

NATIONAL COUNCIL OF INSURANCE LEGISLATORS
FINANCIAL SERVICES & MULTI-LINES ISSUES COMMITTEE
NEWPORT BEACH, CALIFORNIA
JULY 12, 2019
DRAFT MINUTES

The National Council of Insurance Legislators (NCOIL) Financial Services & Multi-Lines Issues Committee met at The Marriott Newport Beach Hotel on Friday, July 12, 2019 at 9:00 a.m.

Senator Bob Hackett of Ohio, Chair of the Committee, presided.

Other members of the Committees present were:

Rep. Austin McCollum (AR)	Rep. Edmond Jordan (LA)
Sen. Jason Rapert (AR)	Rep. George Keiser (ND)
Asm. Ken Cooley (CA)	Sen. Jerry Klein (ND)
Rep. Martin Carbaugh (IN)	Rep. Tom Oliverson, M.D. (TX)
Rep. Matt Lehman (IN)	Del. Steve Westfall (WV)
Rep. Joe Fischer (KY)	

Other legislators present were:

Sen. Jack Tate (CO)	Sen. Paul Utke (MN)
Rep. Richard Smith (GA)	Rep. Kevin Ford (MS)
Rep. Tammy Nichols (ID)	Sen. Vickie Sawyer (NC)
Rep. Deanna Frazier (KY)	Asw. Ellen Spiegel (NV)
Sen. Dan "Blade" Morrish (LA)	Asm. Kevin Cahill (NY)

Also in attendance were:

Commissioner Tom Considine, NCOL CEO
Paul Penna, Executive Director, NCOIL Support Services, LLC
Will Melofchik, NCOIL General Counsel

MINUTES

After a motion was made by Rep. George Keiser (ND) and seconded by Sen. Jerry Klein (ND) to waive the quorum requirement, the Committee unanimously approved the minutes of its March 15, 2019 meeting in Nashville, TN upon a Motion made by Rep. Joe Fischer (KY), and seconded by Rep. Martin Carbaugh (IN).

CONTINUED DISCUSSION ON DEVELOPMENT OF NCOIL INSURANCE MODERNIZATION MODEL LEGISLATION

Before the Committee's discussions began, Sen. Bob Hackett (OH), Chair of the Committee, provided a few words as a reminder for those not aware of the direction the Committee would like to take this topic of "Insurance Modernization." This discussion is aimed toward developing model legislation aimed at helping the insurance industry move past some outdated ways of doing business. At the NCOIL Spring Meeting in Nashville a few months ago, the Committee started the discussion having identified three main

issues as ripe for development of model “modernization” model legislation: a.) rebate reform initiatives; b.) optional electronic delivery and posting of insurance information; and c.) the electronic issuance of salvage titles. Sen. Hackett stated that today, the Committee will be continuing the discussion on rebate reform initiatives and the electronic delivery issues and will aim to have the salvage title issue back on the agenda at our next meeting in December. As a reminder, these are just three issues that the Committee have targeted as ripe for inclusion in the insurance modernization topic and NCOIL of course welcomes suggestions for other issues. Legislators and interested parties are encouraged to reach out to the NCOIL national office with any issues they think would be appropriately addressed under this topic of “insurance modernization.”

a.) Rebate Reform Initiatives

The Honorable Eric Cioppa, Superintendent of the Maine Bureau of Insurance (Bureau) and NAIC President, stated that rebating is something that the NAIC is beginning to look at and is something that Maine enacted significant reforms on several years ago. Rebating is essentially giving some consideration as an inducement for someone to buy a policy. Supt. Cioppa stated that he has been at the Bureau for a long time and one of his first meetings as Deputy Supt. consisted of five Bureau insurance attorneys debating whether a frozen turkey was a rebate. Supt. Cioppa stated that following that meeting he said to himself if he ever got the opportunity he would change the rebating laws as it seemed like a waste of valuable resources to talk about frozen turkey being rebates.

Maine had a series of stakeholder meetings over the course of two years to look at rebating and Supt. Cioppa that during his 30 years at the Bureau he has not had one complaint from a consumer expressing anger that his or her company gave them a rebate. If you look back at the history rebating, there was a valid reason why rebating laws were put in place – there were solvency and prudential implications for companies at the turn of the last century. But now we are talking about Fitbits and devices for homes and COBRA services that entities can offer to employers. Supt. Cioppa stated that he struggled in Maine when thinking why those products were a bad thing – why shouldn’t companies be allowed to compete on services at some level as long as it is related to the policy. Accordingly, after the stakeholder meetings, Supt. Cioppa met with the Committee of jurisdiction and got a unanimous vote out of the Committee changing the rebating laws to accomplish meaningful reforms.

There were two main elements to the reforms. The dollar amounts for raffles and gifts you can give were increased, but the other part of the reform was more important – allowing entities and carriers to provide services related to the policy for loss control services such as Fitbits and water monitors. The Maine rebating statute was modernized to allow that. The NAIC through its Innovation and Technology Task Force under North Dakota Insurance Commissioner Jon Godfread’s leadership is starting to look at these issues. Supt. Cioppa stated that he believes that carriers and entities should be able to allow and compete on services and rebating laws need to be modernized to allow for that but there also still needs to be some line. In Maine, the dollar amounts originally proposed were \$250 for gifts and \$2,500 for raffles and the legislature cut that back. It is incumbent upon NCOIL and NAIC to look at rebating in the context of what is going on today with the technology and services that carriers can offer to consumers as a good thing for consumers. Supt. Cioppa stated that the Maine rebate reforms took some time to get enacted because there was some trepidation among the

producer community about competition issues, but at the end of the day they agreed that rebate modernization was needed.

Frank O'Brien, VP of State Gov't Relations at the American Property Casualty Insurance Association (APCIA), stated that he participated in some of the stakeholder meetings referenced by Supt. Cioppa and vividly recalls the frozen turkey story. Mr. O'Brien stated that his home state of Massachusetts had a very strict rebating law where it was perfectly appropriate for an independent agent to put stress balls and pens on the table for a customer to take but the insurance division considered it a violation of rebate laws for the agent to actually hand them to the consumer. Mr. O'Brien stated that rebating statutes are anachronistic and may continue to serve a purpose in some ways but they cry out badly for reform, particularly with regards to the fact that the expectations of consumers are changing. With the availability of smart phones and wireless technology, customers are growing more and more accustomed to getting a wide variety of services and customers are saying "why can't you help us with this?" and "why can't you provide us with loss control services and other services that would assist us in managing our risk?" Customers essentially want more for the premium dollar.

Mr. O'Brien stated that APCIA has provided draft model language to be added to existing rebating statutes. To use a football analogy, the draft is a kickoff and something for people to react to. Based upon the Maine rebate statute and bulletin, and other state's rebate bulletins, APCIA focuses on the particular area of loss-control because that is the main item that APCIA's customers are asking for assistance with. More flexibility on marketing would be beneficial as well but that is not the focus – it is reacting to what the customer's needs and wants are.

In response to whether or not such language needs to be in a statute as opposed to a bulletin, as has been frequently stated during NCOIL innovation session the past several years, insurtech and fintech representatives state that they want to be able to look at the statute or regulations and tell from the get-go whether or not the particular service they want to provide is going to be something that is ok. Right now in many states that is not really possible. The response to some in the regulatory community has been "this is not a problem – just come in and talk to us." However, the problems with that are: a.) the aforementioned representatives don't want to come in and talk to regulators – they want to know from the beginning and avoid going down a path of developing a product or service and then going in and discussing whether or not is ok; and b.) it is important to have something that is predictable and hopefully encourage some sort of relative uniformity. Part of the problem with going in and speaking with the regulator is that it is a one-off process and could very well change when the regulator changes. One of the fundamental things that APCIA's members always ask for is to be told what the rules of the road are.

Accordingly, Mr. O'Brien stated that APCIA is looking to put some rules of the road in so that there is some predictability so that companies can begin to provide the type of products that their companies are asking for.

John Fielding, General Counsel for The Council of Insurance Agents & Brokers (the Council), stated that this is a huge issue for brokers and comes down to turf protection in many cases. There is uneven enforcement across the country and people do not know where the lines are drawn. The Council believes that for commercial insurance, the anti-rebating statutes should be repealed as rebating should not be a concept in the

commercial insurance space. Sophisticated consumers should be able to negotiate like they do with any other transaction for the insurance and services they get.

Asm. Kevin Cahill (NY), NCOIL Secretary, stated that the confusion over rebating and marketing materials continues to persist and there has been the risk of scandalizing companies because they have chosen to use some methodology of attracting customers that some regulators may not have understood. The idea of repealing rebating laws altogether, however, flies in the face of what is going on particularly in the health insurance field with pharmacy benefit managers (PBMs) hiding rebates that they are giving to insurance companies or rebates that somehow make their way back to the consumer. It appears that maybe the appropriate thing to do is not necessarily completely repeal rebating laws but at least allow continued restrictions or guidelines for sunshine so that we can be aware of what they are. Asm. Cahill asked for the panel's thoughts on that.

Mr. Fielding stated that one of the Council's policies that has been in place for about 20 years is for transparency in for example, compensation disclosure and things like that. Mr. Fielding stated that while he would have to discuss Asm. Cahill's proposal with the Council's Board before opining on it, the Council believes that transparency is really important in these areas and in terms of a negotiated deal, some things are going to be confidential but there is probably portions of it that would be subject to regulatory review and disclosure.

Mr. O'Brien stated that APCIA agrees with Asm. Cahill and they debated long and hard about whether or not it should support wholesale repeal of rebating laws. Some of APCIA's membership would support that, but at the end of the day it may be a step too far. There are certain practices that require some additional oversight and that is why APCIA's initial draft model law proposal has opted for simplification. Some rebating statutes are simple on their face but not simple as to how they have been enforced and interpreted. APCIA has tried to take an approach of trying to carve out some practices that there is consensus on, at least at NCOIL, being beneficial to consumers and making it clear that there are some practices are going to be ok. There are other things which the legislature in its wisdom could decide to prohibit or restrict. APCIA's proposal is a relatively modest start to this conversation and meets the needs of the general consensus that has been reached here at NCOIL and which is also beginning to develop at the NAIC.

Supt. Cioppa stated that when they went through the process in Maine they ended up in the same place – the dollar amounts mentioned earlier were increased to \$100 for gifts and \$500 for raffles but certain guardrails were kept in place such as marketing restrictions.

Sen. Hackett asked Mr. O'Brien if he supports the Maine reforms. Mr. O'Brien replied yes but with one caveat – one of the other issues that was debated was the merit of specific dollar amounts. From a simplicity point of view there is nothing simpler than having a bright-line dollar amount, but it is almost too simplistic as something may be introduced that saves the insurance industry and consumers a lot of money that costs \$101. Accordingly, with inflation and other consideration, that is why APCIA in its draft proposal opted to focus on loss control and loss mitigation services and not on specific dollar amounts. Mr. O'Brien noted that that is not necessarily an opposition to the Maine reforms but rather an evolution in that area.

Mr. Fielding stated that with respect to the Maine and APCIA language, while the Council would prefer repeal of rebate laws, it is a good start. Mr. Fielding stated that he does have concerns with specific dollar amounts because they are different across the country. The Council has conducted a state survey of rebating laws and there are significant differences, from \$5 for a life application in Michigan to \$10 for a P&C application in Michigan, to \$500 in Maine. It is very difficult to figure out how to thread that needle so to have a logical approach to it, such as a product based or risk based approach, would be very helpful.

b.) Discussion on NCOIL Insurance E-Commerce Model Act

Rep. Edmond Jordan (LA), sponsor of the NCOIL Insurance E-Commerce Model Act (Model), stated that the Model is intended to be the first part of NCOIL's "insurance modernization" effort. The Model is essentially divided into three sections: a.) permitting insurers to deliver any document required by law in an insurance transaction or that will serve as evidence of insurance coverage – except cancellation or nonrenewal of any insurance coverage – to be delivered, stored, and presented by electronic means, if the party has affirmatively consented to such; b.) permitting an insurance policy and an endorsement that does not contain personally identifiable information to be posted on the insurer's website, if the insurer obtains affirmative consent from the policyholder to do so; and c.) permitting insurers, if the claimant requests, to pay claims via electronic transfer of funds.

Rep. Jordan stated that this type of legislation has been adopted in many states, including his home state of Louisiana, and he does not believe there has been any issues with it. Rep. Jordan stated that the Model protects consumers while modernizing insurance contracts and while a few tweaks may need to be made to it, he looks forward to adopting it in December at the NCOIL Annual Meeting.

Ron Jackson, VP of State Affairs – Southeast Region at APCIA, stated that APCIA supports modernization efforts and appreciates NCOIL this matter forward. With regard to the Model, APCIA does have some issues that it looks forward to discussing with the Committee between now and December. Louisiana is one of the 38 states that have taken action allowing for electronic commerce in insurance transactions with the express consent of the consumer which is a good thing as we all operate electronically more and more in our everyday life, and insurance should be no different. Mr. Jackson stated that the Model excludes cancellation and non-renewal notices and that has not been the case in Louisiana's enactment of the law, and while there has been variation in such language in a couple of states where it made it harder to execute, that has been allowed because it is only allowed with the express consent of the consumer. APCIA would like to address that portion of the Model.

With regard to e-posting, 24 states have enacted laws allowing for the posting of documents that don't contain personally identifiable information. The current Model includes language requiring express consent of the consumer for e-posting which is redundant to the consent they have given for e-delivery. In the other states that have passed this type of legislation, it has been in the opt-out nature whereby the insurer will post the standard documents online unless the consumer expressly says otherwise and wants the insurer to mail them. APCIA would like to address that portion of the Model. Along the same lines, that section of the Model address storage of those documents for a period of years and APCIA would like to address that as well. The maintenance of that

standard form for a period of years after the policy has expired could be burdensome and there may be other ways to address altering consumers as to how they can keep those documents after the policy expires.

Sen. Hackett noted that NCOIL staff did reach out to consumer advocacy groups to attend and participate in this discussion in-person but they declined to do so.

MEASURING THE IMMEASURABLE? – A DISCUSSION ON A.M. BEST’S PROPOSAL TO SCORE AND ASSESS INSURER INNOVATION

Steve Irwin, Senior Director at A.M. Best, stated that the draft criteria titled “Scoring and Assessing Innovation” is currently out of the comment period and then walked through what the process is at A.M. Best when working on a new rating criteria. After internal reviews and approval of new or materially changed criteria, a draft copy of the criteria is released for comments for a period of no less than 30 days. The draft is accompanied by a press release which goes out to the public and indicates the reason for the new or revised criteria procedure. Once the comment period closes, all comments are reviewed to determine if changes are warranted based on the feedback received. Normally comments center around areas in the criteria that need further clarification. Once that process is completed, the criteria may be released for use following regulator notification or a second comment period may occur. If the latter option is chosen the process repeats itself and a FAQ may be released as well which highlights what changes are made and what the next steps may be. Mr. Irwin stated that for this criteria, A.M. Best is currently digesting the first set of comments received and can offer thoughts on some of the comments received at the end of his remarks.

A.M. Best believes innovation is important because the history of insurance and risk management is one of innovation. A.M. Best believes that innovation has always been important for the success of an insurance company to increase pace of changes in society, climate-related trends, and technology. Innovation is becoming increasingly critical for the long term success of insurers. By incorporating innovative principles, companies can develop sustainable competitive advantages and better respond to external challenges such as evolving consumer preferences, growing business complexity, shifting market dynamics and ever-expanding technological developments. A.M. Best believes that insurance companies need to innovate to outpace competitors, fend off potential external disruptors, and promote organizational longevity.

Mr. Irwin stated that given the accelerating pace of innovation and magnitude of change, insurance companies that fail to innovate may find it difficult to sustain long term success and profitability and may ultimately be subject to anti-selection and loss of relevant. Those insurers that successfully incorporate innovation will likely strengthen their organization, increase customer base, and improve efficiency which will support their financial strength. The release of this draft criteria outlines the procedures A.M. Best will use to evaluate a company’s level of innovation. Mr. Irwin noted that there was a recent insurance company survey which asked if insurance will be more different in the next five years and 96% of those surveyed stated that they strongly agreed with that statement so innovation is certainly something that is on the industry’s mind.

Mr. Irwin stated that A.M. Best conducted some research before it got started regarding how the industry feels about innovation. A.M. Best surveyed its rated universe to get a better read on the state of innovation in the insurance industry. More than 450 insurers

in 48 markets representing every segment of the industry worldwide responded to the survey. The survey reported in A.M. Best's November 2018 report titled "Insurers Agree Innovation is Critical for Future Success." More than 80% of the insurers surveyed viewed innovation as either moderately to extremely to the success of their organization. Accordingly, it is A.M. Best's view that as technology continues to evolve, insurance companies that do not successfully incorporate principles of innovation may be significantly disadvantaged. Over time, failing to innovate may inevitably lead to an erosion in their competitive advantage and ultimately their financial strength.

Mr. Irwin stated that at the same time, A.M. Best's survey also demonstrated that only a small segment of the industry believes that it has adopted and implemented innovation well and nearly a quarter of the respondents indicated that their assessment of the insurance industry's adoption and implementation as not well. Finally, the survey identified that nearly 90% of insurers are hopeful that innovation can help them address system inefficiencies while nearly 2/3 believe that ongoing investment in innovation can help them navigate business disruption and remain relevant, and more than half believe that innovation can minimize underwriting risk.

Mr. Irwin stated that historically, A.M. Best has captured innovation indirectly through the various building blocks of its rating process. A.M. Best is releasing this criteria now because A.M. Best now believes that the pace of innovation in the insurance industry is accelerating and that insurers' ability to innovate is becoming an increasingly important indicator of its long term financial strength. With this particular draft criteria, A.M. Best is forming a starting point for the formal assessment of a company's innovation level. From a ratings perspective, A.M. Best's innovation initiative is two-pronged: a.) rated companies will be scored and then assigned an innovation assessment; and b.) within its business profile building block, A.M. Best will explicitly consider whether a company's innovation efforts have had a demonstrable effect on its long term financial strength.

Mr. Irwin stated that the first step is defining what innovation is, recognizing that there many different definitions of innovation. A.M. Best has chosen to define innovation as a "multi-stage process whereby an organization transforms new ideas into new or significantly improved products, processes, services, or business models that have measurable positive impact over time and enable an organization to stay relevant and successful and can be organically grown or adopted from external sources."

There are a few aspects to that definition. First, innovation can take many forms and is not limited to a specific type of innovation or technological development. The definition also allows for flexibility regarding the source of the innovation. For some organizations, innovation can be adopted to the most appropriate path as there may be inherent barriers to innovation within the organization. Second, A.M. Best expects the output of the innovation process of those new or significantly improved products, processes, services or business models to have a measurable impact. Some level of failure is an expected part of any innovation program but companies receiving higher innovation scores will have demonstrable success in innovating. Without productive results, the resources consumed by innovation processes may be a financial drain rather than a gain. Third, innovation is a dynamic and ongoing process as well as a long term commitment. Companies that receive higher scores will be those that treat innovation as part of a continuing cycle of organizational growth and development, and that successfully integrate their new-stream innovations with their main-stream legacy operations. Finally, while important, innovation is not just about technology.

Regarding the process of how A.M. Best will score insurer's innovation that is outlined in the draft criteria, A.M. Best's evaluation of a company's innovation level takes into account an input and output approach and is based on two elements. The first is the innovation inputs, or the components of a company's innovation process, and the second is innovation outputs, or the impact of the company's innovation efforts. The resulting innovation score is the sum of those two evaluations. The innovation input score consists of four sub-components: leadership, culture, resources, and processes and structure. The sub-components capture a company's innovation capacity and its potential innovation ability or whether the structural elements of the innovation process are positioned in such a way that the company can leverage its available resources to create value. Each of the sub-components is scored from 1 to 4, with 1 corresponding to the most negative assessment and 4 the most positive.

Leadership can be a driver of innovation success or a cause of innovation failure and thus has a direct influence on the other sub-components in the innovation assessment. AM Best expects that industry leaders of innovation will have the sponsorship of top management and support throughout the organization—including board participation. Companies that successfully innovate typically benefit from buy-in at the senior management level, evidence of which can be found when the concept of innovation dovetails with the corporate mission statement. Encouraging new ideas, fostering productive organizational evolution, and backing innovation with strategic actions are among the hallmarks of management at an innovative organization. Good leadership should have a strategy communicated to employees that says: what are we doing and why are we doing it. Good leadership is supportive of a mindset that supports cross-functional collaboration to identify, develop, and implement new innovative ideas. The clear enumeration of goals by leadership is essential, so that all parts of the organization understand what the result should be. By embracing and fostering a culture of innovation, leadership can generate a high level of interest/buy-in, so that all employees are empowered to be change agents.

Like leadership, culture can either stimulate or suppress innovation. Organizational cultures that inspire innovation allow for risk-taking as well as the possibility of failure. Companies receiving the most positive assessment approach the innovation process purposefully and systematically, and can demonstrate that their innovation initiatives are integrated throughout the organization. The culture of these companies fosters ownership and transparency, while also encouraging cross-functional knowledge-sharing, recognizing that innovation flourishes in a diverse environment. For these companies, innovation is part of the enterprise mission statement and is embraced as a key element for long-term success. Mr. Irwin stated that this is an example of where A.M. Best took into consideration some of the comments received as there was some interpretation that this should be incorporated in the corporate mission-statement but that was not the intention so that clarification was helpful and will be mentioned in the next draft. Tolerance for risk-taking is well defined, with failure an acceptable option but with a process in place to kill ineffective innovation ideas after an appropriate and timely review. There is openness to both internal and external innovative solutions as part of a regular assessment of customer needs, market conditions, and internal/external threats to the business model.

The resources critical to a company's innovation strategy can generally be divided into one of three categories: technical, creative, and financial. It is important for a company to take stock of the resources it has internally and then decide whether to focus

internally or partner with third parties – the decision could be a mix of both strategies. Technical resources include systems and data allocation, with an eye towards the potential for harnessing new technological breakthroughs. Creative oversight encompasses not just the generation of ideas to develop new, practicable solutions, but also ensuring that the right people are assigned to the project. Thus, hiring practices that focus on a diversity of experience and backgrounds, as well as the ability to attract and retain high-level talent, are key. Finally, financial resources should focus on the appropriate allocation of budgetary resources: Is the process properly funded? Can the idea be monetized or implemented so that it results in improvement or growth in the top/bottom lines? Additionally, the financial process should include rewarding the organization's innovators. As a result, expenses may be temporarily elevated owing to innovation investments. AM Best expects that these expenses will be explained to the analytical team as part of the normal rating process. AM Best also expects that companies will be able to provide detailed analyses of the return on investment for their innovation initiatives. Partnering with, or purchasing solutions from, external providers is also incorporated into the Resources sub-component. Mr. Irwin stated that some questions typically asked by the company are: are we organized for speed and innovation?; do we need more people?; do we need more skills?; is agile development using small teams part of the overall resource allocation?

The organizations that optimize processes and structure promote organizational intelligence while avoiding innovation silos. Without a proper process and structure in place, implementing innovation process and initiatives will be difficult. Elements of an innovation program that may be evaluated include the company's data management, innovation strategy, and governance processes. Proper data management is a building block for a successful innovation strategy, as good data is fundamental for innovation to succeed. Proper data management includes data governance that is well defined and clearly delineates (1) the parameters for the organization's investment for data initiatives; (2) the prioritization of these investments; (3) data standardization policies/procedures; and (4) the responsibility for data quality, data stewardship, and data ownership. Access to data and transparency are embraced as corporate-wide objectives. Effective data management processes and structure will ultimately lead to better innovation outputs. Mr. Irwin stated that some typical questions that might be asked are: do we have the right processes in place to drive speed, agility and innovation?; are we managing our data well?; will governance help us?

The Innovation Output Score is based on two components: (1) results and (2) level of transformation. The formula for the output score is 2X the sum of the results + the transformation score. Ultimately, innovation needs to lead to measurable results to make the investment of resources worthwhile. Companies that invest significantly in innovation infrastructure (systems, talent, and processes) but derive no tangible benefit will score poorly on this sub-assessment – so companies may score well with input but measurable output is where the rubber hits the road. The innovation output can include results such as a lower expense ratio; higher revenue growth; more robust, customer-centric, data-driven product design; better customer retention; greater brand recognition; or stronger data analytics. Companies can sustain the competitive edge they gain from innovation only by continual evolution of their innovation strategies and initiatives. Therefore, companies receiving the highest scores in this sub-assessment will demonstrate: a well-balanced mix of operational and growth-oriented innovation; the ability to respond quickly to both internal and external pressures; and an implementation strategy that appropriately balances short and long-term initiatives—for example, by

encompassing a mixture of incremental and disruptive innovations with various time horizons

Regarding the level of transformation, a company's innovation initiatives may be fruitful but may not be transformative or even allow the company to remain relevant or competitive. For example, a company may switch from manual policy filings to digitized storage. Although this process would result in lower expense ratios and would therefore have a positive impact on the results sub-assessment, the level of transformation involved is rather low relative to the industry and leaders outside the insurance industry. The transformation score would therefore be low. Only those companies with best-in-class output will be eligible for a higher transformation sub-assessment. Transformation does not encompass splashy initiatives that do not create value; rather, it encompasses initiatives that create value, improve customer engagement and experience, lead to a superior business model, or significantly enhance growth opportunities. AM Best translates its innovation scores into five assessment categories: Non-innovator; Reactor; Adopter; Innovator; and Innovation Leader.

Mr. Irwin stated that the building blocks outline the process drive for credit rating. The starting point is the evaluation of balance sheet strength to develop a baseline and the rating analyst will then review the other building blocks, either increasing or decreasing from the baseline assessment, and as currently considered the innovation assessment will be captured within the business profile building block. Mr. Irwin stated that the official comment period for this criteria ended on May 13 and AM Best is still going through the comments submitted. The comments have been generally supportive of the initiative while some have asked for clarification of certain aspects of it. AM Best takes into consideration all comments received.

Mr. Irwin stated that AM Best will explicitly consider whether company's innovation efforts or lack thereof have had a demonstrable positive or negative impact on its long term financial strength within its business profile building block. To be clear, AM Best is not endorsing investment in InsurTech for all companies – the goal is really to provide a framework for understanding the role of innovation in the organization and providing a roadmap for discussion with companies. While a formal assessment is being created, it does not change the weight innovation is given in the rating process. It is important to note that the innovation score is not necessarily correlated with an insurer's credit rating. There may instances where lower rated companies may actually have a high innovation score and higher rated companies have a low innovation score. This means that there is an absolute assessment of the innovation score itself but the relative impact on the rating is different. The innovation score does not automatically translate into a rating positive or negative as AM Best must also assess whether innovativeness provides any enhancement or reduction in the company's long term financial strength.

Mr. Irwin closed by stating that no rating changes are expected at the time the criteria is finalized and in use. AM Best is evaluating the timeline of disclosure of innovation assessments and at this time is leaning towards publishing the assessments over time in a measured approach.

Erin Collins, Asst. VP of State Affairs at the National Association of Mutual Insurance Companies (NAMIC), stated that NAMIC shares AM Best's interests of innovation and adaptability. The good news is that the insurance industry is pretty good at that already. NAMIC has 1,400 member companies and of those, 80% have been in operation over

100 years. 10% of NAMIC's members been in operation for over 150 years. To have that longevity, it is imperative to be adaptable and adaptability and innovation are in a way synonyms. The insurance industry is natural incentivized to adapt to changes not only in the world but to expectations of policyholders and future policyholders. NAMIC does have significant concerns with AM Best's proposal.

Innovation can mean a lot of things such as new products, or innovations to back office systems, platforms, or anti-fraud measures. Innovation is a moving target and is a balance to weigh in everything that insurers do, something they have done very well for a long time and will continue to do. The easiest way to try and capture that success of adaptability and change is to try and look at the outputs. In the rating methodology there already is methodology to measure those outputs – the things that are clear and not nebulous such as the enterprise risk management (ERM) or the operational success.

Ms. Collins stated that NAMIC believes that having a separate factor like this as opposed to the clear-cut factors of ERM or other building blocks, may upset ERM and may create inappropriate market pressure towards innovation for just the sake of innovation as opposed to the concerted approach that companies take now to how best serve its policyholders and that is the mission insurance companies. Moving forward, NAMIC believes that the best way to foster innovation is to ensure that companies have the free market space to naturally innovate and that success can be measured in the easier, more finite methodologies mentioned.

Sen. Hackett stated that many here have been in the industry for a long time and it seems that rating companies are moving towards the speculative side of things. In the past, numbers were the numbers. Sen. Hackett asked Mr. Irwin if he agreed with his comment. Mr. Irwin stated that he would not characterize the draft innovation rating criteria as speculative. The process of innovation is part of the ongoing dialogue that AM Best has with companies and innovation is one component of the business profile assessment. There are a number of other components in the business profile assessment. AM Best recognizes that there are changes going on in the industry. The framework set forth in the draft criteria provides companies some transparency in how AM Best likes to conduct the dialogue.

In response to Ms. Collins' comments, Mr. Irwin stated that AM Best supports the longevity and thought leadership of the insurance industry and part of the process of the draft criteria is to highlight the importance of innovation going forward. AM Best is certainly not saying that the insurance industry is not innovating, but it is seeing that the pace of change is accelerating and felt that it was appropriate to highlight it as part of its thought leadership to the industry, similar to the process that went on with ERM a number of years ago and that is incorporated into the building blocks.

Rep. Matt Lehman (IN), NCOIL Vice President, followed up on Sen. Hackett's question and asked if the rating criteria is speculative and if it will impact a company's credit rating. Rep. Lehman noted that the general public essentially cares only whether the company will pay claims appropriately and, as an agent, part of placing clients with companies is looking at its financial strength rating. Accordingly, will that rating now be clouded with things that are speculative? Mr. Irwin first stated that AM Best does not anticipate any rating changes at this point in time. Also, the criteria is absolute but its impact on the rating is relative as a company's level of focus on innovation may vary but need and geography, for example a company in Asia that is very technology driven and

focused on customer engagement vs. a small company focused on funeral distribution that might not need to focus on innovation. The focus is really on whether the focus, or lack thereof, on innovation is going to erode the company's competitive position over time.

Rep. George Keiser (ND) stated that during the presentation he was wondering what the value is of a third party rating innovation when that is really the function of the marketplace. A rating may be developed that has no correlation to what the market does in terms of innovative value. Accordingly, Rep. Keiser asked why this rating criteria is needed. Rep. Keiser also stated that he has a fear that if companies wish to score high on the rating criteria, even the innovative companies will start to "teach to the test" or will in effect look at the criteria and leave the potential to be innovative just so they can get a high score which is the opposite of what we want to happen in the industry.

Mr. Irwin noted that there is no specific innovation rating but rather it is part of the building block business profile. Rep. Keiser asked why that is necessary and why not let that market determine it. Mr. Irwin reiterated that the criteria is absolute but its impact on the rating is relative as a company's level of focus on innovation may vary by need – the criteria is really just a framework for companies to use. Regarding Rep. Keiser's "teach to the test" comment, Mr. Irwin noted that relates to this comments earlier regarding publishing the innovation assessments and AM Best's thought at this time is to take a measured position by initially discussing it with companies rather than publicly disclosing it. Rep. Keiser asked Mr. Irwin if he understood that if there is an innovation that he should be using and is not, he will lose market share so he does not need someone to score it. Mr. Irwin stated that is why this is in the business profile building block because the company would be losing market share and distribution breadth.

Sen. Hackett asked if this criteria is being introduced in part because of AM Best looking back at certain ratings it gave and wishing it had done things differently. Mr. Irwin stated that AM Best sees things moving more quickly as they were previously and noted the survey results he discussed earlier - AM Best is reacting to that.

Asm. Ken Cooley (CA), NCOIL Treasurer, stated that this is an interesting topic and when you look at the health side of things, long term care insurance was trying to be innovative but is now dealing with rating problems. In southern California there was Twentieth Century Auto which in the 1980s went into the homeowners market and started writing earthquake coverage as a part of that and following a big earthquake, all of their premium collected in nine years was gone with 15 seconds of shaking. Accordingly, aspects of change can seem to be of value until "life" happens. Asm. Cooley stated that he believes that if there was a productive area for AM Best to focus on it would be how to rate the internal culture of a company - not so much on innovation which is a buzz word that can push people in different directions - as to how they vet ideas. A start up can try to innovate by breaking the law. Also, Asm. Cooley noted that by providing certain insurers with poor innovation ratings, that could result in problems for the industry in attracting younger talent.

Mr. Irwin stated that AM Best is looking at the internal culture of companies in terms of what the process is when vetting new ideas and what is learned during that process. AM Best is certainly not trying to get companies to take more risk without having the proper safeguards in place.

Rep. Bart Rowland (KY), Vice Chair of the Committee, asked if any thought was given to creating a separate rating just for innovation and continue with the financial rating that everyone currently understands. Mr. Irwin stated that there were a number of iterations that the criteria went through but it was ultimately determined that it should be part of the overall rating structure. However, it is still in draft form so the final result could change.

DISCUSSION ON KENTUCKY'S FIRST-IN-THE-NATION INSURTECH REGULATORY SANDBOX

Rep. Rowland stated that the idea of Kentucky being the first state to pass an insurtech regulatory sandbox started last summer at the NCOIL Summer Meeting in Salt Lake City, UT with conversations between him and Greg Mitchell, Esq. of Frost Brown Todd, LLC. Conversations continued afterwards as it was an educational process for Rep. Rowland to learn more and more as to what the legislation would look like and kinds of innovators might be attracted to Kentucky. After several version of the legislation was discussed and debated, it was passed during "short session" overwhelmingly by both chambers and went into effect in late June. Rep. Rowland stated that he believes the bill allows innovates to test their new ideas in Kentucky while not creating unregulated competition between insurance agents and brokers. The bill is transparent and has consumer protections built into it.

Mr. Mitchell stated that he is Chair of the insurance industry group at Frost Brown Todd, LLC and has been involved in the insurance industry for almost 30 years. Mr. Mitchell states that among other things, he defends insurers in market conduct actions and deals with regulators across the country as well as internationally. He has had the fortunate opportunity as well as the angst of trying to innovate over that period of time of things that you would think today are common sense and are known in the market but when you understand the history you understand the difficult that exists in arcane insurance codes. The codes have only been updated in a piecemeal way and they don't contemplate things like cell phone coverage that we all take for granted now. Accordingly, a great deal of time is spent trying to help insurers comply with these arcane codes. Frost Brown Todd is an advocate for compliance but also understands the difficult and in some examples the complete frustration of the lack of common sense of some of the code's provisions that there is not an ability to conform regulations to whatever the subject is that is trying to be regulated.

Whether you want to call it insurance innovation or smart regulation in that you are trying to apply regulation around the innovation or the product so that you are tailoring it specifically to what you are trying to rather than opening up the code and trying to fit a square peg into a round whole which can put insurance executives into a bad situation. Or, as Supt. Cioppa indicated earlier, certain concepts may have been proper 100 years ago and it still in existence but no one really remembers why it is still in the code. Accordingly, the labor of putting the legislation together started with experience of defending companies and developing products.

Mr. Mitchell stated that the legislation was also a way to think about regulation from a different perspective – to allow a company or startup that wants to innovate, to come forward with the concept very clearly and point out the sections of the insurance code that they think will make the concept not work. If exceptions to those sections of the code were granted and the company can still protect the consumer than that is common sense. In working with Rep. Rowland, the insurance department and the administration,

the legislation was developed to provide a framework for companies to beta-test a concept and if it worked properly than a no-action letter will be provided so the company is not worried about the regulator second guessing things or a different administration coming in with a different attitude, or worse – class action lawyers getting involved. Regulatory protection can be provided if there is upfront investment and thoughtful consideration to going about things the proper way and making sure consumers are protected. The legislation is not perfect but it is a starting point and was done with the best intentions of trying to think about insurance regulation from a different perspective.

Patrick O'Connor, Deputy Commissioner of Policy at the Kentucky Department of Insurance, stated that Kentucky has a population of about 4.5 million people and is very geographically diverse. Kentucky's economy is generally known for coal, thoroughbred horse racing, and bourbon. However, the economy is expanding and evolving and since 2016 nearly 40,000 new manufacturing, service and technology jobs have located in Kentucky, and there has been over \$15 billion dollars in new business investments. That is based on the pro-growth policies that Rep. Rowland and the administration have put forth. Kentucky is expanding and evolving and its economy is ripe for new sector innovation and investment. Accordingly, it was thought that insurance was underseeded in Kentucky and new investment could be attracted by making Kentucky a hotbed for insurance innovation by allowing beta-tests that could bring in new economic dollars and also new options for policyholders that would benefit all of Kentucky.

Mr. O'Connor stated that there were several goals in mind when developing the legislation. One was flexibility – to provide the insurance department with some flexibility to review meritorious innovation and permit its limited use in the marketplace. However, it was important to not sacrifice consumer protection. Accordingly, consumer protection essentially governs the legislation – the application process; the review of the application; the limited no-action letter process; and the beta-process. It was also important to create a dialogue, or at least an opportunity for a dialogue, between the regulators and the industry. Along those same lines it was important to foster a spirit of collaboration among interest parties.

Mr. O'Connor stated that the bill has certainly increased the dialogue and collaboration as he has fielded a number of calls from interested parties looking to take advantage of the legislation and some of the opportunities that may be out there. A lot of good discussions have taken place with some entities which has resulted in the department learning more about the entities and their products with the end result telling them that they actually don't need to utilize the legislation and put fears to bed.

Mr. O'Connor stated that the legislation sets forth a framework by providing the Insurance Commissioner with the statutory authority to waive specific regulatory and/or statutory barriers to permit the use, sale, or licensure of an approved insurance innovation. There is a detailed application process that is reviewed by the Director of Insurance Innovation as designated by the commissioner. The commissioner has broad discretion throughout the entire process and this is part of the bill that did undergo substantial changes. Consumer protection is the main priority, including a terms and conditions letter that sets forth the requirements for a beta test to adhere to and if it does not it gets terminated. Some statutes also specifically cannot be waived such as those related to taxes, investments, licensure, and guaranty funds. There is also an early termination and civil penalty provision so if somebody goes outside the guardrails set forth in the terms and conditions letter the Commissioner has the authority to shut it

down and issue a penalty. Additionally, the bill requires legislative oversight as there are specific reporting requirements for the department of insurance to update the legislature on any applications received and granted and how the process worked and overall statistics to see what has been successful and what has not. The legislation also provides the opportunity to make recommendations as to possible statutory changes as it was important to use the process as not only to allow for innovation and to allow Kentuckians to benefit from new products but also as a vehicle for change. So if the department sees an innovative product that is subject to a statutory or regulatory barrier, the department can report to the legislature that certain changes to the code should be made for the specific reasons.

Mr. O'Connor then noted the application process section of the legislation which basically reads like a checklist. At this point there is no formal application on the department's website but that may be done in the future. Some important requirements of the application include: a detailed explanation of the innovation and how it adds value and doesn't pose an unreasonable risk of consumer harm; applicable licensed that or held or will be held before the innovation goes live; specific citation to the regulatory/statutory barriers; and disclosure of financial security – the calls for a minimum of \$25,000 but the Commissioner has the discretion to increase or decrease that amount and it can be satisfied in a number of different ways such as cash, bonds or a contractual liability insurance policy. The application can be submitted hard copy, hand delivery, and electronically - which is in progress of being developed on the department's website.

With regard to the application review process, Mr. O'Connor stated that the department has the authority to request more information and it is anticipated that the entire application process will be interactive in nature. The legislation calls for a 60 day initial timeframe plus a 30 day extension with a deemed approved stipulation at the end of 90 days if there is no decision made. The Commissioner then may issue a notice of acceptance or rejection to the applicant. Some other important noteworthy provisions of the legislation include the terms and conditions letter which is going to be the safeguard for the beta test – it will have all of the consumer protections in it and govern the whole process. At that point, a limited no-action letter (LNAL) could be issued which provides the initial safe-harbor and is good for a one year period. At the end of the one year period, an applicant may apply for another year. The LNAL and beta test can be terminated if complaints arise. An extended no-action letter (ENAL) comes at the end of an LNAL – if the reporting shows that it was successful and worthy for consumers then it can be issued and is posted on the website for other companies to use who are looking to engage in a similar process. The ENAL has a three year maximum period.

Mr. O'Connor noted that the system has been set up so that at the end of the ENAL it is essentially a five year process for the safe harbor to apply. If the legislature does not act at the end of that five year period to amend the statutory barriers that have been cited in the applications, then the safe harbor would cease to exist and everyone would have to comply with the code as it exists. Mr. O'Connor stated that the bill strikes a good balance of maintaining legislative oversight so that the legislature can review and make any necessary changes to any statutes, while still allowing the safe harbors to apply for as much as five years. Mr. O'Connor stated that the department is currently accepting applications and there has been a lot of interest thus far. Mr. O'Connor noted that any questions can be directed to him or his colleague, John Melvin, as they are splitting the duties of the Director of Insurance Innovation for the time being.

Wes Bissett, Senior Counsel of Gov't Affairs at the Independent Insurance Agents & Brokers of America (IIABA) stated that he appreciates the opportunity to talk about this Kentucky legislation as well as similar legislation that was recently enacted in Vermont. This is a fairly unique and novel approach to policymaking. The core element of the proposal is legislators giving their Commissioner the unique ability to waive requirements that legislators enacted into law for certain competitors in the marketplace. It is an approach to policymaking that requires a balancing act and the Kentucky legislation enacted, thanks to Rep. Rowland, is a much better product than its original version.

Mr. Bissett stated that this is challenging as the things that the Commissioner is not going to be able to do are typically the kind of policymaking that legislators do – determining what statutory requirements apply to particular competitors. There are obviously marketplace fairness issues. If you are a competitor and you have an exemption from a statutory requirement that is great but if your competitors are still subject to it they may feel differently. Mr. Bissett noted that IIABA and some insurers were troubled by some of the provisions in earlier versions of the legislation but significant improvements were made. There was a provision that would have given a company that submitted an application essentially a monopoly on that service as others would not have been able to come into the marketplace and offer it – that provision was taken out. There was also a provision that would have required the use of a Kentucky-based regulatory compliance law firm which was taken. There is some irony about hiring a regulatory attorney to help you submit an application to get exempt from a regulatory requirement.

Mr. Bissett noted that one thing that Vermont address that Kentucky did not was the ability of outside interested parties to comment on an application. The only voices that the Kentucky insurance department will hear from when an application for a waiver is submitted is from the party submitting the application. Mr. Bissett stated that IIABA hopes that provision will be added in to the Kentucky process as you can imagine there are facts and situations that will not be brought to the department's attention that others can bring to the table. Mr. Bissett stated that IIABA looks forward to seeing how this process rolls out in Kentucky and thanked Rep. Rowland again for his leadership in making several improvements to the legislation.

Rep. Rowland thanked Mr. Bissett and everyone involved for working hard to improve the legislation and get it passed in such a short timeframe during "short session."

RE-ADOPTION OF INSURANCE FRAUD MODEL ACT

Sen. Jason Rapert (AR), NCOIL Immediate Past President, stated that insurance fraud is a very serious problem that everyone faces in their respective states. Sen. Rapert stated that he greatly respects the work that the Coalition Against Insurance Fraud (Coalition) does to help states combat insurance fraud. In fact, Sen. Rapert noted that he spoke at a recent Coalition meeting on one of his favorite issues – the business practice of Pharmacy Benefit Managers – and it was a very productive discussion. Sen. Rapert stated that a few years ago, he also sponsored the NCOIL Storm Chaser Model Law which protects consumers from contractors who would travel around following the night of the storm, offer to fix a home or structure, receive a down payment, and never return to finish the job. Sen. Rapert stated that he continues to make efforts to fight insurance fraud in his home state of Arkansas, and urged everyone to do the same in

order to make sure consumers are properly protected. Accordingly, Sen. Rapert stated that he supports the changes to this Model and then turned it over to Matthew Smith, Director of Gov't Affairs & General Counsel at the Coalition.

Mr. Smith stated that the Coalition was formed in 1993 and one of its initial charges was to develop what was then the first-in-the-nation model act on anti-insurance fraud efforts. That model initially rolled out in 1995 and in 1998 it was amended by the Coalition and that is when NCOIL adopted it. From 1998 to today, the model has been adopted either in whole or in part in 28 different states. Proving the test of time, for 20 years the model went un-updated. A few things happened during that time like the internet and the movement towards international fraud and multi-ring fraud. Accordingly, in 2018 - the Coalition's 25th anniversary – the Coalition established a select committee to update the model which included NCOIL General Counsel, Will Melofchik. The model that is before the Committee today was adopted by the Coalition during its mid-year meeting last month.

Mr. Smith then noted some of the highlights and improvements to the updated model. The model provides increased authority for prosecutors; streamlines the proof of intent to defraud and how the intent to defraud is identified; and eliminates multiple-proof requirements in many areas so it allows for greater prosecution. Mr. Smith further noted that as the move towards international and multi-ring fraud accelerates the model allows for evidence of multi-state operations or fraud committed in another state to be used in the prosecution of insurance fraud in another state. The model also calls for – depending on individual state laws and federal bankruptcy laws – orders of restitution against people who commit fraud to be non-dischargeable in bankruptcy so that they cannot escape the restitution order.

Further, the model allows in civil actions the recovery of attorney's fees, and on the insurance carrier side, the model allows for the rise of the independent contractor's outsourcing third party's that insurance companies are using to both protect those individuals under provisions of the model and if they are the ones committing fraud, the model allows them to be held liable. The model now includes fraud in-the-part vs. fraud in-the-whole meaning that under the prior version of the model the entire claim or act had to be fraudulent before the model applied. Now, if only a portion of the claim or act such as medical billing is fraudulent, the model applies. Also, there have been a lot of changes in the past 20 years with regard to medical services, so now terms such as healing arts and pharmacology are included in the model.

Mr. Smith stated that the Coalition feels that the model is a very strong, pro-consumer advocacy model law and urged the Committee members to adopt it in their states.

Upon a Motion made by Rep. Keiser and seconded by Rep. Carbaugh, the Committee voted without objection to adopt the amendments by way of a voice vote. Upon another Motion by Rep. Keiser and seconded by Rep. Carbaugh, the Committee voted without objection to re-adopt the model as amended by way of a voice vote.

ADJOURNMENT

There being no further business, the Committee adjourned at 10:45 a.m.