From the same hymn sheet

A pilot scheme led by Hannover Re is exploring the standardisation of communication in property placements across Europe. Professor Volker Gruhn, Jürgen Petzold and Clemens Schäfer explain more.

DEMAND FOR REINSURANCE HAS risen steadily in recent years. Without it, insurance protection would be unable to meet the needs of today’s economic systems, especially in industrialised nations. As a result, significant changes have been observed on the international reinsurance markets over the last five years. The average premium rates in international non-life reinsurance business, for example, have declined to a level unprecedented prior to the second half of 2001. At the same time, loss potentials are growing – due, in part, to processes that are leading to increasing concentrations of risk in the industry and the service sector. There also continue to be new risks that are difficult to forecast and price, such as in the IT sector.

The net written premiums of the top 50 international non-life reinsurance companies totalled around $75bn in 2004, of which $67.4bn was shared amongst the top ten. This contrasts with rising expense ratios in active reinsurance, due to, among other things, an increase in the cost of capital and personnel spending. The average expense ratio at the top 50 companies was approximately 26.6%.

This has prompted leading international reinsurers to look for increases in efficiency. This is especially true of facultative reinsurance, where the expense ratio is normally around 10 percentage points higher than the average treaty expense ratio. Assuming that it accounts for roughly 14.5% of total premium, the facultative reinsurance premium (net in non-life business) in 2004 would have amounted to around $10.9bn. Given an expense ratio of approximately 36.6%, this gives rise to total expenses (excluding claims expenses) close to $4bn.

One of the most popular methods for saving a portion of these expenses is through the use of efficiency-enhancing e-business solutions. These have the aim of cultivating niche businesses which have historically proved uneconomic.

HISTORICAL PRECEDENT

The first e-business platforms went online in the late 1990s and included projects such as the reinsurance platform Inrecon (which is now defunct). Since 2000 further e-business solutions have continued to be implemented, including so-called “marketplaces” and “hubs” such as eReinsure and R13K. Yet insurers and reinsurers are also launching their own proprietary portals. Axa operates its e-b@c and t@c service, Royal & SunAlliance seeks to do the same with eFacRe and Hannover Re offers reCover. And in 2006 Aon indicated that it was seeking to place 20% of its reinsurance business through e-platforms.

In the past the premium volumes generated by these individual solutions fell short of expectations – sometimes by a wide margin. This was due to the fact that the various approaches were geared primarily towards the operator and no other parties.

Unfortunately, there have been few – if any – value-adding partnerships that take account of the interests of all parties concerned (ceding companies, reinsurance brokers and reinsurance enterprises). Furthermore, consistent industry-wide standards are lacking. In this regard the reinsurance industry can learn from the banking sector, where e-business was successfully implemented more than 30 years ago.

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involved in a business process should exchange data. The standardisation of processes is especially necessary where electronic systems are involved to ensure adequate communication between insurers.

LEARNING FROM THE BANKING SECTOR

Data standards and electronic interchange mechanisms in the banking sector appear as far back as 1973 when the Society for Worldwide Interbank Financial Telecommunication (SWIFT) was established. This is an international society of financial institutions that maintain a telecommunications network for the exchange of communications between institutions. Each day, SWIFT forwards financial transactions worth more than $6bn (€4.8bn) between banks, brokerage firms, exchanges and other financial institutions.

A meeting of leading international insurers in 2005 attempted to tackle the issue of standardisation of business processes and data flows in reinsurance in a simiar way. In addition to ceding companies, reinsurance brokers and reinsurers, the gathering was also attended by the operators of electronic marketplaces. One outcome of the meeting was the formation of the Industry Working Groups, which tackle the core processes of reinsurance business with the aim of bringing about standardisation.

In the spring of 2005, the following three working groups were set up:

• IWG1 (eBot): for standardisation of clearing transactions between ceding companies, reinsurance brokers and reinsurers;
• IWG2 (Fac Smart Form): for standardisation of the quotation and placement process and the interchange of data across companies; and
• IWG3 (eCot): for the standardisation of claims settlement in reinsurance business.

All groups are composed of representatives of the major insurance and reinsurance companies and brokers. The goal of the working groups is to define standards for the business processes and in this context, the aim is to achieve quick and early successes. With this in mind, the business segment under consideration was initially limited to property insurance of so-called “simpler risks” (one location, sums insured up to €50m) in Europe and the UK. Allowance is made for both proportional and non-proportional business.

PROOF OF CONCEPT

During preparation of the data model for property business in Europe, it became evident that in many instances, a relatively simple standard offers sufficient scope for mapping treaty-related information. Indeed, much of the work involved the ACORD XML/reinsurance standard, whenever it is “available” and applicable. In certain cases it was, however, necessary to model in more detail so as to satisfy the “data appetite” of reinsurers. In terms of their scope, the specific features of the interchange messages were nevertheless such that they were acceptable to all members of the working group including brokers and ceding companies.

Yet it also became clear that the original goal of facilitating an unambiguous data interchange between any interested parties could not be accomplished. The differences in the coding of certain items of information – such as the line of business or class of business – are too great. In this context it was evident that the emergence and evolution of companies frequently has an influence on how values are currently encrypted – something which cannot be resolved within the framework of a working group. Consequently, the working group took the pragmatic approach and settled for defining bilateral mappings that facilitate the recoding of one company’s encrypted figures into those of another.

From a technical standpoint, the solution arrived at by IWG2 is based on proven industry process standards, which set out in detail how data can be exchanged between IT systems. With the aid of this standard, reinsurers, brokers and ceding companies

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from three European countries intend to draw up a proof-of-concept that for the first time will be exchanged in the new format defined by IWG2.

OUTLOOK

Even now, at a stage where technical implementation has not yet been completed, structural mapping is possible in principle. The basic ambiguities could also be resolved – but the effort required to do this was too much for one working group. The technical infrastructures are, however, ready for the interchange.

Within the coming months, further work will be carried out on uniform standards and interfaces for existing and future e-business solutions. The goal is to bring together all data from proprietary insurance and reinsurance platforms as well as reinsurance marketplaces. It can be assumed that in this respect it will be incumbent upon leading insurers, reinsurers and brokers to press ahead with their initiatives and to carry on communicating with each other.

Marketplace and hub operators can provide active support in this context.

Only on the basis of standards and and/or structured mappings, combined with a broad e-business approach, will it be possible to achieve success. One thing is certain – in the current climate, e-business will evolve into a key competitive factor in the reinsurance industry.

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