



I've seen the future...

In 1989, Matthew Fosh, now CEO of Novae Group, co-founded Seagray Fosh Futures Ltd, a company involved in the sale and execution of equity and interest rate derivatives. The company grew to become one of the largest brokers on LIFFE before its sale to ICAP in 2000. During this period LIFFE evolved from a purely "open outcry" market to one where all trading is done electronically via the platform LIFFE Connect. In this article he explores some of the lessons this experience can teach the London Insurance market as it contemplates a similar progression with the growth of electronic placing.



First and foremost we should get one thing straight: in the end, technology will automate all those bits of a business process that it can automate, and it won't automate those bits it can't. To my mind this is a truism of modern business – perhaps one could call it "Techy's Law". In other words, because the benefits from taking people out of a business process are so great, ultimately you can't fight automation even if you want to; if the technology is there, you just have to get on with it, because ultimately 'Techy's Law' means it is going to happen.

Having got that bit off my chest, I would say firmly that London has nothing to fear from an increase in the use of technology in the placing process. Changes only happen if technology delivers a better way of doing the same thing. If it is less good, then the status quo prevails, but if it is better and more efficient, then the technology wins: because greater efficiency equates to better returns. If your process becomes more efficient, you can do more of it: if you have the ability to write more business across the same infrastructure, that has got to be good.

So what has the experience of LIFFE, and of other capital markets which have made the transition away from pure open outcry trading, taught us? Before we start, there are a number of crucial points and distinctions to note. Firstly, London's insurance market is not a 'mark to market', end of day exchange. It takes time for the outcome of 'trades' (ie policies) to come to light. On LIFFE we knew how well or badly we had done by the close of play each night. Indeed, quite often we would spend the afternoon trying to back out of positions we had taken in the morning! Insurance is less immediate – it is essen-

tially a bet that you put on for a pre agreed period and see how it develops.

Secondly, the competition facing the London insurance market, whilst significant and ever present, has not yet parked its tanks on our lawn and threatened our extinction tomorrow. It may come to that one day if we don't act, but we do have time to get this right, as long as we start now. Ultimately, if we don't fully embrace efficient processing, business will find a better place to trade and will go elsewhere. By way of example, on LIFFE it took several years for the competition to develop a better electronic alternative to open outcry trading, with a number of European attempts initially failing. However, when Germany did come up with an

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effective alternative, business moved to the Deutsche Terminbörse (the German exchange) at a rate you could measure almost by the hour. In precisely the same way, if we do not respond and embrace change in the London insurance market, our experiences may one day be similar... and it can be brutal. My small business went from employing 120 people to employing 30 in the space of 18 months as automation took the place of people. It is hard to imagine such a level of downsizing in insurance, but the lessons are clear.

What this experience did teach me and my colleagues was that you have to be absolutely honest with yourself about where you are genuinely adding value to a process and where you aren't. Automation and technology is all about having fewer pairs of hands touching a piece of business. So if you do not add anything or if a machine can do what you do better, you should not be involved, and ultimately you won't be. That is the harsh reality of automation.

But again there are particular positives in this for the London insurance market. Much of our business is towards the high 'value added' end. London writes many of the tricky, bespoke risks that others can't or won't. That involves negotiation and judgement that machines do not (yet?) have the ability to do as well as we do.

That said, we should take only so much comfort from this line of reasoning. The value added piece which we do well relates only to the interpretation of information, not the delivery of it. Yes, there will still be a role for our expertise and judgement to be brought to bear on both the broker and insurer side of the transaction. But that does not mean we need to continue to walk around with bundles of paper under our arm. It does not mean data being taken from a client, keyed into a broking system and then re-keyed into an underwriting system. We have to accept that these are inefficiencies that can and should largely become things of the past if we are to continue to thrive. These are the aspects that can be automated and so, given 'Techy's Law', they will be.

The effect of this will be to streamline our service offering, but if the experience of the LIFFE market is anything to go by, it will also have a significant effect culturally. What I mean by this is that the natural

points of contact, the relationships within the market, will change. In the short term some might view this as detrimental – but it will happen anyway. Without a doubt, on LIFFE an automated exchange meant that there were fewer “characters” around the market. But, whilst that may be regarded as a bad thing to some, it is not necessarily a bad thing as far as the product and servicing clients are concerned – people say there are fewer “characters” in sport these days, but I am not sure how many of them would pick Frank Worthington over Fernando Torres, say, or Ilie Nastase over Rafa Nadal if their life depended on it. On reflection, the open outcry market on LIFFE was a bit like a school playground – lots of personalities, lots of atmosphere, like any market place. Moving to electronic trading was arguably less fun for the brokers and traders on the market floor, but for clients? - they largely preferred it. It is difficult to argue that electronic trading did not improve the overall offering. Significantly, volumes went through the roof.

Certainly the move to automated trading meant you did not interact as much as before with your counterparties, and on one level, that was a pity. But it did not mean that personal relationships ceased to be important. It was still vital that you built a rapport with your trading partners; you just had to work harder at relationships when you weren't seeing people every day on the trading floor.

Now, we live in a world where there are a myriad of communication techniques at our fingertips; where teenagers seem to successfully maintain thousands of “friends” on social networking sites. So it should not be beyond the wit of us to find ways of building and maintaining relationships between brokers and underwriters without so much daily contact, all to render the service to our clients more efficient.

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I see both of these cultural phenomena as something that will be played out as the insurance market moves towards electronic placing. Some people might characterise this as the market becoming less fun. In some ways I would agree with them. But I am conscious that we no longer live in a world where our fun is something that our clients can be expected to fund.

So, I see some ‘electronic placing’ as inevitable – by which I mean some form of technology support for the placing process, helping the data move more efficiently than it does at the moment, but preserving the critical ‘value added’ piece behind the negotiation of complex risks. There are significant benefits available at the transactional level in terms of reduced cost of data entry and better quality data. There are also, potentially,

substantial benefits at the macro level. For instance, we have already seen as a consequence of the focus on contract certainty, that moving to a world where we can get our signed lines at the point that the contract is bound, can allow us as carriers to manage our capital better. No longer having to wait up to thirty days to discover whether we have been holding capital to support a portion of a risk that we haven't actually written can allow us to use that capital more productively and write more business.

All these possible changes offer us opportunities, and so ultimately, if technology can deliver this, ‘Techy’s Law’ will prevail. Undoubtedly we will take time to adjust, but it will be a far better experience if we approach it from a position of strength. At the moment, we have a helpful background – there is a general shortage of capital (and do not expect to see a return to a world of cheap capital any time soon); potential competition from other capital markets is (for now) somewhat on the back foot; our clients are renewed in their admiration of the benefits a subscription market can offer. So I would say that now is exactly the time that we should address what some might see as potentially uncomfortable issues such as this. I would also hope that you can recognise that whilst life might change as we embrace technology in the placing arena, it will still go on and it can actually still be pretty good.

Events...

Dates for your diary

The Market Reform Forum sessions are designed to provide an update on the progress of the reform programme and give more detailed information on particular projects or aspects of the process. Dates coming up are provided below. All sessions start at 9:15am at Willis Auditorium, Lime St.

- Wednesday 20th May**
- Tuesday 16th June**
- Wednesday 22nd June**

Only those who pre-register will gain admittance. Online booking is available via www.marketreform.co.uk Places are reserved on a first come first served basis.

ACORD Club dates:

ACORD Club provides an update on the latest technological innovations in the market. The venue for this is Balls Brothers, Minster Court. All sessions start at 11am. Dates coming up are:

- Thursday 28th May**
- Thursday 25th June**
- Thursday 30th July**

For more details on upcoming speakers, visit the ACORD website (www.acordlondon.org) or email Melanie Harding (mharding@acord.org)