CLIFFORD
CHANCE

Briefing note September 2016

FCA: Big Data in retail general insurance

The Financial Conduct Authority (FCA) has decided not to launch a market study into the use of Big Data in retail general insurance, concluding overall that the use of Big Data produces benefits for consumers in home and motor insurance. However, the FCA has identified two areas of potential concern: risk segmentation and certain pricing practices. It therefore intends to undertake further work looking at the pricing practices of a limited number of retail general insurance firms. The FCA has also published an occasional paper on price discrimination and cross-subsidy in financial services.

Background

In November 2015, the FCA launched a call for inputs on the use of Big Data in the retail general insurance sector. While Big Data is used across the financial sector, it has become particularly important to insurers who use information about customer behaviour to calculate premiums.

The call for inputs focused on whether:

- Big Data affects consumer outcomes;
- Big Data fosters or constrains competition; and
- The effect of the FCA's regulatory framework on developments in Big Data in the retail general insurance sector.

As well as taking into account responses to the call for inputs, the FCA analysed data from two price comparison websites to determine whether there have been any changes to price dispersion and coverage in the last five years and surveyed brokers specialising in consumers with non-standard risk.

Decision not to launch a market study

On 21 September 2016, the FCA announced that it has decided not to launch a market study into the use of Big Data in retail general insurance.

The FCA concluded that Big Data produces a range of benefits for consumers in home and motor insurance, including:

- Encouraging innovation in products and services;
- Supplementing available information which improves firms' ability to predict the likelihood of an insured event happening allowing for more accurate underwriting;
- Streamlining sales and claims processes; and
- Allowing customers to adapt their behaviour to reduce their risk and cost (e.g. customers using motor telematics devices can obtain lower premiums through safer driving).

Key points

- The FCA found that Big Data produces consumer benefits in home and motor insurance and decided not to launch a market study.
- However, improved risk information could lead to some customers being unable to obtain or afford insurance.
- There is also a risk of insurers using Big Data to discriminate on price for reasons other than risk or cost.
- These areas will be kept under review. The FCA also repeatedly noted that the effect of Big Data could change in the future.

However, the FCA identified two areas of potential concern: risk segmentation and certain pricing practices. It also noted that Big Data could have a more mixed effect on competition and consumers in the future.

Big Data includes:

- using new or expanded datasets and data (including from unconventional sources such as social media);
- adopting the technologies required to generate, collect and store these new forums of data;
- using advanced data processing techniques;
- sophisticated analytical techniques such as predictive analytics; and
- applying this data knowledge in business decisions and activities.

Potential concerns

Risk segmentation

The FCA recognised that Big Data can be used to model a consumer's risk profile more accurately, which will produce a more accurate premium and so benefit some consumers.

However, the FCA is concerned that increased risk segmentation could lead to certain high-risk consumers being unable to obtain or afford insurance.

The FCA noted that this issue involves a balance between social policy and commercial reality, best managed by the Government in consultation with regulators and other stakeholders. The FCA therefore intends to remain alert to the potential exclusion of high-risk customers.

Pricing practices

In response to the call for inputs, some stakeholders raised concerns that Big Data may improve firms' ability to identify opportunities to charge certain types of customer higher premiums which do not reflect the consumer's risks or the cost of serving the customer.

The FCA recognised that Big Data does not in itself cause firms to price discriminate, however, its expectation is that the increasing availability of data and sophistication of analytical tools will allow firms to develop these pricing practices more easily in future.

As the FCA received limited responses from firms on how they use Big Data in pricing practices for reasons other than risk or cost, it intends to look at the pricing practices of a limited number of firms to better understand the potential effects of Big Data on the types of pricing practices that are commonly used.

Future developments

The FCA noted that in the future Big Data could give rise to competition concerns and negative customer outcomes.

For example, Big Data could lead to complex features and pricing structures which would make it more difficult for customers to compare products given the limitations of price comparison websites.

Big Data could also increase firms' ability to market and cross-sell products which could lead customers to purchase products that are poor value or not what they need.

If there are difficulties in transferring telematics data between firms this could make it more difficult for customers to switch provider. However, the FCA did not find evidence that consumers using telematics devices currently experience difficulties in switching or of the lack of portability of telematics data.

Additionally, Big Data could increase barriers to entry and market power due to the value of datasets (discussed further below).

Occasional paper

The FCA has also published an occasional paper on practices that lead to:

- Different consumer groups being charged different prices for reasons other than risk or cost (price discrimination); and
- Cross-subsidisation between groups of consumers to enable firms to provide some customers with prices below cost without suffering losses.

The FCA noted that any assessment of pricing practices must be specific to the product and market and that it is not the form of pricing practice which matters but the effect on consumers.

Comment

Next steps

The FCA announced that it will not launch a market study on the basis of the call for inputs. Nevertheless, if its review of insurance pricing practices identifies any behaviour giving rise to competition concerns, the FCA could launch a market study or take enforcement action at a later date. Insurers should therefore monitor their use of Big Data in pricing and ensure that there is no risk of price discrimination (and ensure compliance with Data Protection Regulations).

Ongoing focus

The use of Big Data in the insurance industry in particular is generating increasing attention. The FCA's findings come after the Chartered Institute of Insurers (CII) warned in July that Big Data could create an "underclass" of people who cannot afford insurance. Concluding that data is a "double-edged sword", the CII warned that the insurance sector needs to carefully consider any move away from pooled risk to individual pricing and the impact this could have on the broader public interest. This concern was also raised by stakeholders in response to the FCA's call for inputs.

More generally, Big Data has been considered by several European regulators in 2016. The French and German competition authorities published a joint paper in May 2016. While the authorities did not call for increased enforcement action, the paper sets out their view on the potential impact of Big Data and possible theories of harm, including a "data advantage" depending on the scarcity, scale and scope of the data held by an entity.

The European Commission is also considering Big Data in the context of its Digital Single Market Strategy.

The Commission appears particularly interested in issues surrounding data protection and data as an asset creating barriers to entry, with Commissioner for Competition, Margrethe Vestager, commenting recently that the Commission is keeping "a close eye on whether companies control unique data… and can use it to shut their rivals out of the market". The Commission is expected to focus on these issues in its review of the proposed Microsoft/LinkedIn and Verizon/Yahoo transactions.

The Commission has also indicated that it might make a legislative proposal in early 2017 to increase national competition authorities' powers to pursue antitrust abuses relating to data.

Contacts

Alex Nourry
Partner, London

T: +44 20 7006 8001
E: alex.nourry
@cliffordchance.com

Richard Jones
Director of Data Privacy, London

T: +44 20 7006 8238
E: richard.jones
@cliffordchance.com

Ashley Prebble
Partner, London

T: +44 20 7006 3058
E: ashley.prebble
@cliffordchance.com

Greg Olsen
Partner, London

T: +44 20 7006 2327
E: greg.olsen
@cliffordchance.com

Jenine Hulsmann
Partner, London

T: +44 20 7006 8216
E: jenine.hulsmann
@cliffordchance.com

Elizabeth Morony
Partner, London

T: +44 20 7006 8128
E: elizabeth.morony
@cliffordchance.com

Luke Tolaini
Partner, London

T: +44 20 7006 4666
E: luke.tolaini
@cliffordchance.com

Carlos Conceicao
Partner, London

T: +44 20 7006 8281
E: carlos.conceicao
@cliffordchance.com

Authors

Christopher Duff
Senior Associate, London

T: +44 20 7006 8793
E: christopher.duff
@cliffordchance.com

Fiona Garside
Associate, London

T: +44 20 7006 1813
E: fiona.garside
@cliffordchance.com