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James C. Creal

Department of Insurance, Commonwealth of Kentucky

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KENTUCKY'S NEW INSURANCE CODE

By JAMES C. CREAL*

Introduction

The new Kentucky Insurance Code enacted by the 1950 Session of the Kentucky Legislature was motivated by a number of factors. The existing insurance laws had been in effect for a number of years with the result that numerous amendments enacted to cover particular situations had been adopted without reference to their effect on other related provisions, causing numerous inconsistencies, lack of a coherent body of law, and a number of ineffective provisions.

The old law attempted to treat each type of business organization employed by insurers in a separate category, resulting in many repetitions and a number of unnecessary or unjustifiable distinctions and discriminations.

Tendencies in the field of insurance regulation toward uniformity in the laws of the various states, and certain weaknesses in the old law indicated the desirability of certain additions to the Code.

A number of sections were necessitated by the impact of the *Southeastern Underwriters case*,¹ which held that insurance was commerce, followed by Public Law 15 of the 79th Congress,² in which Congress declared that the continued regulation by the states of the insurance business would be considered in the public interest, but made it incumbent upon the states to enact certain laws bridging the gap between federal and state regulation, if they were to preserve their present status. Following this Act, committees from the Industry and the NAIC (National Association of Insurance Commissioners) worked out a number of bills which were calculated to allow continued state supervision. These have been adopted in substantial form in the new code.

The Insurance Code (House Bill 116) repealed Chapters 296, 297, 298, 301, and 303 of the Kentucky Revised Statutes, which embraced all insurance regulatory law in force in the state, with the exception of those chapters dealing with certain special types of organizations. Such of the old law as was deemed still useful was reorganized and

* General Counsel, Department of Insurance, Commonwealth of Kentucky, Frankfort, Kentucky. A.B., Centre College; LL.B., University of Louisville.

¹ United States v. Southeastern Underwriters Ass'n., 322 U.S. 533 (1944).
² 59 Stat. 33 (1945), 15 U.S.C. secs. 1011-1015 (Supp.), amended 59 Stat. 34 (1945), 15 U.S.C. sec. 1013 (b) (Supp.), amended 60 Stat. 238 (1947). This Act is popularly known as the McCarran Act.

integrated into Chapter 304, constituting the "Kentucky Insurance Code." In this chapter an effort was made, wherever possible, to enact single provisions which would cover all types of companies and insurance coverages.

The Code has been broken down into 30 chapter subheads, the important provisions of which will be treated here in sequence, individually where necessary

Scope of Code

The Code prohibits any person from transacting a business of insurance in the state without compliance with the Code, and defines the words "person", "insurance", and "insurer" in their broadest terms. Hospital Service Corporations, Medical Service Corporations, Burial Associations, Fraternal Benefit Societies, and domestic assessment and cooperative insurers are excluded from the provisions of the Code. Their special nature and historical exemptions are still recognized in the respective chapters governing their operations, which were not repealed.

The right to use existing insurance documents, forms and rates which may not be proper under the new Code is preserved for a period of one year from September 1, 1950, the effective date of the Code.

Insurance Commissioner

A "Department of Insurance" headed by a "Commissioner" was restored, to succeed the Division of Insurance of the Department of Business Regulation. The Commissioner has the usual rule-making power common to administrative bodies, authority to conduct examinations of companies, agents, managers, and promoters engaged in the insurance business whenever he deems it prudent, and a duty to examine domestic companies at least once every four years. He may conduct hearings, subpoena witnesses, administer oaths and take depositions.

Ample protection is provided against illegal or arbitrary action by the Commissioner, through the guarantee of procedural safeguards, including the right of a party to demand formal rules of evidence if desired at hearings, and the right to appeal to Franklin Circuit Court where additional evidence may be offered.

Authorization of Insurers and General Requirements

Substantial increases have been made in the financial requirements necessary to transact business in the state. Under the present law the

financial requirements for all types of insurers—stock, mutual,³ reciprocal, or Lloyd's Plan—are the same, requiring capital for stock companies, or surplus for other types of insurers, in a specified amount depending on the types of insurance to be written. The basic requirements are \$100,000.00 for life insurers, \$100,000.00 for property insurers, and \$200,000.00 for casualty insurers, with increased requirements on a graduated scale for powers to write various combinations of kinds of insurance, running up to \$450,000.00 for all property, casualty, and surety lines. These financial requirements are set forth in tabular form in Section 304.071 and 304.073.

In addition, newly formed domestic insurers, or foreign insurers less than 5 years old, must have surplus funds not less than 50% more than the capital or surplus otherwise required for the kinds of business proposed to be transacted.

Alien insurers must, in addition to complying with the general financial requirements met by other insurers, maintain a deposit equal to the amount of capital or surplus required for the kinds of business to be transacted; except that such deposit shall be for the benefit of all the insurer's policyholders and creditors in the United States.

Insurers existing and licensed in this state as of January 1, 1950, may continue to be licensed without meeting the increased financial requirements, but if they desire to broaden their insuring powers they must meet the new standards.

Revocation or suspension of an insurer's license may be made under the new law if it "Usually compels claimants under policies to accept less than the amount due them or to bring suit to secure full payment thereof," or "fails to pay or satisfy any final judgment rendered against it in this state upon any policy within 60 days" in addition to the usual grounds such as failure to comply with the code, hazardous financial conditions, etc. Before suspending an insurer's license 10 days notice must be given.

Business is still required to be placed through local agents, and policies countersigned by them with certain exceptions, such as marine coverages and business written by direct writing mutual and reciprocals.

The usual type of retaliatory provisions have been included, providing that when any taxes, fees, prohibitions or requirements greater than those in Kentucky are imposed upon Kentucky companies doing business in another state the same may be imposed upon companies domiciled in that state doing business here.

³ Domestic mutual insurers may also be authorized on an application and premium basis as outlined in KRS 304.150 to 304.194, discussed later in this article.

Domestic Stock Insurer

This part of the Code outlines the method of organization of a domestic stock company. It requires 5 or more natural persons, over 21 years of age to incorporate, approval of the articles by both the Attorney General and the Commissioner before filing with the Secretary of State, and a compliance with KRS Chapter 292, "The Blue Sky Law," before they may be granted authority to do business. At least three-fourths of the directors must be United States citizens, and a majority of them residents of Kentucky.

The terms on which a stock company may issue participating (or dividend paying) policies are provided, and a means of conversion from a stock to a mutual company is outlined.

Domestic Mutual Insurers

These sections deal only with "cash premium mutuals," which charge and collect in advance a cash premium adequate to maintain full legal reserves and meet obligations and liabilities without additional calls upon their members.

The manner and method of forming a mutual insurer is detailed here. Such companies may be formed in one of two ways. They may be organized with surplus funds equal in amount to that required of a stock insurer doing the same class of business; or they may be formed with a lesser surplus, usually one-half the amount required for similar stock insurers, after receiving a specified number of applications for policies with premiums collected therefor.

Before any money can be collected from the public in organizing a mutual company, the promoters must file their plans, sales literature, policy forms, etc., for the commissioner's approval, who may require that all funds collected be placed in escrow until organization is completed.

All policyholders must be members of the company, and have the same general character of rights that a stockholder has in a stock company.

All members are subject to a contingent liability within stated amounts for the discharge of the obligations of the company. This contingent liability may, however, be extinguished, and non-assessable policies issued, if the company establishes a surplus not less in amount than the paid-in capital stock required of a domestic stock insurer transacting the same kinds of business.

In the event of liquidation its assets are distributed to all who were

members during the last 3 years, their distributive share being based upon the amount of premiums paid in.

Reciprocal Insurers

This is one of the most complete insurance code chapters on the subject of reciprocal insurers in existence. It governs the formation of domestic reciprocals and the inter-organization relationships of all reciprocals, whether foreign or domestic. Most of this article is new to Kentucky law, though substantially all of the article is to be found in modern insurance codes of some other states. The article provides ample protection for, and declaration of rights of, persons who become insured in reciprocal insurers.

Lloyd's Plan Insurers

A very short section is devoted to the method of organization of Lloyd's Plan Underwriters. It is required that there shall be not less than 25 members of the syndicate and each underwriter must be worth in his own right not less than \$20,000.00.

Such groups of underwriters are required to meet the same financial requirements for transacting various types of business as are required for stock, mutual, or reciprocal insurers.

* * * *

The four preceding subheads outlined briefly methods of organization and matters particular to the type of organization involved. The rest of the code applies generally to all types of organizations engaged in the business of insurance.

Kinds of Insurance; Reinsurance; Limits of Risk

The sections under this subhead define the various kinds of insurance and contain a few innovations.

The large field of "property insurance" is defined as insurance against loss of or damage to real or personal property of every kind and interest therein and is for any or all hazard or cause and against loss consequential upon such loss or damage. The property insurance industry embraces the entire field of fire, inland marine, and allied lines of insurance as they are generally known, and includes also more extensive coverages than were heretofore delegated to the fire insurance field.

Casualty insurance as defined includes all of the well known liability and miscellaneous coverages customarily considered a part

of the casualty field, except that surety insurance has been set up in a separate class apart from the general casualty definition, as is done in a number of other states.

A copy of reinsurance treaties and contracts must be filed with and approved by the Commissioner on his request. Generally speaking, no insurer is allowed to retain, after reduction of reinsurance, any risk in an amount exceeding 10% of its surplus to policyholders.

Assets and Liabilities

Most of this section is new to Kentucky with the exception of the Standard Valuation Law for life policies in effect in most states and the computation of certain reserve liabilities.

More specific rules for unearned premium and loss reserve computations have been set forth in the new code and are informational as well as directory.

The law in effect in most states as regards the acceptance of certain assets as admitted for purposes of determining solvency has been adopted. While not the law in Kentucky previously, these same rules have been in general use for a number of years through the practice of National Association of Insurance Commissioners convention principles in examinations and the use of National Association of Insurance Commissioners convention forms for annual statements.

Such items as good will, trade names and other like intangible assets, furniture, fixtures, equipment, vehicles, advance to officers or directors on personal security only, and other like items are not considered as an asset in determining the insurer's condition. Certain rules are set forth in the statute for the valuation of various securities held by insurers.

Credit for reinsurance is not allowed unless the reinsurance company is authorized to do business in some state of the United States and has not been disapproved for such purposes by the commissioner.

Investments

This section prescribes the type of investments in which domestic insurers may invest their funds. These provisions follow rather closely those in force in this state for a number of years and are relatively conservative.

Generally speaking, investments in United States, state, Canadian, county, municipal and school obligations, public improvement bonds, public utility and railroad securities, certain corporate bonds, bank and preferred stocks, securities of the International Bank and of Federal

agencies, first mortgage loans and certain types of collateral loans are permitted.⁴

Deposit of Insurers

These sections provide for and set up the maintenance of the office of a custodian of insurance securities. The expense of this office and the salary of the custodian are paid by the assessments made against the companies required to maintain deposits with the custodian, prorated on the average annual amount of deposit.

Deposits may be in securities in which the insurer may legally invest its funds, in title to unencumbered real estate, or in legal money of the United States.

Agents, Solicitors and Adjusters

A large portion of this section of the insurance code is new to Kentucky but is gaining rather wide acceptance nation-wide and substantial portions of this law are based upon so-called model bills worked out by the Agents associations and the National Association of Insurance Commissioners.

For the first time in Kentucky history, agents, solicitors and adjusters are required to pass a qualifying examination given by the Department of Insurance before being licensed to transact business.

Agents other than life who have been licensed within the last 5 years, and life agents who have been licensed within the last 2 years, may be licensed without examination.

Adjusters are licensed for the first time and divided into two categories: independent adjusters who represent insurers, and public adjusters who represent insureds. An apprentice adjuster may, upon registration with the Insurance Department, work for a period of one year under the supervision of a licensed adjuster before taking the qualifying examination. A company's salaried employees, and attorneys at law who merely make incidental adjustments in connection with their law practice are not required to be licensed.

⁴With the exception of United States, state, and Canadian securities, an insurer may not have over 4% of its assets invested in any one person, corporation or institution. No insurers may have at any one time over 5% of the outstanding voting stock of any corporation.

With the approval of the commissioner the insurer may invest not over 10% of its assets in real property for the use of its home and branch offices. Any investment held by an insurer prior to September 1, 1950, if legal when made, shall be deemed legal under the new code.

Foreign or alien insurers transacting business in this state must have assets of the same general character as those specified for domestic insurers, except that investments authorized by the laws of the state of the insurer's domicile may be recognized in the discretion of the commissioner.

The Commissioner may from time to time, by regulation, prescribe reasonable groupings of the kind or kinds of insurance for which an apprentice may qualify and be licensed.

The term "solicitor" while widely used in insurance parlance in Kentucky, has never before been provided for by law. Previously, so-called solicitors who work for agents were required to be licensed in the various companies which the agent represented. This practice may still be continued, but in addition the agency and companies have the choice of having the man licensed to represent the agency for all purposes and only one license need be secured. The solicitor, however, may represent only one agency and has no authority to bind any risk.

Partnerships or corporations may hold agency contracts, but the individual members who transact business in behalf of the agency must be individually licensed.

A new provision in the law is the so-called "controlled business" section which is calculated to prevent a person from securing a license merely to write his own business, that of his family, and immediate business associates, which in effect would permit him to procure insurance at a lower cost.

Agents other than life, or health and accident, must be residents of this state. Non-resident agents may be licensed but are not permitted to enter the state to transact business and may only write insurance on property located in Kentucky owned by non-residents of Kentucky. The non-resident agent must designate the commissioner as agent for the service of process.

Temporary licenses without passing a qualifying examination may be issued to agents servicing an industrial orbit to the executor, administrator, or next of kin, of an agent licensed at the time of his death, and to applicants for license other than life or disability, pending their examination, if the commissioner deems it advisable. Temporary licenses expire within 90 days, but may, for good cause, be renewed for an additional 90 days. A limited license without examination may be granted to persons selling only travel ticket policies. The usual provisions for denial, suspension or revocation of an agent's license after a proper hearing are found in this section.

Unauthorized Insurers

The first part of this section is patterned after another of the "Model Bills" approved by the NAIC, and is directed against non-admitted companies, usually soliciting by mail.

There is a reciprocal provision prohibiting a domestic company from doing business in any state in which it is not admitted, providing such other state has a similar law, and a general provision which states that any policy effectuated in this state by an unauthorized company shall be deemed to constitute the commissioner its agent for service of process, permitting Kentucky courts to take jurisdiction of any case against such company. Before answering any such suit, the unauthorized company must deposit a bond with the court in an amount sufficient to satisfy any judgment granted.

If the court finds that an insurer's refusal to pay its contract obligation was vexatious and without cause, the court may allow an attorney's fee, not to exceed 12½% of the judgment. Failure to defend any such action is deemed to be prima facie evidence that its failure to pay was vexatious and without reasonable cause.

The remainder of this section permits the licensing of "surplus line brokers," who may be licensed to procure insurance in unauthorized companies, where such insurance cannot be procured, or in sufficient amounts from authorized insurers. Some business must be placed in solvent insurers having a surplus to policyholders of not less than \$200,000. The broker must file an annual report and pay a tax of 4% on all such premiums collected.

Rates of Fire, Marine, Casualty and Surety Insurers

This is the so-called "All Industry Bill" drafted by the Industry and the NAIC as one of the first efforts to meet the federal challenge to state regulation, and is calculated to permit concerted action in rate making. It provides, in effect, that all fire, marine, casualty, and surety rates, with certain specified exceptions must be filed with and approved by the Commissioner, and if requested, supporting data and statistical information to prove the rate must be filed. The Commissioner may disapprove any rate which he finds to be excessive, inadequate, or discriminatory.

This act further provides for the licensing and regulation of rating organizations, who may file rates and statistical data on behalf of member or subscriber companies. Such members or subscribers may, however, file a deviation from the rate filed by the rate bureau, by justifying the deviation to the Commissioner.

The Insurance Contract

A number of provisions new to Kentucky, but in use in other states have been adopted:

(1) The Commissioner may disapprove the use of any policy not in compliance with applicable provisions of the law, or which is ambiguous, misleading, deceptive, or any part of which is illegible.

(2) Definitions of "insurable interest," what must be included in policies and premiums, and certain rules relating to execution and delivery of policies are covered.

(3) The usual rules relating to use of the application as evidence and the effect of warranties and misrepresentations are stated.

(4) No provision of the insurer's policy or by-laws may be made a part of the contract unless set forth in full in the policy.

(5) Certain benefits are conferred upon minors in contracting for life or disability insurance.

(6) No policy issued in this state may include any condition requiring the contract to be governed by the laws of any other state, or depriving the courts of this state of jurisdiction.

(7) Companies are required to furnish forms for proof of loss upon request, and claim administrative acts are not considered as a waiver of any policy provision.

(8) Purchasers of financed cars must be furnished with written details as to coverage, and if liability insurance is not afforded, such fact must be stamped in bold type on the certificate.

Disability Insurance

Uniform "Standard Provisions" for Health and Accident Policies approved by the NAIC have been enacted. These consist of 15 "Standard Provisions" which must be included in all such policies, and 5 optional standard provisions which may be included and are calculated to insure a minimum floor level of quality to the policyholder. The Commissioner may authorize a variation from the standard provisions if he finds that the substitute is as favorable to the insured, or that a particular provision is unessential for the type of policy issued.

Certain standard provisions and safeguards to group disability policyholders, new to Kentucky, but in use in many other states, were adopted.

Life Insurance and Annuities

A number of standard provisions required by statute in many states, and appearing in many policies now used in Kentucky, were made mandatory in both life and annuity policies. These include provisions covering such matters as grace period, incontestability clauses, effect of misstatement of age, policy loans, reinstatement provisions, etc.

Similar provisions, where applicable, are required for industrial and group life policies. Kentucky has, for the first time, adopted a "group definition", setting forth those groups eligible for such insur-

ance, which includes employee groups, labor union groups, debtor groups and trustee groups, which are the four main categories as approved in most states, and require participation by a specified number and percentage of members of each type of group. In addition, the Kentucky law permits group insurance to public employee associations and agents groups. It is required that each individual insured under the group policy be furnished with a certificate showing the terms of the policy, and be granted the right to convert to some other type of policy upon the termination of the policy, or the policyholder's eligibility

Property Insurance

The old "valued policy law," requiring payment of the face amount of the policy less depreciation since the policy's inception, in the event of a total loss to real property, the right to use a "coinsurance clause" on real property; and the "valued policy law" on livestock, have all been continued.

Surety Insurance

The law now requires that any bond or other undertaking issued by an authorized surety insurer shall be recognized by any court or public official. Costs of court bonds may be included by the court in awarding costs to the party entitled thereto.

Title Insurers

Title insurers must be stock companies and may not transact any other type of insurance. Special financial requirements based upon the population of the county or counties to be served are set up. Certain exemptions from the general investment law are granted to title insurers.

Unfair Practices and Frauds

The Unfair Practices Act constitutes a counterpart of the Federal Trade Commission Powers at a state level. It also was recommended by the NAIC as one of the laws necessary to continue state regulation, and has been adopted in practically all of the states. The Kentucky version is patterned after the Uniform Bill, with some additions.

The Act, in general, prohibits unfair competition; unfair or deceptive practices, boycott, coercion, or intimidation, false or misleading advertising, defamation, rebates, unfair discrimination and illegal inducements to the purchase of insurance. The Kentucky version also prohibits anyone in connection with any loan or sale of property from requiring the borrower or vendee to procure insurance from any par-

ticular company or agent; and the making of any charge for insurance where insurance is not actually afforded by some authorized insurer.

Interlocking ownership or management of companies is permitted unless it substantially lessens competition in the insurance business generally or tends to create a monopoly therein.

Mergers, Rehabilitation and Liquidation

The "Uniform Insurers Liquidation Act" as developed by the American Bar Association, with some additional provisions for efficient and economical administration of the affairs of distressed insurance companies, was enacted. It provides: (1) grounds on which the Commissioner may apply for an order directing him to rehabilitate or liquidate an insurance company; (2) that the Insurance Commissioner is the receiver in the event of liquidation of any domestic insurer, and the ancillary receiver for any foreign insurer operating in Kentucky; and (3) that any claimant in Kentucky may file his claim with the Commissioner an ancillary receiver, or with the domiciliary receiver.

Under the Uniform Insurers Liquidation Act adopted in most states, all policyholders are afforded the same treatment as policyholders in the home state of the defunct company

Penalties

A general penalty is provided for any violation of the code, and specific penalties are provided for infractions of particular sections.

Conclusion

Kentucky, by the enactment of this Code, has assumed a prominent place in the nation in regard to the regulation of insurance. The new insurance code has added many safeguards for policyholders, which they did not have previously