E-commerce and Distribution of Insurance Products: A Few Suggestions for an Appropriate Regulatory Infrastructure

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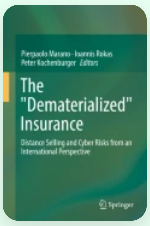

The "Dematerialized" Insurance

Hsin-Chun Wang Ph.D.

Abstract

After the global financial crisis caused by sub-prime mortgage market, electronic commerce in insurance becomes one of the essential components for insurers to improve their competitiveness and performance. In terms of cost-efficiencies in operation and acquisition, it is evident that electronic commerce has already and constantly changed the traditional distribution channels in several no-life insurance markets. Among these markets, the Internet provides a new channel for distributions for insurers particularly in auto insurance products. While a new distributional channel seems to reduce transaction costs between consumers and insurers, risks consequently will cause new challenges to global insurance market.

How to develop an appropriate level of regulation is essential to promote this transaction method and to ensure the interests of consumers.

This Article addresses insurance regulation governing electronic commerce and analyses various developed regulatory models and their frameworks. In terms of prudential regulation, it is suggested that operational risk arising from E-commerce should be incorporated into solvency regulation. In encountering with risks caused by electronic transactions, an insurer should be required to hold adequacy of capital and maintain a certain level of risk management. In relation to market conduct regulation, this Article intends to apply behavioural theory to re-examine the current information-based insurance regulation.

Notes

1. *See* CAPGEMINI (2012), p. 7.

2. *Ibid*., p. 10.

3. *Ibid*.

4. *Ibid*., p. 11.

5. When E-commerce has improved the transaction costs, the Internet and mobile devices have become important tools for insurers to acquire new businesses in several countries, such as Canada, France, India, the Netherlands, Spain, and the US. *Ibid*., pp. 11–19.

6. *See* International Association of Insurance Supervisors (2002), pp. 4–10.

7. The debate concerning the choice between a single regulator and a twin-peak structure has existed in the UK prior to the 1997 reform. *See* Taylor (2009–2010), p. 78.

8. *See* Financial Services Authority (2012), p. 11.

9. *See* Bailey (2012), p. 1.

10. *See* Prudential Regulation Authority, Bank of England (2013), p. 9.

11. This assessment is to identify and analyse “an insurer’s potential to affect adversely the PRA’s objectives by failing, coming under stress, or by the way it carries on its business”. As a result, the PRA divides financial deposit takers, designated investment firms and insurers into five categories of impact based on the capacity to affect the UK financial system. *Ibid*., pp. 19–20.

12. This element mainly focuses on the assessment of the macro-prudential environment and system-wide risks, such as interest rates and longevity risk. *Ibid*., p. 20.

13. The PRA examines the sustainability and vulnerability of an insurer’s business model. Under this assessment, the PRA analyses an insurer’s “profitability, risk appetite, performance targets and underlying assumptions, and an insurer’s own forecasts and their plausibility”. In doing so, the PRA can determine the capacity of the insurer to mitigate risks. *Ibid*., p. 20.

14. These objectives were also the main task of the FSA before the establishment of the FCR. *See* Financial Conduct Authority (2013), pp. 15–32.

15. These conduct risks described in the FCA business plan in 2013 are as follows: “Firms do not design products or services that respond to real consumer needs or are in consumers’ long-terms interests; distribution channels do not promote transparency for consumers on financial products and services; Over-reliance on, and inadequate oversight of, payment and product technologies; Poor understanding of risk and return, combined with

the search for yield or income, lead consumers to take on more risks than is appropriate”. *See above footnote 14,* pp. 15–22.

16. *See above footnote 6*, pp. 9–10.

17. From this issues paper, it proposed that many new issues should be dealt with, such as the identification of the consumer, security of electronic documents and signatures, notification of contract-related information, the format and style of presentation to meet the requirements, proof of coverage for the policyholder, electronic payment acceptability and record retention. *See* International Association of Insurance Supervisors (2004), pp. 5–6.

18. *See above footnote 6*, p. 8.

19. *See above footnote 6*, p. 9.

20. Due to fault in the process of information flows, both parties may have disputes over the insurance products. For example, the insurance provisions and conditions are ambiguous on the website. *See above footnote 6*, p. 7.

21. *See above footnote 6*, p. 5.

22. For others concerning strategic risks, *see above footnote 6*, pp. 5–6.

23. *See above footnote 6*, p. 6.

24. For example, operational risks are treated as one of three main elements of the Solvency Capital Requirement in the Solvency II. However, the standard formula calculation is roughly based on an insurer’s business volume rather than an insurer’s risk profile. For life insurance contracts, “the calculation of

the capital requirement for operational risk should take account of the amount of annual expenses incurred in respect of those insurance obligations". For other insurance contracts, it should "take account of the volume of those operations, in terms of earned premiums and technical provisions...." article 107 of Solvency II Level 1 Text, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:335:0001:0155:en:PDF.

25. Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce) [2000] OJ L178/1.

26. Directive 1999/93/EC on a Community framework for electronic signatures [1999] OJ L 13/12.

27. Directive 2002/65/EC concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, [2002] OJ L 271/16.

28. *See* European Commission (2000).

29. *Ibid*.

30. Art. 8 (1)(2) of Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce') [2000] OJ L178/11-12. *See also* European Commission (Internal Market DG) (2002), p. 2.

31. Lennartz (2010), p. 1; *see also* Flanagan (2012), p. 11.

32. While the ECD governed all the financial services, the DMD only governs the

retail financial sector. Flanagan (2012), p. 25.

33. Art. 3, para. 1 of Directive 2002/65/EC concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, [2002] OJ L 271/16.

34. E.g., the identity and the main business, the representative of the supplier, any professional other than the supplier, the trade register and the relevant supervisory authority. *Ibid*., art. 3 para. 1(1).

35. E.g., the main characteristics of the financial service, the total price to be paid by the consumer, relevant notice concerning special risks, notice of possibility relating to taxes or costs, limitations of period for which the information provided is valid, the arrangements for payment and performance and any costs of using the means of distance communication. *Ibid*., art. 3 para. 1(2).

36. E.g., the existence or absence of a right of withdrawal , and where the right of withdrawal exists, its duration, and the condition for exercising, the minimum duration of the distant contract, information on any rights the parties may have to terminate the contract, practical instructions for exercising the right of withdrawal, the Member State or States whose laws are taken by the supplier as a basis, any contractual clause on law or compete court and languages used in the contract. *Ibid*., art. 3 para. 1(3).

37. E.g., out-of-court complaint and redress mechanism, the existence of guarantee funds or other compensation arrangements. *Ibid*., art. 3 para. 1(4).

38. *Ibid*., art. 5.

39. *Ibid*., art. 6.

40. *Ibid*., art. 7.

41. Financial Consumer Authority, Conduct of Business Sourcebook (COBS), http://fshandbook.info/FS/html/handbook/COBS/5/2.

42. Financial Consumer Authority, ICOBS Insurance: Conduct of Business Sourcebook (ICOBS), http://fshandbook.info/FS/html/handbook/ICOBS/3/2.

43. New York State Insurance Department (2000) cited from Canadian Council of Insurance Regulators (2012), p. 12.

44. *See* Uniform Law Commission (1999).

45. E.g., Tennessee, Maryland, and Alaska. *See* Insurance Advocate (2013).

46. *Ibid*.

47. *Ibid*.

48. For example, it is estimated that nearly 3.1 million auto insurance policies were purchased through the Internet in 2012. *See* Insurance Information Institute (2014).

49. *See* Canadian Council of Insurance Regulators (2012).

50. *Ibid*., pp. 12–14.

51. UNCITRAL, Model Law on Electronic Commerce (1996).

52. Uniform Law Conference of Canada (1999).

53. *Ibid*.

54. Canadian Consumer Measures Committee (2004), p. 1.

55. *Ibid*., pp. 5–13.

56. However, Canada Electronic Commerce Committee (ECC) in Canada Council of Insurance Regulators (CCIR) released several research papers addressing the issues concerning E-commerce in the insurance sector. The final position paper which intends to communicate with stakeholders has been published in November 2013. This paper indicates that it is possible to have more specific regulations governing insurance business in E-commerce in the future. *See* Canada Electronic Commerce Committee (ECC) in Canada Council of Insurance Regulators (CCIR) (2013).

57. Xinhuanet News (2013).

58. China Insurance Regulatory Commission (2014).

59. China Insurance Regulatory Commission (2014), *para* 2(1)–(5).

60. *Ibid*., *para* 3.

61. *Ibid*., *para* 4–5.

62. *Ibid*., *para* 6.

63. *Ibid., para* 9–11.

64. CaixinOnline (2014).

65. E.g., Canadian Code of Practice for Consumer Protection in Electronic Commerce.

66. *See* above *footnote 31*.

67. *See* Baldwin and Cave (1999), p. 12.

68. *See* Llewellyn (1999), p. 35.

69. *Ibid.*, p. 22.

70. It is observed that the characteristics of financial products are different from other goods and services. For instance, “it may be a long time before the consumer is aware of the value and faults of a financial product”. This can usually be found in the disputes arising from insurance contracts in the event of accident of insured or damage of insured properties. *Ibid.*, pp. 37–38.

71. *Ibid.*, p. 35.

72. *See* Dalley (2006–2007), p. 1113.

73. *See* above *footnote 67,* p. 12.

74. *Ibid.*, p. 49.

75. For heuristic biases, *see generally* Tversky and Kahneman (1974), pp. 1124–1131; with regard to information regime in the financial market regulation, *see* Packin (2013), pp. 449–452; for the behavioral approach to securities regulation, *see* Choi and Pritchard (2003–2004), pp. 7–20; for financial market regulation, see *Avgouleas* (2009), pp. 31–34; Juurikkala (2012–2013), pp. 38–50.

76. *See* above *footnote* 72, p. 1114.

77. *Ibid*.

78. "In many situations, people make estimates by starting from an initial value that is adjusted to yield the answer. The initial value, or starting point, may be suggested by the formulation of the problem, or it may be the result of a particular computation. In either case, adjustments are typically insufficient. That is, different staring points yield different estimates, which are biased toward the initial values." See above *footnote* 72, p. 1128, quoted by George et al. (2000), pp. 195–196.

79. Lin (2010–2011), p. 345. *See generally* Rabin (1998), pp. 26–29.

80. *See* above footnote 72, p. 1115.

81. *Ibid*.

82. *See* above footnote 72, p. 1116.

83. *See* above footnote 68, p. 33.

84. *See* Erta et al. (2013), p. 24.

85. *See above footnote* 67, p. 49.

86. *See above footnote 84*, pp. 13–24.

87. These four ways include “1. Provide Information; 2. Change Choice Environment; 3. Control Product Distribution; 4. Control Products”. *Ibid.,* pp. 42–43.

88. *See above footnote 56*, p. 5.

89. E.g., the main characteristics of the product; terms, exclusions and conditions of that product; the total premium and other charges that the consumer may have to pay; options and coverage. *Ibid.*, p. 7.

90. Unlicensed entities must not “provide advice; hold themselves out as licensed insurers or firms; or post insurance publications, which could mislead a consumer into thinking they are an insurance provider”, *ibid.,* p. 12.

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