

Encrypted messages...

Deciphering blockchain's promise in insurance

Views differ on blockchain. Somewhere amidst the hype and the scepticism, lie insights which will help secure the promise which many believe the technology could deliver.

Blockchain is making inroads across a number of industry sectors. Partly linked to its cryptocurrency roots, the financial services sector has been leading the charge with significant investments made already, but that sector also faces material challenges to navigate due to its highly regulated operating environment. In the insurance industry, traditionally more cautious than its banking counterparts and also highly-regulated, it has been a slower burn – but attention is now building with the high profile consortium of b3i now reaching 15 members including Achmea, Aegon, Ageas, Allianz, Generali, Hannover Re, Liberty Mutual, Munich Re, RGA, SCOR, Swiss Re, Sompo Japan Nipponkoa Insurance, Tokio Marine Holdings, XL Catlin and Zurich Insurance Group.

Hogan Lovells has been engaged since the early days in analysing the potential of blockchain and other innovations evolving from forms of distributed ledger technology (DLT). As understanding matures in relation to the potential and the pitfalls of the technology, and its commercial use cases emerge, the significance of the legal and regulatory framework is gaining traction.

This article is based on a series of conversations amongst a number of senior insurance industry participants and blockchain innovators, a panel session at our Insurance Summit in February, at a roundtable dinner discussion at Hogan Lovells in March and at The Blockchain Summit by Marketforce which we sponsored in both October and March. The observations made may enhance perspectives on

whether and where there is true transformational value to be derived.

Our conversations invariably started with what "blockchain" is. Even on that there is a spectrum of interpretation...

Historically, blockchain is the specific technology which underpins bitcoin, enabling the operation of a public ledger open to anyone to access or alter provided that the rules for making new entries, known as consensus protocols, are complied with. It encrypts data in blocks and then links the blocks creating a data chain which is "immutable" as any alteration to one block would affect the blocks below it.

But "blockchain" has now become a broad church with that term and DLT being applied to a range of innovative technologies derived from the benefit of shared control of a single ledger. Indeed consensus often emerged in conversations, even between blockchain cynics and aficionados, over the value of private linked ledgers which essentially allow shared control over one single version of truth – where "I know that what I see is what you see and I know that you know that".

Even as opinions differed in discussion on whether blockchain in the purist's sense is the answer to acknowledged problems, there was agreement that there are parallels with the early days of the internet in terms of the new legal issues it can create and the care which regulators need to take in developing their response.

Some thoughts worth sharing:

- Blockchain has sometimes been called the "internet of value transfer" and its ability to control the issue

of "double spend" seems to offer potential in the arena of asset tracking and claims fraud.

- Blockchain itself should not be regulated – it is the applications which run on it which should be regulated, just as with any other form of technology it is the activity performed which should be the focus.
- Collaboration underpins success – but smaller consortia can sometimes move faster to reach practical implementation while larger consortia seek to evolve the structure of the industry
- Solutions will develop in phases - there may be scope for disintermediation of brokers but by focussing on macro industry issues, there is a risk of overlooking the huge value (and potential for reduction in the cost element of premiums) which could be unlocked by using DLT to make current processes operate with less friction or duplication of human intervention.
- Privacy issues, such as the right to be forgotten, reidentification risk and data minimisation, will be key and tricky to navigate, with it being important to understand that some data protection obligations are not absolute rights
- Solutions will need to achieve the optimum balance between the transparency needed to deliver confidence and functionality but also ensuring that commercially sensitive information is appropriately masked and data protection laws are complied with
- The fragmented nature of insurance regulation globally offers opportunities as well as hurdles to overcome if solutions can help create technology bridges over them
- Governance models will be key to evolving structures, allocating liability and managing disputes as blockchain in insurance will likely operate in permissioned environments
- Care will be needed to manage systemic risk and cyber security issues, recognising that the scale of the potential honey pot as blockchain enters the insurance sector will be vastly greater than the bitcoin honeypot
- Parametric insurance offers an interesting use case and shines a light on the complexity of global regulation with different markets taking a very different approach as to whether parametric insurance is even characterised as insurance by local regulators
- Creating industry standards and focussing on securing interoperability will be key to releasing the value
- The hype and mixed views around the term "blockchain" and its historic associations with bitcoin are giving some innovators pause for thought in referring to the technology in their business models.
- As with all digital transformation, it is essential to keep your focus on the customer and the customer needs and experience.

One comment made was that the energy around "blockchain" is currently like the Gold Rush, with some cowboys but also some nuggets of gold awaiting discovery. Hopefully this article will help contribute to the sifting process and shape the value which emerges.

All that glitters is not gold. But there is broad acknowledgement that blockchain is a fulcrum from which valuable solutions could emerge. The journey may be difficult to predict but there will be elements of distributed ledger technology which will deliver value for those who can identify the opportunities – if they can navigate its challenges. Whether blockchain will be the "badge" which survives is just one more question to ponder...



John Salmon
Partner, London
T +44 20 7296 5071
john.salmon@hoganlovells.com



Richard Diffenthal
Partner, London
T +44 20 7296 5868
richard.diffenthal@hoganlovells.com



Pamela Buxton
Consultant, London
T +44 20 7296 5007
pamela.buxton@hoganlovells.com