INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE

Minutes of the 5th Meeting
of the 2021 Interim

December 1, 2021

Call to Order and Roll Call

The 5th meeting of the Interim Joint Committee on Banking and Insurance was held on Wednesday, December 1, 2021, at 11:00 AM, in Room 149 of the Capitol Annex. Senator Jared Carpenter, 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 Julie Raque Adams, Ralph Alvarado, Donald Douglas, Rick Girdler, Morgan McGarvey, John Schickel, Brandon Smith, and Brandon J. Storm; Representatives Danny Bentley, Joseph M. Fischer, Patrick Flannery, Deanna Frazier Gordon, 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, Cherlynn Stevenson, Ken Upchurch, and Susan Westrom.

Guests: Ballard W. Cassidy, Jr., President and CEO, Kentucky Bankers Association; Debra Stamper, EVP/General Counsel, Kentucky Bankers Association; John Cooper, Governmental Affairs Consultant, Kentucky Bankers Association; Pavan Parikh, Assistant Vice President, Government Relations Officer and Legislative Counsel, Federal Home Loan Bank of Cincinnati; and Dustin Miller, Government Strategies.

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

Approval of November 9, 2021 Minutes

Senator Schickel moved to approve the minutes. The motion was seconded by Representative Lockett. The minutes were approved.

Federal Home Loan Bank Lending Parity

Representative Fischer discussed his proposed legislation for the 2022 Regular Session to allow Kentucky insurance companies to borrow from Federal Home Loan Banks (FHLBs) on the same terms provided to Kentucky banks and credit unions. FHLBs lend money to its financial institution members, which includes banks and credit unions as well as insurance companies, to provide additional capital and liquidity to those financial institutions. This legislation is necessary to have uniformity in lending practices among the states for insurance companies. This bill has already passed in many neighboring states such as Ohio, Indiana, and West Virginia, among others.

Pavan Parikh, Assistant Vice President, Government Relations Officer, and Legislative Counsel at FHLB Cincinnati, explained that FHLB Cincinnati is one of 11 FHLBs in the country, which are organized as member-owned cooperatives. They are a wholesale lender for financial institutions such as banks, credit unions, insurance companies, community development financial institutions, and thrifts and savings. To become a member, an entity has to meet safety and soundness requirements, purchase stock, and have a housing nexus. Mr. Parikh provided Kentucky-specific numbers for its members and their average asset sizes.

FHLB Cincinnati is hoping to create parity between the state systems and the federal system for insurance members. Banks have to put up collateral when becoming members of an FHLB, in case the bank becomes insolvent. Under federal law, FHLBs have access to liquidate that collateral immediately upon insolvency. Due to insurance being regulated on a state-by-state basis, FHLBs have to charge insurance companies an additional two percent in lending costs in states that have not enacted lien priority parity between state and federal systems. Mr. Parikh presented a map showing the states that have passed legislation regarding this issue and others that are working on legislation.

Benefits of the proposed legislation include insurance companies being able to collateralize their loans through FHLB at competitive rates and the elimination of collaterization disparities among members. The legislation would also assist the Department of Insurance (DOI) in the case of an insolvency because FHLBs work with the DOI when liquidating an insurance company's collateral. The language would set strict timelines on documentation, reporting, and communication to ensure there is transparency between all parties.

In response to Chairman Carpenter's questions regarding insolvency of insurance companies and the two percent fee, Mr. Parikh stated that insurance company insolvency rarely happens and that the two percent fee is to guard against something that will likely never happen, which is why it is important to get legislation passed to assist their insurance company members who are domiciled in Kentucky. In response to Chairman Carpenter's question about why this issue has not been addressed sooner, Dustin Miller, Government Strategies, stated that this issue came from the federal regulator in 2012 and the National Association of Insurance Commissioners (NAIC) were approached about this issue in 2013. Mr. Parikh also explained that it was not until 2017, that the federal regulator said there has to be state legislation to get around this issue. In response to another question from Chairman Carpenter, Mr. Parikh stated that any and all insurance companies can go through the FHLB system as long as they have an insurance charter, meet the safety and soundness requirements, and have a housing nexus.

In response to Representative Lockett's question regarding the DOI's position on this legislation, Mr. Miller stated that the department is comfortable with the concept and has sent the bill language off to the NAIC for uniformity purposes.

In response to Representative Smith's question regarding the federal housing infrastructure bill, Mr. Parikh explained that FHLBs are going to be working with multiple entities to ensure their members can do housing. FHLB Cincinnati funds housing in addition to being a liquidity provider for their financial institution members; they also annually set aside 10 percent of profits, which are used to fund affordable housing projects across FHLB Cincinnati's district. They are also looking at other ways money can be used to continue to support affordable housing. He explained that the 10 percent set aside is utilized in a competitive program that allows member institutions to partner with a housing-sponsored organization.

U.S. Treasury IRS Bank Account Reporting Proposal

Ballard W. Cassidy Jr., the President and CEO of the Kentucky Bankers Association (KBA) provided an update on proposed federal legislation relating to Internal Revenue Service (IRS) reporting requirements for banks. Initially, the bill required banks to report to the IRS all inflows and outflows of cash exceeding $600 for every customer. Due to public backlash, the threshold was amended to apply only to customers whose accounts receive $10,000 in non-wage deposits annually, which missed the point that the issue was about privacy, not dollar amounts.

The bill that passed the U.S. House of Representatives on November 19, 2021, did not include the provision requiring banks to report on their customers. However, the bill designated $80 billion to hire more IRS agents, most of which goes to operations support and enforcement, meaning audits, investigations, asset monitoring, and legal actions. Mr. Cassidy added that despite many U.S. Senators opposing this bill, it is unclear what Senate negotiations will lead to and regulators have developed a habit of making laws disguised as regulations.

The banking industry and their customers, advocacy groups for financial institutions, and business and consumer groups all strongly oppose this legislation. The proposal jeopardizes the long-preserved relationship that financial institutions have established with their customers. Mandatory reporting would blight these relationships, as privacy and trust are vital, and it would subject customer data to greater security risk, as evidenced by the 1.4 billion cyberattacks and breaches the IRS currently reports. The proposal would further push away people who don't use bank accounts due to a lack of trust in institutions, the so-called "unbanked." Mr. Cassidy concluded, the additional spending for IRS agents would not produce much more in collections, meaning the IRS's efficiency will plummet, while the misery inflicted on Americans through audits and collections will increase.

Community banks would also have to hire more staff to take on the extra work, which smaller banks cannot afford. Mr. Cassidy noted that most wealthy Americans have legal means to avoid taxes, and thus, the new IRS agents are more likely to be targeting their enforcement efforts against people who are not wealthy or powerful. He stated that the revenue these new audits will produce will not be enough to pay for new spending or to justify the invasion of customers' privacy. The KBA and 5,000 Kentucky citizens sent a letter to Congress expressing opposition to this legislation and the KBA will continue to monitor the issue.

Another issue Mr. Cassidy discussed was cryptocurrency being regulated on a state level. He urged the General Assembly to continue its approach of judicious caution when it comes to financial services innovations. There are no advantages for Kentucky to regulate cryptocurrency before it is regulated on the federal level. The Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) issued a joint statement that they will be working together to issue guidance in 2022 on the risks and opportunities of cryptocurrency as well as how crypto-related activities should be conducted by banks.

In response to Representative Kirk-McCormick's question regarding what the Kentucky General Assembly could do to stop the IRS bank reporting proposal, Mr. Cassidy stated that he is not aware of any state legislation that could help, but he believes a letter from the Kentucky General Assembly or the Interim Joint Committee on Banking and Insurance to Congress would go a long way. Representative Kirk-McCormick commented that there is concern that this is an attempt at global banking and it needs to be stopped. Debra Stamper, EVP/General Counsel at KBA, said she believes this is an attempt at national banking if not global banking.

Representative Smith commented that he would like to see his colleagues on the other side of the aisle contact the administration in Washington D.C. to try to stop this proposal from happening. In response to Representative Smith's question as to whether the KBA is going to propose any cryptocurrency legislation, Mr. Cassidy explained that the KBA is trying to fully understand cryptocurrency and does not plan on submitting language for any legislation in the upcoming session. They are aware of legislation that has been filed and have concerns with the use of the word "bank." KBA is waiting for direction from the OCC, Federal Reserve, and the FDIC to give an idea of how cryptocurrency can be regulated safely. John Cooper, Governmental Affairs Consultant at KBA, stated that the Securities and Exchange Commission classified cryptocurrency as a security while the Commodity Futures Trading Commission said by contrast it is a commodity. Mr. Cooper also expressed concern that there is no back stop for the retail trader. Ms. Stamper commented that KBA's primary concerns are customer confusion and customer protection.

Senator Smith commented that Kentucky is one of three states on the front of this issue and believes it is important to have legislation supporting cryptocurrency because it is an issue that is not going to go away anytime soon and Kentucky is already a gold standard in banking compared to other states. What is driving this industry is what the KBA testified about. People do not want government officials invading their privacy and cryptocurrency does not allow that to happen. Cryptocurrency also allows transactions to happen instantly, which is not possible with current bank transactions.

Representative Meredith commented that federal law is generally going to surpass anything at the state level. The proposal was meant to affect millionaires and billionaires who have effective tax shelters to get around loopholes and employ teams of certified public accountants and tax lawyers that help them get through the tax process. In reality, this proposal is going to affect the average American and would create an adversary relationship between the customer and the bank. Banks follow federal laws and regulation but do not work for the federal government or the IRS. The two main roles of federal regulators is to make sure there is a safe and sound banking system and to make sure consumers are protected and not discriminated against. Representative Meredith stated that the federal government should be focusing more on issues like cryptocurrency. He believes that not many of the community banks will be comfortable doing anything with cryptocurrency until the federal government passes legislation to regulate it.

There being no further business the meeting was adjourned.