

INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE

Minutes of the 1st Meeting of the 2021 Interim

August 3, 2021

Call to Order and Roll Call

The 1st meeting of the Interim Joint Committee on Banking and Insurance was held on Tuesday, August 3, 2021, at 11:00 AM, in Room 154 of the Capitol Annex. Representative Bart Rowland, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Jared Carpenter, Co-Chair; Representative Bart Rowland, Co-Chair; Senators Ralph Alvarado, Rick Girdler, Jason Howell, Morgan McGarvey, Dennis Parrett, John Schickel, and Brandon Smith; Representatives Danny Bentley, Joseph M. Fischer, Patrick Flannery, Deanna Frazier, Jim Gooch Jr., Angie Hatton, Norma Kirk-McCormick, Adam Koenig, Nima Kulkarni, Derek Lewis, Matt Lockett, Shawn McPherson, Michael Meredith, Rachel Roberts, Sal Santoro, Tom Smith, and Cherlynn Stevenson.

Guests: Charles Vice, Commissioner, Department of Financial Institutions; Debbie Painter, President and CEO, Kentucky Credit Union League; Christy Carpenter, President-elect, Bluegrass Community Bankers Association; Ballard W. Cassady, Jr., President and CEO, Kentucky Bankers Association; Debra Stamper, Vice President and General Counsel, Kentucky Bankers Association; John Cooper, Government Affairs Consultant, Kentucky Bankers Association

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

Financial Institutions Update

Charles Vice, Commissioner of the Department of Financial Institutions (DFI), provided updates on DFI operations through the pandemic, on the depository, non-depository, and securities divisions of the department, and on the paycheck protection program (PPP).

During the pandemic, DFI issued four industry-specific guidance documents, which will end when the state of emergency ends. Overall, the guidance issued was intended for regulated entities to work with customers by providing safe access to services, loan modifications, payment extensions, and reduced fees. Some of the guidance also addressed healthy at home initiatives. The guidance documents were not mandates. Many industries

did take initiative to help customers and come up with inventive ways to offer services during the pandemic. DFI continued to conduct examinations of financial institutions predominantly offsite but did have limited onsite activity when necessary. Future examinations will use a hybrid model.

Commissioner Vice provided an update on the depository division, which oversees state-chartered banks and credit unions. Most banks and credit unions have returned to their offices, and lobbies have reopened. Financial institutions are eager to provide loans to customers because of low rates and excess liquidity. Commissioner Vice used a chart to illustrate the increase in deposits during the pandemic following the stimulus funds provided by the U.S. Congress. Between the end of 2019 and the end of the first quarter of 2021, the total assets of Kentucky banks increased from \$53 billion to \$64 billion and total bank loans grew from \$38 billion to \$41 billion. He also discussed statistics relating to net interest margins, returns on average assets, and capital ratios for both state-chartered banks and credit unions.

An update on the non-depository division was also provided, which oversees non-bank lenders, money transmitters, and check cashers. Throughout 2020 and up to June 25, 2021, the number of licensed mortgage companies, brokers, and loan originators increased. Due to supply and demand and a low rate environment, home prices have raised significantly. The average median home price in Kentucky increased 20 percent over the last year and half. This resulted in significant growth in non-depository mortgage dollars originated, number of loans, and the average loan amount. In contrast, payday loan volume decreased in 2020 and again in 2021, while money transmitter licensees and activity volume remained stable during this time period.

With regard to the securities division, which oversees broker-dealers, investment advisers, and issuers, the registrations have remained stable or increased and demand for securities services remains high. Registrants have closed some of their physical locations and transitioned to an electronic delivery format. Some clients that resisted online services have adapted to the electronic format simply because the ability to meet in-person is diminished. Uncertainty in the markets has caused some individuals to move to nontraditional investments, which comes with increased risks. These include agenda-based trading, cryptocurrency, and precious metals.

Lastly, Commissioner Vice discussed the PPP in Kentucky. As of August 8, 2020, the number of loans originated was 50,655, the net dollars loaned was \$5.3 billion, and the average loan size was \$104,000. Congress extended the PPP and for that expansion, as of May 31, 2021, the number of loans originated was 80,225, the net dollars loaned was \$2.6 billion, and the average loan size was \$32,000. The outstanding PPP loans in Kentucky, as of March 31, 2021, is 32,000, the net dollars is \$2.5 billion, and the average loan size is \$78,000.

In response to Representative McPherson's question relating to loan defaults due to renter's reform, Commissioner Vice stated that so far, DFI has not seen a significant increase in past due foreclosures or defaults.

In response to Representative Smith's questions relating to cryptocurrency regulation and whether there will be future cryptocurrency guidance from DFI, Commissioner Vice stated that cryptocurrency is challenging, because it is an emerging industry that does not fit into current regulatory law. Some states are legislating in the area, and DFI is looking at the topic to determine the best for Kentucky to move forward. He also stated that bitcoin machines are not widely used in Kentucky yet, and these machines allow some type of payment in currency in exchange for bitcoin.

In response to Representative Flannery's question relating to the ending of the eviction moratorium, Commissioner Vice stated that DFI has encouraged financial institutions to work with their borrowers, and he has strong faith that financial institutions will do the right thing.

In response to Representative Flannery's question regarding an increase in cold check fees, Commissioner Vice stated that he has not seen an increase in these fees and said some institutions have reduced or waived the fees.

In response to Representative Roberts' questions regarding PPP loans and the impact of the increase in mortgage loans, Commissioner Vice stated that PPP loans did disrupt operations. Many PPP loans will be forgiven which will remove these loans from the institutions' balance sheets, and many mortgage loans will be removed from balance sheets, because they are sold into the secondary market. Regarding why there was a decrease in the average loan size between the first and second rounds of PPP loan funding, this was because the second round was specifically geared toward making loans to small businesses.

Next, Debbie Painter, President and CEO of the Kentucky Credit Union League, discussed the structure and history of credit unions. Kentucky peaked at around 280 credit unions, but today, there are 59. Two credit unions have merged into other credit unions within the last year. All credit union deposits in Kentucky are federally insured up to \$250,000, but unlike the insurance fund for banks, the National Credit Union Share Insurance Fund is self-funded by credit unions.

Thirty-five out of the 59 credit unions are under \$60 million in assets. The smallest has less than a million dollars in total assets, while the largest has about \$1.8 billion in assets. Kentucky credit unions employ about 2,300 people and have about 915,000 members. State-chartered credit unions tend to be a little better capitalized than federally-chartered credit unions, and Kentucky credit unions tend to be better capitalized than other credit unions nationally. Despite decreasing credit union numbers, total assets in Kentucky are increasing and members are being served.

Ms. Painter discussed four issues facing Kentucky credit unions. The first two are issues relating to artificial growth because of stimulus payments being deposited instead of spent and customers not borrowing. Another issue is preventing fraud through cyber security. Lastly, talent recruitment and retention is a concern because of competitive pay and not knowing what new employees want.

Ms. Painter also discussed the focus credit unions have on the financial wellbeing of their members. They have created a website, www.movekyforward.com, that details what credit unions are doing in this area. She stated that the legislature passed an unfunded mandate relating to financial literacy for high school freshman and discussed how credit unions were assisting that initiative. Credit unions committed \$350,000 a year for three years to help fund the Kentucky Financial Empowerment Commission, a commission created by the legislature in 2019.

Senator Schickel relayed a story about depositing quarters in the school credit union from first grade until he had a book full of quarters in the eighth grade. Then, after he graduated high school, the same credit union gave him his first loan, allowing him to purchase a car. He stated that he will do what he can to help credit unions in this committee. Ms. Painter stated that there are still credit unions in high schools today.

Christy Carpenter, President-elect of the Bluegrass Community Bankers Association, discussed her upbringing, her experience at her community bank, and her bank's experience with PPP loans. Her bank, which has about \$375M in assets, made about 550 PPP loans, which resulted in approximately \$1M in fee income. Ms. Carpenter also discussed the struggles community banks are facing today, including uncertainty due to material and worker shortages, competition with non-bank lenders, pressure to pay more interest on deposits, attracting and retaining millennials, keeping employees healthy and safe, cybersecurity, and the cost of technology and compliance. Lastly, she discussed the relevance of community banks and that she hopes they do not go away.

Representative Kirk-McCormick commented that the legislature needs to do what they can do to help community banks, because there is concern that globalized banking will become reality.

Ms. Carpenter responded to Representative Robert's previous question, stating that in the first round of PPP loans, small business owners did not have as much access to benefits because they were told to use net income, but many of them did not have net income because of expense deduction. The second round provided better access because small business owners were allowed to use their gross income.

Lastly, Ballard Cassady, President and CEO of the Kentucky Bankers Association (KBA), discussed the lack of filing technology in county clerk offices, a problem that

appears to be caused by lack of funds. He thanked Representative Meredith for chairing the LRC's County Clerk Office Modernization Task Force, noting that the combined efforts of many stakeholders has resulted in some progress. This progress includes the Kentucky General Assembly passing a revised uniform law that allows electronic notarization of documents, giving clerks authority to voluntarily accept electronically recorded documents, and increasing county clerk fees. However, the fees were not enough to enable smaller county clerk offices to update their systems.

Mr. Cassady discussed the record high levels of refinancing coupled with limited access to county clerk services during the COVID-19 pandemic. This stress test for county clerk offices demonstrated two things: (1) electronic filing should be mandatory; and (2) county clerks need supplemental funding for necessary technology upgrades. Without technology upgrades, which are necessary for timely and efficient filing under our race notice statute, Kentucky citizens are at risk for fraud and expensive litigation to resolve competing claims. A few weeks ago, the operating system used for motor vehicle filing, AVIS, went down because of a system error relating to the new system, KAVIS. It is uncertain whether this disruption will create litigation for lenders. According to Mr. Cassady, both of these problems were reminders of our dependency on electronic technologies.

Mr. Cassady stated that three things are required to ensure that county clerks become a benchmark for other states. The first is the willingness and capability to accept e-recorded documents. The second is a willingness and capability to provide electronic access to a reasonable history of filing documents for title searches. Lastly, the AVIS to KAVIS transition needs to be completed to allow electronic registration, renewal, and transfer of motor vehicles. He also proposed the following funding sources: (1) ensure that fees are not swept from clerks for other uses; (2) prioritize county clerks when making grants that are funded by a document fee collected by those clerks; and (3) allocate federal infrastructure funds for county clerk technology upgrades.

Representative Meredith commented that progress was being made on the clerk issue. In response to Representative Meredith's question regarding whether the influx of deposits was short-term artificial growth, which produces liquidity issues, or long-term monetary supply growth, which requires loan demand growth, Mr. Cassady referred to the Federal Reserve's view of inflation and the relative definition of transitory. He said that there will be a problem as long as the federal government keeps putting money into the economy. Also, now that loans have been made to all of the banks' business customers, who is left to lend money to? Finally, there is discussion as to whether the time has come to quit offering interest on deposits.

Representative Meredith also responded to Representative Roberts' earlier question about PPP loans, stating that the second round of PPP funding had requirements about reductions in income, which resulted in some larger companies not being eligible for the

second round. Mr. Cassady stated that the formula for the second round of PPP funding also required money to go to employees, but businesses couldn't get employees.

In response to Representative Smith's question regarding bank investment in cryptocurrency, Mr. Cassady stated that volatility is a problem with cryptocurrency, that access to the payment system is critical for cryptocurrency viability, and that according to federal government guidelines, you can't have that kind of volatility and be part of the payment system. While there is a ton of conversation about cryptocurrency, there is uncertainty as to its future, in part, because the Federal Reserve may come out with its own crypto-coin. Also, he was not aware of Kentucky bank investment in cryptocurrency. John Cooper, Government Affairs Consultant with the KBA, added that the federal government will have to lead on cryptocurrency regulations because states should not create a patchwork of laws relating to a payment system that is international. Debra Stamper, Executive Vice President and General Counsel to the KBA, stated that regulators would never accept investment in crypto-coin because of the volatility.

A RESOLUTION adjourning the Interim Joint Committee on Banking and Insurance in honor and loving memory of Senator Tom Buford

Co-chair Carpenter introduced the committee resolution, which was read in its entirety, in honor of Senator Buford's service, dedication, friendship, and legacy to both the committee and the General Assembly. Representative Lockett and Co-chair Rowland also made comments in honor of Sen. Buford. Senator Alvarado moved to adopt the resolution and Senator Meredith seconded the motion. Via voice vote, the committee adopted the committee resolution.

There being no further business before the committee the meeting adjourned.