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Best's Methodology and Criteria

Scoring and Assessing Innovation



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Scoring and Assessing Innovation

Outline

- A. The Importance of Innovation
- B. Defining Innovation
- C. Scoring Innovation
- D. Translating the Innovation Score
- E. Business Profile

The following criteria procedure should be read in conjunction with *Best's Credit Rating Methodology (BCRM)* and all other related BCRM-associated criteria procedures. The BCRM provides a comprehensive explanation of AM Best's rating process.

A. The Importance of Innovation

Innovation is becoming increasingly critical to the long-term success of all insurers. With innovation, companies can develop sustainable competitive advantages and better respond to external challenges such as evolving consumer preferences, growing business complexity, shifting market dynamics, and ever-expanding technological advancements. Companies need innovation to outpace competitors, fend off potential external disruptors, and promote organizational longevity.

Insurers may be able to gain a competitive advantage by improving efficiencies through innovation. Technological developments, such as Artificial Intelligence (AI) tend to be the innovations that receive the most attention. However, while technology plays an important role in providing tools for innovation, innovation is not all about technology. Many insurers have historically found nimble ways to adapt to an ever-changing market environment without having to become sophisticated technology players. To keep up with current innovation developments, insurance innovators rely on diverse sources, including employees, customers, and consultants. When innovators are faced with challenges requiring innovations outside of their core competencies, they are willing to make investments and form partnerships.

Given the accelerating pace of innovation and magnitude of change, insurance companies that fail to innovate may find it difficult to sustain long-term success/profitability and may ultimately be subject to anti-selection and loss of relevance. Those insurers that successfully incorporate innovation will likely strengthen their organizations, increase their customer base, and improve their efficiency, supporting their financial strength.



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Scoring and Assessing Innovation

AM Best’s approach to scoring and assessing innovation for operating insurance companies is two-pronged: (1) all rated companies will be scored and then given an innovation capability assessment; and (2) as outlined in BCRM, AM Best will explicitly consider whether a company’s innovation initiatives, or lack thereof, have had a demonstrable impact (positive or negative) on its long-term financial strength in its business profile building block.

B. Defining Innovation

AM Best defines innovation as a multi-stage process whereby an organization transforms ideas into new or significantly improved products, processes, services, or business models that have a measurable positive impact over time and enable the organization to remain relevant and successful. These products, processes, services, or business models can be created organically or adopted from external sources.

There are several key aspects to AM Best’s definition of innovation. First, innovation can take many forms—it is not limited to a particular type of innovation or technological development. The definition also allows for flexibility regarding the source of innovation; for some organizations, innovation through adoption may prove to be the most appropriate path, as there may be inherent barriers to innovation in the organization.

Second, AM Best expects the output of the innovation process—those new or significantly improved products, process, services, or business models—to have a measurable impact. Some level of risk-taking and possible project ‘failure’ is an expected part of any innovation program, but companies receiving the highest innovation scores will have a demonstrable success in innovating. Without productive results, the resources consumed by the innovation process will be a financial drain rather than an aid.

Third, innovation is a dynamic and ongoing process, as well as a long-term commitment. Companies receiving high scores will be those that treat innovation as part of a continuous cycle of organizational growth and development, and that successfully integrate their “new-stream” innovations with their mainstream legacy operations.

C. Scoring Innovation

Components of the Innovation Score

AM Best’s evaluation of a company’s innovation level is based on two elements: (1) innovation inputs—or the components of a company’s innovation process; and (2) innovation outputs—or the impact of the company’s innovation efforts. The resulting innovation score is the sum of these two evaluations.

Exhibit C.1: Innovation Score Formula

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

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Assessing the Components

Innovation Inputs

The evaluation of a company's innovation inputs entails an assessment of four sub-components: (1) leadership; (2) culture; (3) resources: allocation, strategy, and management; and (4) processes and structure. These sub-components capture both a company's innovation capacity—i.e., the resources the company has dedicated to innovation—and its potential innovation capability, or whether the structural elements of the innovation process are positioned in such a way that the company can leverage its available resources and create value. Each of the sub-components is scored from 1 to 4, with 1 corresponding to the lowest assessment and 4 the highest. More detailed scoring considerations for the sub-components are outlined in the following sections.

Exhibit C.2: Innovation Input Score Formula

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

Leadership

Leadership can be a driver of innovation success or a cause of innovation failure and thus has a direct influence on the other sub-components in the innovation assessment. Industry leaders of innovation will have the demonstrated sponsorship of top management and support throughout the organization—including board participation—which can be indicative of senior leadership's commitment to innovation efforts.

Companies that successfully innovate typically benefit from buy-in at the senior management level, evidence of which can be found when the concept of innovation dovetails with the corporate mission statement. Management at these companies can clearly describe the relationship between the company's innovation strategy and its value, mission, and/or vision statements. It has also proven, through past initiatives, the effectiveness of such a strategy.

Encouraging new ideas, fostering productive organizational evolution, and backing innovation with strategic actions are among the hallmarks of management at an innovative organization. Leadership is supportive of a mindset that supports cross-functional collaboration to identify, develop, and implement new, proactive innovative ideas. The clear enumeration of goals by leadership is essential, so that all parts of the organization understand what the result should be. By embracing and fostering a culture of innovation, leadership can generate a high level of interest/buy-in, so that employees, at all levels, are empowered to be change agents.

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Exhibit C.3: Leadership Score Examples

Score	Example Description
1	Management does not recognize that innovation is critical to organizational success. Innovation is not factored into the company's longer-term strategy.
2	Management recognizes that innovation is a critical aspect of the organization's continued operations. However, the company cannot provide evidence of promoting innovation to all levels of the organization. Management pursues innovation initiatives in response to competitive pressures in the industry. The relationship between innovation and the company's mission, vision, and/or values is unclear.
3	Management has demonstrated that innovation is a critical aspect of the organization's continued operations. The company is able to provide evidence of innovation promotion in the organization. Innovation initiatives pursued by management may still be more reactive than proactive.
4	Through deliberate actions and demonstrated expertise, management (including the board and middle management) has established the organization's commitment to the innovation process as articulated by its leadership. Management has exhibited a successful track record of promoting innovation throughout the organization at all levels and displaying the competency needed to enact the company's innovation strategy. Management seeks proactive innovation solutions that are clearly linked to the company's mission, vision, and/or values.

The key characteristics described for each assessment category are ideal scenarios and are not intended to be prescriptive.

Culture

Like leadership, culture can either stimulate or suppress innovation. Organizational cultures that inspire innovation allow for risk-taking as well as the possibility of project 'failure'. Companies receiving higher scores approach the innovation process purposefully and systematically. The culture of these companies fosters ownership and transparency, while also encouraging cross-functional knowledge-sharing, recognizing that innovation flourishes in a diverse environment. Innovation at these companies is embedded throughout the enterprise, rather than being siloed, enabling the transfer of expertise and insights.

Tolerance for risk-taking is well defined, with project 'failure' being an acceptable option but with a process in place to terminate ineffective innovation ideas after an appropriate and timely review. Employees are incentivized to participate in the innovation process and communication regarding innovation is not limited to senior management.

Because leadership often drives culture, an enterprise is unlikely to have a high culture assessment if it does not have strong leadership.

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Exhibit C.4: Culture Score Examples

Score	Example Description
1	There is no evidence that the company reacts to changing market conditions. If they exist, innovation initiatives are developed on an ad hoc basis in a siloed environment with limited communication and a lack of ownership.
2	The company reactively calibrates its innovation efforts to changing market conditions. Innovations are developed on an ad hoc basis, but ownership of such initiatives is clear. These innovations tend to be group-specific and are not undertaken or conceptualized in conjunction with the larger organization.
3	The company seeks to calibrate its innovation efforts to changing market conditions, but so far success has been limited. The company has fostered a structured approach to developing innovation initiatives that includes input from individuals outside designated innovation groups and has a defined rationale for when to accept a project's 'failure'.
4	The company has a demonstrated track record of successfully pivoting to meet changing market conditions. The company can show through specific examples that it encourages its employees to participate in innovation, that innovation is approached from an enterprise-wide perspective, and that ownership of innovation initiatives is shared by business units and leadership. Knowledge from failed initiatives has facilitated the development of successful ones.

The key characteristics described for each assessment category are ideal scenarios and are not intended to be prescriptive.

Resources: Allocation, Strategy, and Management

A company's ability to strategically allocate resources is critical to the success of an innovation initiative. For a company to receive a higher score for this sub-component, the resources it devotes to innovation must be appropriate relative to its operations and financial wherewithal. This requires that management be fully cognizant of the company's level of agility so that it can determine whether partnering makes good business sense. For instance, a company may find it more appropriate to outsource its innovation initiatives or incorporate innovation responsibilities into an established role than to create a Chief Innovation Officer position. Smaller niche insurers may emphasize operational innovation, product design or external partnerships rather than internally developing groundbreaking and expensive technology for their operations.

Moreover, having resources is not enough; a company also needs to be able to use these resources efficiently and create value. For example, companies may invest significant capital in collecting and storing data, but without an effective data strategy and the ability to exploit what it has collected, its efforts and capital expenditures may not yield productive results.

The resources critical to a company's innovation strategy can generally be divided into one of three categories: technical, creative, and financial. Technical resources include systems and data allocation, with an eye towards the potential for harnessing new technological breakthroughs. Creative oversight encompasses not just the generation of ideas to develop new, practicable solutions, but also ensuring that the right people are assigned to the project. Thus, hiring practices that focus on a diversity of experience and backgrounds, as well as the ability to attract and retain high-level talent, are key. Finally, financial resources should focus on the appropriate allocation of budgetary resources. Additionally,

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the financial process should include rewarding the organization's innovators. As a result, expenses may be temporarily elevated owing to investments in innovation. AM Best expects that these expenses will be explained to the analytical team as part of the normal rating process. AM Best also expects that companies will be able to provide detailed analyses of the return on investment for their innovation initiatives. Partnering with, or purchasing solutions from, external providers is also incorporated into the Resources sub-component. Depending on their circumstances, companies may consider both internal and external innovative solutions as part of a regular assessment of customer needs, market conditions, and internal/external threats to the business model.

Exhibit C.5: Resources Score Examples

Score	Example Description
1	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.
2	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.
3	The company devotes appropriate resources to innovation, and its strategy for managing these resources is linked to its operational goals, allowing for their efficient transformation and exploitation. Staff is rewarded for successful innovation ideas and implementation.
4	The company prioritizes resource allocation towards innovation, and is able to attract top talent even outside of the industry. 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. The company has demonstrated a long track record of efficiently utilizing its resources in achieving industry leading innovation output.

The key characteristics described for each assessment category are ideal scenarios and are not intended to be prescriptive.

Processes and Structure

The organizations that optimize processes and structure promote organizational intelligence while avoiding silos. They also successfully integrate innovation efforts with mainstream operations. Without a replicable process and structure in place, implementing innovation process and initiatives will be difficult. Elements of an innovation program that may be evaluated include the company's data management, innovation strategy, and governance processes.

Proper data management is a building block for a successful innovation strategy, as an insurer's ability to access and leverage high quality data is fundamental for innovation to succeed. Proper data management includes data governance that is well defined and clearly delineates (1) the parameters for the organization's investment for data initiatives; (2) the prioritization of these investments; (3) data standardization policies/procedures; and (4) the responsibility for data quality, data stewardship, and data ownership. Access to data and transparency are embraced as corporate-wide objectives. Effective data management processes and structure will ultimately lead to better innovation outputs. Strong data management enables advanced analytics and automation, including the responsible use of AI-enabled tools.

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A challenge for insurers is aligning the use of customer data with varying regulatory restrictions related to consumer privacy. The rules for use of personal data are expected to fall in the confines of governance and encompass regulatory guidance. Governance also looks to manage innovation at a portfolio level.

The innovation strategy should incorporate an honest assessment of a company's capabilities and determine whether the strategy will have an inward or outward focus or an appropriate blend of both approaches. This could be project-dependent: some projects may be handled internally, while others may require external expertise or be wholly outsourced. When dealing with external partners and stakeholders—such as venture capital, government agencies, universities, or insurtech—a process for integrating them into the overall strategy is necessary. Companies should be able to articulate/quantify the benefits derived from these external relationships.

A company receiving higher scores in this sub-component has clearly linked its innovation strategy to specific business objectives, such as explicitly linking innovation-driven growth to business targets, with the goal of creating and sustaining a competitive advantage. The company's development plan for innovation is iterative, allowing for adjustment and refinement, and is replicable for processes that work.

Exhibit C.6: Processes and Structure Score Examples

Score	Example Description
1	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	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, and are removed from mainstream operations.
3	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 and further integration with mainstream operations.
4	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 and is integrated with mainstream operations.

The key characteristics described for each assessment category are ideal scenarios and are not intended to be prescriptive.

Scoring Expectations

Based on observations of the insurance industry, AM Best would expect that most companies would generally score in the lower range in the components of the input score, with only the strongest scoring at the higher ranges. This reflects challenges in process and structure, as well as the relatively recent acceptance of innovation by many industry participants as part of a company-wide corporate culture.

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Innovation Output

To be identified as innovation leaders, companies need to establish that their innovation process is effective and creates value, which can take many forms. In the assessment, the output needs to be tangible and quantifiable. An example of measurable output would be a decline in expenses linked to a specific innovation process, project or event.

The Innovation Output Score is based on two components: (1) results and (2) level of transformation. AM Best doubles the score from these two components due to its belief that outputs (tangible results) are critical. When calculating an organization's innovation output score, AM Best uses the previous five years as its timeframe for the analysis.

Exhibit C.7: Innovation Output Score Formula

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

Results

Ultimately, innovation needs to lead to measurable results to make the investment of resources worthwhile. Companies that invest significantly in innovation infrastructure (systems, talent, and processes) but derive no tangible benefit will score poorly on this sub-component. The innovation output can include results such as 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.

Companies can sustain the competitive edge they gain from innovation only by continual evolution of their innovation strategies and initiatives. Therefore, companies receiving the highest scores in this sub-component will generally demonstrate the following:

- A well-balanced mix of operational and growth-oriented innovation
- The ability to respond quickly to both internal and external pressures
- An implementation strategy that appropriately balances short and long-term initiatives—for example, by encompassing a mixture of incremental and transformational innovations with various time horizons

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Exhibit C.8: Results Score Examples

Score	Example Description
1	The company has minimal, if any, measurable results from its innovation initiatives or has no initiatives in place.
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.
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.
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 outmaneuver competitors and potential disruptors.

The key characteristics described for each assessment category are ideal scenarios and are not intended to be prescriptive.

Level of Transformation

A company's innovation initiatives may be fruitful but may not be transformative or even allow the company to remain relevant or competitive. For example, a company may switch from manual policy filings to digitized storage. Although this process would result in lower expense ratios and would therefore have a positive impact on the sub-components of the results, the level of transformation involved is rather low relative to the industry and leaders outside the insurance industry. The transformation score would therefore be low.

Only those companies with best-in-class processes and technology will be eligible for a higher transformation sub-component. Transformative initiatives are those that create value, improve customer engagement and experience, lead to a superior business model, or significantly enhance growth opportunities.

Exhibit C.9: Level of Transformation Score Examples

Score	Example Description
1	The company's innovation output is primarily the result of replication of well-used or mature processes or technology.
2	The company's innovation output is not industry-leading. The company has adopted some emerging technologies.
3	The company's output indicates that it is an industry leader in innovation. Peers often replicate the output results. The company is viewed as an innovation leader in the industry.
4	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.

The key characteristics described for each assessment category are ideal scenarios and are not intended to be prescriptive.

D. Translating the Innovation Score

AM Best translates its innovation scores into the five assessments of innovation capability shown below.

1. Minimal: Used to describe the innovation capabilities of companies receiving an innovation score of less than 12
2. Moderate: Used to describe the innovation capabilities of companies receiving an innovation score between 12 and 17
3. Significant: Used to describe the innovation capabilities of companies receiving an innovation score between 18 and 22
4. Prominent: Used to describe the innovation capabilities of companies receiving an innovation score between 23 and 27
5. Leader: Used to describe the innovation capabilities of companies receiving an innovation score of 28 or higher

The assignment of an innovation capability assessment follows the summation of the Input and Output scores outlined in Section C. **Exhibit D.1** provides a detailed example of how the scoring system is applied.

Exhibit D.1: Innovation Scoring Example

Company A is a mid-sized personal lines insurer in the U.S. Over a three-year period, senior leadership and the board treated innovation as an operating discipline rather than a standalone technology project, establishing clear sponsorship, cross-functional ownership, and portfolio governance to prioritize initiatives, define success metrics, and discontinue efforts that did not meet expected outcomes. Innovation efforts centered on redesigning core underwriting and claims workflows to reduce friction, improve consistency, and create measurable operating benefits, while building the controls required to use AI responsibly in regulated insurance processes.

Within this broader workflow and governance redesign, the company implemented AI-enabled automation and decision support across underwriting intake and claims operations. The company deployed machine-learning models and natural language processing, explicitly including Large Language Model (LLM)-based tools for document understanding, to extract and structure information from unstructured materials (submissions, loss runs, first notice of loss narratives, adjuster notes, invoices etc.). These AI tools were used to (1) auto-classify incoming documents, (2) pre-fill standardized fields, (3) recommend triage and routing paths, and (4) flag potential severity, leakage, or anomaly indicators for human review. Importantly, the company maintained “human-in-the-loop” controls for underwriting and claim decisions, established model governance (documentation, change control, monitoring, and bias/testing protocols), and implemented data governance and privacy guardrails to ensure appropriate use of customer information.

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As a result of these initiatives, the company reduced average claims handling time and improved the expense ratio over the period, contributing to higher net operating income. However, sustaining and extending these gains entails execution risk: while overall operating efficiency improved, innovation-related build and run costs increased during the implementation phase, and the company recently lost key IT/data talent. Management is responding by tightening initiative-level return on investment (ROI) tracking, strengthening AI governance and vendor oversight, and selectively using external partners to maintain delivery capacity while embedding these AI-enabled capabilities into mainstream operations.

Input Score

Leadership Score = 3

Company A recognizes that innovation is a critical aspect of the organization's continued operations and its strategy is well messaged throughout the organization.

Culture Score = 3

Company A is proactive and has demonstrated that it has a systematic approach to its innovation process. The most recent initiatives had clearly identified owners and followed an assessment of changes in market conditions, with input from varied stakeholders.

Resources: Allocation, Strategy, and Management Score = 3

Company A devotes appropriate financial and technical resources to its innovation program and has formalized resource planning and oversight through portfolio governance and initiative-level tracking. While recent turnover in key IT/data roles and delays in certain system upgrades introduce execution risk, management has mitigated these pressures through targeted hiring, training, and selective use of external partners to maintain delivery capacity.

Processes and Structure Score = 3

Company A's processes and structure are generally aligned with its long-term objectives. Data governance and privacy controls are in place, and the company is leveraging its data more effectively through standardized workflows and decision-support capabilities integrated into underwriting and claims, though monitoring and measurement continue to mature.

Total Input Score = 12

The total input score adds up to 12, as shown below.

$$\begin{aligned} & \text{Innovation Input Score (12)} \\ & = \text{Leadership Score (3)} + \text{Culture Score(3)} + \text{Resources Score(3)} \\ & + \text{Processes and Structure Score(3)} \end{aligned}$$

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Output Score

Results Score = 3

The company has demonstrated measurable, repeatable results from its innovation program, particularly through AI-enabled workflow redesign in underwriting and claims, contributing to sustained expense improvements. While additional benefits are still being expanded into other areas, the results to date are credible and likely to continue over the near to medium term.

Level of Transformation Score = 2

Company A has achieved meaningful efficiency gains by implementing AI-enabled intake, document extraction, and workflow triage layered onto its underwriting and claims processes. However, these capabilities sit largely as “add-on” layers around a legacy core environment, and enterprise-wide transformation is constrained by integration complexity and uneven data standardization. Recent loss of key IT/data talent may further slow scaling. Positive movement in this sub-component could occur as the company completes targeted modernization and demonstrates that these capabilities are embedded and scalable across multiple operations.

Total Output Score = 10

The total output score adds up to 10 as shown below.

$$\text{Innovation Output Score (10)} = 2 \times (\text{Results (3)} + \text{Level of Transformation (2)})$$

Innovation Score

The final innovation score is 22 as shown below.

$$\text{Innovation Score (22)} = \text{Innovation Input Score (12)} + \text{Innovation Output Score (10)}$$

Innovation Assessment

Company A’s innovation score of 22 translates to the innovation capability assessment of Significant.

Company A’s Innovation Abilities = Significant

E. Business Profile

Difference between the Innovation Score and Innovation in Business Profile

AM Best considers the assignment of an innovation score to be an absolute assessment—that is, all insurance companies are subject to the same evaluation criteria regardless of their line of business, location, market position, or other segment-specific characteristics. Although there can be degrees of innovativeness (as demonstrated by AM Best’s five levels of capability assessments), the scoring of innovation is not relative. A company either innovates (to some degree) or it does not. AM Best acknowledges that some companies are consciously choosing not to develop innovation abilities and that every company needs to tailor its innovation strategy to what it deems appropriate for its needs.

The innovation score is not necessarily correlated with Best’s Issuer Credit Ratings (ICR). There may be instances where lower rated companies score well on innovation as well as cases where higher rated companies have more limited innovation abilities. The innovation score does not automatically

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translate into a rating positive or negative, as AM Best must also assess whether the company's innovativeness provides it with any long-term financial strength enhancement (or detriment), given the company's particular business profile assessment.

Business Profile Impact

When assigning a rating AM Best explicitly assesses the impact of innovation in the business profile building block. The impact of innovation on an insurer's financial strength is a relative assessment, and does take into account the unique situational characteristics of a particular company. For instance, a line of business as a whole may not be particularly innovative, with most of the composite receiving an assessment of Moderate innovation abilities. A company in that composite receiving an assessment of Significant that is able to translate its innovative advantage into a competitive one would receive credit for the positive impact innovation has had on its financial strength in the business profile assessment. AM Best anticipates that the importance of innovation will increase over time and that the cultivation of innovation will become a leading indicator of companies with defensible market positions.

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