

World Insurance

REPORT

GLOBAL PERSPECTIVE, DETAILED ANALYSIS

News feature: reinsurance and the internet

Don't throw out the relationship with the lineslip

Direct insurers have never really doubted the marketing potential of the internet, but it took a long time before they were convinced of its effectiveness as a sales tool. Reinsurers, on the other hand, still have their doubts. But this uncertainty has not deterred some reinsurers from investing heavily in the new technology. The dotcom dream may have lost some of its gloss over the last six months, but the long-term promise of the internet is still very much intact.

Few people believe in that promise more than Igor Best-Devereux, a former London market broker who now heads up ereinsure, a Utah-based technology company that specialises in the development of web applications for the reinsurance industry.

Confidence

For Mr Best-Devereux, a big part of the problem has been the marked failure of electronic and internet reinsurance trading exchanges to gain the confidence of the industry over the last two years. Although he is very clear about the specific reasons for this failure, he points out that it affects all industries involved in business-to-business (B2B) interaction on the internet. Indeed, the problem is so extensive that the existing B2B exchange model is in the process of being reinvented by technology companies such as ereinsure.

"A year or so ago everybody in the B2B market thought that the internet was an industry in its own right rather than just an enabling technology. They also thought that businesses would be quite comfortable reinventing themselves and would readily resort to public auctions on the internet to procure supplies or sell goods and services to other companies. The belief was that an open request would be posted on the internet, and the world and his wife would come and quote," Mr Best-Devereux told *WIR*.

Privacy and established relationships

The reality was entirely different. Most companies already had well established procurement relationships for sourcing physical goods or intangibles like insurance or reinsurance cover. "Those relationships are very important to them.

This is particularly the case for a service like reinsurance where companies need to survive the good as well as the bad times. They have no real interest in this open broadcast of their business requirements. Privacy is crucial to them".

The realisation that the B2B public exchange model was not working first became obvious in the intensive trading environments of the chemical and steel industries and, a little later, in other industries. The model that appears to be surviving is that of the private exchange, which is very similar to that established by large corporations such as IBM and Hewlett Packard to more efficiently meet their procurement needs through a network of carefully screened suppliers. According to Mr Best-Devereux, everybody now appreciates that the creation of sales volume or 'liquidity', although important, is not really the issue. "The issue in the B2B market is process improvement through technology and not trying to change long-established relationships and practices".

Proprietary networks

The re-emergence of the private electronic exchange is something of an irony. It harks back to the days of proprietary, highly localised networks such as the London Market's Electronic Placing System (EPS) and Rinet, the electronic reinsurance initiative supported by Swiss Re and Munich Re. Each of these essentially 'closed' networks not only had their own specialised terminals and dedicated phone lines, but also had operating and messaging standards peculiar to themselves. The absence of a standardised protocol and the general lack of flexibility severely restricted the volume of trade over these networks which were soon rendered redundant by the rapid advances in internet technology over the last few years. In particular, the advent of the web browser meant it was possible for a company to access any network or database anywhere in the world by using a personal computer equipped with a modem. "The great attraction of the web-enabled systems is that multiple parties can communicate across them very easily because of standardised networks," he explained.

Enabling the front office

However, the vision of mass access associated with the internet very quickly shifted the emphasis from the idea of a closed, contained network to the idea of a vast, open public exchange. Mr Best-Devereux said this latter vision gave rise to a "euphoria and exuberance" in the B2B market that got deflated very rapidly. He referred to a recent survey of chief information officers in the US by Computer Systems Corporation. "What came through very strongly was that the value of the internet is not to create new content or a new business environment or anything like that. [Rather] that the internet is all about the opportunity for customer service, for process improvement and linking these enhanced front office activities with the back office systems, which up to now have been the sole beneficiaries of most companies' investment in IT".

The key bit of technology that makes this connection possible is Extensible Markup Language (XML), a set of messaging standards that is in the process of replacing the existing Electronic Data Interchange (EDI) standard as the most flexible and efficient means of enabling communications between different networks. "It is really putting an information and processing system in a part of the business where there has not been one before, in the front office. In the reinsurance industry there will be a significant move to front office systems over the next five years in order to leverage the talent and boost the productivity of some of the most expensive people in the company, the underwriters," Mr Best-Devereux said.

Trench war

He explained that the key realisation in the B2B market is that many of the older type businesses like reinsurance have well established practices. "People are slow to change. When I am talking about our business I make it clear that it is foot war rather than an air strike. We are going to be in the trenches for a long time before an online reinsurance exchange really gets off the ground, before people are converted over to some of the process improvements that they

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can achieve with the different types of technology, including the internet," he said.

Not surprisingly, the volume of reinsurance traded over the internet is currently tiny. A number of reinsurers have established sites through which their clients can obtain cover (typically facultative coverages) online. Sites include GeneralCologne Re's FacWorld, ERC Employers Re's Myreinsurance, Zurich Re's eFac, CNA Re's Smartfac, Swiss Re's Elrix and Scor's iFac. More recently, there has been the emergence of life reinsurance sites such as CNA Life Re's AgoraRe and Scor's Sar@.

But all these sites pretty much involve a one-to-one relationship between the buyer and seller. In addition, the owners or managers of these sites are also the sole providers of the reinsurance capacity and the cover on offer tends to be highly standardised. Mr Best-Devereux said that while such sites were useful, there was an increasing need for neutral reinsurance exchanges where, in a secure environment, an insurer could show a risk to a selected number of reinsurers at the same time. His own company is currently beta-testing such a web-hosted software application called ereinsurance.com. "The online offerings at the moment are very narrow. The market really needs a great deal more flexibility in the way in which it buys reinsurance".

Although reinsurers can deal directly with their cedants through ereinsure.com, the system very much preserves the traditional relationships and roles of insurer, broker and reinsurer. "We are not in business to protect brokers, but we are also not in business to disintermediate brokers. And reinsurance is an activity where the middle man does add value. The brokers really contribute, particular in terms of their knowledge of how to structure programmes," Mr Best-Devereux argued.

Although Chubb Corporation is an investor in ereinsure.com, it is very much a neutral platform. "We are neutral in the sense that we are not selling a reinsurance product. We are not an assuming company that has a particular view of what terms and conditions and what pricing should prevail in the market. The other important aspect of neutrality is that this kind of private exchange will only work if the processing application and data base is held in a secure, neutral space where it can be accessed in confidence by multiple parties," Mr Best-Devereux explained.

Broad support

Beside Chubb, there is currently no other strategic investor in ereinsure.com. "We hope that that will change at some point. We are in discussion with other parties at the moment. We currently have a number of insurers, reinsurers and a major broker testing the system and we are keen that our shareholders should be industry players rather than venture capitalists. This is a business that requires a long-term time horizon," Mr Best-Devereux said.

Other attempts to come up with a proper online reinsurance trading exchange that is broadly supported by the industry include Swiss Re and Munich Re's inreon, the independently funded

Risk2Risk, and Gothaer Re's Reway. The plan is for Risk2Risk to confine itself at the outset to facultative satellite reinsurance and then to expand into aviation and marine business later on. Gothaer Re is currently the sole owner of Reway but the company is actively looking for additional shareholders. Swiss Re and Munich Re are also looking to broaden the ownership of inreon.

Mr Best-Devereux said the advantage ereinsure.com had over the competition was its unrivalled flexibility, and its capacity to handle both standard and non-standard transactions from the most simple risk to the most complex treaties or large facultative risks in the oil and gas industry.

He explained that ereinsure was providing the industry with a platform that could be used in different ways. Indeed, its ability to communicate in all directions, with all networks, was such that cedants could access other reinsurers' standardised online offerings.

"We offer a platform that a cedant uses to contact multiple parties in an efficient manner. So our view is that if he is looking for reinsurance, he might want to look at those standard products. But he also might want to get quotations from other companies as well. We are not a policeman in the market. We are not saying you have to use the application in a particular way. We are saying here is a whole range of features and functionalities within the system and we think it will help you reduce the cost of the process".

The capability to allow the parties to enter into negotiation was critical to the successful handling of more complex risks online. "When you are trading price for terms and conditions you need negotiation to occur. And one of the strengths of our product is that we have embedded within the application this negotiation capability, this ability to take terms and conditions and pass them backwards and forwards, qualifying them, and finally reaching an agreement on them. This requires decision making on each side and we provide the structure within which they can do that," Mr Best-Devereux said.

Face to face

In terms of risks with a very high level of complexity, Mr Best-Devereux envisages cedants using a combination of face-to-face meetings and a system like ereinsure as a record keeping and document management tool. "You will inevitably be meeting with people at that point, inevitably be incurring those costs that are necessary in the most complex risks where you are actually sitting down and really thrashing it out face to face".

He said ereinsure.com would probably have a different type of value in each of these risk categories, which, he was at pains to point out, were broad rather than discreet. There was a tendency for the generic and the slightly more complex risk areas to overlap. "So we think the most likely way our application could be deployed is for companies to adopt it as their front office reinsurance platform. They will be using it for the majority of their facultative transactions, but there is no reason it should not be used to place a treaty. With treaties you

have more of an issue of integration with back office systems than you do on the facultative side. We think ereinsure.com will become the front office application that companies will use to place and manage both standard and complex risks".

Document management

He said ereinsure.com had very powerful online reporting capabilities. "It will tell you who is buying what kind of reinsurance with your company. It will also tell you from which companies and from which individual underwriters you are getting success on the reinsurance you are quoting for, and who has declined your offers or your quotes. Information is very easily reported from the system. And you can print off those reports in various formats".

The ereinsure.com system monitors the entire transaction flow. Each change that occurs is documented within the system. "This has huge implications for the industry, because the consequences of every mistake are magnified. Although it might only be a \$10,000 transaction, it could be a \$1mn claim. So transaction monitoring is critical. Our system does not mean people won't make mistakes, but it means it is much easier to figure out where and why they occurred. And because the process is so structured, it also reduces the chances of making a mistake.

"So when we talk to people about the cost benefits of using the system, what we point out is the hard cost savings – which is that underwriters will be able to more efficiently use their time to cut back on travel and communication costs – but we also talk about the soft cost advantages in that you are getting information that you could not get at before and also that you are able to track and audit transactions in a way in which you never could before.

"And if that results in saving thousands of dollars in legal costs and going through depositions in order to try and understand what happened in a transaction, it must be good. Soft costs are very difficult to quantify, but anecdotally we all know in the business that they are very large," he said.

Costs

Mr Best-Devereux believes the current high level of transaction and other business acquisition costs is putting increasing pressure on the industry to adopt a system like ereinsure.com. The average cost of a reinsurance transaction can be as high as 9% of premium. "This is a real problem in the market, a problem which has been there for a long time. But now we have the technology to reduce those costs dramatically".

He noted that reinsurance, in the long run, was a contingent line of credit. "But it is a line of credit which, in addition to the actual premium, costs you 9% in the pure friction of the transaction. This is not a viable long-term model when there are other sources of capital out there in the market. The reality is that the reinsurance market has to have an attractive enough return to stave of the threat of those alternative capital sources. And to do this they have to address the issue of their very high cost base".