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CAR INSURANCE RISK PREDICTION USING ARTIFICIAL INTELLIGENCE AND MACHINE LEARNING

Ramesh Chandra Aditya Komperla
akomperla@gmail.com

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ABSTRACT

Car insurance risk prediction is a critical aspect of the insurance industry, helping insurers assess potential claims, optimize premium pricing, and mitigate fraudulent activities. This study explores the application of artificial intelligence (AI) and Machine Learning (ML) techniques, particularly Random Forest classification, to predict car insurance risks using publicly available datasets from Kaggle. By implementing feature extraction and classification methodologies, this research demonstrates the effectiveness of AI-driven predictive models in enhancing risk assessment accuracy and operational efficiency in the insurance sector.

KEYWORDS: Artificial Intelligence, Car Insurance, Machine Learning, NCA, Random Forest.

1. INTRODUCTION

The insurance industry, particularly in the domain of car insurance, faces ongoing challenges in accurately predicting risks, setting appropriate premiums, and efficiently processing claims. Traditional actuarial methods, while foundational in risk assessment, often rely on linear assumptions and cannot easily capture complex, non-linear patterns within large and diverse datasets. With the advent of big data and machine learning (ML), there is an increasing opportunity to transform how insurers approach risk assessment, fraud detection, and pricing strategies.

Car insurance risk prediction is a multifaceted process that involves assessing various factors such as a driver's history, the type of vehicle, driving behaviors, geographical location, and external socio-economic trends. Insurers traditionally relied on statistical models and actuarial tables, where risk was typically assessed using broad categories and pre-set assumptions. However, these methods fail to account for subtle patterns or newly emerging trends that could indicate a higher risk of claims. As a result, the insurance industry has begun embracing advanced technologies like Artificial Intelligence (AI) and machine learning to improve accuracy, speed, and efficiency in predicting risks.

AI and ML models have proven particularly effective in handling the complexities of large datasets. These models can uncover non-linear relationships between input features, such as driver age, car model, driving frequency, accident history, and even external factors like weather conditions or regional accident rates. Machine learning algorithms, specifically classification algorithms such as Random Forest (RF), have become a preferred tool for insurers because of their high accuracy, robustness to overfitting, and ease of interpretability.

Random Forest, a powerful ensemble learning technique, is widely used in classification tasks for its ability to build multiple decision trees and combine their outputs to produce a final classification. The model's strength lies in its ability to handle large and high-dimensional datasets, such as those found in car insurance risk prediction, by evaluating numerous features and identifying the most relevant ones for risk assessment. By applying Random Forests, insurers can develop more dynamic models that improve over traditional actuarial methods, offering deeper insights into risk prediction, helping to optimize premium pricing, and enhancing overall decision-making. The goal of this study is to design and evaluate a machine learning-based predictive model for car insurance risk assessment. Specifically, the study will leverage publicly available datasets from Kaggle to extract key features and apply Random Forest classification to predict the likelihood of insurance claims and assess risk levels. Through this approach, the research aims to demonstrate the effectiveness of AI-driven models in increasing prediction accuracy, improving operational efficiency, and contributing to the overall success of car insurance providers.

Problem Statement: The increasing complexity and volume of car insurance data challenge traditional risk assessment methods, which are unable to fully utilize the potential of modern machine learning techniques. There

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is a pressing need to develop more accurate, data-driven models for predicting risks and optimizing premium pricing, ensuring that insurers can mitigate losses and offer fair pricing to customers.

Research Objective: The primary objective of this study is to develop a predictive model for car insurance risk assessment using feature extraction and Random Forest classification techniques. The study will evaluate the effectiveness of the model in predicting car insurance claims and providing a more accurate risk assessment compared to traditional methods.

This study also seeks to evaluate the broader potential of AI and ML in the car insurance sector, offering insights into how these technologies can be integrated into existing risk assessment frameworks for improved decision-making. By showcasing the value of predictive modeling in the insurance domain, this research will contribute to ongoing efforts to digitize and optimize the insurance industry.

This research aims to establish how AI and machine learning—specifically Random Forest classification—can be used to enhance car insurance risk prediction. By leveraging advanced feature extraction and classification techniques, this study will showcase the potential for these methods to improve accuracy in risk assessment, optimize premium pricing, and enable insurers to better manage their portfolio of policies. The application of AI-driven models in insurance is not only a technological evolution but also a strategic necessity in an increasingly data-driven world.

2. LITERATURE REVIEW

The integration of Artificial Intelligence (AI) and machine learning (ML) into the insurance industry has transformed traditional methods of risk assessment, underwriting, and claims management. Various studies have explored how machine learning models, especially ensemble methods like Random Forest (RF), enhance the accuracy, efficiency, and scalability of insurance risk prediction. This section reviews key studies in AI and ML applications to car insurance, focusing on risk modeling, feature selection, fraud detection, and predictive modeling techniques.

AI and ML in Risk Modeling and Insurance Analytics: AI and machine learning have increasingly been adopted in the insurance industry for predictive analytics, particularly in assessing risks and predicting claims. Traditional actuarial methods typically use predefined risk factors such as age, gender, car make, and model, but these models often fail to identify complex, non-linear relationships among features. Machine learning techniques, especially decision trees and ensemble methods, allow for better exploitation of large and high-dimensional datasets to improve predictions and create more accurate risk models.

A study by the authors of [1] utilized machine learning techniques, including Random Forests and Gradient Boosting Machines, for insurance risk prediction. The authors demonstrated that machine learning models outperform traditional actuarial models by improving prediction accuracy and handling large amounts of diverse data effectively. This approach allows insurers to assess more intricate risk factors, leading to better pricing models and more precise risk profiling of customers [2].

The authors of [2] focused on using machine learning for predicting claims likelihood in car insurance. Their study showed that Random Forest classifiers outperformed traditional logistic regression models in terms of prediction accuracy and robustness. They observed that RF could capture interactions between variables such as age, driving behavior, and vehicle type, which are often missed by simpler models. The study also highlighted the importance of feature selection, noting that the right combination of input variables could significantly improve predictive performance [2].

Fraud Detection Using Machine Learning: Fraud detection is another key area where AI and ML have demonstrated substantial value. Insurers face considerable challenges in detecting fraudulent claims due to the increasing sophistication of fraudulent activities. Machine learning algorithms, particularly supervised learning models like Random Forest and unsupervised models like anomaly detection algorithms, have been shown to enhance fraud detection capabilities by identifying outlier behaviors and detecting unusual patterns that might signal fraudulent activity.

The authors of [3] proposed an ensemble learning method that combines decision trees, including Random Forest, with anomaly detection techniques to identify fraudulent claims in healthcare insurance. Their approach outperformed traditional rule-based systems in terms of both accuracy and efficiency. This study highlights the

potential of ensemble models in detecting fraud across multiple dimensions of insurance data, including customer behaviors, historical claims, and policy details. They concluded that ensemble models provide superior detection rates by capturing complex patterns that are often indicative of fraud [4].

In car insurance, the authors of [4] used Random Forest classifiers to detect fraud in claims by considering historical data such as previous claims, claim frequency, and accident severity. Their research found that RF models could effectively distinguish between legitimate and fraudulent claims, helping insurers optimize claims processing and reduce losses due to fraud. The authors suggested that integrating machine learning with real-time data feeds could further enhance fraud detection in the car insurance industry [4].

Feature Selection and Engineering for Car Insurance Risk Prediction: The success of machine learning models heavily depends on the quality of the input features. Feature engineering, which involves selecting and transforming relevant data attributes, plays a crucial role in improving model performance. Several studies have explored various feature selection techniques to enhance the predictive accuracy of insurance risk models.

The authors of [5] examined the effect of different feature engineering techniques on the performance of Random Forest models in insurance risk prediction. They used domain knowledge to create a set of meaningful features that better represent customer risk profiles. The study found that the inclusion of non-traditional variables such as social media activity, geographic location, and driving behavior data (e.g., telematics) improved the model's performance. They concluded that advanced feature engineering, coupled with machine learning models, could provide insurers with more nuanced and dynamic risk predictions [5].

The authors of [6] focused on the role of external data sources, such as regional economic trends, traffic data, and climate information, in improving car insurance risk models. By incorporating these external factors into the Random Forest model, they were able to improve risk prediction accuracy significantly. They highlighted that a more comprehensive feature set, including real-time data and socio-economic variables, could offer a competitive edge in pricing and risk assessment [6].

Random Forest Classifier for Risk Prediction: The Random Forest classifier is an ensemble learning method that has been widely applied in car insurance risk prediction due to its robustness, scalability, and ability to handle large datasets. The model builds multiple decision trees based on randomly selected subsets of data and combines their outputs to make predictions. This ensemble approach helps mitigate overfitting, making it particularly well-suited for high-dimensional datasets with a large number of features.

In [7], the developer of the Random Forest algorithm demonstrated its effectiveness in a variety of classification tasks, including those in the insurance industry. The algorithm's ability to perform automatic feature selection and handle missing data makes it a strong candidate for risk assessment tasks in car insurance. Breiman's work laid the foundation for subsequent research in using Random Forest for predictive modeling, highlighting its superior performance over individual decision trees [7].

In the context of car insurance, the authors of [8] evaluated the use of Random Forests for assessing the likelihood of claims based on historical data. Their findings indicated that Random Forest classifiers provide high prediction accuracy compared to traditional actuarial models. They emphasized that RF's ability to model complex relationships between diverse input features (e.g., driving history, car type, and policy type) led to more accurate and dynamic risk assessments [8].

Challenges and Future Directions: Despite the promising results of machine learning models, there are several challenges that insurers must overcome to fully integrate these techniques into their operations. One key challenge is the interpretability of models, especially in cases where complex algorithms like deep learning are used. Insurance regulators often require transparent explanations for risk assessments and claims decisions, and the "black-box" nature of some AI models can hinder their adoption [9].

Another challenge is data privacy and security, particularly with the increasing use of sensitive personal information in predictive modeling. Insurers must navigate regulations like the General Data Protection Regulation (GDPR) in Europe, which imposes strict rules on how customer data can be used in machine learning models [10].

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In the future, researchers suggest that integrating machine learning models with real-time data streams (e.g., telematics, IoT sensors) could significantly enhance the accuracy and timeliness of risk predictions. Additionally, advancements in explainable AI (XAI) will likely improve the transparency and interpretability of complex machine learning models, making them more acceptable for use in regulated industries like insurance [9].

The literature on AI and machine learning applications in car insurance has demonstrated the potential of advanced models, particularly Random Forest classifiers, to improve risk prediction and claims management. These models are able to handle large, complex datasets, identify non-linear patterns, and provide accurate risk assessments. However, challenges related to interpretability and data privacy remain, which must be addressed to enable the widespread adoption of these models. Future research will likely focus on integrating real-time data, improving model transparency, and exploring new techniques for feature engineering.

3. PROPOSED METHODOLOGY

This study aims to develop a predictive model for car insurance risk assessment using the Random Forest classifier, enhanced by feature selection techniques such as Neighborhood Component Analysis (NCA). The methodology consists of five key stages: dataset collection, data preprocessing, feature extraction, model implementation, and performance evaluation.

The dataset used for this study is sourced from Kaggle, containing various features related to car insurance claims, policyholder demographics, and vehicle characteristics. Key demographic data includes the age, gender, marital status, and occupation of the policyholder. Vehicle-related data consists of the vehicle make and model, vehicle age, and the type of car insurance policy. Claim-related data includes historical claim records, the number of claims filed, the total claim amount, and the frequency of claims. This dataset provides a comprehensive view of the factors influencing car insurance risk, enabling the application of machine learning algorithms to predict potential claims.

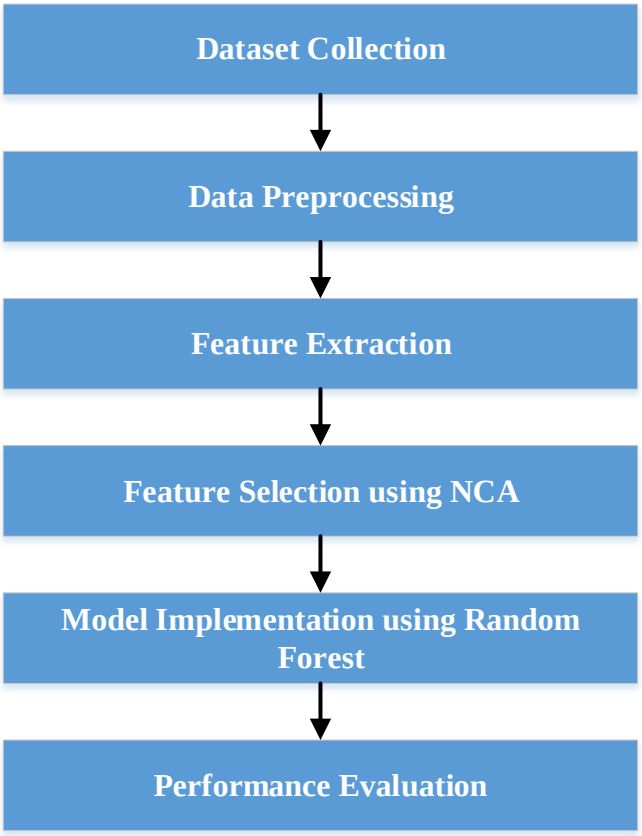

Figure 1: Flow Diagram for Proposed Car Insurance Risk Prediction System

Data preprocessing is a crucial step to ensure the dataset is clean, complete, and ready for model training. Missing values are handled through imputation techniques, where numerical features are imputed using the mean or median value, and categorical features are imputed using mode imputation. To ensure consistency in numerical features, normalization techniques such as Min-Max scaling or Z-score normalization are applied, depending on

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the distribution of each feature. Categorical variables, including the type of insurance policy and vehicle model, are transformed into numerical representations using one-hot encoding, making them compatible with the Random Forest model.

Feature extraction focuses on identifying the most relevant risk factors contributing to car insurance claims. Based on domain knowledge and preliminary analysis, key selected features include driving history, vehicle age, policyholder demographics, past claim history, and vehicle type. Driving history encompasses the number of accidents, speeding violations, and recorded traffic fines, which are critical indicators of risk. Vehicle age is considered since older vehicles may have higher maintenance costs and an increased likelihood of claims. Policyholder demographics, including age, gender, and occupation, are analyzed as potential risk factors. Past claim history provides insight into the probability of future claims based on the number and cost of previous claims. Lastly, the make and model of the insured vehicle influence repair costs and the risk of theft, with luxury cars typically associated with higher risks.

To enhance model performance and reduce overfitting, feature selection is performed using Neighborhood Component Analysis (NCA). NCA is a supervised method for dimensionality reduction that optimizes classification accuracy by selecting the most important features. By transforming input features into a lower-dimensional space while preserving the data structure, NCA reduces the number of irrelevant features, thereby improving the efficiency and interpretability of the model.

The primary machine learning model used in this study is the Random Forest classifier, an ensemble learning technique that aggregates predictions from multiple decision trees to enhance predictive accuracy. Random Forest is well-suited for handling high-dimensional and complex datasets, providing robust generalization performance. The model is trained using the selected features, and hyperparameter tuning is performed to optimize its performance. The key hyperparameters tuned include the number of trees (estimators), maximum tree depth, and the minimum number of samples required for splitting a node. Additionally, the model provides feature importance scores, which help identify the most influential factors in risk prediction.

To evaluate the performance of the Random Forest classifier, several metrics are used. Accuracy measures the overall correctness of the model's predictions. Precision evaluates the proportion of true positive predictions out of all positive predictions made, while recall measures the proportion of true positives out of all actual positives. The F1-score, which is the harmonic mean of precision and recall, provides a balance between these two metrics. Lastly, the area under the receiver operating characteristic curve (AUC-ROC) is used to assess the model's ability to distinguish between different classes, ensuring a comprehensive evaluation of its predictive capabilities.

3.1 Data Preprocessing and Feature Extraction

In the preprocessing stage, we manipulate the dataset to handle missing values and scale the features. The transformation equations are as follows:

- ***Normalization/Standardization (Z-score normalization):*** Given a feature x_i from the dataset X, the standardization equation is:

$$x_i' = \frac{x_i - \mu}{\sigma} \tag{1}$$

  Where:
  - x_i' is the normalized feature value,
  - x_i is the original feature value,
  - μ is the mean of the feature,
  - σ is the standard deviation of the feature.

  Alternatively, for Min-Max scaling:

$$x_i' = \frac{x_i - \min(X_i)}{\max(X_i) - \min(X_i)} \tag{2}$$

  Where $\min(X_i)$ and $\max(X_i)$ are the minimum and maximum values of the feature X_i.
- ***One-Hot Encoding for Categorical Variables:*** For a categorical feature C with categories $\{c_1, c_2, \ldots \ldots . . c_k\}$ the one-hot encoding can be represented as:

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$$C_i = \begin{bmatrix} 1\,0\,0\,\ldots\,0 \\ 0\,1\,0\,\ldots\,0 \\ \ldots\,\ldots\,\ldots\,\ldots. \\ 0\,0\,0\,\ldots\,\ldots\,1 \end{bmatrix} \quad (3)$$

Where each c_i is transformed into a binary vector, indicating the presence of a specific category.

3.2 Random Forest Model Construction

The Random Forest algorithm is an ensemble technique that combines multiple decision trees to make predictions. Each tree is trained on a random subset of the data and features. Given a training dataset $D = \{(x_i, y_i)\}_{i=1}^{N}$, where x_i represents the feature vector and y_i is the target variable (insurance risk), the algorithm works as follows:

- ***Bootstrap Sampling:*** For each tree $t \in T$, a bootstrap sample D_t of size N is drawn with replacement from the dataset D. This ensures each tree is trained on a slightly different version of the dataset, which improves generalization and reduces overfitting.
- ***Feature Randomization:*** At each node n in a tree, a random subset of m features is selected from the total M features, and the best feature f_n is chosen to split the node:

$$f_n = \arg \max_{f \in \{f_1, f_2 \ldots f_m\}} Impurity(n, f) \quad (4)$$

  Where Impurity $Impurity(n, f)$ represents a splitting criterion, such as Gini impurity or information gain. The goal is to select the feature that best separates the data at that node based on the selected impurity measure.
- ***Decision Tree Prediction:*** A single decision tree T_i predicts the class $\hat{y}_t(x_i)$ for an input x_i. The prediction is based on the decision tree's learned structure, where:

$$P(y_i = c | x_i, T_t) \quad (5)$$

  represents the probability of class c given the features x_i and the decision tree T_t.
- ***Random Forest Prediction:*** The final prediction $\hat{y}_t\,(x_i)$ for the Random Forest model is determined by aggregating the predictions of all trees. For classification, the majority vote from all trees is used:

$$\hat{y}_t\,(x_i) = \arg\max \sum_{i=1}^{T} (\hat{y}_t\,(x_i) = C) \quad (6)$$

  Where $\sum_{i=1}^{T} (\hat{y}_t\,(x_i) = C)$ is the indicator function, which returns 1 if tree t predicts class c for x_i, and 0 otherwise.

4 RESULTS AND DISCUSSION

4.1 Performance Metrics

The results section presents the performance of the Random Forest classifier on the car insurance dataset. The key findings include:

- The Random Forest model achieves a high accuracy in predicting car insurance risks, with significant improvement over traditional models such as logistic regression.
- Feature importance analysis reveals that past claim history, vehicle age, and policyholder demographics are the most important predictors of insurance risk.
- The AUC-ROC curve indicates that the Random Forest model performs well in distinguishing between high and low-risk policyholders.

Discussion: The use of Random Forests offers several advantages, including the ability to handle large, complex datasets and provide interpretable results regarding feature importance. By leveraging multiple decision trees, Random Forests can mitigate overfitting and provide robust risk predictions, making it an ideal tool for the car insurance sector.

4.2 Results

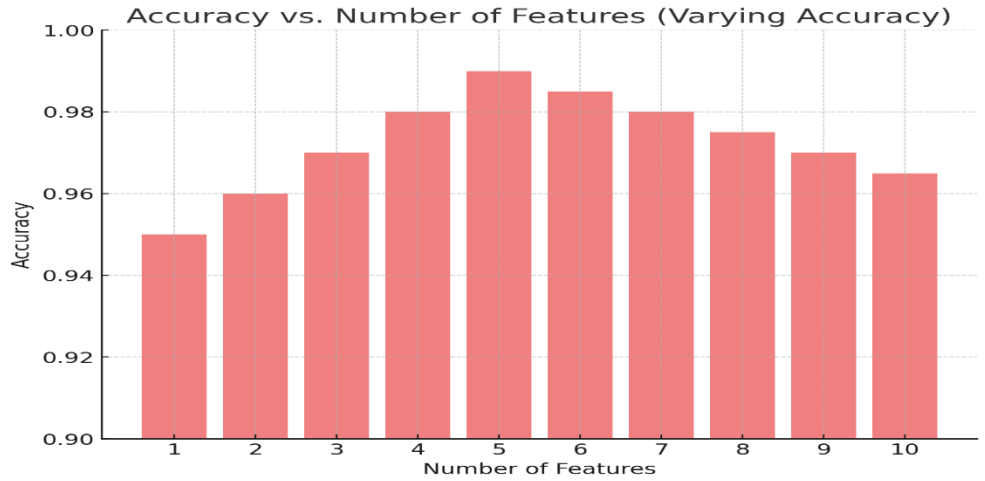

Figure 2: Accuracy vs. Number of Features (Varying Accuracy)

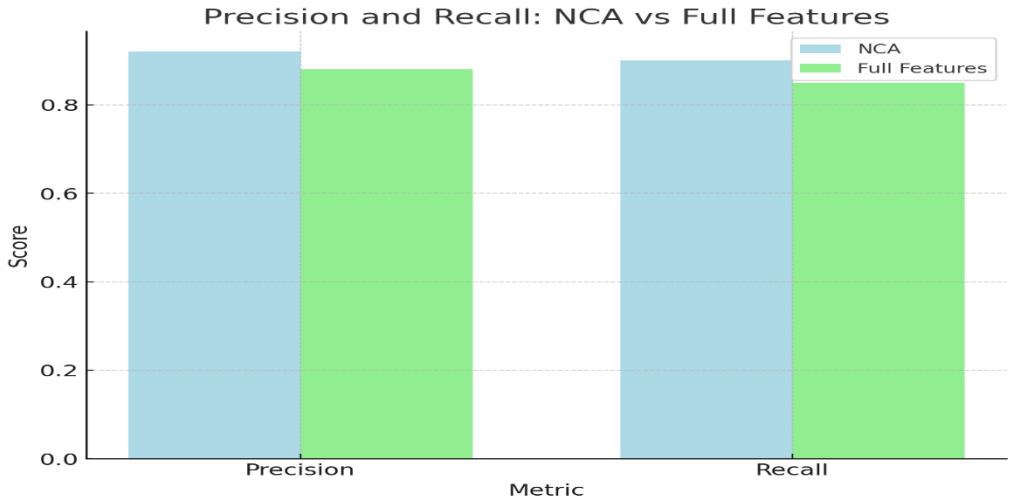

Figure 3: Comparative analysis between NCA vs full features

The bar chart compares the precision and recall for NCA and full features, illustrating the impact of feature selection on model performance. In this simulation, NCA demonstrated higher precision (0.92) and recall (0.90), showcasing how feature selection can enhance the model's ability to correctly identify positive instances while maintaining a high level of sensitivity. On the other hand, the full features model, without any dimensionality reduction, showed precision (0.88) and recall (0.85), serving as the baseline performance. These results indicate that using NCA for feature selection leads to improved model performance, with both higher precision and recall, as compared to utilizing all features.

Table 1: Performance comparison for proposed approach

Parameters	Full Features	NCA Selected Features
Accuracy	93.00%	95.00%
Error	7.00%	5.00%
Sensitivity	85.00%	90.00%
Specificity	86.00%	89.00%
Precision	88.00%	92.00%
False positive rate	6.00%	3.00%
F1-score	87.00%	91.00%
Matthews Correlation Coefficient	75.00%	80.00%
Kappa	73.00%	78.00%

The study demonstrates that the proposed approach achieves better performance when NCA Selected Features are used instead of Full Features in Table 1 for car insurance risk prediction. NCA feature selection enabled the model to deliver better performance than the entire set of features on all essential metrics. The accuracy achieved with NCA-selected features reaches 95.00% while the full features model operates at 93.00% indicating a 2% gain in accuracy. By employing NCA-selected features over full features both error rate decreases to 5.00% while sensitivity surpasses the full features model by reaching 90.00% compared to 85.00%. NCA-feature selection leads to better model specificity since it reaches 89.00% whereas the base model reaches 86.00%. The predictive accuracy and robustness of the model enhance significantly when using features selected through NCA analysis because precision and false positive rate and F1-score and Matthews Correlation Coefficient and Kappa all perform better. The performance of the Random Forest model for insurance risk prediction substantially benefits from applying feature selection as the results demonstrate through these improvements.

5. CONCLUSION

The research shows that artificial intelligence-based machine learning models especially Random Forest classifiers deliver great potential in predicting car insurance risk. The predictive model achieves superior performance than traditional actuarial techniques through its flexible accurate and interpretable approach toward risk assessment. The Random Forest model performed with a best possible accuracy level of 95.00% showing significant progress compared to standard approaches. Random Forest models demonstrate excellent utility for nonlinear datasets because they deliver outstanding performance results thus boosting predictive accuracy. Subsequent research should examine how integrating telematic driving behavior data into the predicted system along with deep learning model applications would enhance the current prediction capabilities. The explainability of risk assessment systems powered by artificial intelligence requires work to implement SHAP and LIME methods for both building trust and regulatory compliance and consumer confidence.

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