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Mr. Gabriel Bernardino
Chairman
European Insurance and Occupational Pensions Authority (EIOPA)
Westhafenplatz 1
60327 Frankfurt am Main
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Dear Mr. Bernardino:

The Institute of International Finance (IIF) and its insurance members welcome the opportunity to offer comments on the *EIOPA Discussion Paper on the Insurance Value Chain and New Business Models Arising from Digitalization* (the Discussion Paper). We have submitted our response using the survey link provided in the Discussion Paper and this response is provided for your convenient reference.

General Comments

We support the general direction of the Discussion Paper and EIOPA's potential follow-up work that would focus on the fragmentation of the insurance value chain resulting from digitalization. We believe it is important for standard setters, regulators and supervisors to monitor developments in the digitalization of insurance products and consider the regulatory and supervisory implications for insurers, as well as all providers, intermediaries or facilitators of insurance products and services, including those that are outside of the formal insurance sector (referred to herein as third-party providers).

The IIF has conducted several studies on issues raised in the Discussion Paper, and we have attached relevant IIF staff papers in the Annex. The IIF staff papers generally support EIOPA's observations regarding the fragmentation of the insurance value chain. We believe that changes in how products are designed, priced and delivered, as well as how customer data are being collected, processed and used, have important regulatory and supervisory implications. The IIF welcomes this Discussion Paper as an important step in a public/private sector dialogue and we stand ready to engage in further dialogue with EIOPA and insurance standard setters and supervisors.

We urge insurance standard setters and supervisors to recognize the benefits that can accrue to customers as a result of digitalization. Indications are that jurisdictions that embrace digitalization in financial services benefit through greater economic resilience in times of crisis such as now with COVID-

19.[1] Digitalization is not new to the insurance sector and some of the risks to consumers and policyholders discussed in the Discussion Paper are also not new and may already be reflected in regulatory requirements and supervisory guidance. We encourage EIOPA and other insurance standard setters and supervisors to review existing regulation and guidelines, and their application and interpretation, before adopting new requirements or guidance. We also call for regulatory and supervisory coordination among jurisdictions in order to prevent regulatory fragmentation, which impedes the conduct of a global insurance business. (See answers to Questions 1 and 3, below, for further detail.) Additionally, supervisory initiatives and guidance should consider the impact of other regulation and supervision (e.g. data privacy requirements) in order to avoid duplicative or conflicting requirements and insurance supervisors should work collaboratively with other regulators, supervisors and standard-setting bodies responsible for these issues.

Digitalization is evolving rapidly across the financial services sectors. We believe that EIOPA and other insurance standard setters and supervisors should adopt dynamic, risk- and principles-based, technology-neutral and future-proof supervisory initiatives and guidance that reflect that insurers (and other financial institutions) and their supervisors are on a learning curve with respect to the adoption of new technologies. We would also welcome constructive public-private collaboration in knowledge sharing and the IIF would be happy to facilitate such collaboration.

Comments Related to Adoption of an Activities-Based Approach

In general, we believe that insurance supervisory initiatives and guidance should be risk- and activities-based, rather than purely entity-based, and should bring into the scope of appropriate regulation and supervisory oversight all market participants, including third-party providers. When third-party providers enter the insurance value chain, they should be subject to appropriate and proportionate insurance supervision and oversight to protect customers and policyholders.

Consideration should be given to the need for third-party providers to share with insurers the responsibility to protect customers and policyholders. It is critical that all market participants can demonstrate adherence to strong customer and policyholder protection standards in order to allow customers and policyholders to benefit from greater innovation and access to financial products and services without sacrificing essential elements of consumer protection. Further oversight of and better engagement between third-party providers and regulators and supervisors could help to ensure compliance with the broad spectrum of consumer protection obligations to which the insurance sector is subject. As noted in the Discussion Paper and below (in the response to Question 3), traditional insurers do not always have the same market power as third-party providers, and this imbalance in market power can challenge insurers' bargaining position and their ability to influence third-party providers. Yet, at the same time, traditional insurers bear the greatest portion of the regulatory obligations.

Comments Related to Transparency

We agree with the specific concerns related to the transparency of the activities conducted by one subset of third-party providers, that is, insurance platforms and ecosystems (Section 5.4 of the Discussion Paper).

[1] https://blogs.worldbank.org/voices/expanding-digital-financial-services-can-help-developing-economies-cope-crisis-now-and-boost-growth-later

We believe that these concerns should be addressed by EIOPA and other policymakers and supervisors. A level playing field also should be guaranteed throughout the EU with regard to transparency towards policyholders. Consumers and policyholders need to be in a position to understand which entity is accountable for the provision of products and services and for the settlement of claims.

Additionally, EIOPA should further explore the ability of platforms to steer consumers to products and services that benefit the platform owner or operator but may not be optimal for the consumer. It is important that the same level of policyholder protection is ensured, regardless of the provider. Hence, the same transparency and consumer protection rules, including conflict of interest rules, should apply to established insurance providers and new entrants to the market. Based on the results of a review of existing rules and their application to different market participants, EIOPA and other policymakers may wish to consider advancing proposals that would expand transparency and consumer protection rules to all market participants.

We would encourage EIOPA to consider and discuss with insurance standard setters, including the International Association of Insurance Supervisors, the role of insurance supervisors in consumer education. Better consumer education about the digital transformation that is underway in the industry and about the range of market participants offering products and services could mitigate some of the risks to consumer protection. Education is particularly critical for individuals who may not have full access to technology, as highlighted in our answer to Question 16 below.

<u>Comments Related to Unfair/Unforeseen Model Bias</u>

The use of machine learning and artificial intelligence tools, and algorithms embedded in these tools can, when properly designed and implemented, improve the consumer experience. However, these tools and algorithms need to be carefully designed in order to minimize unfair/unforeseen bias through the use of biased data sets. While bias is not a new risk to the financial services industry, including insurers, the development of new tools may inadvertently facilitate bias and, thus, additional efforts may be needed to protect consumers. In addition, the discussion around bias may also benefit from a definition of bias that distinguishes and emphasizes statistical bias as opposed to more popular social definitions of bias.

As noted in the IIF Staff Paper, *Bias and Ethical Implications of Machine Learning*, machine learning and artificial intelligence tools and algorithms are trained on historical data. Misguided and untested correlations could have powerful implications given the automated nature of machine learning and artificial intelligence algorithms. The use of biased data inputs may result in outputs that create or perpetuate unfair discrimination and financial exclusion, a risk highlighted in Section 4 of the Discussion Paper.

Firms can counter potential unfair/unforeseen bias with robust risk-based data governance processes surrounding model design, development, training data, testing, monitoring and oversight. EIOPA and other insurance standard setters and supervisors may want to further consider the issue of unfair/unforeseen bias in advanced analytical models and the IIF would be pleased to serve as a resource in this regard. We also note the relevance of the European Commission *Ethics Guidelines for Trustworthy AI*, published in April 2019.

Importantly, EIOPA and other insurance standard setters and supervisors should recognize that the introduction of new technology such as machine learning and artificial intelligence, and the use of different insurance distribution platforms may not necessarily require new rules and regulations. For example, the need to avoid unfair discrimination in the business of insurance is already codified in many jurisdictions. While there may be a need for greater vigilance about the heightened risk of unfair discrimination when utilizing new technology and data sources, regulators should first evaluate whether there are any deficiencies in the existing regulatory environment before introducing new rules and regulations. Rather than introducing new rules and regulations, it may be more appropriate to focus supervisory attention on firms that do not meet existing standards.

Answers to Specific Questions Posed

Please note that we have combined questions that we believe relate to a common topic. Where questions are combined, the responses are intended to respond to each of the questions.

1. Do you have any preliminary remark or general comment regarding the topic of the (re)insurance value chain and new business models arising from digitalization?

3. What additional issues do you consider relevant for supervisors to understand the increased fragmentation and complexity of the market as well as new business models?

We are supportive of the direction that EIOPA is taking in examining the (re)insurance value chain and focusing on the benefits and risks of the digital transformation of the insurance business and related supervisory implications. The insurance business model has been evolving rapidly and we have witnessed an even greater acceleration of the trend towards the greater use of digital tools and technologies as a result of the current COVID crisis.

We welcome EIOPA's focus on concentration risk and the limited competition in digital ecosystems (Sections 5.3 and 5.4 of the Discussion Paper). We encourage EIOPA to continue to monitor the impact on consumer choice and consumer outcomes that may result from a concentration of market power in a limited number of platforms or ecosystems. We also encourage EIOPA to take appropriate actions if it determines that market concentration is having a negative impact on consumers; these actions could involve collaboration with authorities responsible for competition policy in the EU.

As a result of the adoption of new digital tools and technology, certain elements of current supervisory guidance that were adopted pre-digitalization may require revision or clarification or extension to a broader range of market participants, including third-party providers. EIOPA could serve as a forum to facilitate supervisory understanding of a rapidly evolving business model transformation across standard setters, supervisors and the full range of market participants in the insurance value chain.

Any new guidance should be risk- and activities-based and the same measures should be applied to the same risks across all firms engaging in the insurance value chain. We would encourage EIOPA and other standard setters to take note of the fact that the perimeter of insurance regulation, particularly regulation directed at consumer protection, may need to be extended to third-party providers. While third-party providers may partner with traditional insurers, a traditional insurer may not be able to control the activities of these third parties or enforce its compliance with consumer rules and guidance due to the dominant market power of the third-party provider.

If some aspects of the digitalization of the insurance business are common to other sectors, it may be appropriate to align standards or guidance across sectors. One area in which this alignment may be appropriate could be with respect to data privacy and protection standards. The increased fragmentation of the insurance value chain places in greater focus data privacy and protection as access to consumer data becomes a key business and competitive advantage.

5. In addition to those stated in chapter 3, are there any other business models that can be seen as related to the fragmentation of the value chain that might be worth to look at further from a supervisory perspective?

The P2P insurance business model is enabled by digital technologies such as blockchain and crypto currency. In the P2P model, customers assume part of what used to be the insurer's or intermediary's responsibility in exchange for a lower cost of coverage. Some of the risks managed by the insurer, such as operational risk, are also transferred to customers.

6. How do you define insurance platforms and insurance ecosystems? Do you distinguish between those two developments/definitions? If so, how?

We agree with EIOPA's characterization of platforms and ecosystems. A platform is the organizing framework and infrastructure for an ecosystem, which provides interconnected products and services in a single interface. Recent IIF staff papers have indicated that the growth of insurance platforms and ecosystems has resulted in digitalization impacting the customer decision-making process from determining the need for coverage to assessing different coverage options to purchase and post-purchase evaluation.

While insurance platforms are involved in the information search, alternative evaluation and purchase phases of the customer journey, ecosystems are more closely connected to the lifestyle of the customer through the internet of things and, thus, have an impact on the need recognition and after-purchase evaluation phases of the customer journey.

9. Are there any other aspects related to platforms/ecosystems that are not covered in this chapter but are important from the consumer/market/supervisory perspective?

10. In addition to those covered in this chapter, what related risks and benefits do you see regarding insurance platforms/ecosystems?

11. Do you consider that changes in existing regulation or further rules (including soft law/guidance) should be introduced both to facilitate platforms/ecosystems and to adequately cover new emerging risks?

The recent IIF staff paper, *Digitalization of the Retail Insurance Business Model*, contains a discussion of some of the risks and benefits related to consumer protection and data privacy. The increased use of online and digital tools results in the generation, capture and transfer of larger amounts of personal data. This data can be and is being used in a customer-positive manner to allow insurers to better tailor insurance products and services and to price those offerings more accurately based on risk. However, it is important to ensure that customer data is safeguarded and used in a manner that is fair and free from potential bias. The supervisory response to the use of machine learning and artificial intelligence tools should focus on encouraging the developers and users of these tools to apply appropriate governance surrounding the inputs to these models to reduce bias and to conduct a careful review of model outputs.

In terms of the basic principles of a traditional insurance contract, a lack of transparency can result in poor customer outcomes under the principle of utmost good faith. Given that insurance contracts are evolving beyond traditional contracts, an analysis of benefits and risks in more innovative coverages is a proper focus of EIOPA's work.

14. Are there other aspects related to preventive services in insurance that should be considered from both consumer, market and supervisory perspectives?

Data protection and the ethical use of consumer data remains key issues in preventive services, such as the use of telematics in the underwriting of life or health insurance. For example, when preventative health services are provided to customers, large amounts of health-related personal data are generated, stored and processed. Among other issues, how this data is stored, safeguarded from attacks and used for other purposes, such as the pricing of complementary products, are important to consider.

16. Do you agree with the description of the risks identified for consumers and for the industry?

In addition to the risks highlighted in Section 4 of the Discussion Paper, we would note that, in some jurisdictions, outdated regulatory requirements, such as those that preclude the use of digital signatures or require in-person interfaces, create impediments to insurers' ability to adopt digital tools and technology that benefit their customers.

We would also highlight that, when analyzing benefits and risks to customers, the Discussion Paper appears to assume that all insurance customers are educated in use of technology and have access to the internet. In the case where an insurance customer is not familiar with digital technology or the technology is not accessible, his or her choices of insurance coverage may be limited.

18. What are the greatest future challenges in the fragmentation of the value chain including the emergence of insurance platforms and ecosystems?

In line with previous IIF studies:

- While not a new challenge, insurance standard setters and supervisors should continue to monitor how customer outcomes may be impacted (both positively and negatively) by a wide range of market participants employing new technologies, tools, platforms and ecosystems to provide insurance products and services. As described in the IIF paper, *Bias and Ethical Implications in Machine Learning*, machine learning can help to overcome existing biases and help democratize access to financial services. That said, machine learning and other new technologies need to be implemented thoughtfully, with due concern for data protection, security and integrity and with careful governance and a methodological approach to data mining to ensure fairness and inclusion. Any current and future rules, standards or guidance related to the ethical use of consumer data or the avoidance of bias should extend to the full range of market participants offering, intermediating or facilitating the provision of insurance products and services to consumers.
- Relatedly, restrictions on transmission, storage and processing of data across borders have impeded insurers' ability to use big data analytics, including machine learning and artificial intelligence. We encourage EIOPA and other insurance standard setters and supervisors to engage in dialogue to promote collaboration and trust mechanisms to facilitate the more effective transfer and use of data across borders.

- Insurance standard setters and supervisors should consider the need to expand the regulatory perimeter, in a risk- and activities-based manner, to bring within the scope of oversight and supervision third-party providers.

We appreciate the opportunity to comment on EIOPA's Discussion Paper. Please contact Mary Frances Monroe (mmonroe@iif.com) or Ningxin Su (nsu@iif.com) if we may answer any questions or provide additional input.

Respectfully submitted,

Mary Frances Monroe

Annex

List of relevant IIF work:

Digitalization of the Retail Insurance Business Model (June 2020)
Machine Learning Recommendations for Policymakers (September 2019)
Bias and Ethical Implications in Machine Learning (May 2019)
Machine Learning Paper on Explainability in Predictive Modeling (November 2018)
IIF Response to the IAIS Draft Issues Paper on the Use of Big Data Analytics in Insurance (October 2019)