Insurance

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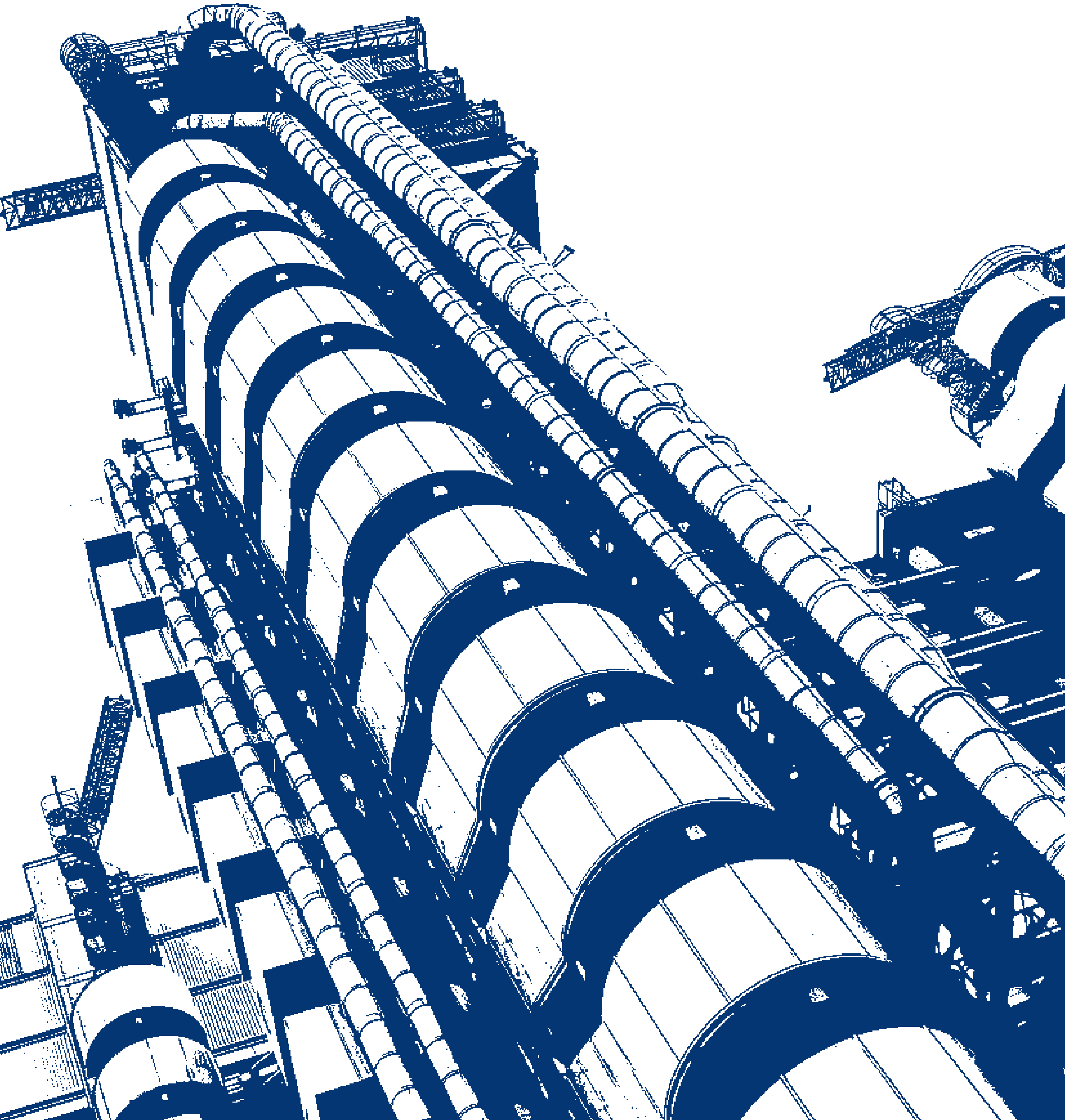

Challenges for the Portuguese insurance sector

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Brief overview of the Portuguese insurance sector

The Portuguese insurance market was under the spotlight in many of the most significant M&A transactions that took place in our country over the last couple of years, a trend that is still ongoing, and investors are looking to local insurance companies as value-creation opportunities.

According to the Portuguese Supervisory Authority for the Insurance Sector (Autoridade de Supervisão de Seguros e Fundos de Pensões or ASF) in information released with respect to the fiscal year of 2015[1], the Portuguese insurance market was composed of no less than 79 insurance companies, including 33 EU branches.

By the end of 2015, the Fosun Group – owner of Fidelidade, Portugal's largest insurance group – held a market share of around 31.4 per cent in the life insurance sector and 26.2 per cent in the non-life sector. Reference should also be made to the private equity fund Apollo Global Management that recently acquired two Portuguese insurers (Tranquilidade and Açoreana) that are part of the country's largest providers in certain classes of insurance (e.g. home and vehicle insurance).

The importance of InsurTech in the Portuguese Insurance Industry

According to a study developed by a consulting company in partnership with the Portuguese Association of Insurers (Associação Portuguesa de Seguradores or APS) before the transposition of the Solvency II Directive, the Portuguese insurance sector was deemed to be very digitally mature and had, on average, a significant propensity to implement digital initiatives and to manage the transformation.

The transposition of the Solvency II Directive into national law created a great opportunity for insurers, reinsurers and insurance intermediaries to revisit their business strategies, product portfolios and technologies, distribution channels (bancassurance is the main life distribution channel in Portugal), risk levels, reporting and investment practices, and to find solutions to optimise processes.

There is obviously, and in spite of said study from the APS, a great deal of room for improvements and the players in the insurance industry are already making investments in digital platforms and technology upgrades in order to save time and costs in their day-to-day relationships with customers and such approach is leading to a significant change in the scope and strategy of the Portuguese insurance industry.

Once InsurTech reaches its maturity in the Portuguese market, mobile apps should become a core element in the distribution and underwriting of insurance products in Portugal, in line with what is expected to occur in the whole EU insurance market.

One of the key objectives of the Solvency II regime is to increase the international competitiveness between EU insurers and the players in the Portuguese insurance sector, all of which are dealing with difficult decisions which can be summarised as follows:

1. How to conciliate the very complex and time-consuming requirements established by the Solvency II regime with new strategies for the distribution and underwriting of insurance products?
2. How to take a more proactive approach towards the new legal framework introduced by Solvency II in order to accommodate InsurTech investments and allow the insurers to remain in this competitive market?

Some of the major insurance companies in Portugal are under the control of financial groups or private equity funds and we would expect the medium and large-sized insurance companies to be in conditions to make substantial investments in InsurTech projects and deal with the increased international competitiveness of EU insurers. The scenario is likely to be different for small-sized insurers that could struggle to meet the financial requirements established by Solvency II and may be forced to continue with their traditional business model that is more and more under threat when compared with their more sophisticated competitors.

In addition to the big benefits that can be achieved with their distribution channels, insurers should also look to the investment in technology from the perspective of a more time and cost effective compliance with the complex calculations and analysis required under Solvency II, notably in financial/solvency requirements, ie, to make the best use of the technological investments from an internal and external perspective.

It is also worth mentioning that the Fintech & Insurtech Portuguese Association was created in October 2016 and such association is aimed to create a favorable environment for development of Startups and Fintech & Insurtech companies in Portugal.

The impact of Solvency II in InsurTech investments

The implementation of the Solvency II regime determined the general review of the Portuguese legal framework governing the access to and the development of the insurance and reinsurance activities, pension fund business and the activity of pension funds management entities[2]. As determined by the EU Directive, the implementation of the new legal regime aims to strengthen consumers protection, improve the competitiveness between all players of the insurance market independently of the regime under which they are acting – freedom of establishment and freedom to provide services – and also to harmonise the supervisory regimes.

When looking into the comprehensive program of regulatory requirements established by the Solvency II regime and, in particular, to its three pillar structure, it is clear that the implementation of technological solutions could raise issues in particular around pillar II (Governance & Supervision).

One of the main questions around pillar II, particularly in what concerns the supervision of activities, is to know to what extent insurers can fully rely on new technological systems used in the underwriting and distribution of insurance products and if such systems allow the insurer to monitor, manage and report risks on a continuous basis.

It should also be noted that – as established under the Solvency II Directive and transposed into the national law – the effective risk management system that shall be maintained by the insurers also comprises the subcontracting (outsourcing) of services. Unless we are dealing with an insurer that has a very sophisticated IT team within its structure, we find it difficult to consider the implementation of innovative InsurTech solutions without having certain services outsourced to technology companies and startups dedicated to developing technological solutions. Having this in mind, it is critical that the parties to such partnerships take in to consideration the legal restrictions on the outsourcing of critical or important operational functions or activities[3] and have such partnerships construed in a way that is deemed acceptable by the ASF[4].

Another challenge that will be faced by insurers and their distribution channels when implementing new technological solutions is to make sure that innovation will not collide with the required level of consumer protection notably with respect to information duties, mis-selling practices, data protection issues, handling of claims, and so on.

The legislation governing the insurance and reinsurance activities is not expected to be subject to major amendments in the near future because the players in the market (and the ASF itself) are still in the process of implementing the new requirements of Solvency II. Nevertheless, the Portuguese Government and the ASF should consider the impact of technology on product design and distribution as a priority since the existing regulatory framework does not cover this new approach of the insurance industry and the implications for consumers resulting therefrom.

It is clear that the implementation of new technological solutions in the insurance industry will lead to new legal, regulatory and ethical issues that will have direct impact on the activity of regulators, insurers, distributors and consumers.

Notes

1 The annual report for the fiscal year of 2016 is not available yet.

2 All these changes were implemented by Law no. 147/2015 of 9 September.

3 Notably in respect of the increase of operational risk.

4 The supervisory authority will have to assess its ability to monitor the compliance of the insurer with its obligations under such outsourcing arrangement.