Big data for insurers' pricing – and potential regulatory limits

By João on May 11, 2015 at 8:00 am
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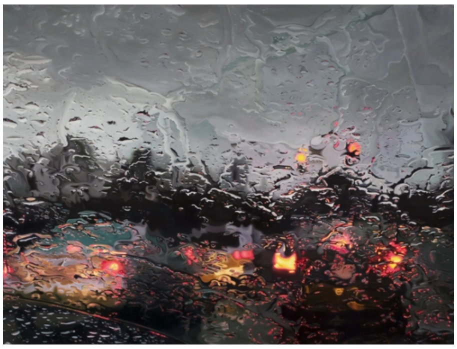

The potential of Big Data has been frequently discussed, including in our book and in this blog, Generally, there is a positive view towards its potential. But the advantages of Big Data may just be "too much" and backfire on its adopters. The insurance industry faces this paradoxical risk, if its use of Big Data triggers a "regulatory crackdown", as the Financial Times recently reported. So, what's the issue?

Big Data analysis of increasingly large amounts of personal data offers the potential to better predict the risk of individual customers – e.g., identifying riskier drivers. Of course, insurers have always tried to match each customer's risk and price charged, charging more to riskier drivers – as every young driver has probably found out, when buying car insurance just after getting the driver's permit. And Big Data seems so suited to support this objective that "the sector is locked in a data-gathering "arms race" as they seek ever more information to help predict whether individual policyholders are likely to put in claims". The problem is that regulators are concerned about avoiding that the "increasing use of personal data does not leave chunks of society without affordable cover", as stated by Paul Evans, chairman of the Association of British Insurers.

A positive view on this predictive power of Big Data is the potential to offer better deals to lower risk customers, such as good drivers. But Paul Evans acknowledges that the reverse is, ultimately, an increase of prices to riskier customers, potentially implying that, in practical terms, some sectors of society may not be able to afford insurance anymore. So, he recommends the industry to "'anticipate regulators' by developing its own code of conduct on how to use data responsibly. 'Let's ensure we don't fall into any pitfalls'".

Indeed, a great example of problems of having "too much" of a good thing!