

## AM Best Proposes to Score Insurer Innovation

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The leading national rating agency will specifically assess insurers according to their level of innovation, an important step toward increased recognition and adoption of technology and other means of innovation to modernize and grow the insurance industry.

While acknowledging that “historically” it has “captured innovation indirectly” through various rating criteria, AM Best is requesting comment from market participants and other interested parties on its March 14, 2019 draft of a new criteria procedure, “Scoring and Assessing Innovation.” This proposed procedure focuses on an insurer’s innovation level based on the analysis of two overarching categories. First, AM Best proposes to measure a company’s “innovation inputs” by scoring and assessing the subcategories of company leadership, culture, resources, and processes and structure. Second, AM Best will analyze a company’s “innovation outputs” by scoring and assessing insurer results and the level of transformation achieved.

The innovation input score will comprise four components, for which insurers will be rated on a scale of one to four, with four being the highest:

- **Leadership.** Top scorers in this category will have “the sponsorship of top management and support throughout the organization” for their efforts to innovate, including at the board level.
- **Culture.** Companies earning the highest scores here will “approach the innovation process purposefully and systematically” and be able to “demonstrate that their innovation initiatives are integrated throughout the organization.”
- **Resources: Allocation, Strategy and Management.** The highest scorers in this category will devote “appropriate” resources to innovation “relative to [their] operations and financial wherewithal” and use their “resources efficiently and create value.”
- **Process and Structure.** Highly rated companies in this set will “promote organizational intelligence while avoiding innovation silos.” Further, an insurer’s approach to data management, innovation strategy, and governance will be considered here.

Companies also will be scored from one to four on their innovation outputs, assessing the following two measures:

- **Results.** This category focuses on measurable results, including, for example, “a lower expense ratio; higher revenue growth; more robust customer-centric, data driven product design; better customer retention; greater brand recognition; or stronger data analytics.”
- **Level of Transformation.** AM Best will aim to measure an insurer’s level of transformation in this category. It recognizes that “transformation does not encompass splashy initiatives that do not create value; rather, it encompasses initiatives that create value, improve customer engagement and experience, lead to a superior business model, or significantly enhance growth opportunities.”

The scores for each of the innovation outputs will be doubled in calculating the total “innovation score.” The innovation score, which could total as little as 8 (one in each of the subcategories above) or as high as 32 (fours across the board), will then be translated into an assessment that AM Best proposes to divide into the five



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categories:

- Non-innovator (score less than 12)
- Reactor (score between 12 and 17)
- Adopter (score between 18 and 22)
- Innovator (score between 23 and 27)
- Innovation Leader (score of 28 or higher).

AM Best proposes to publish its innovation scores and assessment, and further, “explicitly” use the assessment within its business profile building block in analyzing a company’s long-term financial well-being. It requests comments from participants and interested parties no later than **May 13, 2019**.

AM Best is not the only major rating agency to take particular notice of the importance of innovation for insurance companies. Fitch Ratings stated last week that InsurTech is set to “revolutionize how insurers collect, assess and analyze data” and in January, Fitch published its report “Innovation in Workers’ Compensation Insurance Disruptive Technology: Insurance,” in which it emphasizes that workers’ compensation insurers must innovate to remain competitive.

### **Drinker Biddle Observations**

As AM Best acknowledges, innovation is currently addressed in AM Best’s various existing rating criteria. These would include an insurer’s enterprise risk management (ERM) program, for which AM Best began requiring insurer implementation in/around 2011. Though it is unclear whether early adopters of effective ERM gained a competitive advantage in the market, insurers’ thinking about ERM eventually evolved due in part to the AM Best assessment.

There is real, effective innovation that truly transforms a business model, and then there is innovation for the appearance of innovation. It remains to be seen whether AM Best will be able to distinguish between the two, but the new criteria should at least push some insurers to evolve in their thinking about the future of their business.

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