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Legal Update

COVID-19 Impact on Insurtech: Considerations for Insurtech Companies, Their Investors and Traditional Insurers

Acceleration of Existing Trends

While the COVID-19 crisis has many insurtech players reconsidering their short-term needs and long-term strategies, what has not changed is the insurance industry's upward digitization trajectory. In fact, COVID-19 and its impacts are accelerating the implementation of new mobile apps and other online platforms to meet consumer needs.

COVID-19 has fueled certain trends that have been developing in the insurance industry over the past decade, including:

- Online self-directed purchases of insurance and streamlined binding and issuance of insurance policies through digital platforms;
- Expanded use of digital distribution channels and electronic delivery of documents and other communications;
- Increased data collection and analytics; and
- Faster "paperless" claim processing.

The COVID-19 pandemic has posed particular challenges for state insurance regulators. Consumer dissatisfaction, whether expressed or simply feared, has caused regulators to issue varying degrees of guidance. (*See* COVID-19 Insurance Regulatory Department Updates). In a strange twist of fate, regulators that historically would have balked at premium rebates are encouraging, and even ordering, return of premium on insurance products whose risk profile has changed dramatically due to the pandemic. As consumers struggle to acquire insurance through traditional channels and carriers struggle to manage claims in a virtual environment, regulators may be persuaded going forward to work more collaboratively with the industry to advance certain technologies.

Challenges

While many insurtech companies have touted these advancements, some traditional carriers—particularly those in high broker/agency touch and paper-heavy lines of insurance such as annuities and workers' compensation—have been cautious in adopting digital insurance processes. However, the COVID-19 crisis has shown the limitations of insurance models that have not adequately prepared for the digital marketplace. Customer online experience is more important than ever. As people work and shop from home, insurance players that already had online-friendly offerings have been able to continue to reach out to policyholders and new customers at a critical time when people are particularly anxious about their insurance coverage. Even after the COVID-19 public health crisis has passed, customers may continue to expect the faster and more efficient insurance processes that digital platforms offer. Insurance players that will be able to further enhance these digital platforms and customize products to individual customer situations stand to benefit.

First, however, insurtech companies, especially those in the early stages of development, have to survive the operational and liquidity challenges created by COVID-19. While the long-term prospects of the technology and innovation being developed by insurtech companies are promising (and perhaps even more promising as customer preference for a more digital environment has grown during the COVID-19 crisis), the ability of early-stage insurtech companies to meet the short-term challenge of replenishing dwindling, already sparse working capital is a matter of business survival. COVID-19 has caused unexpected and rapid deterioration of revenues, workforce disruptions, and delays by partners (including insurance carriers) of actions that are required for insurtech companies to continue to develop technology and innovation. Insurtech companies are required to navigate in a highly regulated insurance industry, and collaboration with incumbent insurance players has been an important requirement for insurtech innovation to be implemented. Many insurtech companies have felt the negative impact of incumbent insurance carriers diverting their attention to critical functions during the COVID-19 pandemic.

Investment Opportunities

As a result of these developments and other general negative economic drivers, much less capital is available now to invest in insurtech companies.[1] Nonetheless, capital is still being raised.[2] For those financial and strategic investors who are able to envision the long-term gains (and have the liquidity to make it through their own short-term COVID-19 challenges), doubling down on the insurtech space could be highly lucrative in the post-COVID-19 business environment and insurance marketplace.

Some potential insurtech drivers in a post-COVID-19 world include:

- Changes in consumer preferences and perception of technology advancements. The digital age is here, and consumers will want more personalization and more efficient ways to buy insurance and submit claims (e.g., pay-as-you-drive auto insurance; telematics, wearables, IoT and social media that provide personal data to help insurers assess individual risk and provide customers with tailored coverage). This will likely drive both organic R&D and M&A.
- More internal insurance industry collaboration with stronger insurtechs and potentially more M&A/consolidation/partnership due to the need to join forces to meet short-term challenges posed by COVID-19.

- Increased collaboration between insurance industry players and parties from other industries (e.g., health care providers, food and nutrition/healthy lifestyle companies, consumer device companies and employee service providers, to name a few).
- More technology transactions both to reduce costs (e.g., outsourcing of IT, business or administrative functions) and to improve operations (e.g., enhancing digital platforms via licensing, services agreements or joint ventures and employing AI to integrate robo-advisors and to improve fraud detection/loss assessment).
- Competition to better access, protect and analyze data under the backdrop of increasing regulatory oversight for data privacy and use of technology in insurance (e.g., an automated underwriting model needs to be consistent with federal and state data and privacy laws and state insurance regulatory laws).

The following are some considerations for those who are seeking to invest in the insurtech space in the near term:

- Conducting financial, legal and strategic due diligence on the target company is more important than ever to assess short-term COVID-19 impacts and the ability of the technology and innovation to keep up with the related rapidly changing insurance market trends.
- Understanding a target company's existing financing documents and the impact of a potential down round may be important in a transaction structured as a venture capital investment in which the target company's management will be expected to continue developing the business.[3]
- Analyzing insurance regulatory matters relating to the target company's business is critical. While ensuring regulatory compliance is par for the course, analyzing the target company's performance in a rapidly changing regulatory environment could be a key value driver. COVID-19 has forced rapid regulatory changes to the insurance industry, and companies that are able to anticipate and navigate these changes will obviously benefit.
- Implementing contingent payment structures is one way to close the difference in valuation expectations between an acquiror and the sellers of the target company. As the growth prospects of a target company's business may be less certain due to the short-term impacts of COVID-19, a contingent payment structure such as an "earnout" may be a way to reduce investor risk. This structure enables an acquiror to pay a lower price to the sellers for the target company at the closing of the transaction with the contractual promise to pay additional amounts to the sellers if the target company's business meets certain milestones in the future.
- Accounting for materially adverse circumstances on the target company that will allow an investor or acquiror to re-negotiate a signed insurtech deal is a deal point to keep in mind during this period of potential market volatility and regulatory uncertainty. Including a "no material adverse change" closing condition is one way to deal with an unexpected and significant deterioration of the target company's business. However, a more tailored approach of crafting specific closing conditions relating to financial, legal and regulatory matters is a nimbler approach that could reduce the risk of a party that attempts to re-negotiate the terms of a signed insurtech deal or to simply walk away.

Conclusion

The COVID-19 crisis has accelerated existing trends in the insurance industry to advance technology and to innovate in other ways. The pandemic has also created opportunities and challenges for insurtech companies, their investors and traditional insurers, as discussed above. One silver lining to the COVID-19 crisis is that it enables businesses to test their preparedness for working and servicing clients remotely. This will hopefully benefit insurance businesses in the long term, as the world we live in continues to become more digitized and technologically advanced.

If you wish to receive regular updates on the range of the complex issues confronting businesses in the face of the novel coronavirus, please subscribe to our COVID-19 "Special Interest" mailing list.

And for any legal questions related to this pandemic, please contact the authors of this Legal Update or Mayer Brown's COVID-19 Core Response Team at FW-SIG-COVID-19-Core-Response-Team@mayerbrown.com.

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Endnotes

[1] *See* "Insurtech Investment Trends," April 2020, CB Insights ("Q1'20 [insurtech] funding hits 6-quarter low due to Covid-19 concerns. January saw the highest funding in Q1, including PolicyGenius' $100M Series D. Funding waned in February and March as the impact of the virus spread.")

[2] *Id*. ("Deal count increases in Q1'20, despite overall funding dip. In Q1'20, funding plummeted to $911.6M, a 58% decline from the peak of $2.15B in Q4'19. There were 97 deals in Q1'20, a 14% jump from Q4'19.")

[3] A "down round" is when the pre-money valuation in a company's current financing round is lower than the post-money valuation of the previous financing round.