

World Insurance

REPORT

GLOBAL PERSPECTIVE, DETAILED ANALYSIS

WIR REINSURANCE TECHNOLOGY INTERVIEW

Igor Best-Devereux: chief executive, eReinsure

How the tragic events of 11 September gave an unexpected boost to the prospects of internet trading exchanges

To judge by recent reports in the press and the announcements by technology companies such as eReinsure, Inreon and Ri3K which have been piloting their respective platforms in the market over the last two years, the time for an internet based insurance and reinsurance trading exchange has finally come.

And not a moment too soon. It has been a rough three years for insurers, but it has been significantly more difficult for companies in the internet technology sector. Only the most resilient and best capitalised survived the sudden, spectacular crash of investor confidence in the dot-com market in 2000 and then, less than a year later, the terrorist attack on the World Trade Center (WTC) in New York – an event which further reduced the business opportunities and the scope to raise capital for the sector.

So what has changed over the last two years to enable eReinsure, which saw hardly any business in 2001, to handle more than 20,000 reinsurance submissions last year?

The company, which has 1,600 registered users, is now aiming to process between 50,000 and 100,000 submissions by the end of 2003. Last month, the US-based Fireman's Fund Insurance Company, following the example of Chubb (an investor in eReinsure), announced that it would purchase all its facultative reinsurance through the eReinsure platform.

Although eReinsure is way ahead of its competitors in terms of the volume of transactions processed, both Inreon and Ri3K have also reported significant increases in activity over the last year.

Change in attitude

Igor Best-Devereux, the chief executive of eReinsure, says that the attack on the WTC seriously disrupted eReinsure's sales and piloting processes.

"Insurers and reinsurers' attention was concentrated on solving immediate problems. But after the immediate issues had been dealt with, the longer term issues, as well as the benefits that a system like eReinsure could offer the market, became clearer. For example, the loss of documentation as a result of the WTC attack gave a huge impetus to offsite digital storage of critical documents."

Another issue which received a tremendous amount of attention (including regulatory attention) at the time was managing the aggregation of risk.

"Where is the risk placed? To what degree is it overly aggregated in one market, or a particular geographical area or line of business. Traditionally,

this has been something that has been easier to manage on the treaty side than on the facultative side.

"On the facultative side, without that central, consolidated store of information, it has often been very difficult. Also, a large number of companies withdrew from certain lines of business while they assessed what their total exposure was. There was a need to quickly get at that information.

"For example, in the aftermath of 11 September, there was a tremendous effort in the Lloyd's market to fully understand what its net loss was. So it was not only a question of where in the market does the loss lie but determining an insurer's net position given that the loss has occurred."

Withdrawal of capacity

He says that the withdrawal of capacity from the market impacted a lot of companies' reinsurance treaties.

"For example, we saw certain companies which had lost their property treaty reinsurance protection and then went out into the market to buy facultative reinsurance. So we actually saw an increase in the volume of facultative reinsurance both from a capacity standpoint and also from an underwriting standpoint. This was because companies wanted to better understand their liabilities and wanted to look at it on an individual risk rather than on a treaty basis."

Both primary insurers and reinsurers now wanted more and better information about the risks offered to them.

He explains: "The reason that this has not happened in the past is just the practical difficulty of doing it. One of the reasons companies use a treaty to transfer risk in reinsurance is because it is an efficient mechanism where a block of information, the basis of the treaty, the guidelines used to write the business, is packaged and passed on."

Then there was the steep rise in the price of reinsurance cover. Mr Best-Devereux says that for a number of years reinsurance was a relatively cheap spot purchase of capital for insurers.

"If they wanted extra capital they would go and access it through reinsurance, which was a pretty low cost process for them. But as the price in the market increased quite dramatically, particularly on certain lines, it really changed the dynamic of whether buying reinsurance is a good idea from a return on capital perspective."

The pressure on insurers' capital bases and the increased cost of reinsurance made companies

realise that they needed better information on the reinsurance they were purchasing.

Mr Best-Devereux says that along with the price change comes a change in the equilibrium between the risk that is being transferred and the price that is being paid for the reinsurance cover.

"If the price goes up for certain lines of reinsurance, an insurer should be making a decision about whether or not it buys that reinsurance. Whether or not it cedes premium to another party or retains the premium for itself. So there is the interrelationship between capacity and price. But there is also the interrelationship between price and information."

The volume of reinsurance business currently being traded over the internet is still a very small part of the overall volume of business in the market. As Mr Best-Devereux points out, there is quite a bit of difference between acceptance of the technology and its use.

"But we are finding that there is a very broad acceptance that this is the way the business is likely to move. And that comes from both the fact that the technology has now been proven in the market as something that can work and that in everyday life, these types of services and products that are accessed through the internet are increasingly common."

He says that the market now has a much clearer idea of what the internet really is. "It does not change the fundamental nature of a contract or anything like that. It is just a communication method with a standardised network that a lot of people can access. So the acceptance of internet is now at a much higher level than we have ever seen. And that acceptance is growing all the time."

Original operating model

Although some things have changed over the last two years, eReinsure has stayed true to its original operating model, that of a private, neutral business to business trading exchange.

"No major reinsurer owns any part of the company. We are truly neutral because we don't offer the reinsurance capacity ourselves and we are not controlled by sellers of reinsurance. And that is a different position to some of the other companies whether they be individual reinsurance portals or exchanges. We think that the neutral model particularly has allowed us to really focus on what the buyer of reinsurance needs, what functionality they require to help them with the buying process."

Adoption

Mr Best-Devereux says that the decision to use an internet trading exchange for any big company such as Chubb or the Fireman's Fund is always a complex one.

"We are not just talking about one underwriter who is a bit of an enthusiast who is going to give it a go. It is a very significant decision for these companies. There are millions of dollars of premium involved. Significant risk transfer relationships are at stake. So there is a real need for clarity in the handling of the transaction. It may be a relatively small premium, but it could result in a huge loss."

These companies want to look at the new workflow patterns and practices and see how these fit in with their traditional workflow. "But once they have done that they are much more committed. They understand much better where the benefits come from and are much more likely to view this as a long term process. So we are prepared to put in that effort, particularly at this early point in the formation of the market."

De-emphasising exchange

Mr Best-Devereux says that the most significant change has probably been the extent to which the term 'exchange' has been de-emphasised by everybody.

He identifies two main reasons for this development. "If you look back three or four years ago, exchange was a fashionable term. And then it became less fashionable. But that is just one way of looking at it. The other reason is that we have really focused the software application on the buying process and the ability for the customer company using the application to improve their management information through using it.

"So it is not just that the term exchange is less fashionable, but that the exchange function within the application is actually not the most relevant part of it. The market is an exchange in its own right."

He refers to a growing sense of just how important the information is that can now be consolidated by the customer. Both parties to the reinsurance transaction now have much more information available on the transaction than they would have had in their traditional buying process.

Mr Best-Devereux says that this is particularly true on the buyer's side, where this kind of information is normally very fragmented. "Traditional reinsurance buyers have always struggled to understand how much facultative reinsurance they are buying, who they are buying it from, and where it is aggregating in the market."

Who will survive?

Although he believes that there isn't room in the market for all four of the internet based insurance and reinsurance platforms (eReinsure, Inreon, Kinnect and Ri3K) currently touting for business, Mr Best-Devereux doesn't think that it is necessarily the case that only one will survive. At the same time, he thinks it will be difficult for more than two market based platforms to prosper.

"To build the system in the first place is an expensive proposition. So in a way there is always going to be a choice at an individual company level to build or to buy. So, for example, there have been a few companies who as buyers of reinsurance have looked at creating their own buying tool using the internet.

"They have to decide whether they are going to continue to invest in building and maintaining their own propriety system or do they use some neutral market type of platform. But with the pressure on cost, I think in the end most companies will choose to participate in a market type of platform."

He notes that over time one reinsurance platform, because of customer adoption, may prosper in one geographic area rather than another. But he hopes, given the international nature of the reinsurance market, that it will not occur. "I think that there is tremendous benefit in a world wide platform. But there could be a concentration by one platform in one region rather than another. If we take eReinsure at the moment, while we have companies experimenting with our system in Europe, the majority of our customer base is currently in North America.

"But that has also been somewhat our market entry strategy. The North American market has been a good place for us to start. You have a number of big insurers in North America who have been early adopters of this type of technology and these companies will drive business in Europe because of the influence they have with reinsurers in the European market."

He thinks that it is going to come down to whether companies decide to build or buy their own trading infrastructures and whether a platform is designed predominantly around the needs of the buyer or those of the seller.

He says: "Of course, any trading platform will need to satisfy both needs. But it is a question of how, in practical terms, you get a system like this up and running. Is it a matter of just making reinsurance capacity available over the internet? Or is it, in terms of the model adopted by eReinsure, a case of making tools or functionalities available for the buyer of reinsurance?"

Different needs

He could see the argument for different platforms catering to different needs. "But I think that the major distinction will be between a system that is built around the buyer's needs or a system that is built around the seller's needs."

The latter, he thinks, is more likely to be the individual reinsurers' portals. "Where a reinsurance company creates their own portal for product offerings it becomes more problematic to generalise those offerings on a platform. One of the things that we have learned over the last two years is the need to be flexible in the use of our platform because the business itself requires a lot of flexibility in terms of the different types of risks, the different types of relationships, and the different needs of the participants."

Europe and the London market

eReinsure has an office in London. But Mr Best-Devereux says that the London and European insurance markets poses particular challenges for internet trading platforms.

"In the EU you do have different languages, different business cultures and different work processes. In the London market you have lot of different constituencies you are trying to sell into, whether it be the Lloyd's market as a whole or the needs of the individual syndicates, the companies market or interfacing with the various bureaux. So it's a more complex market to introduce technology into. But we do view the London and European markets as very important. That is why we have an office in London and why we are talking to a large number of companies."

He does not regard Project Blue Mountain (recently renamed Kinnect), the Lloyd's market's specific internet trading and data processing platform, as a threat to eReinsure. He sees it as a very London market specific enterprise. "To my knowledge, there has not been a huge emphasis on reinsurance within Project Blue Mountain. Certainly not in terms of a specific internet application which can be used to manage reinsurance work flow, negotiation and transaction."

Instead, he views Project Blue Mountain as a sort of a new legacy system with which the eReinsure platform will have to interface.

"There is never going to be one all encompassing system that does everything in the market. The way we see it, there is going to be a series of systems addressing particular needs in the market and these systems will then talk to each other. That is why we are focusing on ACORD XML data communication standards," he concludes. ☺

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