

INTERIM JOINT COMMITTEE ON BANKING AND INSURANCE

Minutes of the 4th Meeting of the 2019 Interim

November 20, 2019

Call to Order and Roll Call

The 4th meeting of the Interim Joint Committee on Banking and Insurance was held on Wednesday, November 20, 2019, at 10:00 AM, in Room 149 of the Capitol Annex. Representative Bart Rowland, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Jared Carpenter, Co-Chair; Representative Bart Rowland, Co-Chair; Senators Julie Raque Adams, Tom Buford, Rick Girdler, Christian McDaniel, Morgan McGarvey, Dennis Parrett, and Brandon Smith; Representatives Terri Branham Clark, Joseph M. Fischer, Deanna Frazier, Jim Gooch Jr., Kathy Hinkle, Adam Koenig, Stan Lee, Michael Meredith, Sal Santoro, Wilson Stone, and Ken Upchurch.

Guests: Patrick O'Connor, Deputy Commissioner of Policy, Kentucky Department of Insurance (KDOI); Mark Treesh, Executive Director, Insurance Institute of Kentucky (IIK); Lisa Pierce, Regional Counsel, Allstate Insurance, and IIK Board Chair; Lindsey McCutchan, Senior Director, State Government Relations, Nationwide Insurance, and IIK Board Member; Greg Mitchell, Insurance Industry Group Chair and Bill Repasky, Member, Frost Brown Todd; and Adam Koehler, Co-Founder, CryptoProperties.

LRC Staff: Jessica Sharpe, Breanna Miller, and Dawn Johnson.

Approval of Minutes

A motion by Representative Santoro and second by Representative Gooch to approve the minutes of the October 2, 2019, meeting carried by voice vote.

Kentucky Department of Insurance 2019 Year End Review

Patrick O'Connor, Deputy Commissioner of Policy, KDOI said the purpose of the agency is to promote sound, competitive insurance markets, public protection through effective enforcement and regulations, and public empowerment through outreach and education. Most importantly, the KDOI regulates and attempts to maintain the financial solvency of insurance companies so they can continue to pay claims. Deputy Commissioner O'Connor said the insurance industry is an economic driver and source of employment for the state. Kentucky ranks 27th in the country by insurance premium volume at approximately \$29 billion.

Discussing highlights from the past year, Deputy Commissioner O'Connor said the agency has built on the opportunities provided by Chairman Rowland's House Bill 386. KDOI has been involved in conferences with a number of interested parties to discuss the Innovation Application process established by that bill. Although no applications have been submitted yet, the bill has generated a tremendous amount of discussion and provided the impetus for Kentuckians to take advantage of new products and opportunities. He explained the new health insurance options offered by Kentucky's two marketplace insurers, noting that CareSource lowered rates while Anthem's rates increased slightly. There is renewed interest in alternative risk management opportunities, which is probably due in large part to last year's association health plan bill sponsored by Representative Adam Bowling. Deputy Commissioner O'Connor also said that telematics will be used into the foreseeable future to provide new opportunities for consumers, which bring up issues in terms of what data can be used to determine insurance rates.

KDOI's Division of Fraud held an event on Insurance Fraud Day, November 12, which was highly attended.

Deputy Commissioner O'Connor said he was proud of the agency's work on grants, especially for preventative health care services. Preventative services under the Affordable Care Act are provided without cost sharing and extend well beyond standard vaccinations and physicals. These services are underutilized; however, after careful review of preventative care providers, leftover grant money was repurposed to take preventative care to the next level. Insurers and medical providers, groups typically at odds, met to address the issue. A grant extension has been requested to inform the public of the benefits available and how they can improve their health status.

Deputy Commissioner O'Connor said the agency's red tape initiative continues to reduce, repeal, and amend regulations.

Deputy Commissioner O'Connor provided a KDOI division update. The Agent Licensing Division has administered over 9,000 examinations through November 2019. There are over 400,000 insurer appointments and over 144,000 insurance agents licensed to do business in Kentucky. The division continues to administer examinations, handle license renewals, and review and approve continuing education to ensure agents are informed of the latest products and continue to serve their clients. The Consumer Protection Division (CPD), with 14 staff members, received over 8,900 phone calls in the first 10 months of 2019. The majority of calls dealt with property and casualty insurance issues. Through November 20, CPD received over 2,700 complaints. CPD has recovered almost \$5 million for consumers and entities. The Market Conduct Division is the law enforcement of insurers. They perform detailed exams of insurance companies' claims processes to ensure claims are being processed correctly. There are 46 ongoing corrective action plans. The agency has recovered approximately \$163,000 in civil penalties and approximately

\$37,000 in restitution to consumers. Examination costs can be expensive due to the use of contract examiners, who are subject matter experts, but all costs are billed back to the company. The mission of the Financial Standards Division (FSD) is to maintain and ensure the financial solvency of insurance companies. The FSD licenses insurance companies and oversees their financial statuses. There are over 1,600 licensed insurers in Kentucky and 52 captive insurers. Over the past year, FSD has received and approved 21 foreign and three domestic company certificates of authority. The Insurance Product Regulation Division (IPRD) reviews all insurance product filings, of which there are a substantial number, and they are responsible for No Fault rejections submitted under Subtitle 39 of KRS Chapter 304. Over 7,000 rejections were processed in the last year. The IPRD also regulates the surplus lines market. The surplus lines regulation process is now electronic to improve efficiency for both reporting and payment. For the first two quarters of 2019, IPRD collected over \$3 million in surplus lines taxes. The Division of Insurance Fraud Division has 15 fraud investigators throughout the state. In 2019, the division received 1,400 referrals resulting in 155 open cases, 75 felony convictions, and over \$300,000 in restitution. Over the last four years, the fraud investigation unit has been responsible for almost \$10 million in restitution—a record for the Division.

Deputy Commissioner O'Connor outlined other KDOI resources, including the agency's work with local government officials to notify insurers of the Local Government Premium Tax (LGPT) rates, a substantial source of revenue for local governments. The agency has worked diligently with all local governments through the LGPT Advisory Council to address issues as they arise. He said the Administrative Services and Legal Services Divisions are also valuable resources, as well as the KDOI website.

Chairman Rowland thanked Deputy Commissioner O'Connor for being an invaluable source of knowledge, information, and assistance to the committee.

Insurance Institute of Kentucky 2020 Legislative Agenda

Mark Treesh, Executive Director of IIK; Lisa Pierce, Regional Counsel, Allstate Insurance and IIK Board Chair; and Lindsey McCutchan, Senior Director, State Government Relations, Nationwide Insurance and IIK Board Member introduced themselves. Mr. Treesh said the IIK is the state trade organization for property and casualty and life insurers. The IIK is not involved with health insurance. They advocate on behalf of IIK members and insurance consumers. Mr. Treesh said that any comments by Ms. Pierce and Mr. McCutchan will be on behalf of IIK. Mr. Treesh said the legislative issues addressed are those that are ready for public presentation but others may be brought forth during the legislative session.

Two issues are National Council of Insurance Legislators (NCOIL) model acts. NCOIL passed a Model Towing Act, which came after a bill sponsored by Senator Carpenter in 2015, to address some issues in the towing industry. The issues include: rate variances if insurance is involved, lack of transparency, restrictions on insurer access to

vehicles, excessive gate fees, and high storage fees. Key provisions of the model act require tow truck operators to document vehicle damage prior to the vehicle being removed by the tow truck, provide rate information to consumers before a vehicle is towed, require invoicing within 24 hours of request from an insurance company, require release of vehicles to the responsible insurance company upon payment of all costs incurred against the vehicle that is towed and stored, and require towing or storage companies to return calls within 24 hours. Mr. McCutchan said towing issues vary by state. Some states consider these fraud matters and some have a significant problem with “rogue towers.” Most often, fee transparency is a problem as well as adjuster access to towed vehicles. He said Indiana has passed a bill similar to the model act that has been a success.

Mr. Treesh explained that in May 2018 the American Law Institute (ALI) approved its Restatement of the Law of Liability Insurance, which was controversial. The restatement was seen as deviating from settled insurance law in a majority of jurisdictions. A number of states have addressed this and several others are considering action. NCOIL passed a model law, sponsored by Representative Joe Fischer, in July 2019. Representative Fischer said he currently has a bill in progress that is based on the model law. Traditionally, the interpretation of insurance contracts has been reserved to state legislators and judicial branches of government. Academic treatises, like restatements, have been given respectful due deference, but they have never been traditionally allowed to be an actual restatement of the law in any state. The ALI treatise does depart from Kentucky law on a number of contract interpretation issues. Mr. Treesh said the IIK would like to go on record as supporting Representative Fischer’s legislation and will advocate on its behalf.

Another area of interest to the IIK is depreciation of labor with actual cash value property claims, which primarily involves homeowners insurance. The question, which was addressed in the federal court case of State Farm v. Hicks, is whether labor should be included in depreciation calculations. The court interpreted 806 KAR 12:095, a Kentucky insurance regulation. Holding the regulation to be ambiguous, the court construed the regulation in favor of policyholders, which meant that labor would not be depreciated even though premiums had been based on that expectation. IIK is looking at what language may be necessary to address the issue. The Kentucky Department of Insurance is watching a federal case in Ohio before taking action. This issue could be addressed statutorily by allowing insurers to use depreciation of labor to determine actual cash value if it is stated in the policy.

Mr. Treesh explained that due to the growing problem of distracted drivers and the impact on claims, IIK members support banning the use of hand-held cell phones and other devices. There are currently two prefiled bills, BR 166, sponsored by Representative James Tipton, and BR 212, sponsored by Representative Regina Huff that address the issue. IIK supports the concept of legislation addressing the issue and is not advocating for any particular piece of legislation.

Blockchain Technology in the Banking and Insurance Industries

Greg Mitchell, Insurance Industry Group Chair, Frost Brown Todd said the presentation would include a description of the high level concept of blockchain technology, its application, and potential uses in the insurance and financial services industries.

Adam Koehler, Co-Founder of CryptoProperties described blockchain technology as a ledger of transactions. The most well-known application of blockchain is Bitcoin; however, cryptocurrency and blockchain are not the same thing. Blockchain is the underlying technology that has a lot of applications in many different industries. One benefit of blockchain is that it is decentralized. There is no central authority overseeing blockchain. Its members control the blockchain and have full transparency of what is on it. This type of technology works best in applications such as supply chain and logistics. Blockchain is distributed ledger technology using advanced cryptography techniques to secure the blockchain and ensure it is immutable. It creates a secure ledger of information and prevents unauthorized modification, addition, or removal of data. There must be a consensus of a majority of members on a blockchain to update a blockchain ledger. It is only updated; it cannot be changed. The advantages of this technology are data security and a clear audit trail. Blockchain technology removes the need for trust between third party organizations, allowing collaboration between competitors. There is an ability to create a more secure, efficient, cost-effective, and consumer-friendly experience.

Mr. Mitchell discussed practical applications within the insurance industry. He said insurance is simply a contract. In using blockchain technology, insurance companies and the distribution channel can design an insurance contract that can be executed without “friction,” with the ability to trace transactions. All parties to the contract will have the same information. It can be used in adjudicating claims. Referring to previous testimony about claims audits, Mr. Mitchell said blockchain will be cost-effective because it enables claims to be paid faster and reduces mistakes made during the claims process. Blockchain will allow one system of record for everyone involved and will allow everyone to have access to the same information.

Mr. Mitchell spoke about smart contracts through blockchain technology. Distributed ledgers will enable simple contracts to automatically execute when specified conditions are met and will enable full transparency. A smart contract is a pre-programmed contract containing rules and conditions of the agreement by all counterparties, which is then translated into code. If an event within the contract occurs, the code automatically executes. Once executed, the terms of the contract will automatically transfer the value to the relevant parties, followed by the settlement and the transfer of the value to counterparties, which is recorded on the blockchain.

Bill Repasky, Member, Frost Brown Todd said that now is the time to promote blockchain technology. Its use in the industry will be transformative. Mr. Repasky

recommended forming a study group or task force to provide data and information, and establish guidelines for this growing technology. He said many Kentucky businesses are already involved in blockchain technology. Logistics and insurance are prime examples. He recommended identifying businesses in the state who use blockchain technology to determine what can be done to encourage its growth in the state. Mr. Repasky suggested legislatively recognizing and defining what blockchain technology and smart contracts are as other states have done. He said property interests should be protected for innovative companies who want to bring jobs to Kentucky. He also recommended adopting a definition of money under the Kentucky Money Transmitter Act, KRS Ch. 286.11, that excludes virtual currencies, noting that several states are moving in that direction.

Mr. Koehler said he is in the business of start-ups and is involved in start-up communities. He spoke on Cintrifuse and their start-up space. He noted the top technology in their strategic plan is blockchain because they understand blockchain is a game changer and is the direction the start-up community is headed. Focusing on blockchain and supply chain can be of tremendous value to the region. It develops a brand. Supply chain logistics employs everyone. He noted that certain areas of Kentucky are strategically located and are within a day's drive from 40 percent of the United States population. Many companies want to bring jobs to the area promoting blockchain technology. Mr. Koehler said financial services is another key area to focus on. Ohio and Wyoming are moving ahead in blockchain technology. Mr. Koehler said Kentucky should move forward and create a brand for technology in Kentucky. Blockchain is on the cutting edge.

Senator Smith said Kentucky is farther along in blockchain than most people realize. The Natural Resources Committee has been talking about blockchain technology and its use in energy and security since this spring. Senator Smith said there is a bill being drafted, but it is on hold until after today's testimony. He suggested committee members may want to cosponsor the bill. It will create a task force for Kentucky to become a leader in how we secure access for different utilities and different investments, whether it is insurance or banking. He said this technology is not new, it has existed since 1991, but it took Bitcoin to show how effective it is. It brings clarity and a degree of security to the internet that has not been available until now. Senator Smith commended the presenters for their work.

There being no further business, the meeting adjourned at 11:15 AM.