

INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE
Minutes of the third Meeting of the 2023 Interim
November 1, 2023

Call to Order and Roll Call

The third meeting of the Interim Joint Committee on Banking and Insurance was held on November 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, Rick Girdler, Jason Howell, Gerald A. Neal, Brandon J. Storm, Johnnie Turner, and David Yates; Representatives Chad Aull, Danny Bentley, Josh Bray, Robert Duvall, Deanna Frazier Gordon, Jim Gooch Jr., Derek Lewis, Matt Lockett, Shawn McPherson, Rachel Roarx, Rachel Roberts, Tom Smith, and Cherlynn Stevenson.

Guests: John Sparrow, Executive Vice President and CEO, Kentucky Farm Bureau Mutual Insurance; Paula Smith, Vice President of Legal Services, Kentucky Farm Bureau Mutual Insurance; Anne Marie Franklin, Governmental Affairs Manager, Kentucky Farm Bureau Mutual Insurance; Kimberly Halbauer, President, Kentucky Region, Fifth Third Bank; Nick Podsiadly, National Director, Government Affairs, Fifth Third Bank; Marni Gibson, Acting Commissioner, Department of Financial Institutions; Representative Michael Meredith, District 19; Ballard Cassady Jr., President and CEO, Kentucky Bankers Association; John Cooper, Governmental Affairs Consultant, Kentucky Bankers Association; Tim Schenk, General Counsel, Kentucky Bankers Association; and Gary Broady, Bluegrass Community Bankers Association.

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

Approval of October 17, 2023, Minutes

Representative McPherson moved to approve the October 17, 2023, minutes. Senator Douglas seconded the motion, and the minutes were approved by unanimous voice vote.

Industry update from Kentucky Farm Bureau Mutual Insurance

Mr. Sparrow provided an update on Kentucky Farm Bureau Mutual Insurance and the insurance industry. He discussed issues impacting the industry, including labor supply chain and inflation, severe weather events, the cost of reinsurance, and market conditions. The rising cost of reinsurance for property and casualty insurance is impacting the pricing of insurance and the ability of insurers to make a profit.

In response to Representative Gooch, Mr. Sparrow explained that through renewals, Kentucky Farm Bureau is transitioning to actual cash value (ACV) on storm losses instead of replacement cost. They are going to have full replacement expense on labor but the materials will be depreciated. In other states where organizations have moved to ACV, both members and insurance companies have been positively served. In response to Representative Gooch's question regarding whether the transition to ACV would apply to sidings, gutters, or other things, Mr. Sparrow explained that it would only apply to roofs because of their deteriorating nature.

Senator Girdler recalled previous severe weather events, noting that these significant events happen all the time. He is glad that Kentucky Farm Bureau is transitioning to ACV and stated other insurance companies will follow suit if they wish to stay competitive. In response to Senator Girdler's questions, Mr. Sparrow explained that although depreciation starts happening the day someone gets a new roof, they are not going to start applying it until year seven based on roofing industry standards. He also said that there are actuarial indications that would suggest a large rate increase but as a mutually owned and financially secure organization, they will strive to be modest with rate increases.

In response to Representative Aull, Mr. Sparrow stated that he is not aware of any major insurance carriers considering leaving Kentucky as they have in coastal states due to catastrophic weather. In the reinsurance market, Kentucky is being considered the new "coastal state" because of loss experience as a result of severe convective storms. He believes these events are cyclical and that severe events happen consecutively every several years.

The role of regional banks in Kentucky's economy

Mr. Podsiadly discussed how Fifth Third Bank is different from those involved in the recent regional bank failures. He stated that federal regulatory changes are going to change how banks will operate. Fifth Third Bank continues to manage their balance sheet for long-term outperformance and believes this will be seen across the industry. The biggest challenge going forward will be workforce development as many of the industries they bank are struggling with recruitment and retainment. Ms. Halbauer commented on the importance of a diverse banking ecosystem in Kentucky from community banks to money center organizations.

In response to Representative Smith, Mr. Podsiadly stated that Fifth Third Bank does not have any position in cryptocurrency. Federal regulators are not supportive of banks

being involved in it. They continue to look at it from the innovative side of the blockchain and the ledger.

In response to Representative Smith's question regarding banks using cryptocurrency as collateral, Ms. Halbauer explained that while they do have customers ask if they are able to invest part of their portfolio into cryptocurrency, that is beyond Fifth Third Bank's risk profile from an investment perspective.

In response to Representative Smith's question regarding JP Morgan and other large banks utilizing cryptocurrency, Ms. Halbauer stated that this is not a concern to them as large money center financial institutions have a different risk appetite and profile than most regional or community banks.

Representative Smith recommended that they look into community colleges for workforce development. Ms. Halbauer stated that they have many college students employed in their retail spaces, they hire part-time employees, and welcome the opportunity to partner with organizations at the college level to address workforce issues.

Representative Meredith commented that there is a concern about the unregulated nature of cryptocurrency ATMs and that cryptocurrency is a level of risk that most community and regional banks are not comfortable with. There is a big difference in the risk-profile of globally significant banks versus regional and community banks. He questioned whether Basel III and Basel IV should apply to regional and community banks. In response to Representative Meredith, Mr. Podsiadly commented that the biggest thing to watch is how the proposed capital rules change how banks operate.

Department of Financial Institutions update

Acting Commissioner Gibson provided an update on the Department of Financial Institutions' (DFI) depository, nondepository, and securities divisions.

In the depository division, there has been a decrease in the number of state-chartered banks. Despite this, assets are increasing and being retained in state-chartered banks. The number of credit unions in the state has remained relatively consistent, with an increase in assets for credit unions so far this year. DFI performs various types of examinations on depository institutions and has been enhancing examinations relating to information technology.

Acting Commissioner Gibson discussed the securities division. This division oversees many licenses and registrations and DFI is the sole regulatory body for investment

advisers. The licensing and registration numbers in the securities division reflect the healthiness of Kentucky's economy, as many types of investments and opportunities for investments are occurring in the state. During COVID, there was a heavy focus on investment adviser examinations. DFI did perform several multi-state examinations with other regulators resulting in a large amount of restitution ordered.

In the nondepository division, the number of deferred deposit lenders has decreased due to the moratorium on licenses. DFI is slowly increasing the number of mortgage company and broker examinations. Since COVID, DFI has been operating in a more hybrid approach for examinations but believes being on-site remains important for many reasons. For money transmitters, the number of examinations has decreased but the examinations have increased in complexity. DFI received a number of complaints on regulated industries, which generally correlate with the economic cycle.

Representative Meredith commented that it is good to see that Kentucky banks still hold the number one position in capital compared to banks in surrounding states and is in the middle of the pack for other metrics.

In response to Representative Bentley, Acting Commissioner Gibson explained that DFI takes complaints against persons with central registration depository numbers and persons who are both licensed and unlicensed, as well as from constituents or citizens.

Banking code modernization and unlawful financial trade practices

Representative Meredith commented that the committee has discussed the financial institution marketplace because of recent bank failures in other states as well as the continued decrease in Kentucky-chartered financial institutions.

BR 159 is a legislative proposal that seeks to address concerns from bankers and consumers about solicitations from groups that appear to be associated with banks, but in fact are not. He discussed the provisions of BR 159, including requirements for disclaimers, enforcement and penalties, and provisions addressing persons trying to appear as a bank without being chartered or authorized. He noted several changes that may be made to the proposal.

Representative Meredith discussed a legislative proposal to modernize Kentucky's banking and trust statutes. Much of the proposal are technical updates to account for changes in federal law, segments of the industry that are no longer active, representation of new regulated entities on the financial institutions board, and outdated banking code provisions, like required banking holidays. They are working with both the industry and regulators to ensure there are no unintended consequences.

Mr. Schenk discussed provisions that would enable Kentucky trust companies to operate in other states as well as to allow other states' companies to operate here. Mr. Broady expressed support of the modernization proposal.

Mr. Cassady discussed concerns about the discrepancies between the salaries of bank examiners at the state versus federal level. There is not enough funding going into DFI in a manner that allows them to properly function. DFI is short on both the number of examiners and examiners with experience. Examiners leave DFI to work for federal regulators where there are higher salaries. There is money in DFI's reserve account that could be used to increase salaries. Representative Meredith commented on the importance of bank examiners having real world experience. Mr. Broady added that it is important to be competitive in both salary and benefits.

Representative Aull commented that he is happy that this legislation is being discussed. In response to Representative Aull's question, Representative Meredith responded that he believes the civil penalties in BR 159 are in line with what is already in statute. Representative Aull commented that the number should be indexed for inflation. Representative Meredith responded that they will take that into account.

In response to Representative Bentley, Representative Meredith explained that there is a big difference between a bank and credit union, the biggest difference being that banks pay federal and state income taxes while credit unions do not.

In response to Senator Howell, Representative Meredith explained that bank examiners are important to the banking ecosystem. If examinations are not properly done at the state level, there could be an increase in federal oversight. It is important to have experienced examiners so that decisions can be based on the specific circumstances of individual banks and communities. Mr. Cassady commented that banks want proper examinations because bad bank decisions affect the entire industry. Representative Meredith explained that cybersecurity has made regulation more complex and is being reviewed at both the state and federal level. It costs more to retain individuals with expertise in cybersecurity.

Representative McPherson commented that it is important for examiners to have experience with economic cycles so that they are not overreactive. In response to Representative McPherson, Representative Meredith commented that there have been significant market changes which affects bank liquidity as well as consumer costs.

Adjournment

There being no further business before the committee, the meeting adjourned at 11:21 a.m.