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Regulation

At the Intersection

Insurtech firms are bringing disruptive innovation to an industry that is often slow to change. Traditional insurers, producers and regulators should work together to drive innovation.

by Alan J. Levin and Aaron J. Igdalsky

The rapid growth of insurtech is important to C-suite insurance executives, and for good reason. Examples of insurtech companies that are penetrating the market with innovative products abound.

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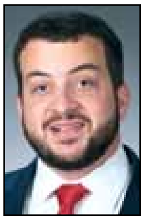

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Lemonade, a New York-based property/casualty insurer offering homeowners and renters coverage, replaced brokers with bots that use artificial intelligence and behavioral economics to sell policies online with no physical paperwork.

Another insurtech startup, Trōv, is a technology company operating in the United Kingdom and Australia that will begin offering products in the United States in the next several months. Trōv's application offers different insurers' products on an on-demand basis for personal property like computers, cameras and sports equipment.

Insure a Thing is a British startup that offers

bicycle coverage and charges insureds at the end of each month for the claims made by the risk pool for that month, plus a fixed claim settlement fee.

Health insurers have begun providing wearable devices and other smart technology, such as scales equipped with Bluetooth devices, to insureds with chronic medical conditions to monitor their adherence to medical advice.

All of these entities are using disruptive innovation to make changes in an industry that is known for its reluctance to change. If there is one common theme that the fastest-growing businesses of the past 10 years share, it is that they

Key Points

Changing Times: As insurtech continues to develop, legal and regulatory questions from an industry steeped in a tradition of heavy regulations are mounting.

Sellers Beware: As consumers buy more of their insurance online, the entities that offer that insurance will need to obtain proper licenses.

Let's Talk: Proactive, regular dialogue must occur between regulators, insurtech firms and insurance industry leaders.

too embrace disruption and change. For example, Facebook encouraged its developers to "move fast and break things." Amazon is developing a product whereby a drone will deliver products to consumers in 30 minutes or less. Uber moved to new markets aggressively across the globe, regularly fighting with deeply entrenched taxi unions and regulators along the way.

As insurance companies and producers evolve and embrace the best aspects of technology companies, will they be able to create disruptive products that better satisfy consumer demands, while still complying with applicable statutes and regulations, in a timely manner? Can insurance regulation keep up with the rapid pace of innovation in the insurtech space? Are regulators equipped to adapt to a world where the product that they regulate is bought and sold on a mobile device, just like ordering an Uber or a pizza? As of yet, the answer is unclear.

But as businesses and consumers move to strictly digital platforms, **how can proper notices and disclosures be provided to consumers on a mobile device** in a way that they can actually access and understand?

Legal and Regulatory Questions

As insurtech continues to develop, legal and regulatory questions from an industry steeped in a tradition of heavy regulations are mounting. Insurtech is replacing functions that have historically been performed by licensed and regulated humans and legal entities using technology. Examples include applications that offer insurance directly to consumers (in lieu of producers) and bots that adjust claims (in lieu of licensed adjusters).

The declining use of traditional insurance intermediaries, and the increasing trend of purchasing insurance directly through a website or application, will require restructuring of remuneration in the insurance industry. More specifically, as consumers buy more of their insurance online, the entities that offer that insurance will need to obtain proper licenses.

Technology companies and application developers that wish to begin selling insurance through their websites and applications will need to familiarize themselves with the applicable licensing requirements necessary to sell insurance. They need to obtain the necessary licenses in advance of beginning to sell, solicit or negotiate insurance products, and appoint licensed producers.

Complying with state notice and disclosure requirements is a critical task for insurers and insurance producers. The variety of notice requirements run the gamut, ranging from what is included or excluded from an insurance policy, to what activities a prospective insured will be required, or perhaps prohibited, from performing under the policy. Such notices are very strictly regulated in all jurisdictions throughout the United States.

But as businesses and consumers move to strictly digital platforms, how can proper notices and disclosures be provided to consumers on a mobile device in a way that they can actually access and understand? For example, Lemonade's website advertises that it takes only 90 seconds to purchase insurance through Lemonade's application. Can a prospective insured actually obtain, let alone understand, all necessary information regarding a consumer's rights and duties under a policy in 90 seconds?

Additional potential issues include state filing and approval requirements. Under the traditional insurance regulatory structure, insurers must file changes to their rates and forms before use. In some states, the review and approval period may take several months. However, mobile applications are regularly tweaked and modified to improve performance and rectify bugs. If the developer of a mobile insurance application makes a small change to a small part of its application, will it be required to refile a form or otherwise seek the approval of one or more insurance regulators?

Also, application-based insurance platforms may have better claim and underwriting algorithms than traditional insurers. Would those application-based insurance platforms be permitted to adjust their pricing in real time to account for claim and underwriting trends?

Another major concern for insurtech developers is privacy and cybersecurity. In addition to the common responsibilities incumbent upon all electronic merchants, such as protecting credit card numbers and preventing cyber intrusions, insurers also are responsible for safeguarding unique and highly sensitive personal data such as protected health information and HIPAA (Health Insurance Portability and Accountability Act of 1996) data.

These are just a few of the numerous regulatory challenges that insurtech developers will need to address, and there do not appear to be easy answers.

Investment in Insurtech

Despite the open legal and regulatory questions, investment in insurtech is soaring. Insurtech investment was $800 million in 2014, but spiked to more than $1.7 billion in 2016. IA Capital, a New York private equity firm, is seeking investors for a $100 million insurtech fund. As insurtech investment ramps up, C-Suite executives at insurers and producers now consider insurtech to be a key priority, and are investing in insurtech as such. For example, Chubb said in its 2016 annual report that it has the objective of transforming the company into "a digitally integrated enterprise from top to bottom."

According to a recent report from Accenture, artificial intelligence and the internet of things now account for nearly half of total investment in insurtech startups globally. According to the report, the combined number of deals across artificial intelligence (including automation) and the IoT (including connected insurance) increased 79% in 2016. Even though the two technologies represented only 24% of the 216 global insurtech deals in 2016, they accounted for 44% of total insurtech investment.

Why Insurtech Now?

Insurtech is part of the future of insurance, and it offers meaningful benefits to both consumers and insurers. Insurtech helps insurers reach consumers, especially millennials, with products that make buying insurance an easier and more pleasant experience. Potential insureds can buy insurance on an app whenever and wherever they want.

Insurtech allows prospective insureds to compare different insurance products at the touch of their fingertips, thus promoting greater competition in the insurance industry and more competitive products for consumers. Insurtech also allows for real-time interaction with consumers through artificial intelligence, which can lead to better outcomes for insureds.

Insurtech benefits insurers in numerous ways. One is obvious: it helps trim selling, general and administrative expenses. For example, Fukoku Mutual, a Japanese insurance company, began using artificial intelligence to evaluate claims in January 2017. Fukoku in turn laid off 34 employees who had previously been performing that function, netting an annual savings of $1.3 million.

Additionally, insurtech creates risk management benefits: Traditional insurers assess risk based on past experience, but insurtech enables insurers to monitor risks in real time and mitigate losses or appropriately adjust pricing. In the health insurance space, for example, insurers can continuously monitor insureds with chronic medical conditions by using smart technology. With continuous monitoring, insurers can stamp out or manage certain illnesses before they become more severe and expensive to treat.

Closing Thoughts

Traditional insurers, producers, insurtech firms and regulators need to jointly embrace the change that is upon us. Proactive, regular dialogue must occur between regulators, insurtech firms and insurance industry leaders. Regulators should seek to foster the development of insurtech because of its benefits to consumers.

Likewise, insurers and insurtech firms should seek to proactively engage regulators in a way that does not hamper business growth, but also keeps products compliant. The NAIC's innovation and technology task force is but one example of such a forum, though regular, less formal engagement is critical. Working together, insurers, insurtech firms and regulators can help drive disruptive innovation in the insurance space that will benefit both consumers and businesses alike. BR