“PLAYING BY THE RULES”: ADVANCES TO PRUDENTIAL REGULATION AND SUPERVISION OF UK INSURANCE STARTUPS AND INSURTECH.

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Abstract: This paper focus on advances to legal and regulatory challenges in the digital insurance era, focusing on the UK insurance industry, with developments of the regulatory environment and prudential supervision. It presents a critical analysis of existing supervisory practices from the Prudential Regulation Authority (PRA) for the UK re-insurance sector, inclusive of the Lloyd’s of London. The aim of this analysis performed is to comment on gaps identified from the latest PRA’s approach to insurance supervision[1] and the New Insurer Start-Up Unit Guide[2], towards the effective supervision of insurance startups and insurtech. The underlying objective is to examine the impact of insurance startups and insurtech on traditional insurance models from a regulatory perspective. Particularly about risk management practices and the prudential regulatory expectations based on the PRA’s Rulebook[3], and in line with the Lloyd’s of London Principles[4] for the London market. Considering the developments observed in the insurance industry, shaped by consolidation and collaboration with insurtechs in the form or partnerships, enhancements to the underlying prudential framework are required. The supervisory approach should evolve to address the challenges introduced by the relationship between the insurance startups and the traditional insurers. Insurtechs strive to develop technological innovations, using digital technologies, leading to improvements in the insurance business model. From that partnership with traditional re-insurers, they provide tailored solutions to support different processes and parts of the insurance value chain. Often insurtechs partner with multiple re-insurers competing in the same sub-sector. To account for the effective supervision of those activities and partnerships towards establishing the overarching prudential framework without hindering innovation, a principles-based vs. a rules-based approach is examined, commenting on their cross-comparison. This is linked to the supervision of big techs’ activities in insurance, with the applicable regulatory requirements in the area of insurance underwriting, digital distribution and service provision[5]. In this article the existing supervisory approach and regulatory view considering risk management practices and expectations against Solvency II Pillars are critically discussed and analysed. Especially focusing on the Own Risk and Solvency Assessment (ORSA) and model risk management (MRM) building on prior findings about stress and scenario testing (S&ST) methodologies and practices[6]. Combining those areas, recommendations about the development of regulatory prescribed stress testing exercises are presented, building on the prior PRA’s 2022 Insurance Stress Test (IST)[7], and in preparation to the forthcoming market wide exercise in 2025[8]. These are combined with the realistic disaster scenarios (RDS) developed for the London Market by Lloyd’s of London[9], as additional recurring stress testing exercise. The emphasis is placed on the insurers and insurtechs not invited to participate in the IST, with proposals to address the

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[1] Prudential Regulation Authority ‘The Prudential Regulation Authority’s approach to insurance supervision’ (2023) PRA, Bank of England.
[2] Prudential Regulation Authority ‘New Insurer Start-Up Unit Guide: What you need to know from the PRA and the FCA’ (2023) PRA, Bank of England.
[3] R*eferring to the Insurance Rules for both insurance firms not subject to and subject to the Solvency II Directive*.
[4] *Primarily the Solvency principles, Capital (#7), Liquidity (#8) and Investments (#9), with the Governance, Risk Management and Reporting principle (#10).* Lloyd’s of London, ‘Principles for doing business at Lloyd’s’ (2023) Lloyd’s of London.
[5] Denise Garcia Ocampo, Jatin Taneja, Jeffery Yong and Julie Zhu ‘From clicks to claims: emerging trends and risks of big techs’ foray into insurance’ (2023) No 51, FSI Insights on policy implementation, Financial Stability Institute, Bank for International Settlements.
[6] Stavros Pantos ‘Designing Stress Tests for UK Fast-Growing Firms and Fintech’ (2023) Risks 11(2) 31.
[7] Prudential Regulation Authority ‘Dear CEO Letter: Insurance Stress Test 2022 feedback’ (2023) PRA, Bank of England.
[8] Prudential Regulation Authority ‘PRA statement on the dynamic general insurance stress test in 2025’ (2023) PRA Bank of England.
[9] Lloyd’s of London ‘RDS 2023: Realistic Disaster Scenarios Scenario Specification’ (2023) Lloyd’s of London.

associated gaps in supervising their risk management capabilities in the areas of stress testing, the ORSA and MRM. This doctrinal legal research adopts a socio-legal methodology combined with economic theory in analysing the UK prudential regulatory frameworks and supervisory approach underpinning insurance starts ups and insurtechs. The economic analysis of law and regulation constitutes the methodological approach followed to critically evaluate the effectiveness of existing supervisory practices towards insurtech. This article using the UK re-insurance industry as a case study attempts to provide empirical insight from the prudential supervision of re-insurers and tech startups. Recommendations for the design and development of the prudent supervisory approach of insurtechs risk management practices are included. Overall, this research examines the approach and practices of UK regulators towards the prudent supervision of insurance startups and insuretchs. It describes their evolution, differing characteristics with proposals for future developments to ensure their sound prudential risk management. The ultimate aim of this research is to provide insights to the insurance practice, adding to the literature about enhancements to prudential regulation.

***Keywords*:** insurance, insurtech, regulation, risk management, prudential supervision.