SHIFT

The Combined Ratio Problem: Closing the Gap Between Claims Costs and Premiums using AI

by Jeremy Jawish

The first in a series of commentaries on the combined ratio problem facing the insurance industry

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Executive Summary
According to the EY Motor Insurance report, 2022 has been labeled as the "worst performing year in a decade" with an average combined ratio of more than 109% and 2023 is on track to surpass it.

Insurers that can generate process efficiency while at the same time reducing claims losses are in the best position to improve loss ratios by as much as 3-6 points.

AI-powered technology solutions are already proving adept at providing insurers the capabilities to address the factors driving the combined ratio crisis from underwriting to claims.

The insurance industry is facing a period where claims costs are outpacing premiums by a significant margin. In fact, according to the Association of British Insurers, underwriting losses have been steadily rising with £2.4Bn paid out for motor claims in Q1 of 2023 which is up 11% on the previous quarter and 14% on Q1 in 2022. Insurers have been significantly impacted by lingering supply chain issues and inflation which has driven up the cost to make policyholders whole following a claim. The increasing occurrence and intensity of weather incidents and other natural disasters is having a profound impact on the cost of property claims and the number of policyholders seeking compensation. The **reinsurance renewal period** in Jan 2023 was one of the most challenging for the UK insurance industry in decades according to brokers and reinsurers[2].

Despite having a solid grasp on the factors causing the issue, tackling the problem is proving elusive. Data collected from comparison sites such as confused.com, Compare The Market, GoCompare and MoneySupermarket show that **the average premium has increased by 48% in the year leading up to June 2023**, the highest premiums since the financial crash in 2018[1].

The culprits fuelling the rise include increased interest rates pushing up the cost of claims for both motor and personal injury along with increased pressure to price premiums fairly for both new and existing customers according to recent FCA legislation. Of course the cost of living crisis is driving more fraud, adding even more pressure. We have seen major industry players pulling out of motor lines for all of these reasons.

Globally, the situation is not much different. As such, insurers must look to both lower claims expenses and better manage loss payments, which have proven difficult in the face of these looming macroeconomic factors.

The Automation Conundrum

Since raising premiums or finding less expensive ways to settle claims can be difficult, the industry has sought other ways to improve loss ratios. Primary among these strategies are process improvements that fall into the general category of "claims automation." Making the claims process more efficient is clearly one way to reduce the cost of claims. Yet, we also know that there is no one single solution to the problem and that claims automation alone is not enough.

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Claims automation should be strategic, and paired with effective fraud and risk detection across underwriting and claims. The industry has long known that without proper mitigation strategies in place, claims automation has the propensity to introduce greater amounts of fraud into the process. Conventional wisdom puts that increase at up to 30%. When that happens, insurers offset any efficiency gains with increased claims fraud losses.

In the battle to improve combined ratios insurers need to be thinking bigger than just automation or fraud. Starting with the point of sale, insurers can mitigate the risk of writing bad policies. They can approach subrogation and recovery differently. They can apply modern techniques and technologies such as artificial intelligence (AI) to both the policy and claims lifecycle to improve combined ratios which is good for the insurers and their insureds.

[1] Independent, "The great car insurance con: Premiums soar to record high as prices hiked 50% in a year"
[2] Insurance Age, "News analysis: The 1/1 reinsurance renewals – What will 2023's 'challenging' reinsurance market mean for UK brokers?"

Avoiding Future Loss During Underwriting

Effective fraud detection supported by AI (more on that later) is proven to be a valuable way to reduce the cost of claims and improve combined ratios. But, what if there are opportunities to affect combined ratios much earlier in the policy lifecycle? We have found that AI can play a significant role during the application process and at point of sale.

Understanding your underwriting risk is critical to minimising premium leakage resulting from a variety of misrepresentation factors. Shift's data indicates that premium leakage can be reduced significantly through the use of AI analysis in the underwriting process.

Perhaps more impactful, however, is the ability to uncover sophisticated and organised fraudsters who represent significant future risk in the claims process. Ghost broking, agent gaming, hyper endorsement, and policy hijacking are among several other types of schemes negatively impacting combined ratios from both a claim loss and an earned premium perspective.

Shift has found the loss ratios of organised networks is over 500% on average. If insurers identify and prevent that risk before it becomes a part of their book of business, the opportunity to improve their combined ratio increases significantly. Shift's analysis indicates that insurers taking this approach can eliminate millions in future claims losses while simultaneously reducing the operating expenses associated with fraud downstream and improving the chances of earning more of the written premium in the portfolio as a whole.

Reducing the Impact of Claims Fraud using AI

We all know insurance fraud costs the P&C industry billions of pounds a year. Implementing effective AI-based fraud mitigation is just one of the ways insurers can positively impact their combined ratio through both process efficiency and better loss payment management. Shift recently published the 2023 Claims Fraud Benchmark Report showcasing just how impactful AI-powered fraud detection can be to an insurer's bottom line. Shift's analysis of millions of claims indicates that property insurers are able to successfully stop an incremental £50,000 for every 1,000 claims analysed using AI-powered claims fraud detection. Motor insurers could achieve an incremental £35,000 for every 1,000 claims analysed using AI. This means an motor insurer that processes three million annual claims could generate nearly £100 million in claims fraud savings. Ultimately, effective fraud mitigation strategies can represent an improvement in combined ratio of 1 point.[3]

> "Shift has found the loss ratios of organised networks is over 500% on average"

[3] Shift Technology, "Shift Technology Insurance Perspectives: 2023 SIU Claims Fraud Benchmark Report"

Making Recovery a Prerogative

Industry estimates put the cost of missed or ignored recovery opportunities at more than £16 billion annually. Unfortunately, it is easy to understand why. Identifying and pursuing recovery opportunities can be a tedious, time consuming, and highly manual process. For many insurers, recovery is viewed as a "best effort" process. But, with the economic headwinds facing the insurance industry, every process must be reexamined with the explicit goal of improving combined ratios.

When looking at the potential impact AI-powered recovery strategies can have, Shift's own research has shown that insurers stand to recoup up to an additional 7% of a claim's total value when AI is applied to the problem.These are bottom-line savings insurers can leverage to mitigate rising loss ratios and profitability issues and represent an approximate two point combined ratio improvement.[4]

AI as a Force Multiplier

It is clear that AI can be applied individually to various processes throughout the policy and claims lifecycle to help insurers improve their combined ratios. And while improving combined ratios by just a few points can mean the difference between suffering a loss, breaking even, or reporting a profit, the use of multiple complementary AI-powered solutions can be even more impactful, shaving between 3-6 points off your combined ratio. That is a very powerful value proposition.

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Conclusion

The combined ratio problem insurers are currently facing is not going away anytime soon. It is a daunting problem that has many wondering where we go from here. However, if we think carefully about the various processes that impact an insurer's combined ratio, there are steps you can take now to lessen the impact of these outside forces through a powerful combination of process efficiency and claims loss management. AI has proven effective at detecting suspicious claims activities, shortening investigative cycles, and avoiding paying out on fraudulent claims. We are also seeing what AI can do to significantly improve recovery. Finally, AI can help insurers start off with a clean book of business, avoiding premium leakage and future claims costs. Individually, these approaches are incredibly valuable. Taken together, they are invaluable.

[4] Shift Technology, "Shift Technology Insurance Perspectives: 2023 Intelligent Subrogation Detection"

Jeremy Jawish
CEO and Co-Founder
Shift Technology