemic, which was focused on ensuring continuity of operations for both the agency and the insurance industry and addressing consumer-critical issues. To date, the department has

issued 15 guidance policies, available on the department's website, eight of which have expired. The commissioner explained that the department has been carrying out its duties with employees working remotely. The first guidance was issued on March 9, 2020 and pertained to the elimination of cost sharing for COVID-19 testing. Similar guidance was issued in every other state. The department also issued guidance to clarify that insurance is an essential service during the pandemic and to require that coverage be available for restaurant employees using their personal vehicles for food delivery.

Commissioner Clark stated that DOI addressed incoming issues, as well as prepared for issues that could occur because of the pandemic, with its guidance documents. For example, DOI was proactive in locating medical malpractice insurance for out-of-state health care providers and medical students and in addressing the telehealth situation. DOI worked with the Kentucky Hospital Association to address the authorization and pre-authorization needed for patient admittance to field hospitals and to suspend hospital audits. Commissioner Clark stated that the department did not go as far as other states. For example, the agency did not order refunds from insurance companies, but companies did voluntarily lower their rates. DOI also issued guidance to enable insurers to work with consumers to address their needs. Commissioner Clark stated that DOI is well-prepared if there is another uptick in COVID-19 cases. Finally, she noted that temporary agent licenses were issued because of a testing shutdown, but that as of August 1, the DOI is testing again.

DJ Wasson, Deputy Commissioner, DOI, discussed how Kentucky is beginning to transfer from a federally-based health insurance exchange to a state-based health insurance exchange. DOI has been working collaboratively with the Cabinet for Health and Family Services (CHFS), which is in charge of implementing the transfer. DOI will approve policies and product rates and license agents. The state-based exchange is still in the planning stages. Both DOI and CHFS value the role of agents and have reached out to agents, through their associations, to include them in discussions relating to the operation of the exchange.

In response to questions from Co-chair Rowland relating to the state-based exchange, Deputy Commissioner Wasson stated that the exchange is expected to roll out for the 2022 plan year, starting with open enrollment on November 1, 2021. She stated that the state-based exchange will still have persons serving in the role of "connectors" that can facilitate enrollment, but cannot solicit or explain the coverage that is offered. Finally, Deputy Commissioner Wasson said that it is her understanding that the state-based exchange platform will be expanded to include other state services.

In response to a question from Co-chair Rowland regarding legislation for the 2021 session, Commissioner Clark stated that DOI will not be requesting legislation.

Next, Commissioner Clark discussed workers' compensation rates. The National Council on Compensation Insurance files rates with the department that are used by the

majority of workers' compensation insurers. For 2021, the rates dropped an average of 8.4 percent, which is good news for employers. Manufacturing classes decreased 7.4 percent, contracting decreased 10.4 percent, clerical decreased 10 percent, goods and services decreased 9.2 percent, and there was a miscellaneous decrease of 6.5 percent. The impact of COVID-19 on workers' compensation rates will not be fully known until next year.

Commissioner Clark also stated that Kentucky completed its five year accreditation process with the National Association of Insurance Commissioners the week of September 21, 2020. This accreditation is critical for the department, because it shows other states that they can rely on Kentucky's insurance companies in maintaining solvency. Kentucky was given a full recommendation for accreditation for the next five years with no exceptions.

Finally, Commissioner Clark praised the insurance industry for their response to the COVID-19 pandemic and also Co-chair Rowland for sponsoring a credit for reinsurance bill last session that was critical to the accreditation process.

Co-chair Rowland commented that he appreciated the department's responsiveness relating to agent licensing issues.

Department of Financial Institutions Update

Charles Vice, Commissioner, Department of Financial Institutions (DFI) gave an update on the condition of state-chartered financial institutions, which includes depository, nondepository, and securities institutions. During the pandemic, the financial services industry is considered essential and have continued to conduct business. DFI issued guidance to its regulated institutions to limit face-to-face transactions and work with customers by providing loan extensions and modifications and by easing loan terms, when possible. The institutions have been innovative in serving customers while limiting face-to-face transactions. The guidance also provided relief relating to notary requirements for department filings and for securities form filings.

From an operational perspective, DFI continued its examination and supervisory activity throughout the pandemic. Between March 2020 and July 2020, DFI transitioned to 100 percent off-site examinations. The department has started to conduct some on-site examination procedures, but the activity is limited. While conducting off-site examinations, the department received feedback from its regulated entities and used the opportunity to improve its processes. Off-site examinations will not be a permanent fixture of the department, but future examinations will utilize off-site procedures. The benefits of off-site examinations include reduced travel costs, less burden on the regulated entity, and the ability for the commissioner to participate in more activities.

Commissioner Vice discussed how the current economic situation is affecting financial institutions. Normally, banks suffer alongside the economy, but this has not been the case during the pandemic yet. Although there has been an economic shock, that shock

has yet to flow to the financial industry. Banks and credit unions have actually seen a short term increase in earnings, in some cases, and in deposits and assets. It will take time to see the full impact of the COVID-19 economic shock on financial institutions.

Commissioner Vice provided an update on the Paycheck Protection Program (PPP). In Kentucky, 50,655 PPP loans were made, which totaled \$5.4 billion. This injected liquidity into the system and increased bank and credit union balance sheets. Financial institutions are expected to experience margin compression in the future because of the low rate environment. DFI has also seen capital fluctuation of balance sheets, the worst being a leverage ratio decline of between 200 to 300 basis points due to asset growth. This is temporary, as many of the PPP loans are expected to be forgiven by the federal government. Financial institution earnings have also increased because of fee income. According to an article in the Lane Report, lending institutions generated fees totaling about \$159 million from the PPP.

Another loan program that was not used as much as the PPP is called the Main Street Lending Program. It contains \$600 million in funds at the Federal Reserve. To qualify for this program, the company has to have 15,000 employees or less with an annual revenue of \$5 billion or less. Companies can receive loans between \$250,000 and \$30 million and most loans are originated by banks with less than \$10 million in total assets.

Commissioner Vice discussed state-chartered bank conditions. Since 2017, the number of state-chartered banks decreased from 124 to 110. In 2019, state-chartered banks had \$53 billion in total assets, which increased 12 to 13 percent as of June 30, 2020, to a total of \$60 billion. The total number of loans also increased from \$37.9 billion to \$41.7 billion from 2019 to 2020. Compared to surrounding states, bank net interest margin was ranked number one at 3.72. Kentucky also ranked number one in capital ratio as of June 30, 2020. The return on average assets ratio was 1.22, placing Kentucky at number 2. Return on equity was at 10.72, ranking Kentucky at number three. These numbers reflect sound and stable bank performance, but this could change depending on how the economy progresses in the future.

Commissioner Vice stated that Kentucky has 22 state-chartered credit unions, with a collective net worth ratio of 11.35, ranking Kentucky number three amongst the surrounding states. The return on average assets ratio was 0.30, which is a number eight ranking, and the net interest margin was 2.93, a number four ranking. Finally, 100 percent of Kentucky credit unions have a capital, or asset quality, rating of a one or two, which are the strongest ratings the department assigns.

With regard to the securities industry, Commissioner Vice noted that securities businesses have to register with DFI if they offer services to Kentucky residents. There are different registration categories, including broker-dealer, investment advisers, and

investment adviser representatives. There was slight growth in registration numbers from 2019 to 2020.

He also reported that throughout the pandemic, the mortgage industry has seen a financial boom. There was an increase in the number of loans, which include refinances and origination to purchase. For the first 6 months of 2020, the registrations for mortgage companies and brokers were up 6.3 percent, and the number of loan originators increased 8.31 percent. There was a small decline in the number of registered consumer and industrial loan companies and deferred deposit businesses, while money transmitters stayed the same.

Nationally, home loans outstanding are expected to rise by 8.4% by year-end 2020, with additional increases expected in 2021. According to a Lane Report article published August 20, 2020, for the Louisville market, July 2020 home sales volume was 8.6 percent higher versus the same time last year. Total year-to-date sales were down because of a halt in activity through April and May due to COVID-19, but has shown strong growth since May. The average home price was up 5.3 percent, as well as up 4.2 percent on year-to-date sales versus 2019. Commissioner Vice explained that this was because of supply and demand. The inventory of available properties was 41.5% lower than at the same time last year, which drives up price.

In response to Representative Stone's question as to whether there has been an increase in business bankruptcies in Kentucky, Commissioner Vice stated that he did not have that information. However, due to his service on a national work group, he has witnessed a decrease in personal bankruptcies in the Charlotte market. He believes this is because the Coronavirus Aid, Relief, and Economic Security (CARES) Act offered financial assistance to businesses.

Representative Meredith commented that he appreciated regulators, including the DFI, being proactive in working with financial institutions to provide modifications, extensions, and deferments for customers. Commissioner Vice discussed his pride in the response he observed from regulated institutions.

Senator Thomas commented that from his observations, credit unions were easier than banks to deal with and more accessible to small businesses with regard to CARES Act funding. He said that he is a credit union member and applauds the work of credit unions during the pandemic. Commissioner Vice stated that he was pleased with the work of many financial institutions in the facilitation of PPP loans, even with customers that did not have an account with the institution.

In response to a question from Co-chair Rowland regarding legislation for the 2021 session, Commissioner Vice stated that DFI is looking at possible legislative initiatives relating to third-party debt service providers, cryptocurrencies in relation to the regulation of money transmitters, and contingency planning and cybersecurity for securities businesses.

There being no further business the meeting adjourned at 9:33 AM.