



Cherry Bekaert Financial Institutions Summit 2023

Keeping You Up to Date – Current and Emerging Legal Issues for Community Banks (3Q 2023 Edition)

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**Allison J. Donovan, Member
Walter R. Byrne, Jr., Member**

Stoll Keenon Ogden PLLC



Current and Emerging Legal Issues

- **Potential Impact of Challenge to *Chevron* case**

- May 2023 – U.S. Supreme Court agreed to consider a challenge to long-standing precedent set in *Chevron USA, Inc. v. Natural Resources Defense Council, Inc.* (467 U.S. 837) (1984).
- *Chevron* requires courts to defer to a federal agency’s interpretation of a statute when the statute is ambiguous or leaves a gap for the agency to fill (known as “Chevron deference”).
- Court will consider the following: Whether the Court should overrule *Chevron* or at least clarify that statutory silence concerning controversial powers expressly but narrowly granted does not constitute an ambiguity requiring deference of the agency.
- Decision could impact how federal agencies, including the Federal Reserve, FDIC, OCC, SEC, CFPB, and other regulatory agencies, conduct rulemakings.



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Current and Emerging Legal Issues

• **Constitutionality of CFPB Funding Structure**

- October 2022 – Fifth Circuit U.S. Court of Appeals holds the CFPB funding structure is unconstitutional.
- February 2023 – U.S. Supreme Court agrees to take the case (*Community Financial Services Association of America Ltd. v. CFPB*).
 - Expedited ruling sought, but Court decided to wait until its new term.
- March 2023 – Second Circuit U.S. Court of Appeals declines to follow the Fifth Circuit.
- May 2023 – CFPB filed brief with U.S. Supreme Court.
 - Brief contended the manner of funding falls under traditional readings of the Constitution's text, using similar reasoning as the ruling made by the Second Circuit
- July 2023 – CFSA filed its brief.
- August 2023 – CFPB filed reply brief.
- U.S. Supreme Court has scheduled oral arguments for October 3, 2023.
 - Decision is possible by year-end or early 2024.
- Numerous amicus briefs have been filed in support of each party.



Current and Emerging Legal Issues

- **Creation of Novel Activities Supervision Program (SR 23-7)**
 - Established by the Federal Reserve to enhance the supervision of novel activities conducted by banking organizations.
 - Program will focus on novel activities, including those related to crypto-assets and technology-driven partnerships with nonbanks to deliver financial services to customers.
- **Supervisory Nonobjection Process to Engage in Certain Activities Involving Dollar Tokens (SR 23-8)**
 - Applies to Federal Reserve state members banks seeking to engage in activities relating to dollar token activities.
 - Establishes a process for obtaining a written notification of supervisory nonobjection.



Current and Emerging Legal Issues

- **SEC Rule – Disclosure of “material” cybersecurity breaches**
 - Public companies must disclose such breaches within 4 days.
 - Rule also includes a new annual disclosure describing cybersecurity processes, oversight of such risks, and impacts of previous incidents.
- **Cybersecurity Law Issues to Track**
 - Cyber Incident Reporting
 - Interagency Rule – Computer-Security Incident Notification Requirements for Banking Organizations and their Service Providers took effect in 2022.
 - Requires banking organizations to report actual compromise to information or systems reasonably likely to cause material disruption.
 - Must report as soon as possible, but within 36 hours of determining occurrence of a notification event.
 - State laws, including privacy laws, may be relevant.



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Current and Emerging Legal Issues

- **Highlights and Challenges for Bank Acquisition Process**
 - Federal Reserve Timing regarding Merger Approvals
 - Semiannual report published in May stated average time to receive Fed's approval of a bank M&A deal has increased.
 - The average time to obtain approval was the longest since the Fed's earliest publicly available figures (in 2011).
 - The increase in average approval was not just respecting mergers involving bigger banks.



Current and Emerging Legal Issues

- **Highlights and Challenges for Bank Acquisition Process (cont'd)**
 - U.S. Department of Justice Signaling of Closer Scrutiny of Bank Mergers
 - June 2023 – U.S. DOJ Assistant Attorney General states his division will take a more expansive view of potential anticompetitive effects when reviewing proposed bank mergers.
 - Focusing narrowly on deposit concentration may be “inadequate to assess the likely competitive effect of a modern bank merger.”
 - DOJ to seek to broaden its reviews to take into account more of the “dimensions” of bank competition – fees, interest rates, product variety, customer services, etc.
 - DOJ and banking agencies expected to develop new guidelines.



Current and Emerging Legal Issues

- **Highlights and Challenges for Bank Acquisition Process (cont'd)**
 - Other Considerations/Updates in the M&A Landscape
 - Current Kentucky banking market (see FDIC state profile).
 - M&A drivers are still largely unchanged from prior years.



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FDIC State Profile

Kentucky

First Quarter 2023

ECONOMIC INDICATORS (NOT SEASONALLY ADJUSTED, UNLESS NOTED)

Employment Growth Rates (% change from year ago, unless noted)	Q1-23	Q4-22	Q1-22	2022	2021
Total Nonfarm (share of trailing four quarter employment in parentheses)	2.5%	2.2%	3.6%	3.0%	3.6%
Manufacturing (13%)	3.7%	4.4%	2.0%	3.9%	3.2%
Other (non-manufacturing) Goods-Producing (5%)	4.2%	2.6%	4.8%	4.2%	2.4%
Private Service-Providing (67%)	2.5%	2.1%	4.2%	3.4%	4.8%
Government (15%)	1.3%	1.0%	1.7%	0.7%	-0.8%
Unemployment Rate (% of labor force, seasonally adjusted)	3.9%	3.9%	3.9%	3.9%	4.4%
Other Indicators (% change of 4-qtr moving total, unless noted)	Q1-23	Q4-22	Q1-22	2022	2021
Single-Family Home Permits	-23.1%	-15.5%	7.4%	-15.5%	15.2%
Multifamily Building Permits	76.0%	9.4%	-16.8%	9.4%	33.3%
Home Price Index (change from year ago)	10.1%	11.9%	16.5%	15.2%	11.8%
Nonbusiness Bankruptcy Filings per 1000 people (quarterly annualized level)	N/A	1.91	1.84	1.91	2.00

BANKING TRENDS

General Information	Q1-23	Q4-22	Q1-22	2022	2021
Institutions (#)	123	124	125	124	127
Total Assets (in millions)	74,493	73,655	73,350	73,655	73,848
New Institutions (# < 3 years)	0	0	0	0	0
Subchapter S Institutions (#)	43	44	44	44	45

Asset Quality	Q1-23	Q4-22	Q1-22	2022	2021
Past-Due and Nonaccrual Loans / Total Loans (median %)	0.70	0.83	0.96	0.83	0.92
Noncurrent Loans / Total Loans (median %)	0.26	0.30	0.41	0.30	0.41
Loan and Lease Allowance / Total Loans (median %)	1.26	1.23	1.30	1.23	1.28
Loan and Lease Allowance / Noncurrent Loans (median multiple)	3.68	3.27	2.69	3.27	2.75
Net Loan Losses / Total Loans (median %, year-to-date annualized)	0.01	0.01	0.00	0.01	0.01

Capital / Earnings (year-to-date annualized, unless noted)	Q1-23	Q4-22	Q1-22	2022	2021
Tier 1 Leverage (median %, end of period)	10.64	10.52	10.43	10.52	10.37
Return on Assets (median %)	1.07	1.11	0.94	1.11	1.10
Pretax Return on Assets (median %)	1.23	1.30	1.06	1.30	1.30
Net Interest Margin (median %)	3.59	3.51	3.22	3.51	3.42
Yield on Earning Assets (median %)	4.57	3.92	3.51	3.92	3.83
Cost of Funding Earning Assets (median %)	0.92	0.39	0.28	0.39	0.35
Provisions to Avg. Assets (median %)	0.04	0.05	0.02	0.05	0.04
Noninterest Income to Avg. Assets (median %)	0.55	0.58	0.56	0.58	0.59
Overhead to Avg. Assets (median %)	2.59	2.51	2.43	2.51	2.51

Liquidity/Sensitivity	Q1-23	Q4-22	Q1-22	2022	2021
Net Loans to Assets (median %)	64.09	64.18	57.58	64.18	57.90
Noncore Funding to Assets (median %)	9.19	9.00	6.50	9.00	6.58
Long-term Assets to Assets (median %, call filers)	49.28	49.55	49.80	49.55	51.79
Brokered Deposits (number of institutions)	43	42	28	42	31
Brokered Deposits to Assets (median % for those above)	3.20	3.10	2.83	3.10	2.81

Loan Concentrations (median % of Tier 1 Capital plus the Reserve for Loan and Lease Losses)	Q1-23	Q4-22	Q1-22	2022	2021
Commercial and Industrial	38	39	39	39	41
Commercial Real Estate	204	203	191	203	188
Construction & Development	40	39	33	39	33
Multifamily Residential Real Estate	17	18	17	18	17
Nonresidential Real Estate	124	130	121	130	119
Residential Real Estate	204	204	185	204	186
Consumer	23	21	21	21	22
Agriculture	34	34	36	34	35

BANKING PROFILE

Largest Deposit Markets (from 2022 Summary of Deposits)	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
Cincinnati, OH-KY-IN	58	170,606	< \$100 million	18 (34.6%)
Louisville/Jefferson County, KY-IN	40	43,361	\$100 million to \$250 million	37 (30.1%)
Lexington-Fayette, KY	39	16,188	\$250 million to \$1 billion	52 (42.3%)
Evansville, IN-KY	18	10,699	\$1 billion to \$10 billion	16 (1.3%)
Huntington-Ashland, WV-KY-OH	24	7,629	> \$10 billion	0 (0%)



Current and Emerging Legal Issues

- **Other Regulatory Bank Updates**

- **Interagency Final Guidance on Third-Party Risk Management**

- Issued in June 2023 – designed to help manage risks associated with third-party relationships; replaces each agency’s existing guidance in an effort to promote consistency.
 - Describes principles and considerations for risk management of third-party relationships, through various stages in the life-cycle of such relationships: planning, due diligence and third-party selection, contract negotiation, ongoing monitoring, and termination.
 - Includes illustrative examples.
 - Agencies plan to develop additional resources.



Current and Emerging Legal Issues

- **Other Regulatory Bank Updates (cont'd)**

- **FDIC Order impacting Fintech Alliances**

- FDIC issued a consent order in March 2023 (made public in May 2023) against Cross River Bank in New Jersey – unsafe or unsound banking practices related to fair lending regulations, due to its fintech partnerships.
- Board of directors ordered to increase its supervision and direction of management and its oversight and monitoring of internal controls, information systems, credit underwriting practices and internal audit systems related to consumer protection laws and regulations.
- Bank must send the FDIC a list of all its credit products and fintech partners and obtain the FDIC's nonobjection before taking on any new fintech partner or credit product.
- Bank must hire an independent third party to review the technology it uses.
- The order puts all banks that partner with fintechs on notice.



Current and Emerging Legal Issues

- **Proposed Executive Compensation Rule**

- 2010 Dodd-Frank Act, Section 956 – incomplete, to date.
- Recent bank failures has generated renewed interest in finalizing a rule.

- **Other Lessons and Impacts Resulting from Recent Bank Failures**

- Proposal for large banks to boost capital.



Current and Emerging Legal Issues

- **PPP Fraud Investigations**

- Determining the amount of fraud?
- Which lenders will be the focus?
- Investigations and prosecutions against individuals.
 - Tennessee man pled guilty to approx. \$1 million in filings related to pandemic relief programs.
- Cases related to fintechs.



For Further Information or Questions Contact:

Allison J. Donovan
allison.donovan@skofirm.com
(859) 231-3098

Walter R. Byrne, Jr.
walter.byrne@skofirm.com
(859) 231-3021

Stoll Keenon Ogden PLLC
300 West Vine Street, Suite 2100
Lexington, KY 40507