Trend Review
August 25, 2023

Insurer Innovation Accelerated by COVID-19 Continues Post-Pandemic

Residual economic and societal impacts from pandemic bolster insurer innovation

Principal Takeaways

- Reinsurers are using the knowledge they gain from predictive modeling and artificial intelligence (AI) to develop new products that will help clients manage risk.
- Advanced forms of visual computing are playing a greater role in property claims management, underwriting, and catastrophe modeling.
- More homogeneous lines of business such as personal auto/home are the furthest ahead in automated claims management.
- Health insurers are placing greater emphasis on shifting to more economical/efficient care delivery through plan design, which is leading to greater product innovation.

Immediately after AM Best released its *Scoring and Assessing Innovation* in March 2020, the world was transformed by COVID-19. The pandemic altered the way people live and work, and spurred immense changes and innovation throughout the insurance industry. Challenges due to the pandemic continued in 2021, and persistently low yields and stagnant growth contributed to industry pressures, while 2022 saw a transition to inflationary pressures and rising interest rates, for the first time in more than 20 years. Technological changes continue to alter consumer behavior, transforming the insurance landscape. These trends have created challenges and opportunities for insurers, accelerating the need for innovation and rewarding the most innovative insurers.

In response to the evolving risk environment, insurers accelerated their shift to digital technology and intensified their focus on product innovation. Certain lines lend themselves more readily to innovative strategies than others. Complexity influences innovation adoption. Because the auto/home and health insurance lines deal with large homogeneous risks, initiatives can be scaled and replicated relatively easily.

For some lines of business, such as non-standard auto, applying innovative strategies is difficult. For others, such as credit life and accident & health, the arm's-length distance between the insurer and the consumer, limited competitive pressures, and low-risk products have moderated the drive to innovate. As the pace of innovation accelerates, the top performers in more complex lines may be those that overcome the innate challenges of their segment to develop new products, processes, services, and business models.

The impact of innovation on an insurer's financial strength will depend on the company's unique characteristics. For instance, even within the same line, the competitive position and innovation needs of a small regional insurer are much different from those of a national writer. When assessing the impact of innovation on a company's rating, AM Best considers the line of business as well as the circumstances specific to an insurer.

Ultimately, COVID led to a sense of urgency for digital transformation and has expanded the industry's view of what's possible, especially for lines such as home and auto, which are

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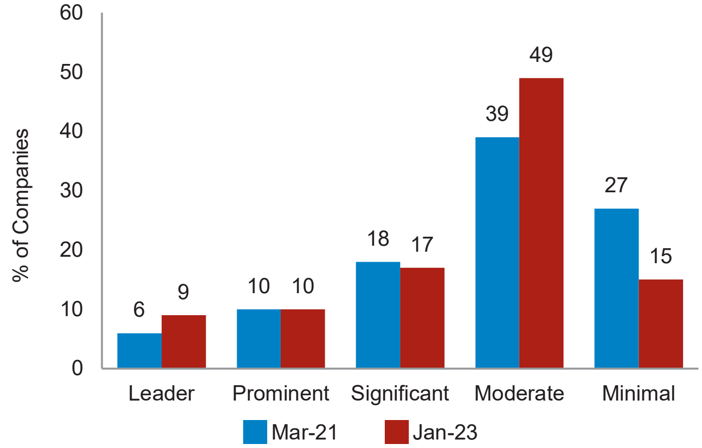
becoming more integrated with Internet of Things (IoT) devices that track driving behavior in automobiles and devices in homes that detect and prevent water damage, burglaries, and other items. The need to embrace remote processes—from customer interaction to claims assessment to remote employees—has provided momentum to increase insurers' digital literacy and initiate efforts to modernize processes and systems.

Exhibit 1
Innovation Assessments: Reinsurance



Source: AM Best data and research

Reinsurance – In the Lead on Innovation

The reinsurance segment again had the largest share of Leaders (9%) (**Exhibit 1**). Reinsurers are one or more steps removed from the ultimate policyholder and therefore have had to innovate in areas of enterprise risk management, portfolio construction, and risk accumulation. This has become evident recently with the series of losses due to significant natural catastrophic storm activity, which has been exacerbated by secondary perils and heightened inflation. Reinsurers are being consistently challenged by these high severity events and competitive pressures and have had to embed a culture of innovation to stay solvent, relevant, and profitable. During soft pricing cycles, they have to contend with relatively low pricing and high competition. As the market has hardened, the focus has shifted to risk appetite and risk selection.

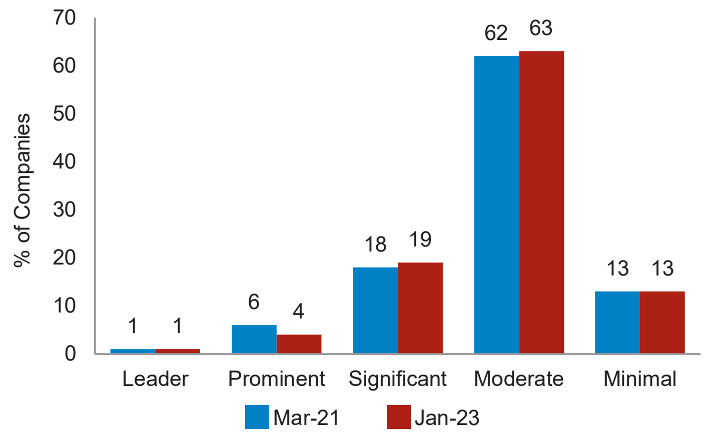
Innovation efforts that reinsurers initially developed after the severe natural catastrophe years of 1989 through 1992 have paid off even more than three decades later. We did not observe widespread ratings deterioration as a result of recent natural catastrophes such as Hurricane Ida in 2021 and Hurricane Ian in 2022, two of the costliest storms in recent history. Indeed, reinsurance rates have hardened precipitously, allowing reinsurers that maintained excess capital to write reinsurance business with significantly improved terms and conditions in addition to higher rates-on-line. Reinsurers have been able to thrive following these events because of their use of sophisticated risk and economic capital models that measure and manage capital to a high level of precision. The more successful reinsurers have used prudent modeling—along with analytical judgment—to achieve operating results that exceed their cost of capital over the long run.

The relatively straightforward composition of most reinsurance contracts lends itself readily to innovation, given that ceding companies manage much of the complex underwriting and claims functions. Some offshore domiciles have embraced innovation, enabling reinsurers to craft terms and conditions and charge rates that incorporate the results of sophisticated risk modeling, contingent pricing, and novel ways of approaching difficult risks. These efforts may include tailored cyber coverages, introduction of alternative capacity vehicles, and products that specifically address frequency and severity issues regarding secondary perils. A reinsurer's value proposition is closely aligned with an innovative culture, which rewards creative product design and uses internal risk modeling to seek out profitable opportunities.

Growing Competition

Competition in the industry has intensified over the last 20-25 years, but innovative risk modeling, risk accumulation, and pricing tools have informed underwriting decisions on both account and aggregate bases, which have led to significantly improved operating performance projections for the next year

Exhibit 2
Innovation Assessments: Property/Casualty



Source: AM Best data and research

or more. Additionally, reinsurers have made significant strides forward by matching informed risk modeling with third-party capital in sidecars, cat bonds, and other insurance-linked securities (ILS) structures that are now being developed and used by relatively small reinsurers. These strategic partnerships benefit reinsurers by providing flexible off-balance-sheet capital, while the capital providers benefit from a more informed view of risk. Finally, reinsurers are using the knowledge they gain from predictive modeling and AI to develop new products that will help clients manage risk, such as providing supplemental information in addition to the standardized catastrophic peril model used, making them even more valuable business partners. Large reinsurers with economies of scale have made more advances in this area by partnering with technology firms, investing in accelerators, and engaging with innovators. However, reinsurers—as well as primary carriers—understand that the line between primary and secondary perils continues to blur, making the modeling of catastrophic risks challenging.

Property/Casualty – Mostly Moderate Innovation Assessments

Given the P/C segment's diversity of size and scale, the impact of innovation has varied. Roughly three quarters of our P/C rating units placed in the bottom two innovation assessment profiles (63% Moderate, 13% Minimal) (**Exhibit 2**).

P/C insurance has always been a data-centric industry—the industry has been using analytics and data for decades, but the pandemic boosted insurers' focus on innovation. Digitization allows companies to become even more data-driven. Predictive modeling provides carriers with an edge as they seek to charge premiums commensurate with the actual underlying risk. The growing amount of data gleaned from telematics devices or social media websites is rapidly expanding the possibilities for even deeper data mining. Insurers can use Big Data to build unique customer profiles, enabling the creation of personalized offers based on individual preferences and behavioral data. A deeper understanding of customers can facilitate cross-selling opportunities, increase retention, and enhance the customer experience. At the same time, the ongoing digitization of the economy has led to a variety of technology platforms that impact the insurance distribution landscape, as exemplified by the rise of embedded insurance.

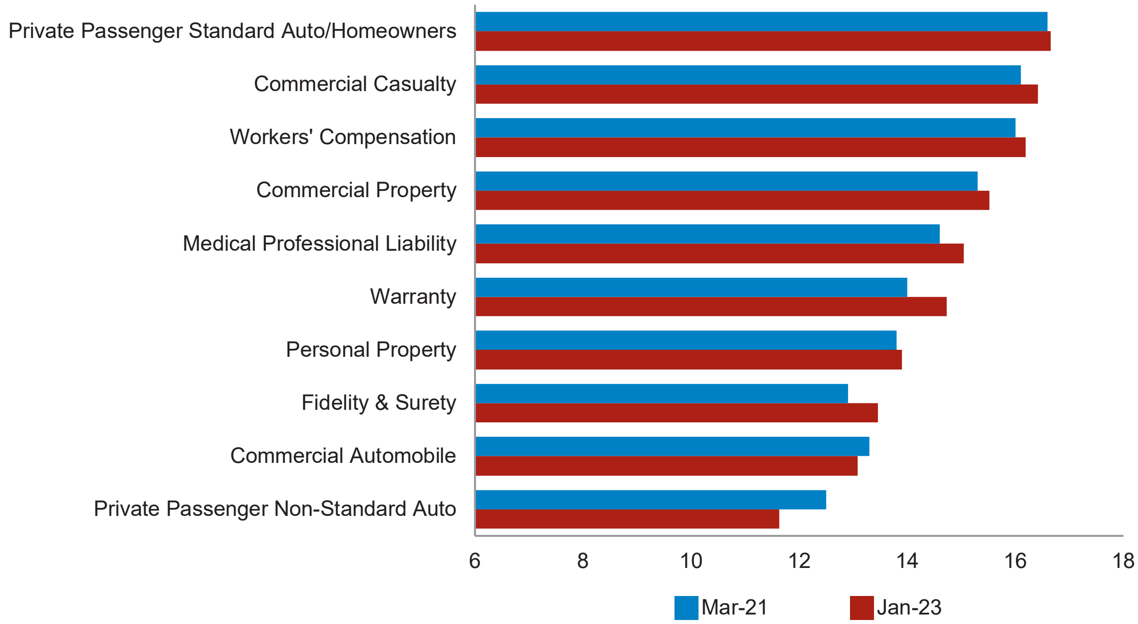
Technology has had a stronger impact on the personal lines, as well as commercial lines such as small commercial and workers' compensation (**Exhibit 3**). The more complex risks, such as surplus lines and large commercial, use technological advancements to some extent but still depend on old-fashioned boots-on-the-ground, engineering-oriented underwriting. We expect P/C insurers with complex risks and liabilities (which may have unknown mass tort elements) to continue to use experience-based underwriting judgment.

Streamlining Claims Management

Although the insurance industry still has a long way to go before touchless claims become commonplace, the more innovative insurance carriers have made significant progress in implementing

Exhibit 3

Average Innovation Score by P/C Line of Business



Source: AM Best data and research

automated workflows, including claims intake, assessment, and settlement. Identifying the right claims for touchless processing has been a challenge, due in part to fraud-related issues, as well as the complexity of certain claims. However, carriers are becoming adept at using Big Data to improve fraud detection and identify criminal activity through data management and predictive modeling. Forward-looking carriers are constantly seeking ways to optimize claims performance by balancing process automation and human involvement.

Lines of business with more homogeneous risks such as personal auto/home are the furthest ahead in automated claims management. Users can upload images of a car accident that can be processed automatically by advanced machine learning algorithms, with an automatic payout. Advanced forms of visual computing are playing a greater role in property claims management, underwriting, and catastrophe modeling. Drones, airplanes, and satellites improve response time, and drones are particularly valuable in catastrophe property claims, because they can reach hard-to-access sites post-event, diminishing human danger.

Given the proliferation of IoT sensors, which is one of the drivers of Big Data growth, insurance companies are seeing greater opportunities to approach risks in different ways as analysis moves from proxy to in-house data. This is most commonly seen today in the use of telematics in auto insurance. IoT sensors are also helping the insurance industry become more focused on active loss prevention rather than just playing claims.

Strengthening Underwriting

The explosion in data, along with more advanced analytics, is transforming the underwriting capability of all insurance segments and lines of business—especially the personal auto and small commercial lines. The more innovative players are looking beyond routine automation and increasingly leveraging machine learning and data sources to enhance underwriting capabilities. Lines of business with more homogeneous risks such as auto/home were the first to embrace underwriting automation, with innovation leaders nearly eliminating manual underwriting. Small commercial lines are increasingly replicating a personal lines approach to underwriting, given that both customers and brokers are becoming accustomed to a digital experience. More complex lines of business with less homogeneous risks are now starting to incorporate aspects of automation in areas such as light-touch renewals, pre-qualification of new business submissions, and real-time tracking of key exposures for any given class. The most forward-looking carriers are constantly experimenting in an effort to realize a future in which the majority of policies undergo straight-through processing. Innovative insurers have also leveraged data analytics to develop more specialized products and solutions for emerging risks, such as the evolving cyber insurance market.

Advanced analytics, combined with Big Data, are also allowing innovative insurers to derive insights that can drive top-line growth, by either improving risk selection or enhancing the customer experience. Data generated outside the insurance industry is attracting new entrants such as auto OEMs (original equipment manufacturers) in personal auto. Further, many innovative carriers have extended analytics beyond traditional customer data to include behavioral economics and social engineering. These analytics and predictive insights can spur the development of highly customized products and services that are immediately relevant to a policyholder's situation. Some carriers have used predictive analytics and Big Data to identify whether a customer is a retention risk in need of proactive corrective actions. Policyholder data and related analytics are also helping carriers anticipate customer needs, providing insurers with cross- and up-selling opportunities.

Enhancing Back-Office Operations/Customer Interaction

Today, most insurance companies realize efficiencies through automation, especially in back-office operations. Companies increasingly use automation to reduce errors, lower costs, and increase speed with compliance checks, data entry, and repetitive tasks. Optimizing customer interaction is another area of focus, with many insurers racing to leverage generative AI in their customer interactions. Many companies are digitizing call centers and expanding available forms of communication to include chat tools, social media, and self-service channels.

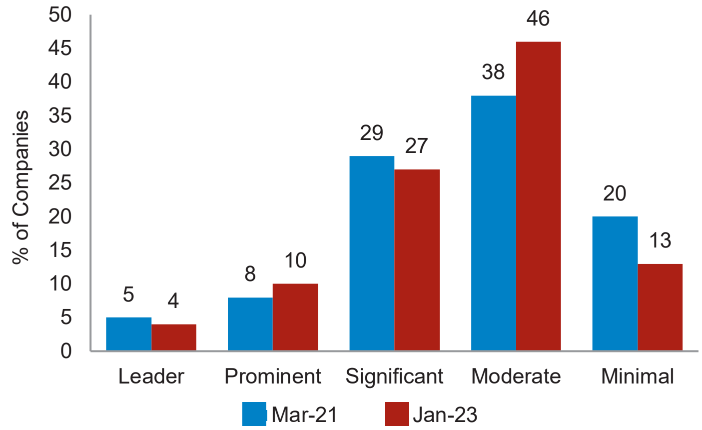
Like the auto lines, small commercial lines face growing pressure to innovate and digitally transform operations and distribution, which was particularly evident during the pandemic when operational innovation and flexibility were key to insurers' success. More innovative carriers benefited from investments in efficient infrastructure, a multi-channel distribution model, advanced analytical capabilities, and a customer-centric approach.

Purchase price will be the most important factor for the customer, but billing and payment, policy offerings, and online and offline service have grown in importance. The notion that insurance is a low-engagement category is becoming outdated. Developing a more streamlined and personalized buying experience can rapidly affect growth, profitability, and expenses. Younger consumers are drawn to digital, self-driven experiences that include advice but remain unintrusive and available on demand. Given these trends, innovative carriers have been developing solutions that allow policyholders to move between digital or self-service channels and human-based interactions. These investments have paid off handsomely for the most innovative players over the last two years, given the pandemic.

Health Segment – Generally Favorable Innovation Assessments

The COVID-19 pandemic accelerated the use of technology in health insurance in a variety of processes, including digital sales (both online and through video calls), greater use of virtual provider visits, and increased access to information via apps and the internet. Many of these changes are becoming more accepted by the provider community and are increasingly preferred by brokers and consumers. Health insurers have expanded their innovation to remain attractive and competitive, targeting initiatives that improve the customer experience, quality of care, and the management of medical and administrative costs through enhancements to systems, processes, products, or market expansion. As a result, health insurers have more favorable innovation assessments compared to most other insurance segments and lines (**Exhibit 4**).

Exhibit 4
Innovation Assessments: Health



Source: AM Best data and research

Product Innovation Focusing on More Efficient Delivery

Health insurers are placing greater emphasis on shifting to more efficient care delivery through plan design, which is leading to greater product innovation. Telemedicine is a cost-effective means to enhance capacity and access for less critical care or for behavioral health. Virtual doctor appointments are becoming more popular, with some health plans making visits available to members via an app, with reduced or no cost-sharing. Telehealth has been around for a long time, but insurers are increasingly focused on expanding telehealth adoption among members and lowering the cost of care. More health plans are offering telemedicine for primary care, as well as other providers. Telehealth has the added benefit of providing healthcare in areas with limited access to providers or at off-hours when doctors' offices are closed. Other examples of product innovation include the following:

- Benefit plans that provide a significant financial incentive for the member to engage in preventive care and to see in-network providers, as these screenings allow for early detection and treatment, which can be key for certain medical conditions and chronic diseases
- Benefit designs that provide up-front pricing whereby the member has more control when it comes to medical care choices and costs, an approach that allows individuals to compare costs and consider the quality of providers, to reduce out-of-pocket costs

Big Data and AI Helping Prevent and Manage Disease

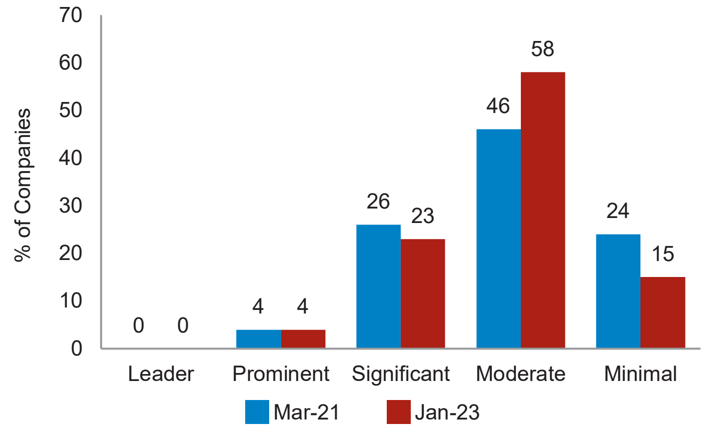
Insurers are using AI, cloud computing, and data analytics to address physical, behavioral, and social issues, for disease prevention/early intervention and better outcomes. These technologies help clinicians and members address high-risk/chronic conditions in the early stages, and address whole person health, which may also cover issues such as access to healthful food, the ability to fill prescriptions, and transportation needs. One disability carrier has introduced a digital absence and leave management solution that can simplify the process for both employer and employees, to help navigate complex rules and regulations, which can expedite the claims process.

The proliferation of wearable devices, used to monitor and collect data, has become more integrated with health insurance plans. Some insurers offer discounts for the use of these wearable technologies, including smart watches, fitness trackers, and other devices. Transmitting data directly from the patient to the healthcare provider is more convenient, timely, cost-effective, and potentially life-saving.

Life/Annuity – Mostly Moderate Innovation Assessments

Overall, more than two thirds of our L/A rating units are concentrated in the Moderate (58%) and Significant (23%) Innovation Assessment categories, with an additional 15% assessed as Minimal (**Exhibit 5**).

Exhibit 5
Innovation Assessments: Life/Annuity



Source: AM Best data and research

AM Best has assessed no pure L/A carrier in the "Leader" category, and only a handful have received a "Prominent" assessment. Those with "Prominent" assessments have focused on automated underwriting, direct-to-consumer distribution, new product offerings, advanced investment platforms, end-to-end digital applications for agents, and the use of Big Data to improve just about every aspect of day-to-day operations. Most of these initiatives are driven by a desire to improve the customer experience in the hopes of better penetrating the elusive middle and Millennial markets. Furthermore, many L/A carriers, including those without the resources to foster innovation in-house, continue to invest in insurtechs, through venture funds or direct partnerships.

For the majority of L/A carriers in the "Moderate" and "Significant" assessment categories, the focus also remains on customer satisfaction, to drive improved retention, create cross-selling opportunities, and improve efficiency to benefit the carrier and the policyholder. One ongoing expensive and time-consuming initiative that addresses all these items is the effort to integrate legacy systems. Digital tools to minimize paper and the willingness to hire non-local talent for virtual positions are two commonly cited post-COVID benefits.

Barring a recessionary environment, the pace and scale of innovation in the segment is likely to accelerate, particularly in portfolio management. Rising interest rates pose new challenges and opportunities, as L/A companies refine their investment strategies. Furthermore, the availability and analysis of data has improved drastically, paving the way for new initiatives to enhance competitive positions, improve the customer experience, strengthen profitability, and remain relevant in an ever-changing market.

Appendix

Innovation Assessment Distributions

(%)

		Minimal	Moderate	Significant	Prominent	Leader
FSR Category	Superior	3.4	23.1	44.2	21.1	8.2
	Excellent	8.0	63.0	23.6	4.0	1.4
	Good	31.9	63.5	4.2	0.4	0.0
	Fair	50.0	48.1	1.9	0.0	0.0
	Marginal	42.9	57.1	0.0	0.0	0.0
	Weak	66.7	33.3	0.0	0.0	0.0
Operating Performance Assessment	Very Strong	4.5	27.3	40.9	9.1	18.2
	Strong	9.2	57.2	23.9	8.2	1.5
	Adequate	12.8	61.5	20.7	3.5	1.5
	Marginal	34.5	46.9	13.1	3.4	2.1
	Weak	75.0	25.0	0.0	0.0	0.0
Business Profile Assessment	Very Favorable	0.0	3.6	39.3	39.3	17.8
	Favorable	0.7	33.6	46.8	14.0	4.9
	Neutral	9.0	60.3	24.9	4.2	1.6
	Limited	21.4	65.0	10.7	2.2	0.7
	Very Limited	46.2	42.3	11.5	0.0	0.0
Financial Size Category	II-IV (Less than $10 Million)	53.8	46.2	0.0	0.0	0.0
	V ($10 Million to $25 Million)	38.0	59.5	2.5	0.0	0.0
	VI ($25 Million to $50 Million)	27.9	62.6	8.8	0.0	0.7
	VII ($50 Million to $100 Million)	12.1	77.3	8.1	2.0	0.5
	VIII ($100 Million to $250 Million)	11.3	68.1	17.2	2.1	1.3
	IX ($250 Million to $500 Million)	4.9	69.3	21.4	3.3	1.1
	X-XI ($500 Million to $1 Billion)	2.7	55.9	30.6	9.0	1.8
	XII-XIV ($1 Billion to $2 Billion)	1.3	46.7	41.8	8.9	1.3
	XV ($2 Billion or greater)	1.9	25.6	50.2	16.1	6.2
Industry Composite	Private Passenger Non-Standard Auto	47.0	53.0	0.0	0.0	0.0
	Commercial Automobile	38.0	50.0	8.0	0.0	4.0
	Fidelity & Surety	36.0	50.0	9.0	0.0	5.0
	Personal Property	16.3	77.2	5.4	1.1	0.0
	Warranty	0.0	82.0	18.0	0.0	0.0
	Medical Professional Liability	0.0	88.0	7.0	5.0	0.0
	Commercial Property	10.0	67.0	14.0	7.0	2.0
	Workers' Compensation	9.0	58.0	28.0	5.0	0.0
	Commercial Casualty	5.4	67.6	21.6	4.5	0.9
	Private Passenger Standard Auto/Homeowners	9.0	57.0	27.0	6.0	1.0
	Surplus Lines	7.0	40.0	53.0	0.0	0.0
	Reinsurance	15.0	49.0	17.0	10.0	9.0
	Health	13.0	46.0	27.0	10.0	4.0
	Credit	25.0	37.5	25.0	12.5	0.0
	Credit Life and A&H	45.0	55.0	0.0	0.0	0.0
	Individual Annuity	6.0	74.0	18.0	2.0	0.0
	Group Annuity	25.0	50.0	25.0	0.0	0.0
	Individual Life	18.0	51.0	25.0	6.0	0.0
	Group Life	0.0	100.0	0.0	0.0	0.0
	Multiple Lines	10.0	45.0	40.0	5.0	0.0
	Title	0.0	29.0	57.0	14.0	0.0
Financial Metrics	Median 10-Year Avg. ROE	9.1	8.5	7.1	10.1	13.0
	Change in NPW	11.5	10.0	11.0	10.9	7.2
	Combined Ratio	94.3	91.3	94.7	94.7	85.5
	Operating Ratio	82.0	87.3	89.0	85.3	84.0
	Non-Life Expense Ratio	47.3	36.5	37.4	29.0	36.1
	Life Expense Ratio	39.4	29.3	25.7	22.7	28.4

Notes: FSR = Financial strength rating. FSR of lead operating company used for holding company rating units.

Source: AM Best data and research

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