

AM Best Request for Comment Response: Scoring and Assessing Innovation & BCRM

In March 2019, AM Best introduced its initial draft of *Scoring and Assessing Innovation*. The revision process for this draft criteria procedure extended through 2019 into the first quarter of 2020 and entailed two requests for comment (RFC) periods. AM Best published the first RFC on March 14, 2019, which was followed by another RFC on September 13, 2019. The September 13, 2019 RFC included a revised *Best Credit Rating Methodology* (BCRM), which incorporated innovation as the ninth component of the business profile building block assessment. Both criteria were released for use on March 5, 2020. Changes made to the final version of the *Scoring and Assessing Innovation* criteria from the initial version published in March include the following:

- The word “published” when referencing the innovation assessment was removed.
- The title of Section E, “Interpreting the Innovation Assessment in the Context of the Rating Process,” was changed to “Business Profile.”
- The five assessment category names were changed to Minimal, Moderate, Significant, Prominent, Leader from Non-innovator, Reactor, Adopter, Innovator, Innovation Leader to reflect innovation ability.
- The assessment text box examples were clarified.
- Language referring to the inclusion of innovation as part of the enterprise mission statement in “Culture” was removed.
- Language referring to the inclusion of innovation in the BCRM was updated.

AM Best did not respond individually to comments from the RFCs, but is publishing the 42 comments it did receive, all of which pertain to the *Scoring and Assessing Innovation* criteria procedure; no comments were received on the revised BCRM. For respondents who chose to remain anonymous, best efforts have been made to shield the identity of both author and company by redacting any text that could be used to identify the commenter. AM Best greatly appreciates all of the responses received during the public consultation periods. Common themes and, when possible, questions and comments on topics have been grouped into general responses.

Industry engagement enabled AM Best to identify areas in the criteria in need of further revision or clarification; AM Best believes these revisions promote greater transparency. The significant changes made to *Scoring and Assessing Innovation* between the initial draft release and the final version are addressed in the following FAQs. These changes resulted from both public feedback and internal review.

Please note that AM Best has also made minor nonmaterial editorial revisions to the final *Scoring and Assessing Innovation* criteria procedure. These changes added clarity or were stylistic or grammatical.

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FAQs

General

How does AM Best define innovation?

AM Best defines innovation as a multistage process whereby an organization transforms ideas into new or significantly improved products, processes, or business models that have a positive, quantifiable impact over time and enable the organization to remain relevant and successful.

How is AM Best qualified to make an innovation assessment?

AM Best is uniquely qualified to make this assessment, given its leadership role in the evaluation of companies in the insurance industry, the breadth of its insurance ratings coverage, and its long-standing and expansive dialogue with the insurance industry. Given the accelerating pace of change in society, climate, and technology, innovation is becoming increasingly critical to the long-term success of insurers. In its discussions with insurers, AM Best has included the topic of innovation for some time now, given that insurers also believe that innovation is critical to their success. Only 1% of participating insurers surveyed by AM Best felt that innovation was not critical, as noted in [Insurers Agree Innovation is Critical for Future Success](#) (September 2018).

Do companies need to incorporate innovation into their mission statements?

In the initial draft of *Scoring and Assessing Innovation*, the description of the relationship between a company's enterprise mission statement and innovation was unclear. In the final version, AM Best removed language referring to the inclusion of innovation as part of a company's enterprise mission statement.

AM Best does not expect companies to change their enterprise mission statements to explicitly incorporate innovation. In AM Best's view, to receive a high score for the leadership input component, companies will be able to clearly explain how their innovation efforts tie into their enterprise mission statements and support their long-term strategic objectives.

Will the innovation assessment affect a company's financial strength assessment?

AM Best determines the financial strength assessment using the building block approach described in the BCRM. AM Best will now explicitly evaluate the impact of innovation in its business profile building block. Like other elements of the business profile (such as product risk or management quality), the weighting of a positive or negative innovation assessment will depend on the circumstances specific to the insurer and its market. Innovation has a positive impact on the business profile when it provides a tangible benefit, and a neutral impact when it has a limited to no effect on a company.

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Will this criteria lead to an excessive focus on innovation, which could cause a company to miss other fundamental issues?

Innovation is being added as a ninth subcomponent of the business profile building block; it is not the basis for the whole business profile assessment. AM Best expects that company management teams will continue to focus on the areas that are most relevant to their companies' operations, which may include innovation.

How will AM Best score innovation—at the group level or the subsidiary level? Could there be different scores for a parent and a subsidiary?

In most cases, innovation will be assessed at the enterprise level; this will be the default/general approach. Scoring individual units differently will be considered on a case-by-case basis.

Do you expect that scores will change over time?

Just as a rating can change over time, the innovation score may rise or decline depending on management actions and company results. Innovation is a continual process; AM Best expects that companies scoring highly on the innovation assessment will demonstrate the ongoing evolution of their innovation initiatives.

Is the assessment of innovation biased against small companies?

There is no bias against small companies. AM Best believes that there are many avenues for smaller companies to innovate and that not all of them require significant investment outlays. Many smaller insurers are nimble and understand their markets well, and they can therefore be responsive to changing market conditions despite limited resources.

Should innovation have been combined with or linked to the enterprise risk management (ERM) building blocks in the existing criteria, as having separate criteria is redundant?

By highlighting innovation in its rating process, AM Best is simply emphasizing its view that innovation will be key to a company's future relevance, given the belief that innovation is becoming critical to a company's long-term financial strength.

With respect to including innovation in the ERM assessment, innovation does not necessarily need to focus on risks or risk-taking. As such, AM Best believes that the business profile is the more appropriate area to assess the impact of innovation; over time, given the accelerating pace of change, the lack of innovation could lead to erosion in an insurer's competitive position.

In its rating process, AM Best explicitly captures the impact of innovation on an insurer's financial strength in the business profile building block—in the context of a company's particular circumstances. The innovation score is an absolute assessment of the level of a company's innovativeness.

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Scoring innovation is a subjective exercise, not an objective one. Could this introduce vagueness into the process?

The foundation of AM Best's credit rating process is an ongoing dialogue with the rated company's management and has always included both quantitative and qualitative factors. AM Best expects that, during a rating meeting, a company's management will be able to demonstrate that its innovation initiatives are having a measurable positive impact.

How will AM Best's assess the new insurance carrier entrants to the industry?

AM Best will assess all insurance companies in the same manner outlined in the BCRM. For insurers to score highly on AM Best's innovation assessment, they must show that their innovation initiatives are having a positive and quantifiable impact.

Will this criteria cause there to be too much focus on Return on Investment (ROI)?

ROI is one measure used in the assessment of operating performance. Companies should focus on the metrics that are most relevant to their enterprises.

Are you aware that there is specific terminology used in insurtech, such as stakeholder, capability (instead of ability), disruptor (which normally corresponds with external forces), and transformational (which usually corresponds with internal activities)?

Yes. This terminology was adopted in the final version of the *Scoring and Assessing Innovation* criteria procedure.

Process

Will there be new information that companies will need to provide as a result of the criteria? How will the data be captured? And will the documentation required be standardized so that the process is consistent?

Yes. Additional information may be required to assess the impact of innovation. Any additional information requests will be coordinated through the rating analysts.

How frequently will innovation be assessed?

Innovation will be assessed in keeping with the regular rating review cycle.

Why is AM Best using a five-year measurement period for scoring and assessing innovation?

In AM Best's view, companies should be innovating continually; the five-year measurement period is thus viewed as an appropriate window for capturing the process.

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Are you publishing my innovation score? What should I expect and when? Will the components of my innovation score be shared with me? Some have suggested that AM Best should have a one-year grace period before disclosing scores to the market.

AM Best is not publishing innovation scores at this time, but will publish industry-level data based on preliminary scoring assessments. Analysts will discuss with insurers their specific scores and any potential impact on their business profile assessments.

Will companies be able to compare themselves to other companies through a peer review?

As stated above, AM Best is not publishing innovation scores at this time, but will publish industry-level data based on preliminary scoring assessments. However, company-level scoring data may become available in the future.

How transparent will the process of scoring and assessing innovation be?

AM Best plans to discuss scores with the companies being assessed. As stated above, analysts will discuss with insurers their specific scores and any potential impact on their business profile assessments.

Inputs

How do you differentiate between leadership and culture? Should they be assessed together?

Leadership often drives culture—hence, there may be overlap. However, AM Best distinguishes between the two through the elements in each assessment. The draft criteria procedure has been revised to more clearly differentiate the elements that will be considered in the assessments for these components. The leadership assessment focuses on upper management’s vision, commitment, and promotion of innovation, while the culture assessment focuses on tangible levels of participation, evidence of collaboration, links to performance incentives, and an issuer’s agility in reacting to market conditions.

Will AM Best take a top-down or bottom-up approach when reviewing the involvement of a company’s leadership in innovation?

In AM Best’s view, both approaches will come into play in the assessment of both leadership and culture.

How will failure be viewed in AM Best’s scoring and assessing of innovation?

In the criteria’s culture input, it is noted that companies that inspire innovation allow for risk taking and the possibility of failure; its tolerance for risk-taking is well defined. Failure is an acceptable option, if companies have a process in place to kill ineffective innovation ideas after an appropriate and timely review.

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Should change management strategy be added to culture and/or resources?

Change management strategy is addressed in our input score assessment.

How will partnerships be evaluated?

Resources are critical to a company's innovation strategy. Taking stock of internal resources and then deciding whether to focus inwardly or partner with external parties is important. A company may decide on a mix of both strategies—one isn't favored over the other. Effective third-party partnerships will be those that result in a positive, quantifiable impact for the company.

What is AM Best's view on the replicable process model?

By optimizing replicable processes and structure, companies promote organizational intelligence; having a replicable process and structure in place make implementing innovation less difficult.

Will partnerships and M&A be considered in the input assessment?

Yes. Partnerships and M&A are included in the input section of the criteria in the resources input category.

How will the scoring account for the limitations of human capital?

AM Best evaluates the human capital component in the resources input category. Limited human capital may result in a lower resources input assessment.

Technology investments have diminishing returns over time; how will this be assessed? Does technology equal innovation? Must a company invest in insurtech?

Innovation is a continuous, iterative process, and AM Best expects that innovative companies will continue to innovate over time. Technology doesn't necessarily equate to innovation, as there are many ways to innovate. The criteria procedure does not require insurers to invest in insurtech companies to receive a positive assessment. Partnering with companies that may have technical expertise outside an insurer's core competencies is one of many paths to innovation.

Does AM Best believe that recognizing employees for successful innovation ideas is a good approach when it comes to innovation?

AM Best believes that companies should adopt the approach best suited to their individual circumstances.

Outputs

Why is there such a strong emphasis on output in the innovation scoring process?

The output score carries twice the weight of the input score in the overall scoring, as AM Best believes that strong output is the proof of successful innovation efforts. AM Best assumes that companies scoring highly in the input section will also have measurable results.

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What is AM Best’s view of customer-centric innovation?

AM Best’s innovation criteria does not specifically address innovation related to the customer experience; however, a company’s customer-centric approach to innovation will be indirectly captured in the output score.

How will AM Best weigh innovators with a history of success?

Only companies with a history of success are likely to score highly in the innovation assessment (in the results subcomponent score).

Will AM Best consider customer reviews and/or NPS scores in the innovation assessment?

AM Best will consider any information a company deems appropriate with regard to its innovation efforts and results.

Will innovation ideas generated internally be given the same weight as innovation ideas that come from outside consultants?

The origin of innovative ideas has no bearing on how they are considered in the assessment. The emphasis will be on the results of a company’s innovation efforts.

Will maturity models be taken into consideration for the innovation assessment?

Although maturity models aren’t directly addressed in the criteria, the components—such as culture, process and structure, and resources—of these models are.

How is the importance of incremental innovation viewed?

Incremental innovation will be viewed in the same context as overall innovation. The importance of incremental innovation will depend on its impact on the organization.

How will AM Best differentiate between traditional results and those tied specifically to innovation efforts?

A company is given the opportunity to show the impacts of its innovation process/initiatives on its results in the results subcomponent of the output component. We would expect a company to be able to explain the measures that led to the improvement in results and tie them directly to an innovation initiative.

Based on AM Best’s definition of innovation, normal process improvements, such as standard systems updates or process changes due to regulatory or accounting requirements, would not be considered innovative.

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Assessments

How does AM Best view a company that is fast follower verses a company that is an innovation Leader?

AM Best refers to fast followers as either Prominent or Significant scorers depending on their circumstances. Companies assessed as being more innovative (Leader and Prominent) differentiate themselves by demonstrating quantifiable, credible, and direct links between their innovation efforts and their results. Leaders further distinguish themselves by pushing the industry's innovation ceiling and responding to market pressures by offering new products to solve emerging needs. They often leverage cutting-edge technology to enhance the customer experience, redefining the role of an insurer. Unsurprisingly, these companies generally have high "level of transformation" scores.

What does it mean to be assessed as Moderate?

An assessment of Moderate is given to companies with scores ranging from 12 to 17. Companies assessed as Moderate are generally focused on the insurance basics. Although aware of emerging risks and potential opportunities, they have not benefited directly from innovation, materially or directly.

Innovation may not be a priority for these companies owing to limited resources. Moreover, they may be slower than their competitors to adopt new systems and strategies. However, Moderate companies are not necessarily behind the curve, even if their operating results have not benefited from recent innovation. For these companies, there may be early signs of innovation outputs, but a longer record of accomplishment is needed to determine their commitment to innovation. Their business profile assessments are typically Limited or Neutral.