Predictive Modeling Applications in Actuarial Science

Volume II: Case Studies in Insurance

Predictive modeling uses data to forecast future events. It exploits relationships between explanatory variables and the predicted variables from past occurrences to predict future outcomes. Forecasting financial events is a core skill that actuaries routinely apply in insurance and other risk-management applications. Predictive Modeling Applications in Actuarial Science emphasizes lifelong learning by developing tools in an insurance context, providing the relevant actuarial applications, and introducing advanced statistical techniques that can be used to gain a competitive advantage in situations with complex data.

Volume II examines applications of predictive modeling. Where Volume I developed the foundations of predictive modeling, Volume II explores practical uses for techniques, focusing especially on property and casualty insurance. Readers are exposed to a variety of techniques in concrete, real-life contexts that demonstrate their value, and the overall value of predictive modeling, for seasoned practicing analysts as well as those just starting out.

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Piet De Jong & Gillian Z. Heller
PREDICTIVE MODELING APPLICATIONS IN ACTUARIAL SCIENCE

Volume II: Case Studies in Insurance

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Contents

Contributors xi
Preface xv
Acknowledgments xix

1 Pure Premium Modeling Using Generalized Linear Models
Ernesto Schirmacher
1.1 Introduction 1
1.2 Data Characteristics 3
1.3 Exploratory Data Analysis 6
1.4 Frequency Modeling 12
1.5 Severity Modeling 23
1.6 Pure Premium 30
1.7 Validation 34
1.8 Conclusions 37
References 38

2 Applying Generalized Linear Models to Insurance Data: Frequency/Severity versus Pure Premium Modeling
Dan Tevet
2.1 Introduction 39
2.2 Comparing Model Forms 40
2.3 The Dataset and Model Forms 44
2.4 Results 47
Appendix 2.A Proof of Equivalence between Pure Premium Model Forms 55
Conclusion 57
Appendix 2.B The Gini Index 57
References 58

vii
### Contents

3 Generalized Linear Models as Predictive Claim Models 60  
Greg Taylor and James Sullivan  
3.1 Review of Loss Reserving 60  
3.2 Additional Notation 63  
3.3 GLM Background 64  
3.4 Advantages of GLMs 66  
3.5 Diagnostics 68  
3.6 Example 73  
3.7 Conclusion 97  
References 98

4 Frameworks for General Insurance Ratemaking: Beyond the Generalized Linear Model 100  
Peng Shi and James Guszcza  
4.1 Introduction 100  
4.2 Data 102  
4.3 Univariate Ratemaking Framework 104  
4.4 Multivariate Ratemaking Frameworks 113  
4.5 Model Comparisons 122  
4.6 Conclusion 123  
References 124

5 Using Multilevel Modeling for Group Health Insurance Ratemaking: A Case Study from the Egyptian Market 126  
Mona S. A. Hammad and Galal A. H. Harby  
5.1 Motivation and Background 126  
5.2 Data 130  
5.3 Methods and Models 141  
5.4 Results 144  
5.5 Conclusions 146  
Acknowledgments 147  
Appendix 147  
References 157

6 Clustering in General Insurance Pricing 159  
Ji Yao  
6.1 Introduction 159  
6.2 Overview of Clustering 160  
6.3 Dataset for Case Study 161  
6.4 Clustering Methods 163  
6.5 Exposure-Adjusted Hybrid (EAH) Clustering Method 168
# Contents

6.6 Results of Case Study 171
6.7 Other Considerations 177
6.8 Conclusions 178
References 179

7 Application of Two Unsupervised Learning Techniques to Questionable Claims: PRIDIT and Random Forest 180
Louise A. Francis
7.1 Introduction 180
7.2 Unsupervised Learning 181
7.3 Simulated Automobile PIP Questionable Claims Data and the Fraud Issue 182
7.4 The Questionable Claims Dependent Variable Problem 185
7.5 The PRIDIT Method 185
7.6 Processing the Questionable Claims Data for PRIDIT Analysis 187
7.7 Computing RIDITS and PRIDITS 187
7.8 PRIDIT Results for Simulated PIP Questionable Claims Data 188
7.9 How Good Is the PRIDIT Score? 189
7.10 Trees and Random Forests 192
7.11 Unsupervised Learning with Random Forest 194
7.12 Software for Random Forest Computation 195
7.13 Some Findings from the Brockett et al. Study 201
7.14 Random Forest Visualization via Multidimensional Scaling 202
7.15 Kohonen Neural Networks 204
7.16 Summary 205
References 206

8 The Predictive Distribution of Loss Reserve Estimates over a Finite Time Horizon 208
Glenn Meyers
8.1 Introduction 208
8.2 The CAS Loss Reserve Database 210
8.3 The Correlated Chain Ladder Model 212
8.4 The Predictive Distribution of Future Estimates 213
8.5 The Implications for Capital Management 216
8.6 Summary and Conclusions 223
References 223
Contents

9 Finite Mixture Model and Workers’ Compensation Large-Loss Regression Analysis
Luyang Fu and Xianfang Liu
9.1 Introduction 224
9.2 DGLM and FMM 230
9.3 Data 232
9.4 Traditional Distribution Analysis 234
9.5 Univariate and Correlation Analyses 239
9.6 Regression Analysis 246
9.7 Conclusions 257
References 258

10 A Framework for Managing Claim Escalation Using Predictive Modeling
Mohamad A. Hindawi and Claudine H. Modlin
10.1 Introduction 261
10.2 Loss Development Models 262
10.3 Additional Data for Triage Models 267
10.4 Factor Selection 271
10.5 Modeling Method 274
10.6 Conclusions 277
10.7 Further Research Opportunities 277
Appendix: Penalized Regression 280
References 289

11 Predictive Modeling for Usage-Based Auto Insurance
Udi Makov and Jim Weiss
11.1 Introduction to Usage-Based Auto Insurance 290
11.2 Poisson Model for Usage-Based Auto Insurance 294
11.3 Classification Trees 301
11.4 Implementing UBI Models with a Traditional Rating Plan 305
11.5 Summary and Areas for Future Research 306
Acknowledgments 307
References 308

Index 309
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Preface

In January 1983, the North American actuarial education societies (the Society of Actuaries and the Casualty Actuarial Society) announced that a course based on regression and time series would be part of their basic educational requirements. Since that announcement, a generation of actuaries has been trained in these fundamental applied statistical tools. This two-set volume builds on this training by developing the fundamentals of predictive modeling and providing corresponding applications in actuarial science, risk management, and insurance.

The series is written for practicing actuaries who wish to get a refresher on modern-day data-mining techniques and predictive modeling. Almost all of the international actuarial organizations now require continuing education of their members. Thus, in addition to responding to competitive pressures, actuaries will need materials like these books for their own continuing education. Moreover, it is anticipated that these books could be used for seminars that are held for practicing actuaries who wish to get professional accreditation (known as VEE, or validated by educational experience).

Volume I lays out the foundations of predictive modeling. Beginning with reviews of regression and time series methods, this book provides step-by-step introductions to advanced predictive modeling techniques that are particularly useful in actuarial practice. Readers will gain expertise in several statistical topics, including generalized linear modeling and the analysis of longitudinal, two-part (frequency/severity) and fat-tailed data. Thus, although the audience is primarily professional actuaries, the book exhibits a “textbook” approach, and so this volume will also be useful for continuing professional development.

An international author team (seven countries, three continents) developed Volume I, published in 2014. You can more learn more about Volume I at http://research.bus.wisc.edu/PredModelActuaries

Volume II examines applications of predictive models, focusing on property and casualty insurance, primarily through the use of case studies. Case studies provide a learning experience that is closer to real-world actuarial work than can be provided
Preface

by traditional self-study or lecture/work settings. They can integrate several analysis techniques or, alternatively, can demonstrate that a technique normally used in one practice area could have value in another area. Readers can learn that there is no unique correct answer. Practicing actuaries can be exposed to a variety of techniques in contexts that demonstrates their value. Academic actuaries and students see that there are valid applications for the theoretical material presented in Volume I. As with Volume I, we have extensive sample data and statistical code on the series website so that readers can learn by doing.

The first three chapters of Volume II focus on applications of the generalized linear model (GLM), arguably the workhorse of predictive modeling in actuarial applications. Chapter 1, by Ernesto Schirmacher, gives an overview of the use of GLMs in pricing strategy, focusing on private passenger automobile. Dan Tevet’s Chapter 2 reinforces this discussion by examining insurance for motorcycles, emphasizing the comparison between frequency-severity and pure premium models. In Chapter 3, Greg Taylor and James Sullivan demonstrate how to use GLM techniques in loss reserving. Although the two books in the series are written independently, readers with access to the first book will appreciate these three chapters more deeply after reviewing the foundations in Chapters 2–6 of Volume I.

Chapters 4 and 5 provide extensions of the generalized linear model. Like Chapter 1, in Chapter 4, Peng Shi and James Guszcza also examine pricing strategies for personal automobile insurance. However, they show how to price insurance when more than one type of coverage, such as third-party liability and personal injury protection, is available in the database; by taking advantage of the multivariate nature of claims, they are able to incorporate dependencies among coverages in their pricing structure. For another approach to incorporating dependencies, in Chapter 5, Mona S. A. Hammad and Galal A. H. Harby use multilevel models. They provide a unique and interesting case study of group health insurance in the Egyptian market. Chapters 8 and 16 of Volume I provide an introduction to mixed and multilevel modeling.

Chapters 6 and 7 describe applications of unsupervised predictive modeling methods. Most predictive modeling tools require that one or more variables be identified as “dependent variables” or the “outcome of interest,” and other variables are used to explain or predict them; this is known as a supervised predictive model. In contrast, unsupervised models treat all variables alike and do not require this identification. Chapter 12 of Volume I, by Louise Frances, introduced unsupervised learning with a focus on common methods of dimension reduction, principal components/factor analysis, and clustering. Chapter 6 of this volume, by Ji Yao, builds on this introduction with an application in insurance ratemaking. Louise A. Frances, the author of Chapter 7 of this volume, also follows up with two advanced unsupervised learning techniques, a variation of principal components known as PRIDIT, and a
Preface

(unsupervised) variation of random forests, a tree-based data-mining method. She applies these techniques to help identify predictors of claims that are fraudulent or questionable.

Chapters 8 through 11 show how to use predictive modeling techniques in problems that are currently receiving substantial attention in actuarial science and insurance risk modeling. In Chapter 8, Glenn Meyers shows how to take the output of a Bayesian Monte Carlo Markov chain (MCMC) stochastic loss reserve model and calculate the predictive distribution of the estimates of the expected loss over a finite time horizon. Luyang Fu and Xianfang (Frank) Liu, in Chapter 9, compare GLM modeling to finite mixture models to study claims triaging and high-deductible pricing using workers’ compensation data.

Chapter 10, by Mohamad A. Hindawi and Claudine H. Modlin, provides a framework for managing claim escalation. This chapter also discusses claims triaging and text mining, using penalized regression techniques, such as elastic net, to help with variable selection. In Chapter 11, Udi Makov and Jim Weiss describe how to analyze data collected from policyholders’ vehicles via telematics to help determine motor vehicle premium rates. Data collected via telematics are volatile and voluminous, and actuaries and data scientists must take particular care when applying predictive modeling techniques.
Acknowledgments

Funding for this project was provided by the Casualty Actuarial Society and the Canadian Institute of Actuaries. The authors also thank the Wisconsin School of Business for hosting the book’s website.