

**‘AFTER THE GOLD RUSH: INSURANCE
REGULATION FOR THE FINTECH
ERA’**

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PLAN OF ACTION...

1. What features of insurance make it require regulation (beyond contract)?
2. What is Fintech?
3. How does this change the features described in (1)?
4. Lessons for R&D in law and regulation...

I. WHAT MAKES INSURANCE = INSURANCE

- J Feinman, 'The Insurance Relationship as Relational Contract and the Fairly Debatable Rule for First-Party Bad Faith' (2009) 46 San Diego L. Rev. 553, 556-559:
 1. Contractual performance often never required, and best outcome for BOTH parties is no loss.
 2. Insurance contracts cannot (do not) capture the process of claims settlement, i.e. performance. Much is implicit.
 3. Many insurance contracts key to wider social structures (liability insurance & tort system; life insurance & home ownership; property insurance & natural disasters)...

FEATURES OF INSURANCE (CONTD)

4. Mismatch of '*presentation*': level of forethought of insured often **much** less detailed than underwriter. Key for 'how much is left to be decided'...
5. Order of performance. Limited ability of insured to influence underwriter at claims stage by eg withholding payment. Cf other commercial contracts. SEE ALSO 6..
6. Insured cannot normally purchase alternate performance at claims stage.

OTHER FEATURES: CONTROLLING INSUREDS?

- Antagonistic attitude to invested premium fund: source of compensation & profit.
- Assumed asymmetries of information, at formation and claims.
- Assumed vulnerability to moral hazard when underwriter on risk.
 - Failure to mitigate risk;
 - Propensity to fraud.

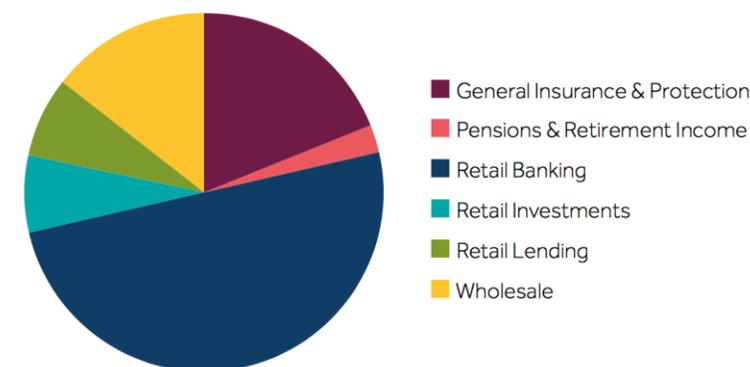
2. WHAT IS FINTECH / INSURTECH (AND REGTECH)

- Iris H-Y Chiu ‘Fintech And Disruptive Business Models in Financial Products, Intermediation and Markets- Policy Implications for Financial Regulator’ (2016) 21 J. Tech. L. & Pol'y 55, 57:
- ‘... fintech specifically focuses on the embedment of digital technology into financial technology, different aspects of which have, to larger or smaller extents, also required innovation in legal technology’
- Insurance...
- Big data; automation of formation (including underwriting) and claims handling, including fraud detection.
- Service before loss...

ENABLING INNOVATION: THE FCA SANDBOX

- <https://www.fca.org.uk/firms/regulatory-sandbox>
- Limited licence with additional oversight, but much reduced entry formalities.
- Excellent for ‘proof of concept’.
- FCA, *Regulatory sandbox lessons learned report* (Oct 2017)
- Lots of ‘distributed ledgers’ (Blockchain).

Figure 1: Sandbox firms by sector



3. SANDBOX AND FINTECH INSURANCE EXAMPLES

- *(re-)Align underwriter and insured contract incentives...*
- *Behavioural science & technology.*
 1. *Ex post* premium setting, ‘transparently’ imposed at end of each month. Claimed effect on moral hazard.
 2. Linked ‘savings’ with insurance. Savings reduced by claims frequency.
 3. [‘Lemonade’, US model, with 20% of premium income as fee/costs, and premium fund invested for claims and/or charitable donations].

BALKANISATION OF COVER

Many policies, short periods of cover, simple(r) descriptions of cover.

- <https://inmybag.co>. ‘Gadget’ insurance
- ‘Think of us as a breakdown service for your bag. We put you before the paperwork, doing everything we can to help when something goes wrong.
- Your membership covers the devices you’ve told us about both inside and away from your home. You also get enterprise-grade data recovery with Crashplan’
- Theft? *Dobson v General Accident Fire & Life Ass Corpn* [1990] 1 QB 274.

BLINK: [HTTPS://WWW.BLINKBLINK.IO](https://www.blinkblink.io).

Service, not cover...

- No relationship to this or any other product!
- Commercial flight insurance. Rebooking service.
- Real time data. E.g. your flight to Hamburg at 16:30pm is scheduled to be serviced by aircraft currently sat in Madrid at 11:30am due to a wildcat strike by Spanish air traffic control.
- Rebook? Text options. Service provided before loss, and potentially before aware.
- Efficiency? But how do people like automatic ticket sales? OR high frequency stock trades?

BLINK AND YOU MISS IT?

- L Budd, et al 'A Fiasco of Volcanic Proportions? Eyjafjallajökull and the Closure of European Airspace', (2011) 6 Mobilities 31.
- Dynamic pricing structure. Not smoothed over long term policy.
- Effectively, withdraws from market when risk is (exceptionally) high.

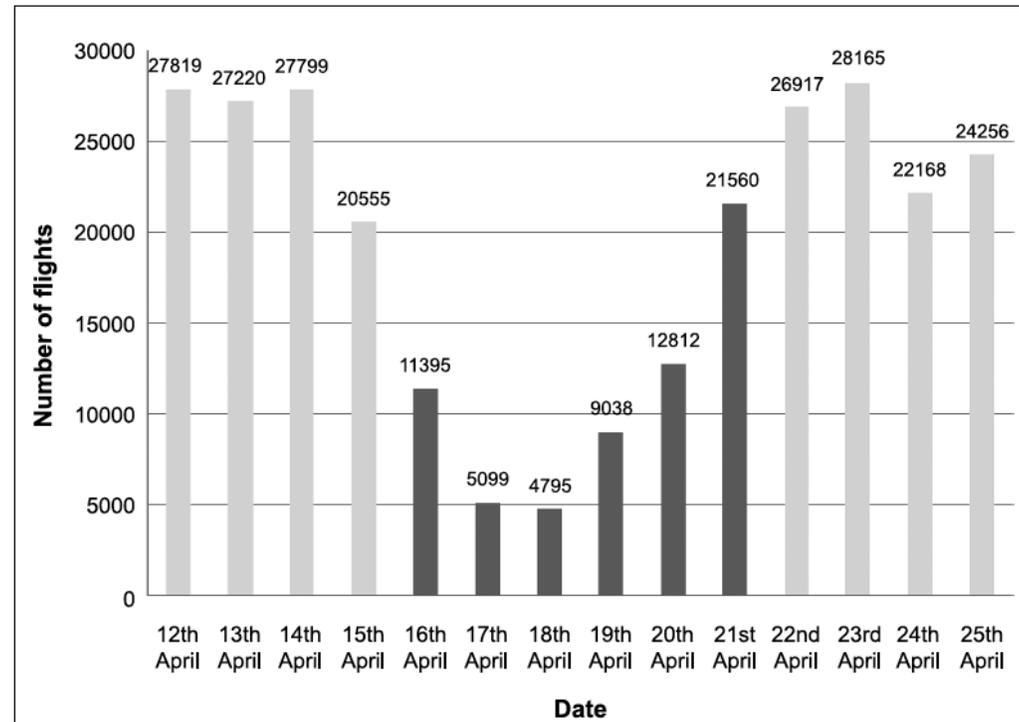


Figure 1. Eyjafjallajökull's effects on European air traffic, 12–25 April 2010.
Source: Based on Eurocontrol (2010, p. 1) figures.

THE (POTENTIAL) DARK SIDE OF FINTECH

- ‘Price optimisation’: dynamically and strategically test consumer sensitivity to price.
- ‘Claims optimisation’: dynamically and strategically test consumer sensitivity to full (contractual) indemnification.
- Efficiencies by narrowing risk pools (bespoke insurance), at cost of social solidarity? Correlation & cause.
- R Swedloff ‘Risk Classification’s Big Data (R)evolution’ (2014) 21 Conn ILJ 339
- J Davey & M Bek (2015) *Insurance & Big Data: Evidence to Select Cttee on Science & Technology* (2015) (<https://eprints.soton.ac.uk/381274/>)

4. REAL OR PERCEIVED CHANGE FOR REGULATORS AND LITIGATORS?

- Consumer focus, at present.
- But why not immediate AI-driven cover for shipment of containers of named mobile phones from Shanghai to Southampton?
- Why not 'big data' driven assessment of war risks cover, with monthly repricing?
- Why not AI-driven fraud detection of suspicious H&M claims?
- **What products & activities MUST be bespoke, and could not be automated with sufficient data and complex algorithms.**

4. SOME OLD IDEAS REMADE: HOMOGENEITY OF INSURANCE PRODUCTS

- **Service not cover...**
- Roadside Assistance

Financial Services and Markets Act 2000 (Regulated Activities) Order (SI 2001/544)

12.— Breakdown insurance

(1) There is excluded from article 10(1) or (2) the effecting or carrying out, by a person who does not otherwise carry on an activity of the kind specified by that article, of a contract of insurance which—

(a) is a contract under which the benefits provided by that person (“the provider”) are exclusively or primarily benefits in kind in the event of accident to or breakdown of a vehicle; and ...

INSURE BUT WITHDRAW...

War risks cover is long-term, but limited...

5.2 Whether or not such notice of cancellation has been given this insurance shall TERMINATE AUTOMATICALLY

5.2.1 upon the occurrence of any hostile detonation of any nuclear weapon of war as defined in Clause 4.1.1 wheresoever or whensoever such detonation may occur and whether or not the Vessel may be involved

5.2.2 upon the outbreak of war (whether there be a declaration of war or not) between any of the following countries:

United Kingdom, United States of America, France, the Union of Soviet Socialist Republics, the People's Republic of China

5.2.3 in the event of the Vessel being requisitioned, either for title or use.

THE HIDDEN USE OF TECH

- AI risk classification: discrimination, and the atomisation of risk.
- Ability to identify similar risks more accurately, more cheaply.
- Price optimisation. Who pays more without thinking? 'Brand new customers only' and renewal pricing.
- Claims optimisation. Who will settle for less? And the Enterprise Act 2016 duty to pay? Less but quickly is outside the statute?
- Lawyers and IT experts as teams. As fellow students. Numerate lawyers.

THE ARMS RACE?

- FCA global lead in application of behavioral science & economics in regulating financial services
- ‘Add on’ insurance: T Baker & P Siegelman “‘You Want Insurance with That?’ Using Behavioral Economics to Protect Consumers from Add-on Insurance Products’ (2013) 20 Conn Ins LJ 1.
- Also developing partnerships with entrepreneurs to redesign regulatory models...
- <https://www.fca.org.uk/firms/regtech>

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