



Evolving Criteria Bulletin: AM Best Proposed Innovation Criteria

March 2019

On March 14, 2019, AM Best released a Request for Comment (RFC) on Scoring and Assessing Innovation. AM Best discusses the importance of insurers being innovative and the relationship between the company’s ability to innovate and their long-term performance and financial strength. Comments from the industry are due by May 13, 2019.

Innovation Score

The score will consist of two components; the addition of innovation input score and innovation output score. Innovation inputs refers to the varying components of the innovation process while innovation outputs help measure the impact of innovation effort for the company.

$$\text{Innovation Score} = \text{Innovation Input Score} + \text{Innovation Output Score}$$

Inputs

AM Best will use four sub-components to derive a total score for innovation inputs. Each sub-component will be scored on a scale of 1 (lowest) to 4 (highest).

$$\text{Innovation Input Score} = \text{Leadership} + \text{Culture} + \text{Resources} + \text{Processes \& Structure}$$

Score	Leadership	Culture	Resources	Processes/Structure
1	Management does not recognize that innovation is critical to organizational success. Prioritization of innovation is not part of a longer-term strategy.	Any innovation initiatives are approached from a limited, risk-averse perspective. Innovation is developed on an ad hoc basis.	The company does not devote resources to innovation, or, if it does, the resources are not appropriate for its operations. Its strategy for managing these resources is not clearly defined.	The company does not have an innovation strategy. The processes and structure of its innovation initiatives are not linked to its goals or operations.
2	Management recognizes that innovation is a critical aspect of the organization’s continued operations. However, converting that recognition into action tends to be irregular, and innovation goals do not appear to be prioritized.	Innovation initiatives are approached largely from a reactive perspective. Innovations may be developed on an ad hoc basis, but ownership of such initiatives is clear. However, these innovations tend to be group-specific and are not undertaken or conceptualized in conjunction with mainstream operations and the larger organization.	The company devotes some resources to innovation, but its strategy for managing these resources is not linked to its critical operational goals and the use of these resources is not tracked effectively.	The company’s innovation strategy is not clearly aligned with the company’s long-term strategic objectives. The processes and structure of its innovation strategy are sometimes ineffective, given its business objectives.
3	Management demonstrates that innovation is a critical aspect of the organization’s continued operations. Management’s actions are generally organized and structured; however, the focus is typically still on immediate operational concerns, which appear to be prioritized over innovation goals.	Innovation initiatives are approached largely from a proactive perspective. The company has fostered a structured approach to developing innovation initiatives that includes input from individuals outside designated innovation groups. However, the company has found it difficult to integrate innovation into its mainstream operations.	The company devotes resources to innovation, and its strategy for managing these resources is linked at least in part to its operational goals. However, there may be some inefficiencies that diminish the overall effectiveness of its resource allocation.	The company’s innovation strategy is aligned with long-term strategic objectives. The processes and structure of its innovation program are generally appropriate given its business objectives but may have areas in need of further development.

Score	Leadership	Culture	Resources	Processes /Structure
4	Through deliberate actions, all levels of management have demonstrated the organization's commitment to the innovation process as articulated by its leadership. Companies operating at this level should be able to provide evidence that middle management understands leadership's innovation directives, is actively working to accomplish these goals, and addresses immediate operational concerns in conjunction with—rather than at the expense of—innovation goals.	Innovation initiatives are approached from a proactive perspective. The company can show through specific examples that it successfully encourages innovation throughout the organization and that innovation is part of its vision and mission statement. The company has successfully reintegrated innovation into mainstream operations across multiple business lines and products. Culture is forward-looking and focused and fosters a collaborative environment.	The company devotes resources to innovation, and actively hiring/retaining talent is a key priority. Its strategy for managing these resources is clearly linked to its operational goals, allowing for their efficient transformation and exploitation. Staff is rewarded for successful innovation ideas and implementation. Not only does the company exhibit effective resource allocation, its resource management strategy also includes opportunities for effective reallocation.	The company's innovation strategy and the processes and structure that support it are clearly aligned with its long-term strategic and business objectives. Facilities are in place to explore emerging issues. Data is used to make better decisions, create solutions, and solve problems, and data governance is well defined and managed at a portfolio level. These processes and structure facilitate innovation-driven growth that supports business objectives.

Source: AM Best Scoring and Assessing Innovation Criteria

Outputs

AM Best will use two sub-components to derive a total score for innovation outputs: results and level of transformation. In this assessment, the output is required to be tangible and quantifiable. AM Best will use information from the past five years for the analysis, with each sub-component scored on a scale of 1 (lowest) to 4 (highest). The sum of both scores will be multiplied by two.

$\text{Innovation Output Score} = 2 \times (\text{Results} + \text{Level of Transformation})$

Score	Results	Level of Transformation
1	The company has minimal, if any, measurable results from its innovation initiatives or has no initiatives in place.	The company's innovation output is primarily the result of replication of well-used or mature processes or technology.
2	The company has demonstrated a measurable impact on its results from its innovative process/initiatives. The company has been able to generate ad-hoc innovation results, but whether the results can continue into the foreseeable future is uncertain.	The company's innovation output is not industry-leading. The company has adopted some emerging technologies.
3	The company has demonstrated measurable results from its innovative process/initiatives in its financial results and can identify areas affected quantitatively, such as improved underwriting experience. The results are sustainable and very likely to continue over the near to medium term.	The company's output indicates that it is an industry leader in innovation. Peers often replicate the output results. The company is viewed as a disruptor in the industry.
4	Innovation has resulted in a sustainable competitive advantage, with a measurable impact over a sustained period, and is replicable. The company has been proactive in using innovation to out maneuver competitors and potential disruptors.	The company effectively uses cutting-edge processes and technology throughout the enterprise. The company's innovation is at levels comparable to leaders even outside the insurance industry.

Source: AM Best Scoring and Assessing Innovation Criteria

Innovation Assessment

AM Best plans to publish the results of the overall innovation score assessment for each rated company based on the five assessment categories below:

Assessment	Non-innovator	Reactor	Adopter	Innovator	Innovation Leader
Innovation Score	Less than 12	12 - 17	18 - 22	23 - 27	28 or higher

AM Best anticipates most companies will generally score in the lower end for the innovation input score, reflecting the fact that the insurance industry is just beginning to embrace an innovative culture. AM Best also expects more companies will generally score in the lower end for the innovation output score, reflecting the challenging customer experience the insurance industry faces relative to other industries.

The impact of innovation of a company's financial strength rating will be relative depending on the individual characteristics of each company. Innovation was previously considered in the overall rating process but will now be specifically assessed within the business risk profile assessment to determine the ratings impact. AM Best highlights that the innovation score is not directly correlated to the issuer credit rating of an insurer or does not automatically have a positive or negative impact on a company's rating.

How Aon Can Help

Aon's Rating Agency Advisory Group plans to provide written feedback to AM Best regarding the RfC. Please reach out to any of our experts listed below as to assist in understating implications of potential changes for your company and discuss key considerations regarding feedback to AM Best.

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