Kentucky Banker

July/August 2023

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WHO WE ARE: The KBA is a nonprofit trade association that has been providing legislative, legal, compliance and educational services to its member institutions since 1891. KBA's directors and staff work together with its members to make the financial services industry a more effective and successful place to work. The strength of the KBA is bankers unifying as an industry to speak as one voice.

WHAT WE DO: The purpose of the Kentucky Bankers Association is to provide effective advocacy for the financial services industry both in Kentucky and on a national level; to serve as a reliable and responsive source of information and education about areas of interest to the industry; and to provide a catalyst and forum for collective industry action. The KBA does this in 4 ways:

1. Government relations & industry advocacy
2. Information interchange
3. Education
4. Products and services

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In Loving Memory

Debra Stamper

October 26, 1962 - August 26, 2023

Only mere days before this issue was to go to print, we received word that our beloved Debra Stamper had unexpectedly passed away at her home in Louisville, KY. To say that the staff here at the KBA took it hard would be an understatement. We are all devastated.

Debra loved the Kentucky Banker magazine. Her final article will be included in the following pages. It's not lost on me that she chose to write about rallying people together in support of bankers across the country. A leader until the end.

Debra's 27 years of service to Kentucky bankers could fill an entire magazine. The story is one of leadership, dedication, support, and love. She had a passion for Emerging Leaders. She loved taking the fight to bullies. She led with empathy, respect, and authority, and she worked tirelessly to create a better future for bankers not only across Kentucky, but for the entire industry.

And, of course, she had something of an obsession with Halloween. Neighborhood pumpkin contests and extravagant decorations were something Debra looked foward to every year, and her joy for the season was contagious.

We will forever be in awe of Debra's desire and ability to serve. Her commitment to the work at hand will inspire us all to carry on, even in the face of tremendous grief. She would have demanded it of us, and everyone here knows it.

Debra is survived by her partner John Hudson, her daughter, Drew Costa, her cherished grandson, Lucas Costa, and Son-in-Law, Alexis Costa. She is also survived by her two sisters, Bobbie and Peggy, nephew Logan, and niece Autumn, who meant the world to her.

My service might be coming to an end, but my commitment never will.

by **Ruth O'Bryan Bale,** *KBA Chairwoman*

As I'm writing this article, I realize another two months have passed since my last correspondence. I am now nearing completion of my service as Chairwoman of the Kentucky Bankers Association. The past two months, just like all of the months before, have been enlightening and fulfilling.

In particular, I was privileged to meet many of you and renew old acquaintances during the KBA Group Meetings. I've also continued to nurture my relationship with the KBA, and have been amazed with the level of service and education they provide to our member banks. They continue to shape and influence our banking world on the local, statewide and national levels.

I've experienced a lot here! One of the highlights of my tenure was the recent visit to Washington, D. C. I have to admit, on a deep, personal level I was overwhelmed and inspired by just being present in our wonderful capital. The gravity of being in a city where so many still work to preserve our nations values and freedoms are truly awe inspiring.

One of the most essential pieces of programming for the Washington event was the time afforded us by regulatory agencies. As you know, we all spend at least some mental energy in criticism of regulatory oversight. In my opinion, we should also recognize that, in spite of some aggravation, our regulatory agencies are also our essential partners. As such, dialogue with them, especially at the highest levels, is critical to success for ourselves and our customers.

On July 17, we met with Rohit Chopra, Director of the CFPB, Travis Hill, Vice Chairman of the FDIC, and Michael J. Hsu, Acting Comptroller of the OCC. Gratitude is due for the dedication shown to us by some of the highest ranking representatives of our regulatory agencies. This was an excellent opportunity for enhanced cooperation and understanding between all parties.

We were also privileged to meet with some of U. S. Congressmen and individuals who represent Kentucky in the House of Representatives. Each of them were extremely gracious as they literally carved time out of their busy schedule and left their work of leading our country and representing Kentucky. Specifically, we met with Andy Barr, Brett Guthrie and James Comer.

I am especially grateful to Andy Barr for his persistent support of the KBA and our mission. As a result of our trip, I am a even more proud to be a Kentucky Banker and more appreciative of being an American.

Before I finish here, I'd like to take a few moments to write about one of my favorite programs at the KBA. I'm talking about Billy Wade and his team of powerhouses at Hope of the Midwest.

This is one of our best examples of service to our member banks. Not only does it serve bankers, it provides extraordinary promise to often underserved communities in Kentucky.

At the banking level, "Hope" provides a consortium of banks with an opportunity to participate in long term lending investments with risk profiles that have historically been very low. The rates received are very competitive with similar long term loans and contribute to Community Reinvestment Act related activities.

The projects funded provide affordable housing for a variety of our most vulnerable populations. Currently there are three completed Louisville area "Hope" projects featured on the KBA website. In my opinion, the most noteworthy feature of these three projects is the diversity within them.

"Hope" has facilitated the construction and permanent financing for "The Foundry Apartments", a 198 unit complex serving families whose income is below 60% of the area median income, with a goal for no family to pay more than 30% of their income for rent and utilities. Another "Hope" project is the 247 unit Puritan Apartments, exclusively developed for elderly and handicapped residents. Once again rent and utilities are capped at 30% of the resident's income. Finally, "The Mansion on Main" in New Albany features 108 assisted living units, with services that support older adults.

The KBA website also features a list of Kentucky banks that participate in "Hope" projects, along with testimonials from lenders and developers alike.

For banks, participation has a variety of advantages. First, the investment can be managed more passively as "Hope" provides all the technical knowledge base for getting through deals. Obviously, there is also interest rate risks, but that is mitigated by spreading the risk over a variety of projects.

It should be noted that some of our own employees might fit into the income levels that will qualify them for tenancy. Personally, I observe no communities within our bank footprint that boast an abundance of affordable housing for their citizens. We have a consistent need for safe and affordable housing and it is coupled with the entrance of the largest generation our country has ever produced into the housing market. It's my sincere belief that "Hope of the Midwest" is a program we should all be advocating.

To close this up, let me say it again...it is such a pleasure to have served as your Chairwoman. I have truly enjoyed forging new relationships within our industry and I will cherish these friendships for a lifetime. I've mentioned to many of you that the learning opportunities have felt like drinking from a fire hose. Regardless of the speed and volume, I have gained so much from the experience. I highly recommend your participation in Kentucky Bankers Association events and leadership, at whatever level best fits you.

Ruth O'Bryan-Bale during our Washington DC visit to regulators and representatives.


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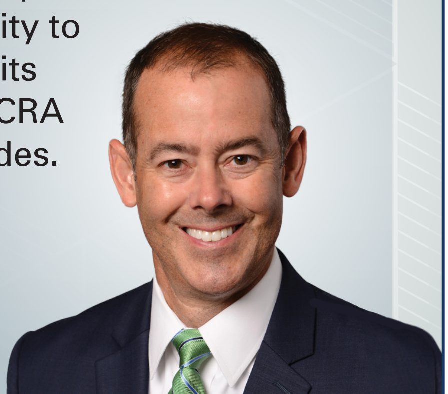

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In the
Trenches

When you're in the foxhole, who's got your back?

by **Ballard Cassady** *KBA President*

An old soldier once said, "As long as we're on the same side, I don't care who's in the foxhole with me!"

By the time you read this, we should know how our lawsuit against the CFPB on the implementation of 1071 went. One of the things that made our announcement more palatable for many bankers was our commitment, if we win this case, to invite any bank in the country to join the KBA for one dollar until this issue is resolved.

For us, that's what it looks like to be in this battle together. The membership drive opportunity of this kind of litigation is clear, but that would splinter industry unity at a time we've never needed it more. We're ALL in this foxhole and we're ALL on the same side. Honoring that with integrity – when it doesn't cost us a dime – was an easy call to make.

As of publication, 26 banks from around the country have taken us up on our offer. All are welcome. Our fellow state associations have assurances that we won't be trying to make Kentuckians of their members or sell them anything. We aim to be nothing but a safe harbor for fellow bankers who may find themselves on the wrong side of a court order that creates winners and losers.

HOPE OF THE MIDWEST

While thinking about banking beyond our borders, I want to highlight the remarkable success of our HOPE OF THE MIDWEST subsidiary. This is the KBA's low-income housing tax credit lending arm. Since its inception in 2011, HOPE has made over $480 Million in loans with over 60 banks in Kentucky and the midwest.

HOPE has constructed or renovated over 6,600 units around the midwest as of publication. This year alone, we've done $62 million in construction financing for our banks, enabling us to return over $4 million in interest income to those participating banks in this year alone. What is most amazing about Hope of the Midwest is a zero-delinquency rate since their inception. Twelve years of lending without one single late payment!

Who drives this operation? Billie Wade, a long time CPA, banker and KBA partner. Billie's reputation precedes him wherever he goes. If he underwrites the credit, you can safely sign on, sight unseen. Billie is joined by Tamuna Loladze, who we stole from the World Bank, and Tammy Nichols (MBA) who has been with the KBA for as long as I can remember. This is truly a Dream Team.

CONVENTION

Our convention is coming up in Colorado Springs at the Broadmoor Resort, a destination so fabulous it defies description. The speakers will be excellent, as always, but I confess the one I can't wait for is comedienne Leanne Morgan the night of our final banquet. I have never laughed so hard in my life as the last time I heard her speak. Congressman Barr, ABA's Dan Robb, Dr. Lindsey Piegza and several others are good draws, but it's hard to compete with a good belly laugh!

At the same time, long-time convention attendees will miss Bob Owsley. This will be the first convention without his attendance since 1958! Bob's health is letting him down, and he wrote to tell me he wouldn't be able to make it. I'll miss him, and our conversations between speakers.

LITIGATION

Meanwhile, I hope this finds you happy, healthy and in good spirits! Here at the KBA, we are having a blast –– waging war in the courts with everyone from the FDIC to CFPB to our Attorney General. I know lawsuits are few people's idea of a good time, but if it's the only way to prevent our bankers – or anyone else's, for that matter – from being taken advantage of, it's game on! Stay tuned for the play-by-play in the months ahead.

WITH A LITTLE HELP FROM MY FRIENDS

Associations offer the strength of numbers to amplify their influence at a time when we need it most!

by **Debra Stamper,** *KBA EVP & General Counsel*

The past few weeks have reminded me of the strength in numbers and the reason why "associations," in the most generic sense of the word, are preferable to going it alone on important issues. I've got a few reasons, although I'm sure there are more:

- **Benefiting from the strength/influence of numbers.**
- **Making sure that the best idea, not the first idea, is used.**
- **Finding access through networks and connections.**
- **Sharing the cost associated with an issue that benefits all.**
- **Creating an available support group for trying times.**
- **Celebrating with the like-minded.**

I am certain there's more - add your own. But associations can also separate us. Sometimes we get so connected with our special, insulated group that we forget that there are others who can help us and who we can help. It's easy to put up blinders and create more problems than existed before.

Sometimes I think about that when considering banking issues. For instance, when we advocate legislative issues in Frankfort or Washington, there is no reason to try to point out differences between our positions and those of the Bluegrass Community Bankers.

We share many of the same members and often testify in Frankfort on the same bills. We try to support each other and coordinate our testimony, if possible, to ensure that we are covering all the bases.

In DC we want EVERY Kentucky bank (actually, every bank in the US) to speak out in support of bills we want and in opposition to bills we do not want.

With regard to regulations, we encourage all banks, regardless of the state or association to do the same. When it comes to lawsuits, we have to want the same things. It is important for all associations to be proactive, but in lawsuits, the efforts are a bit more complex.

When deciding to select a court to file suit, there are a number of factors that have to be considered, including: where you have standing; which courts have prior rulings that would seem to be beneficial to your case; and the temperament of the judge that you

Debra Stamper addressing a group of women bankers at the 2023 Women in Banking Conference in Louisville, KY.

April Perry, Kentucky Farmers Bank, Susan Guess, Paducah Bank, Christy Carpenter, Springfield State Bank and Debra Stamper, Kentucky Bankers Association - featured panelist at the 2023 Women in Banking Conference.

might get. That was exactly what we were faced with on the 1071 lawsuit filed by the Texas Bankers Association. The KBA had been considering filing, but it made sense for the case to be covered in Texas with the courts that ruled against the CFPB in the constitutionality case. We offered to join in with the TBA and/or provide any other assistance necessary.

The TBA was very gracious but felt covered, especially once the ABA joined. I just wish that the ICBA had been involved as well. That probably would not have covered every bank through membership, but certainly would have reduced the number of those left out. So, now that we see the gap left by the Texas ruling everyone is trying to find a way to close that gap.

Strength in numbers again is the way to go. Strength in numbers is also important in DC. We recently went on our Washington trip. We had a great attendance, but even more would have been great! Our Emerging Leaders were enthusiastic and up to speed on the issues. Our experienced bankers helped to fill in the gaps. But, let me give you some of my thoughts on the Washington trip:

First, and this applies to Frankfort as well as DC, there still seems to be a COVID effect. In-person meetings don't seem as dynamic as they used to be. I get the impression from some, but not all, of the folks in the Capitals that they prefer the distance to speaking to bankers in person. We must change that! Whether by phone calls or in-person visits with legislators and regulators throughout the year, we need to remind them that we are an interest group who they should want to hear from.

Second, we must remember that the people we speak to are not always aware of the differences between one banker or another. This is especially true of size differences.

It is important to remind legislators and regulators of the size of your bank. They need to know that whether you are a $6B bank or a $500M bank, your issues can be different in so far as logical applicability to your bank or cost of compliance. But, at the end of the day, every bank's opinion is just as important and deserves to be heard.

Third, not all legislators have a full understanding of the banking issue that you want to discuss. Whether in Frankfort or in DC, legislators are facing an enormous number of bills to keep track of and some have more specialized staff than others (often depending upon committee assignments) which have knowledge of certain topics. Make sure that you provide background on your issue.

Again, numbers are important—if a legislator has no bank compliance experience and does not serve on any relevant committees, that legislator is likely to listen to numbers (how many constituents are opposed vs. supportive). Always ask if they have any questions and provide follow-up information if they ask. You can call us for materials. AND remember that legislators can change their minds on an issue, which means you need to stay in touch.

Fourth, regulators are different than legislators—regulators do not have constituents…no matter what they say. Regulators have different degrees of autonomy from the administration's agendas, usually dependent upon the administration's agenda! Issues reflective of administrative agendas might include things like ESG and climate goals. Also, personalities/backgrounds of various regulators also make it more or less likely for a regulator to respond to your comments.

For instance, Chopra has no banking experience and comes from an agency (the FTC) where his sole existence was designed to penalize the bad guy. At the CFPB, his stated position is that the agency is there to protect the consumer, without regard to the damage that his actions have on doing just that. He very seldom ever loses his cool and says that the US needs more community banks while ignoring the fact that his regulations are destroying those very banks. He does not understand that all banks are important in their own way. He doesn't understand that there are communities that are served by only the smallest of banks, which does not make them less relevant. He does not understand that all successful banks are hurting consumers. And he does not understand that there are more than just two sizes of banks…big and small.

There are other things that he doesn't understand. And below him, all other regulators from the worst to the best are at varying levels of understanding that a safe and sound industry is dependent upon not just the accounting of the bank, but also on the community it serves.

Finally, we must remember that there are no unimportant banks in today's economy. Each bank serves a purpose, helps a customer, and tries to comply with the onslaught of regulations. That is why it is so important to work in association with one another.

CFPB Director Rohit Chopra answers questions during a meeting with the KBA in a forum hosted by KBA Chairwoman, Ruth O'Bryan Bale. Photo: Matt Simpson

CFPB Priorities Are Out Of Step With Consumer Concerns

From "problems with a purchase" to "credit card rewards", consumers have made crystal clear their concerns with modern lending.
So why does CFPB continue to ignore them?

by **Timothy Schenk,** *Deputy General Counsel*

I began my law career working at a large firm in Washington D.C. Every time I visit our nation's capital, I take time to see the monuments, revisit the tiny apartment I lived in, and make the walk over to the building I worked at in DuPont Circle.

While walking down G Street, I couldn't help but notice the giant letters of "CFPB" with Consumer Financial Protection Bureau underneath. It occured to me that those letters didn't exist when I lived there. There simply was no CFPB. There was no Dodd-Frank and quite frankly, many of the regulations we have today did not exist.

As I continued, I couldn't stop thinking about how much things have changed in banking since my time in Washington. TRID, 1071 and other regulations came to mind. It was a whirlwind of trying to recall how we got here. My thoughts quickly came into focus on a key question: what is the purpose of the CFPB?

The CFPB's website states that, "The CFPB was created to provide a single point of accountability for enforcing federal consumer financial laws and protecting consumers in the financial marketplace. Before, that responsibility was divided among several agencies. Today, it's our primary focus."

While I doubt any banker would agree that there is a "single point of accountability" for enforcing federal consumer financial laws, I understand the CFPB's premise that, "...we protect the consumer from unfair, deceptive, or abusive practices and take action against companies that break the law."

But who is that consumer the CFPB is serving? According to the CFPB's 2022 Consumer Response Annual Report, "the CFPB received approximately 1,287,300 consumer complaints". Those complaints are categorized with "credit or consumer reporting" accounting for 978,900 or seventy six percent (76%) of the 1,287,300 complaints the CFPB received.

Debt collection accounted for 115,980 or nine percent (9%) of the complaints the CFPB received. More interesting is categories with a lack of complaints. Credit cards, for example, which accounted for 50,800 or four percent (4%) of the 1,287,300 complaints the CFPB received.

Looking at that data more granularly, well over half of the complaints on credit cards were for "problems with a purchase," "getting a credit card," and "problem when making a payment." Fees or interest accounted for 3,100 or nine percent (9%) of the 50,800 complaints regarding credit cards. Summarily, complaints regarding credit card fees and interest accounted for .2% of all consumer complaints.

Despite complaints about card fees and interest accounting for a mere .2% of total CFPB complaints, the CFPB has undertaken significant rulemaking to limit credit card fees. In issuing the proposed rule, the CFPB stated in its press release, "These excessive late fees may not be needed to deter late payments, nor be justified based on the consumer's conduct in paying late. These late fees also may be on top of other consequences of paying late, such as a lost grace period on paying interest or a lower credit score, depending on how long the missed payment lasts."

In short, the CFPB drafted a 191-page proposed rule to address .2% of all consumer complaints.

Conversely, according to a Deloitte Study for Financial Services, "nearly three-quarters of consumers surveyed (who prefer credit cards over other instruments) say that rewards, discounts, and other offers are the most important reason for using credit cards." This finding is consistent with other studies. It is also consistent with the CFPB's own statistics that show that 74% of Americans who have credit cards never pay late. Other studies show that most consumers choose their credit cards based on rewards.

The bottom line is that most consumers are concerned about their credit card rewards; not late fees and interest. So why is the CFPB regulating for the .2% at the cost of the seventy-five (75%) who pay on time and are reward focused? It's non-sensical.

But credit card fees are just one example. The CFPB started a marketing campaign last year about reducing "junk fees," which ultimately included fees such as overdraft fees that impacted banks.

There were 48,700 complaints filed with the CFPB in 2022 regarding checking and savings accounts that represent just four percent (4%) of the 1,287,300 complaints. Of the 48,700 "checking and saving" complaints, only 3,900 or eleven percent (11%) of those complaints were for "problems with a lender or other company charging your account."

Those 3,900 complaints account for a mere .3% of all complaints. However, the CFPB decided that these .3% of complaints were really important and sent banks and regulators alike scrambling to review all fees despite a complete lack of empirical data showing that there was any consumer harm that was "unfair, deceptive or abusive."

Why? While the CFPB's decision-making priorities in addressing actual consumer complaints remain unclear, its effectiveness remains just as opaque. The CFPB alleges from its "Data Snapshot Through 2022," which can only be assumed to begin with its inception in 2012, that it has provided $16 billion in consumer relief consisting of "approximate monetary compensation, principal reductions, canceled debts, and other consumer relief ordered as a result of enforcement actions."

It states that there are 192 million people eligible for relief defined as "Estimated consumers or consumer accounts eligible to receive relief from enforcement actions." The CFPB also states that there are $3.7 billion in penalties consisting of "approximate civil money penalties ordered as a result of enforcement actions."

While we do not know how these statistics were accumulated, how much of these penalties were collected or how much of this money was, if collected, paid to consumers, we do know that the CFPB was allocated $3.39 billion in budgetary resources for 2023, which if drawn upon in full, would come close to all of its accumulated penalties for eleven (11) years of enforcement.

Which in all totality begs the question: what if my walk had continued and the letters "CFPB" had never adorned a building in Washington? Would true consumers, meaning more than a fraction of one percent, be harmed?

Affordable Housing Legislation:

How House Bill 360 is a Beacon of Hope for Affordable Housing and A Lifeline for Kentuckians Struggling with Rent Burden.

by **Tiffany Marthaler,** *Affordable Housing Coalition*
and **Billie Wade,** *Hope of the Midwest, Executive Director*

As our Commonwealth continues to experience a critical shortage of affordable housing, new legislation emerging from the 2023 session of the Kentucky General Assembly will provide much-needed relief for current owners of affordable workplace housing, while also encouraging the development of new projects and reducing risk for banks as both investors and lenders.

Legislative language within House Bill 360 creates a new section of KRS Chapter 132 that will provide owners of government-restricted multi-unit rental housing with a more equitable approach to assessments when considering a property's actual cash value. Left unaddressed, an interpretation of previous assessment language presented dire financial consequences for current owners -- with assessments in some cases increasing by as much as 400 percent -- and discouraged future investments.

Throughout the 2023 legislative session, the Kentucky Affordable Housing Coalition worked in tandem with HOPE of the Midwest -- a consortium of banks seeking to build a brighter future for the Commonwealth by increasing the supply of well-built, affordable housing -- to build support for legislation that codifies property valuation assessments fairly and appropriately for multi-family housing developments that have rent and/or income restrictions secured by a restrictive covenant or deed restriction.

These provisions are necessary for the industry's success because -- unlike market rate projects -- affordable workforce housing developments are bound by eligibility requirements, rent and income restrictions, and a lengthy application process requiring third-party verification of all income and assets. This regulatory compliance creates a heavy administrative burden and significantly increases costs as compared to those developed under the market rate.

The new assessment language within House Bill 360 will:

- **Eliminate uncertainty regarding the assessments and budgets;**

- **Eliminate the risk of having the intangible value of the tax credits taxed separately;**

- **Reduce risk for banks as both investors and lenders in projects in terms of meeting debt service requirements;**

- **Reduce risks that bank lenders might have to allocate loan loss reserves for projects with marginal cash flows;**

- **Help lenders, investors, and developers in developing realistic budgets for proposed new projects.**

The passage of this legislation was essential as we address the ever-expanding need for affordable, workplace housing -- nearly one in every four Kentuckians is severely rent-burdened, spending more than half of their income on rent. Additionally, recent record-breaking efforts to recruit new industry to locate with the Commonwealth means even more homes are needed for new arrivals as well as current employees.

The Kentucky Affordable Housing Coalition and HOPE of the Midwest offer their great thanks to the banking community and to the many supporters of affordable housing for their assistance in contacting their elected officials throughout the 2023 session to make the need for this legislation known. Working together, we will expand opportunities for safe, affordable housing and build better, more just communities.

HOPE in the NEWS!

It's been a big month for HOPE of the Midwest! Billie Wade and his team have made the news with their ongoing projects in both Lexington and Louisville! For more info on how Hope is building a better future, visit hopeofthemidwest.com!

HOPE OF THE MIDWEST
Building a Brighter Future

6,500 + Units Constructed

$478 mil+ Loans Funded

127 funded

14 Tax-Exempt Bond Projects Funded

0 Losses & Defaults

United in D.C.

I'm grateful to every person that made the trip to the capital with the KBA, braving heat and humidity and the stress of air travel. (Hard to say which of those is hardest to take!) As a group from all parts of the state and banking generations, we did what no one or two of us could have done: we spoke with a collective voice too loud to ignore. You made the KBA staff proud to be representing you before these legislators and regulators. Let's make 2024 our biggest D.C. trip yet!
- Ballard Cassady

KBA, Central Bank & Trust Co. Introduce First of Its Kind Fight Against Fraud

by **Timothy Schenk,** *Deputy General Counsel*

Shane Ensminger, KBA Fraud Academy's co-founder and Director of Financial Intelligence & Security at Central Bank & Trust Company, is dedicated to taking the fight against fraud.

According to FinCEN, Kentucky is a leader in fraud; and not in a good way.

Based on suspicious activity reports (SAR), increases from the reporting periods from July 1, 2021 to June 30,2022 and July 1, 2022 to June 30, 2023, Kentucky check fraud has increased 49.58% compared to a national average of 28.68%.

For the same period, Kentucky has seen an increase in counterfeit instruments of 69.94% compared to a national average of 29.92%, an increase in forgeries of 89.29% compared to a national average of 53.13% and an increase in identity theft of 43.03% compared to a national average of 24.42% respectively.

In short, Kentucky has a big fraud problem, and it was time to do something about it. Enter: the KBA Fraud Academy.

On August 8th and 9th, the KBA hosted a "first of its kind" KBA Fraud Academy, where over 70 financial institutions of various asset sizes and areas gathered to learn and collaborate on how to combat fraud within our banking footprint.

Speakers for the Fraud Academy included representatives from the United States Attorney's Office for the Eastern District of Kentucky, Secret Service, Federal Bureau of Investigation, Kentucky Cabinet for Health and Human Services, former and current local law enforcement and the Cybersecurity and Infrastructure Agency. These speakers covered a range

of topics including counterfeit checks, wire fraud, skimming, elder fraud, scams, human trafficking awareness, cyber-crimes, bitcoin and other topics.

Shane Ensminger, KBA Fraud Academy's co-founder and Director of Financial Intelligence & Security at Central Bank & Trust Company talked about the purpose of Fraud Academy, stating, "We compete for deposits and loans, but we must be united to fight fraud. Community banks aren't large enough to fight off the rapidly growing financial crime attacks against our institutions from local, national and international organized crime groups. Together we can help reduce and control the threat against our banks, customers and communities."

The response was tremendous. Tracy Hatfield, Vice President at People's Bank, said, "The 2023 KBA Fraud Academy was an amazing course! I am so grateful Shane Ensminger and Tim Schenk were able to offer their course to Kentucky banks. All the speakers were able to share their wealth of knowledge and years of experience so we can be more educated to detect and prevent fraud. Fighting against fraud requires a collaborative effort by all bankers. I hope every banker, regardless of their role, has an opportunity to attend KBA Fraud Academy to better protect their institution."

One bank executive stated, "Fantastic school! So glad I attended and wish I could send my entire management team!"

While the KBA's first Fraud Academy was a tremendous success, it is just a first step in making Kentucky leaders in combatting fraud.

"We were able to accomplish a lot in educating bankers on tracking fraud and best practices," said KBA's Deputy General Counsel and Director of Education, Tim Schenk. "We now need to come back with a larger audience next year so that we can continue to collaborate in fighting fraud as an industry. We need to be leaders in winning the war on fraud according to FinCEN and not leaders in being the victim of fraud."

The KBA will be hosting another Fraud Academy in 2024. Please join us again so that we can continue to fight fraud in all areas affecting our industry!

(1) The first KBA Fraud Academy classroom. (2) Fraud Academy Co-Founders, Shane Ensminger and Timothy Schenk. (3) Fraud Academy classes included bitcoin 101, skimming, human trafficking, and more. (4) Mike Helsby leads a discussion.

Event Calendar

SEPT. 23-26

132nd Annual KBA Convention

With its views of the Rocky Mountains, The Broadmoor is a world-renowned resort located in the heart of Colorado Springs. Reunite with old friends, learn from the outstanding line-up of speakers, and take time to explore all that Colorado Springs has to offer. Don't miss this special opportunity to attend the KBA's 2023 Annual Convention. Register today!

The Boardmoor | Colorado Springs, CO | kbaconvention.com

OCT. 13

KBPAC Sporting Shoot Fundraiser

Join us for another exciting KBPAC fundraising event at "The Farm" in beautiful Floyd County. Shoot sporting clays while networking with other Kentucky bankers, all while supporting the ongoing efforts of the KBPAC.

The Farm | New Albany, IN | kybanks.com

OCT. 26

Banking Innovation Conference

From Instant Payments to Cyber Security and more, our Banking Innovation Conference will help your bank stay on top of the latest innovations in financial tech! Check kybanks.com for our current list of speakers.

The Hilton | Lexington, KY | kybanks.com

OCTOBER 26, 2023 | HILTON DOWNTOWN LEXINGTON | KYBANKS.COM

The growing complexity of the financial industry is moving fast, with no sign of slowing down. Your ability to keep up will be the key to your bank's future success.That's where we come in. Join us at this year's Innovation Conference for the latest on navigating relationships with fintechs, regulatory guidance, and innovative best-practices to modernize the community banking model.

Onward & Upward

Have a promotion or branch news you want to see featured? Email us at mattsimpson@kybanks.com

FNB Bank is pleased to announce the recent promotion of officers at the Annual Meeting of the Board. During the meeting, the Board of Directors promoted **Nick Johnson and Andrew McGlenon** to Assistant Vice President. Congratulations!

Mark A. Gooch, Vice Chairman, President and CEO of **Community Trust Bancorp, Inc**., announced today that **Barry Pennington** is a new member of the Community Trust Bank Campbellsville Market Advisory Board of Directors.

Peoples Bancorp Inc. announced that **Chuck Sulerzyski**, 66, has retired as President and CEO, effective March 31, 2024. He also intends to retire from the Boards of Directors. It was announced that **Tyler Wilcox**, 44, will become the next President and CEO of each of Peoples and Peoples Bank, and will be elected as a director of each. We celebrate Mr. Sulerzyski's retirement and the appointment of Mr. Wilcox to his new role at Peoples!

Mark A. Gooch, Vice Chairman, President and CEO of **Community Trust Bancorp, Inc**., is pleased to announce that **Marie Wheeler** has been promoted to the position of Market Senior Vice President, Branch Manager of **Community Trust Bank, Inc.**

Donald E. Bloomer, President/ CEO of **Citizens National Bank**, has formally announced his plan to retire on February 29, 2024. Mr. Bloomer has been employed with Citizens National Bank since 1976 where he started as a Management Trainee right after college, then transitioned to Auditor, Comptroller and Cashier. In 2007, he was promoted to President/ CEO, where he has served for sixteen years.

Forcht Bank is delighted to announce a Brand Partnership deal with University of Kentucky Men's Basketball Player **Reed Sheppard**, a renowned name across Kentucky and surrounding areas.

Central Bank Chairman, President and CEO, **Luther Deaton, Jr.**, has announced that **Jamie Cooper** has joined Central Bank as our new loan compliance officer. Jamie joins Central Bank with more than 11 years of compliance, BSA, and CRA officer experience. Congrats!

Peoples Exchange Bank is pleased to announce that **Blanton Coats**, a Clark County native and resident, has joined the bank's board of directors. With more than 25 years of experience in construction, Blanton brings a wealth of knowledge and expertise to the board.

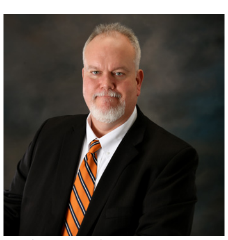
FNB Bank is proud to announce that **Ray Wagner** has joined FNB as Chief Credit Officer. Ray brings with him more than 20 years of banking experience having served in various roles including SVP Consumer Credit Analytics, SVP Enterprise Risk Manager and VP Chief Risk Officer.

First Kentucky Bank Branch Administration Officer, **Corie Young** announces that **Samantha Wilson** has been named Branch Manager at our Mayfield South Office. Wilson has ten years of banking experience and has been with First Kentucky since 2013!

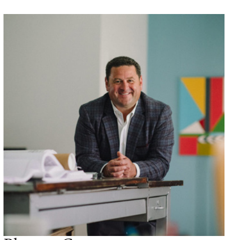
First Kentucky Bank Residential Mortgage Production Manager, **Kay Allen** announces that **Jami Carr** has been named Residential Lender. Carr has over four years of banking experience, and within that time, she has held a variety of positions, including her most recent role as Commercial Loan Assistant.

Central Bank & Trust's Louisville office celebrated their sponsorship of the Senior Crimestoppers Program at Community Towers, Louisville. The Central Bank plaque was presented to Community Towers by the bank and CRA Partners. Thank you to everyone involved in this touching gesture.

Central Bank, Ben Morris; Central Bank, Bridgette Wingate; CRA Partners, Marnie Stewart; Community Towers, Barbara Ray; Community Towers, Markena Hill.



Andrew McGlenon



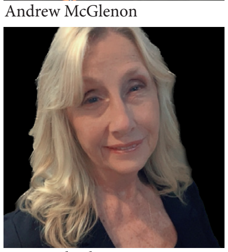
Blanton Coates

Campbellsville Market Advisory Board of Directors, Community Trust Bank

Chuck Sulerzyski

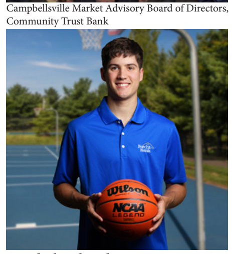
Jamie Cooper

Jami Carr

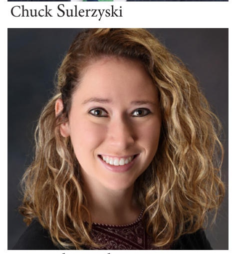


Marie Wheeler

Nick Johnson



Reed Shepherd



Samantha Wilson

Tyler Wilcox

Ray Wagner

IN THE SPOTLIGHT

SHINING A LIGHT ON NEW KBA ASSOCIATE MEMBERS!

Bacon Farmer Workman Engineering & Testing, Inc., Paducah, KY
Bacon Farmer Workman Engineering & Testing, Inc., provides Phase I/II Environmental Assessments; Civil, Structural, Transportation, Geotechnical, Survey, Asset Management; Environmental, Geospatial Testing & Inspections. Contact: Susannah Campbell – scampbell@bfwengineers.com; (270) 443-1995

The Kentucky IOLTA Fund (Interest On Lawyers Trust Accounts) exists to assist or help establish legal services programs, pro bono programs, and other Law-related programs for the public's benefit. It is governed by Kentucky Supreme Court Rule 3.830.
Contact: Guion Johnstone – gjohnstone@kybar.org; (502) 564-3795

Shield Compliance, LLC, Seattle, WA
Shield Compliance, LLC provides software that Financial Institutions use to compliantly onboard and monitor cannabis related business accounts.
Contact: Richard Drennen – richard@shieldbanking.com; (859) 595-6440

Squire Patton Boggs (US) LLP, Cincinnati, OH
As one of the world's strongest integrated law firms with banking capabilities encompassing virtually every matter and jurisdiction, Squire Patton Boggs offer first-rate litigation, investigative, regulatory, transactional, disputes-based and policy expertise to Kentucky's banking community. Notably, their team includes the first Solicitor General appointed to the Commonwealth of Kentucky, S. Chad Meredith, who served from 2019-2021.
Contact: S. Chad Meredith – chad.meredith@squirepb.com; (513) 361-1235

Associate Members serve an important and supportive role in the KBA and to the Kentucky banking industry by providing quality products and services. We look forward to having these new associate members involved in KBA and supporting the member banks!

To learn how you can be a KBA Associate Member, contact Selina Parrish at sparrish@kybanks.com

In Conversation with Representative Michael Meredith

Balancing his legislative duties with a full-time career as a loan officer at the Bank of Edmonson County, Rep. Michael Meredith celebrates the opportunity to serve as one of Kentucky's "Citizen Legislators". The KBA would like to thank Rep. Meredith for agreeing to this sit-down interview, where we discussed legislation, accountability, and why community banks matter.

Photography and Interview by **Matt Simpson,** *Managing Editor*

Kentucky Banker (KB): Along with your work as a civil servant, you also have a "day job", too. Can you describe what it means to be a citizen legislator and why that role is important today?

Rep. Michael Meredith (MM): So when you think about a citizen legislator, you think about it being a part-time position. From experience, I can tell you, it's not! But, you do have a full-time job back home. In my case, I'm a commercial consumer loan officer for the Bank of Edmonson County. I have been with the bank since I was 16 years old. Worked my way through a lot of different positions there and have been serving as a loan officer since late 2015. As a citizen legislator, you have to juggle that side of your career along with your work as a Representative. And that's the difficulty of the job.

But I think that's the good part about the citizen legislature process, too. We're back home in our districts nine months out of the year. We're here for three months, at the capitol, and we're consumed by what's going on with the lawmaking process. But when we're back home, we're involved in the community first. Whether that's through community service work, through our day to day jobs, with our families, those kinds of things.

And I think it gives us a perspective that folks in Washington or in states that have a full-time legislature don't get to have. I think we're lucky to experience both sides of the coin, really.

KB: How does your citizen life inform what happens with your legislative work?

MM: When I'm home, and I'm at the grocery store, it never fails. Someone is going to have a question or want to talk to me about something that's affecting them. And that simple conversation, just listening to my community, might lead to a piece of legislation that happens the next year. These are people that might not feel comfortable picking up the phone or sending an email to the office up here, but when they see you out in blue jeans and a t-shirt, they can open up.

When those issues come up, you're not going to be able to hide. You're accountable, and I think there's immense value in that process of the citizen legislature.

KB: Can you tell me a little more about your career in banking?

MM: I'm a fifth generation stockholder at the Bank of Edmonson County. My great-great-grandfather founded it with his two brothers and two other local businessmen and it still continues to be an enterprise that is largely owned by the heirs of those five men that started the bank almost a hundred years ago.

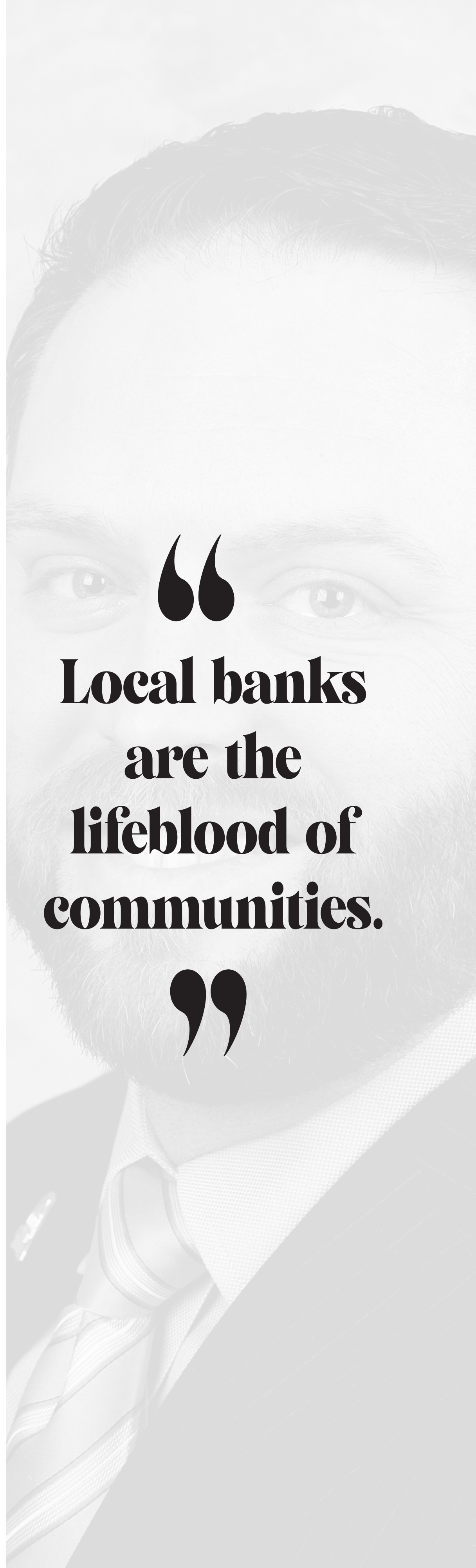
Several cousins are involved in the bank as well, from shareholders down to being members on the board of directors, things like that. I've got two cousins; one is president of the bank, one is the CEO of the bank who runs the day-to-day operations.

We all love the banking industry. There's always something new that you're having to adapt to, and that makes it difficult sometimes, but it makes it interesting too. And, you know, we've always tried to continue the heritage that was started by our ancestors who started the bank. We are all very proud of what we've been able to do together.

KB: You have some experience in the KBA's Educational resources, right?

MM: Yes! I graduated with the KBA General Banking School, matter of fact. Right after college – I got out in 2007 at Western, I started going through the general banking school two year program there. I got to meet a lot of good friends. Interestingly enough, a few of them are still in banking, but also in politics too.

KB: You grew up in a rural area. Can you talk to me about your thoughts on community banks and their importance to places like where you live?



"Local banks are the lifeblood of communities."

MM: Well, Bowling Green is developing into now the third largest city in the state. But the community where I'm from is very, very rural, and very small. What we find time and time again, is that having personal relationships with a banker has always been a big deal in smaller communities.

Those relationships are important, not just in banking, but in everything that we do in those small communities, because you want to feel connected in a small town like that. In most of these small towns, the local banks are the lifeblood of the communities. Whether it's supporting the local schools and their booster programs for athletics, academic teams, and so on. Whether we're offering money or volunteering.

It's about supporting all the different nonprofits, whether it's the Lions Club or the Women's Club, or little league programs, whatever it may be. The bank is providing monetary support to all of them. Another interesting thing you may not have considered either, but is actually really important, is that these local banks are generally one of the largest taxpayers back to the local government. It's a constant cycle of reinvesting back into the communities we serve.

KB: What are some of banking's biggest legislative problems right now, in your opinion?

MM: We've been dealing with a few things that probably need to come out a little bit louder right now. You've mentioned the dwindling numbers of community banks over the years… One of the things that I've been watching closely, and I've served on the banking and insurance committee since 2011, is those dwindling numbers.

I think three to four years ago, we had 120 state chartered financial institutions in Kentucky. That number has dwindled over the last four years from 120 down to 98 or 99, below a hundred. I think that's a concerning number, and it's a concerning trend.

If you continue to have consolidations of charters, whether they're being bought out by banks from out of state, whether they're closing their doors for some other reason…it's just bad for us on so many levels. So one of the things that I'm working with regulators closely on, is determining what are the causes of this decline? Is there anything that we can do at the state level to try to remedy that? I think there is, despite a lot of our problems being on a federal level.

And so we advocate. The work never ends. Specifically, I think as we go forward, we're looking at a modernization of the banking code right now. We're in the early stages of that. We've got bill drafters in house who are working on old and outdated structures in the statute that may need to be updated for modern vocabulary.

The commissioner of financial institutions has some things that are priorities. He's developing a list with his team right now. And I've also talked to the Kentucky Bankers Association about coming up with some priority things that the industry would like to see done in the statute.

At the end of this process, hopefully in July or August, we're going to be able to get all those people in a room together, and we're going to be able to make a big list of all the things that each group wants to do with modernization. And it may be that the industry tells the commissioner, there are things that we can't agree to that you want to do. These are things that are problems for us. Knock those things off the list.

There are things that the industry may want that the commissioner may feel reluctant about. And we may either move those things off the list or amend them down to get something more palatable for everybody. But my goal is to have a package that hopefully both modernizes and makes the statutes that the banks in Kentucky operate under more friendly to the future of the industry going forward.

KB: Do you feel like the commissioner and your colleagues understand the concern about dwindling community bank numbers?

MM: I think the commissioner is very concerned about it, especially if those numbers drop much more. And I think my colleagues are concerned about it. I do think they do have a lot of concern about that issue because the loss of a Kentucky chartered bank is many times the loss of jobs in their community. It's the loss of investment in their community. And so they're concerned about those things.

And I think that's why we were successful in fixing the issue with the state taxation a few years ago. So far, what we've brought has passed the general assembly in a pretty broad based bipartisan manner. And I'll say this, from the perspective of the committee and chairing the committee and being on the committee now for 13 years, the committee has always had a focus

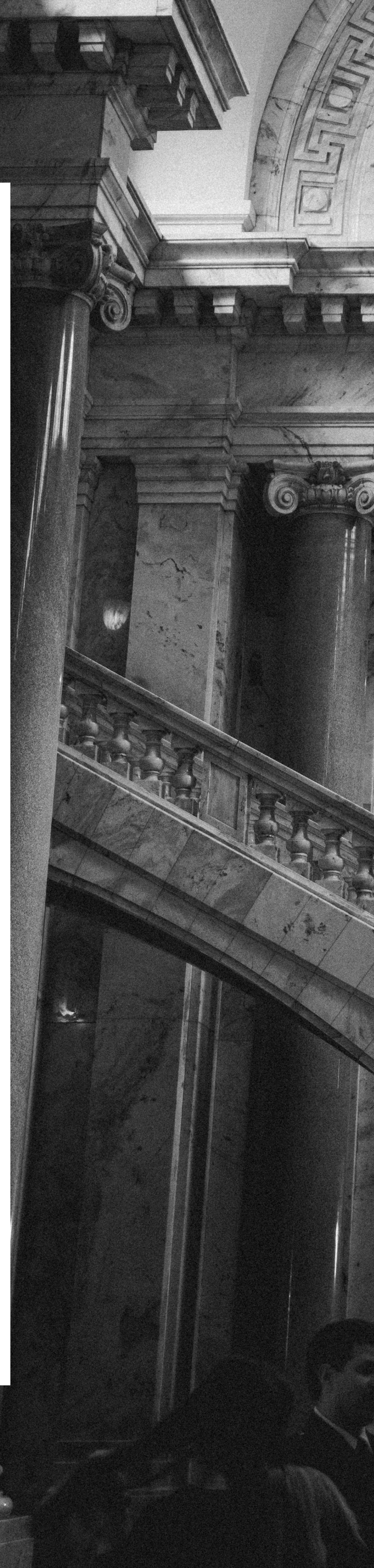
on insurance. Because if you look historically, the chairs have been from the insurance industry. My predecessor was an insurance agent. His predecessor was an insurance agent. And insurance is a fully state regulated endeavor, where banking has the dual regulated issue between the federal and the state government. And so, yes, we have to focus on insurance regulation at the state level in a big way because we fully regulate it.

But we have, as an industry, and I'm really speaking more as a banker than a legislator right now, we have played so much defense at the federal level over bad legislation or bad regulation in the federal banking codes that we've, a lot of times, ignored what's going on the state level. Unless you have that big tax issue that's comes up like it did a few years ago, we have a pretty generally friendly environment for banking in Kentucky.

That's why I think you don't see failures, and you don't see banks just leaving the state in droves. You're just seeing consolidation charters a lot of times. Again, sometimes it's out-of-state purchases, sometimes it's in-state purchases. But I think this is an opportunity as a banker chairing the committee now, and we talked about this, nobody could come up with the last banker that chaired the house banking and insurance committee that was actually a day-to-day banker. We've had a few that were board members over the years or things like that, but actually engaged daily in the profession, we've not had one in a long, long time.

And so this is an opportunity to have a voice in that policy making and to bring a spotlight to it. And so that's why this banking modernization has been a priority for me, because it's not just about what we're thinking about in the short term, but it's about trying to have a few wins for the long term industry as we move into the future.

We know we're going to continue to play defense at the federal level in a big way. Let's see what we can do at the state level to make things better.




HOUSE OF REPRESENTATIVES
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FHLB MPP

Mortgage Purchase Program (MPP)

Have you considered the Federal Home Loan Bank of Cincinnati's Mortgage Purchase Program (MPP) recently?

Five Ways the Mortgage Purchase Program Pays You!

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2. Rebates from the Lender Risk Account (LRA)
3. FHLB Dividend
4. Few Loan Level Price Adjustments
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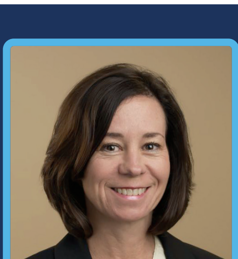

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Judy Rose
VP, Marketing
rosejm@fhlbcin.com
(513) 324-2789

FHLB CINCINNATI

UCC Article 12 – Coming to a State Near You?

Theo Kelly, SBA

BANKERS ALLIANCE
Owned by Kentucky Bankers Association
A Holding Company for Review Alliance and Compliance Alliance

In 2022, the Uniform Law Commission (ULC) introduced amendments to the Uniform Commercial Code (UCC), including a new Article 12 (UCC-12). Already introduced in over 29 states, this new Article seeks to govern certain transfers of Controllable Electronic Records (CERs). The 2022 amendments also updated Article 9 to contemplate the perfection of security interests for digital assets. So far, these amendments have been enacted in seven states: Alabama, Colorado, Indiana, Nevada, New Mexico, North Dakota, and Washington.

The federal government has not yet created a legal framework for digital assets, although the Basel Committee on Banking Supervision (BCBS) did introduce its Prudential Treatment of Cryptoasset Exposure guidance late last year. It may be many years before banks see legislation enacted by the federal government, and potentially years longer until a regulatory framework is in place (think of the substantial delays in promulgating regulations associated with Dodd-Frank, e.g., 1033 and 1071). States have begun to fill in these gaps to address market concerns about the lack of structure and guidance for commercial transactions involving digital assets.

New provisions under UCC-12 include rules for transactions involving new types of digital assets like cryptocurrency and non-fungible tokens (NFTs). The Article calls these assets "controllable electronic records" or CERs. CERs are defined as, "a record stored in an electronic medium that can be subjected to control under Section 12-105. The term does not include a controllable account, a controllable payment intangible, a deposit account, an electronic copy of a record evidencing chattel paper, an electronic document of title, electronic money, investment property, or a transferable record." UCC 12-102(a)(1). The UCC now defines "controllable account" and "controllable payment intangible" under Article 9. These are representative of tethered assets akin to an electronic promissory note. "Controllable account" means those that are "evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that has control under Section 12-105 of the controllable electronic record. UCC 9-102(a)(27A). And "controllable payment intangible" means "a payment intangible evidenced by a controllable electronic record that provides that the account debtor undertakes to pay the person that has control under Section 12-105 of the controllable electronic record. UCC 9-102(a)(27B).

One of the biggest concerns for lenders in dealing with CERs, controllable accounts, and controllable payment intangibles is undoubtedly the method of attachment and perfection, as well as the priority of their security interest. UCC Article 9 (UCC-9) has now been updated to reflect these new rules. Like non-electronic accounts and payment intangibles, lenders may perfect their security interest in CERs either by establishing control or by filing a financing statement. However, control prevails in a priority battle vs. a financing statement on its own. UCC 9-331.

Other important considerations in the new UCC provisions are the take-free and the governing law rules. The take-free rules of UCC-9 are akin to the "holder in due course" rules from UCC Article 3 (UCC-3). "Qualifying purchasers" take priority over an earlier security interest, even if perfected. UCC 12-104(e). And, under the governing law provision, if there is no logical jurisdiction, the parties to the agreement may choose the jurisdiction. If no jurisdiction is agreed to, the governing law will be the District of Columbia. UCC 12-107(c).

Banks that have delved into crypto-assets are likely familiar with the Joint Statement on Crypto-Asset Risks to Banking Organizations released earlier this year, which reiterates the Agencies' position "that issuing or holding as principal crypto-assets that are issued, stored, or transferred on an open, public, and/or decentralized network, or similar system is highly likely to be inconsistent with safe and sound banking practices. Further, the agencies have significant safety and soundness concerns with business models that are concentrated in crypto-asset-related activities or have concentrated exposures to the crypto-asset sector." Of course, this Statement was viewed as a response to the November 2022 downfall of FTX. Suffice to say, the Agencies expect a good deal of partnership and cooperation with them when proposing, and prior to beginning, new crypto-asset-related activities.

So, banks now have a little guidance regarding risk-weighting crypto-assets, a little guidance from the Agencies, and a little guidance from the UCC (at least in some states). What's next? Banks should continue to monitor these changes in their applicable jurisdictions, particularly banks that have already begun to enter the crypto-asset space. Consider how these changes will affect existing loan agreements, including the grace period in Article 13 (UCC-13) to renegotiate pre-existing loan agreements regarding the method of perfection. Policies, procedures, and training should be updated to reflect the bank's position on crypto-asset lending and custody services, even to simply state that the bank does not engage in crypto-asset activities. Contemplate and implement the requisite security standards and vendors for custody of CERs, controllable accounts, and controllable payment intangibles. Review the tax consequences and reporting obligations for crypto-asset transactions. Identify the risks associated with future laws and regulations that will affect the bank's loan agreements and other services, and design controls and contract language to mitigate those risks to the extent possible.

What Can FedNow, RTP, and RFP do for your bank?

SouthState
DuncanWilliams
Robert Biggs, Managing Director

The Federal Reserve went live as the newest and likely the most significant provider of Real-Time Payments (RTP) in mid-July with the unveiling of FedNow. RTPs are the next wave of transferring money with instant delivery 24/7/365 and immediate confirmation. The funds are withdrawn from the sender's account, and the recipient has access to the proceeds instantaneously. As of the end of July, over half a billion instant payments have been made on the RTP Network, with over 150,000 businesses and three million consumers sending payments that clear and settle on the RTP Network.

Early adopters of RTPs are not just the Too Big to Fail banks. Over 350 financial institutions are on the RTP Network, and over 90% of them are community depositories (less than $10BN in assets). Furthermore, the RTP Network reaches 65% of US DDA accounts. Request-for-Payment (RFP) is another revolutionary process to evolve from the RTP adaptation. RFP allows an entity to request payment, and, in turn, the counterparty can respond with an RTP. Businesses can send direct requests to customers for goods/services rendered, with the ability to attach invoices, and the customer can submit payment. The requesting entity receives their funds immediately upon the customer sending funds—no longer will business have to wait for transactions to settle.

What does it mean for your bank?
Stop the migration of transactions to non-depository entities: As of 2021, Venmo had over 83 million active users that generated $229.6 billion of payment volume in that year. 35% of Venmo's customer base is between the ages of 18-29—a key demographic for institutions with growth expectations over the next couple of decades. Furthermore, almost half of Venmo users state they would pay merchants with Venmo at checkout if it was an option, while only 1.2% of the top retailers accept Venmo as a payment.

Depositors are actively pulling deposits from banks to pay family, friends, and businesses. However, Venmo users often keep funds in their Venmo account after receiving monies from other Venmo users for future purchasers. Banks are losing those deposits.

Bring in and Retain Deposits: In the not-so-distant future, RTP and RFP will become the norm; yet only ~350 of the over 9,000 depositories are on the RTP network, with significantly less allowing RFP. Early adapters of RTP and RFP will have a competitive advantage over institutions slow to evolve. Venmo is one of many non-depository payment processers, and consumers have shown their hunger for an easy payment solution. RTP will allow banks to attract new customers and retain their deposits. Additionally, RTP will help businesses with cash flow efficiency. Payments received from invoices via RTP will be ready instantaneously for improved cash flow management. RFP will dramatically reduce costs as businesses will no longer need to send bills, invoices, remittance requests, follow-up notices, etc. separately. Accounts receivable turnover should shorten, as the consumer can remit payment with a single click of their phone, while also reducing chargebacks via instant confirmation and transfer of funds. RTP and RFP will become integral components to effective Treasury Management Services.

In the next 18-24 months, we expect tremendous growth in financial institutions set up to receive instant payments. The U.S. Department of the Treasury's Bureau of the Fiscal Service is on the list of FedNow participants, which means that those receiving funds from the US Government will gravitate towards financial institutions on the FedNow network. Early adapters of RFP will have a competitive advantage in bringing in new customers and retaining deposits, which will lead to greater control over their deposit costs and create lending opportunities—leading to a more profitable institution.

Deposit Diaries: An Autopsy of Deposit Pricing in a Rapidly Escalating Rate Environment

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During the pandemic, banks became the best deposit gatherers in history. Some say it was like the entire banking industry was completing a deposit-only acquisition. Waves of deposits came in at ultra-low rates and resulted in record low loan-to-deposit ratios.

There is a well-documented historical relationship between the movement in fed funds and the costs of our deposit base, but other factors can drive an institution's need to adjust deposit pricing. While the Fed controls short-term rates, each institution controls their funding curve. Could an institution's loan-to-deposit ratio or on-balance sheet liquidity ratio have an equally important impact on funding costs?

The loan-to-deposit ratio and the liquidity ratio, often inversely related, strongly influence deposit pricing. When liquidity gets tight, the supply of excess deposits is low, and thus funding costs increase to retain deposit supply. Traditionally, the equation for on-balance sheet liquidity is relatively straightforward: cash and equivalents + fed funds sold + unencumbered securities. New to this rising rate cycle was the swift change in unrealized losses within the securities portfolio. In interest rate cycles of recent memory, institutions had been able to generate reasonable liquidity from security sales within the investment portfolio. Borrowing against investments is still a good option but can result in higher-than-desired wholesale funding reliance over time. This challenge has raised the bar on the importance of deposit pricing.
With industry liquidity tightening, deposit pricing focus has shifted towards retention at a tolerable cost. To accomplish this, institutions must take a deeper dive into their deposit base. Which accounts or customer types are the most rate sensitive? Who are we at risk of losing?

STUDY THE PAST – UNDERSTANDING THE DEPOSIT BASE

Wholesale Funding: Brokered Deposits, Internet CDs, Fed Funds

Bank Deposits	
WSF / FHLB	Highly Rate Sensitive
Public Funds	
Time Deposits	
MMDA	Somewhat Rate Sensitive
SAV	Less Rate Sensitive
NOW	
DDA	Stable, Core Funding

General Population
Balances <$50K
Less Rate Sensitive

Excess Savers
Balances <$150K
Somewhat Rate Sensitive

HNW, Public Funds, Rate Shoppers
Balances >$150K
Highly Rate Sensitive

Institutions must understand their unique deposit base. We emphasize a top-down approach - starting with the most rate sensitive or the closest to market pricing.

Once we identify our rate sensitive account types, the next step is to understand where our depositors fall across certain dollar thresholds or tiers. Do we have a granular, small dollar account balance, or do we have a tilt towards large balances, over $150k for example? Do they require pledging or collateralization? For those institutions that cannot pinpoint the exact source of pressure, building deposit stratification reports can be helpful. Breaking down each deposit product by the dollar thresholds allows one to be targeted and defensive with deposit pricing. More information allows your institution to identify who needs a rate concession and who is at risk of moving to competition.

And if customers are lost, which competitor did they migrate to? What type of account and what branch is seeing the most outflows? Are institutions even tracking this information? The data is available, but first it must be identified and analyzed to empower ALCO to form and execute on the pricing strategies. Although strategies for each institution have shifted over time, one common theme is the importance of a defensive posture towards deposit pricing. At Taylor Advisors, we like to use a medical analogy to emphasize defensive deposit pricing. The Hippocratic Oath include the phrase "First do no harm" and your deposit pricing should reflect this as well. Continuing this theme, we echo the concept of "Rate Adjustment Surgery".

The Rate Adjustment Surgery

The Scalpel, the Saber, and the Chainsaw

Making broad tiered and posted rate changes with publicity is like doing surgery with a Chainsaw: It'll be quick…It'll be messy…but the patient may not survive! Not only have you immediately shocked your interest expense higher overnight, but now more attention is on rates offered across all your products and your competitors! With this approach the institution could be rewarding rate sensitive and non-rate sensitive depositors the same.

What if you accelerated rate sensitivity in your deposit base if broad rate increases were not enough?
To mitigate this, some ALCOs started to raise rates on higher non-maturity product tiers but what if the current tiering system is inefficient and over-rewarded the bulk of the deposit base on tier structures topped out at too low. This is like doing surgery with a Saber: Relatively efficient…less messy than a chainsaw…but still very painful!

A surgeon takes their time. The Scalpel requires effort,

Deposit Diaries (cont.)

precision, and finesse. The Scalpel approach forces defensive pricing, focusing on higher beta relationships and using the exception pricing and relationship pricing as key tools. While this approach requires far more effort, it enhances the likelihood of mitigating conversions risk and limiting parabolic increases in cost of funds.

Further, some institutions willing to accept some rate sensitive runoff, saw weighted average costs come down compared against conversion risk and marginal cost of funds related to Chainsaw and Saber pricing. With a Scalpel, the patient has the highest chance of survival, and the surgeon avoids malpractice!

HUB | Taylor Advisors' Take:
First Do no Harm! As you evaluate deposit pricing with this challenging liquidity and economic backdrop, remember that this is no silver bullet. Crafting strategies and pricing accounts requires time, effort, skill and precision to satisfy your goals and to ensure the patient survives the rate surgery! Don't forget to listen to your balance sheet and remember what your institution is pricing for: Retention? Growth? Bragging Rights? All eyes will be on the deposit base over the coming quarters and the impact that rising cost of funds has on NIM. The pricing and funding strategies that you pursue today can impact your NIM and profitability for quarters and year to come.

Regulatory Rundown: New Vendor Management Guidance

By now you've probably heard that the federal agencies have finalized the Interagency Guidance on Third-Party Relationships: Risk Management. It replaces existing guidance and aligns vendor management requirements among the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve.

Here's what this new guidance means for banks:

Vendor Management Lifecycle

The guidance breaks the vendor management lifecycle into five phases.

1. Planning
Planning is a strategic phase. Banks should consider the business case for outsourcing an activity. Identify risks and controls and determine if the bank will be able to effectively oversee the relationship.

2. Due diligence and third-party selection
Once the bank understands if third-party vendor needs and the potential risks, due diligence helps a bank assess if a vendor is capable of delivering products and services as promised and complying with laws, regulations and bank policies while operating safely and soundly. The risk and complexity of the third-party relationship determines the degree of due diligence needed.

3. Contract negotiation
Contract negotiation is a bank's chance to mitigate risk by adding provisions and other addendums. This is especially important for riskier relationships.

4. Ongoing monitoring
Ongoing monitoring is conducted either periodically or continually, depending on how high-risk a vendor. It includes verifying vendor products, services, and controls are as expected and escalating issues.

5. Termination
Define causes for termination, costs, and how data and intellectual property management along with other terms and conditions for ending a vendor relationship. Have a plan for transitioning to another service provider if needed. Free Guide: The Ultimate Guide to Fintech and Third-Party Vendor Onboarding

New Guidance Highlights

New definition of a critical vendor.
Under the new guidance, a critical vendor is one whose failure could create significant risk or greatly impact customers or the bank's finances or operations.

Access to significant amounts of protected or confidential customer information is considered a significant customer impact.

Digging deeper into due diligence and analyzing third-party risk.
Vendor risk assessments need to dig into the details. Residual risk is highlighted prominently, and specific factors are listed (compared to the broader categories of risk in previous guidance). Some of those factors include: strategies and goals; compliance; financials, company background, IT security, business continuity, and subcontracting.

Linking third-party risk with overall risk management.
Vendor management has always been a subcategory of enterprise risk management (ERM), the guidance makes the link explicit saying that bank should be "Integrating third party risk management with the banking organization's overall risk management process." A vendor management program should integrate into other elements of risk management including compliance, business continuity, audit, fair lending, and IT, among others. The board should establish the risk appetite for third-party risk management. Management should enact a program that aligns with the statement.

Contracts as a third-party risk control.
While contracts have always been addressed by guidance, the new guidance presses deeper into vendor contracts, including areas contracts should define. This includes scope of the arrangement, performance measures or benchmarks, compliance, data management, and dispute resolution, among others.

Implementation timeline.
This guidance takes effect immediately. Guidance doesn't have the force of a regulation, but examiners can use it to cite a bank for unsafe and unsound banking practices.

Conclusion.
Third-party vendor management is evolving. Make sure your vendor management program is integrated with your ERM program and that it addresses all the areas mentioned in the guidance. Now is the time to proactively evaluate your vendor management program to ensure it aligns with new guidance.


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