Getting supervision “just right”

The supervision of digital innovation must be neither too light nor too heavy

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The rapid advance in digital innovation and financial technology, or fintech, is often characterised by the term “disruption”, encompassing the new market players, new business models and new products. As with all innovation, change can be accompanied by new risks for the market. With the right governance and risk management measures in place, accompanied by adequate supervision, digital innovation can be better integrated into the insurance landscape, enabling significant opportunities for financial inclusion and policyholder value.

The challenge is getting supervision “just right”. Too light a touch and the risks of consumer detriment and distrust in the sector grow, while too heavy a hand might stifle innovation, diminishing the possible benefits to insurers and consumers. It is no surprise that digital innovation is one of the strategic themes of the International Association of Insurance Supervisors (IAIS), touching jurisdictions worldwide.

Rewards …

Since 2021, the IAIS has looked at the use of application programme interfaces, or APIs; distributed ledger technologies (DLTs) and blockchain; as well as the use of artificial intelligence (AI) and machine-learning (ML) technologies. All three areas have the potential to benefit both insurers and policyholders, for example through lower costs and more efficient processes, improved customer experiences and transparency. Dynamic technology can enable new ways of providing information to consumers, helping address the significant challenges consumers face in understanding insurance products.

… but risks

Nonetheless, risks are also clear. For example, the interconnectedness of digital systems, cyber attacks or the increasing use of the cloud computing technology from a reduced number of third-party providers raise issues from an IT operational resilience perspective.The collection, storage and use of personal data is another area that poses potential risks.

One approach to managing the adoption of digital innovation is through regulation. In Europe, in addition to existing regulation, there are a number of cross-sectoral regulatory packages on the horizon, including the AI Act, the Digital Operational Resilience Act (DORA) and the Framework for Financial Data Access (FIDA).

> **“In Europe ... there are a number of cross-sectoral regulatory packages on the horizon.”**

However, regulation alone will not be enough. Rather, it must always be accompanied by effective supervisory practices.

How, then, to get supervision just right? As a starting point, in addition to a technology-neutral approach, there are three key areas that supervisors should consider.

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A balanced approach

The first consideration is proportionality, already a well-established principle in European insurance legislation. Supervisors need to focus on those areas where there are greater risks for consumers, insurance undertakings and financial stability as whole, with interventions proportional to the risks. Adopting a balanced approach to the benefits and risks of innovation will also help supervisors fulfil their mandate more effectively.

Data safeguards

A second consideration is data. Insurers hold vast amounts of data from both traditional and non-traditional sources, and it is essential that there are appropriate safeguards in place to prevent theft or misuse. Supervisors have to challenge insurers not only on the sufficiency of their own data governance and related risk management policies, but also on whether the third parties that insurers deal with have adopted sufficient security measures. This includes getting clarity on the ethical use of data and biases — where integrating new data sources and using new analytic techniques can raise issues.

Specific to AI, the ongoing work of the AI/ML workstream of the IAIS FinTech Forum has shown that several jurisdictions have already adopted high-level AI principles, and the most advanced jurisdictions are moving to further develop these principles by providing more detailed guidance on the use of AI and how to challenge and supervise it in practice. The clarification of supervisory expectations is also welcomed by market participants, since the “rules of the game” are clearer and ensure a level playing field.

Supervisory skills

The third consideration relates to the skills and capacity of supervisors. For effective supervision — “just right” supervision — supervisors must have the technical expertise and resources to understand developments in the field, the landscape and trends. The speed of development is incredibly fast and cooperation between different supervisory authorities benefits the entire community. This is where supervisors need to join forces and share information to continuously update their own knowledge.

Digital technology can also facilitate the work of supervisors. Market-monitoring toolkits, for example, can not only analyse traditional sources of information, such as regulatory reports, but can also combine

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When it comes to both regulation and supervision, it is important that supervisors work together with fintech and incumbent players to get the “just right” approach. A close dialogue with stakeholders is crucial, as supervisors can benefit from the industry’s practical experience in using AI, and the industry can benefit from a better understanding of supervisory expectations.

It is clear that the pace, scale and scope of digital innovation show no sign of abating. Cooperation through forums like the IAIS FinTech Forum will help make sure that supervisors are ready for the developments as they happen.

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