FINANCE ON-REQUEST INSURANCE
A NEW DISTRIBUTION MODEL

White Paper
December 2006

Table of Contents

Introduction

Insurance distribution is going through a structural change with increasing need for organizations to deal with regulatory changes on a constant basis. The risk capital based regimes, measuring solvency by balancing capital against the ability to pay claims, will trigger mergers and acquisitions as books of business are taken over by the companies that satisfy the regulator's standard level of capital adequacy. This creates a real need to reduce the cost of acquisition. At a boardroom level the need to satisfy the various stakeholder expectations leads to a dual strategy of cost reduction at the bottom line expense ratio and increasing top line growth by finding alternate, profitable distribution channels to retain and grow market share.

Outsourced distribution is becoming mainstream in addressing top of line growth. In fact, more than half of today's insurance companies are considering outsourcing as part of their bigger strategy for introduction and selling of new, competitive products[1]. This strategy will also aid in cost reduction on the IT side.

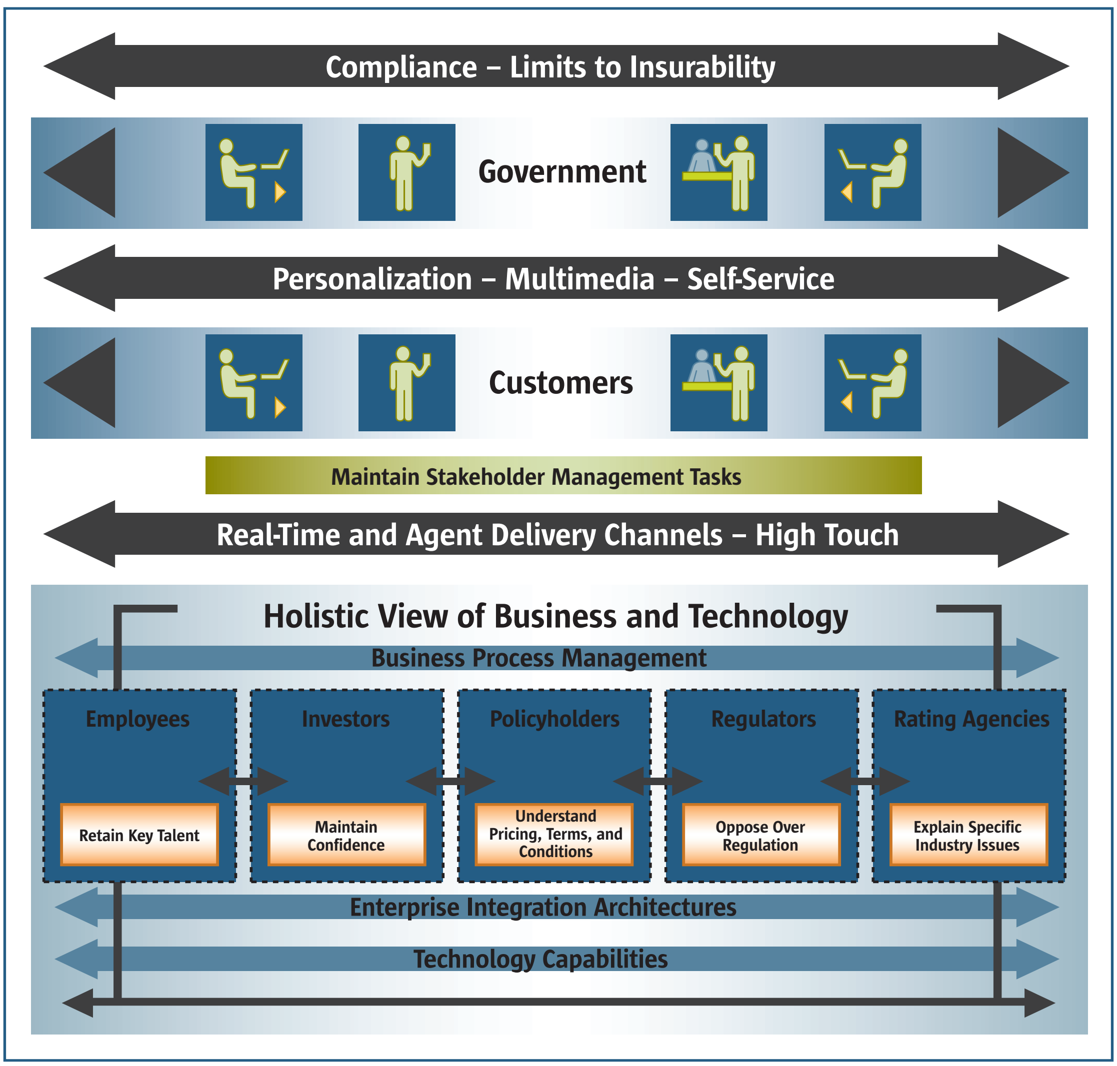

Figure 1 Technology Driven by Business Process

1. Forrester Research Report Process-Oriented Insurance Will Drive BPO, August 23, 2006

Technology plays a key role when driven by the overall business strategy and there is a similar need to lower the cost of entry of technology adoption. This is addressed by changing the technology pricing model from capital expenditure to a periodic business expense thus not reducing the tangible assets of the balance sheet but outsourcing operating expense.

To achieve this Sun Microsystems has combined core competency best practice in insurance solutions, telecommunications, leasing, and OEM to create a flexible pricing model for reaching new distribution channels and creating new products with rapid time to market. This model is similar to leasing a mobile phone where a minimum number of calls or transactions are included in the monthly price providing a “pay as you go” approach, essentially sharing the fortunes of the organization as a partner in industry. At the end of the year or quarter if growth has been good a balloon payment is made to a pre-agreed level of transaction cost.

Industry Trends

Trends prevalent in the insurance industry today run in parallel with the confluence of the financial services as banks, capital markets, and insurance combine distribution channels. This confluence is occurring on an unprecedented global scale causing massive growth in emerging markets and an increase in affinity group distribution such as Islamic finance, microfinance, retail outlets, post office, work site marketing, and banc Assurance. This industry is seeing the need to distribute these affinity groups over device type channels such as kiosk, PDA, mobile phone, digital TV, motor car black boxes, and network linked pens.

Time to market for new products and channels is causing a need for business users to be in control of products and regulatory changes and not wait for changes to occur at the IT level as the rules and product definitions are imbedded in the legacy systems. The trend is to abstract the business rules from the business logic using a business rules engine which in effect becomes the underwriting engine. Summarizing these trends:

- Compliance and regulatory change
- Globalization and enterprise required risk management
- Consolidation, mergers, and acquisitions
- Need for alternate distribution channels
- Need to streamline traditional agent distribution model
- Core replacement of older legacy systems with next generation insurance
- Business user handling of product management, cross selling, and channels
- Straight through payment processing of premiums, claims, and reinsurance.
- Confluence of financial services into wealth management products
- Need to aggregate exposures and produce single view of the client.
- Need to move IT accounting from capital expense to operating expense
- Reinsurance into capital markets – move to tradable assets for insurance books
- Growth of emerging markets and affinity insurance.
- Time to market of insurance products and channels
- Price, service, time pressure for new entrants to established players in the market
- Contract certainty for policy and claims

The Value Proposition

Sun Microsystems has created the Finance On Request (FOR) solution to address the issues and challenges created by the global trends at hand. It is very important that a distribution channel solution does not duplicate the back office but links to the back office, running in parallel, even having the capability of bringing the back office through to the front office for straight through processing. The FOR solution provides this functionality and can also be used as the back office in a greenfield site.

The main value is in reducing the bottom line cost and expense ratios of traditional distribution channels while increasing the top line growth by providing more coverage for distribution. In this regard business users can rapidly create, launch, cross sell, white label, and manage insurance products via any distribution channel in any currency and any language. There is no software change downtime and the time to deployment is a two week training course to educate the users on how to enter products, connect to channels and handle the risk configuration for the insurance life cycle. This will allow 24X7 access via the Internet and access offline when necessary. All of the processing can occur in real time with MIS report showing the exposure, loss ratios, and any triangulation reporting that can be extended to data warehousing program and cell phone dashboards real time. As the FOR solution is about straight through processing, the ability to create as much of the policy and claim administration cycle at the point of sale or first notice of loss has been incorporated. This also means ease of payment or claims settlement by devices such as cell phones.

The costs and ROI from this solution are highly beneficial as this helps manage long term revenue based on renewable lines. General insurance and term life, as well as unit linked policies, annuities, and pensions can all be distributed in this fashion - basically any line of business not managed by IFA's in the wealth management space. However talking with the industry we would not rule out any line of business being distributed in this fashion. The technology is geared up to produce monthly and on request premium and claim bordereau for the transactions processed. The creation of reinsurance profiles is also possible managing claims in the secondary market if required. The minimum transaction model allows the technology providers to share the fortunes of the industry rather than collect large licenses based on the previous year's gross premium, ensuring a true partnership.

Documentation is easily set up, created, changed, and warranty wordings created for various conditions. Documentation is assigned to the product and policy ensuring contract certainty. The creation of reinsurance profiles is also possible. As all policies are in one place it is possible across single view of client to change beneficiary or change of address only once plus assign a single monthly premium to all policies for one client. The validation approach reduces E&O (errors and omissions) at an early stage.

There is a reduction of initial outlay as there is no outright purchase of hardware and software. Thus low start up costs and transactional pricing means low cost entry to new markets on a "pay as you go" basis or as needs basis. Predictable pricing and metered pricing based on minimum transactions is a good fit for insurers who currently will know their level of transactions and seasonal peaks. The unlimited size of distribution channels leads to increase revenues and the end-to-end sales process leads to a reduction in leakage and claims costs. The real time management of risk exposures will lead to a reduction in loss ratios as coverage will be declined in high-risk areas and this will lead to increased profit

Channels

- Broker
- Agents
- MicroInsurance
- Banc Assurance
- Cell Phone/PDA
- Kiosks
- Work Site Marketing
- Direct Marketing – INTERNET
- Islamic Insurance – Takaful
- Digital TV/Satellite Selling
- E-Wallet in Retail
- Supermarkets and other retail outlets
- Affinity Channels and Groups
- Insurance specific debit/credit cards
- Black box collection in cars
- Java™ Card OEM to any device
- Policy Pens
- Call Centres
- Run Off Channels

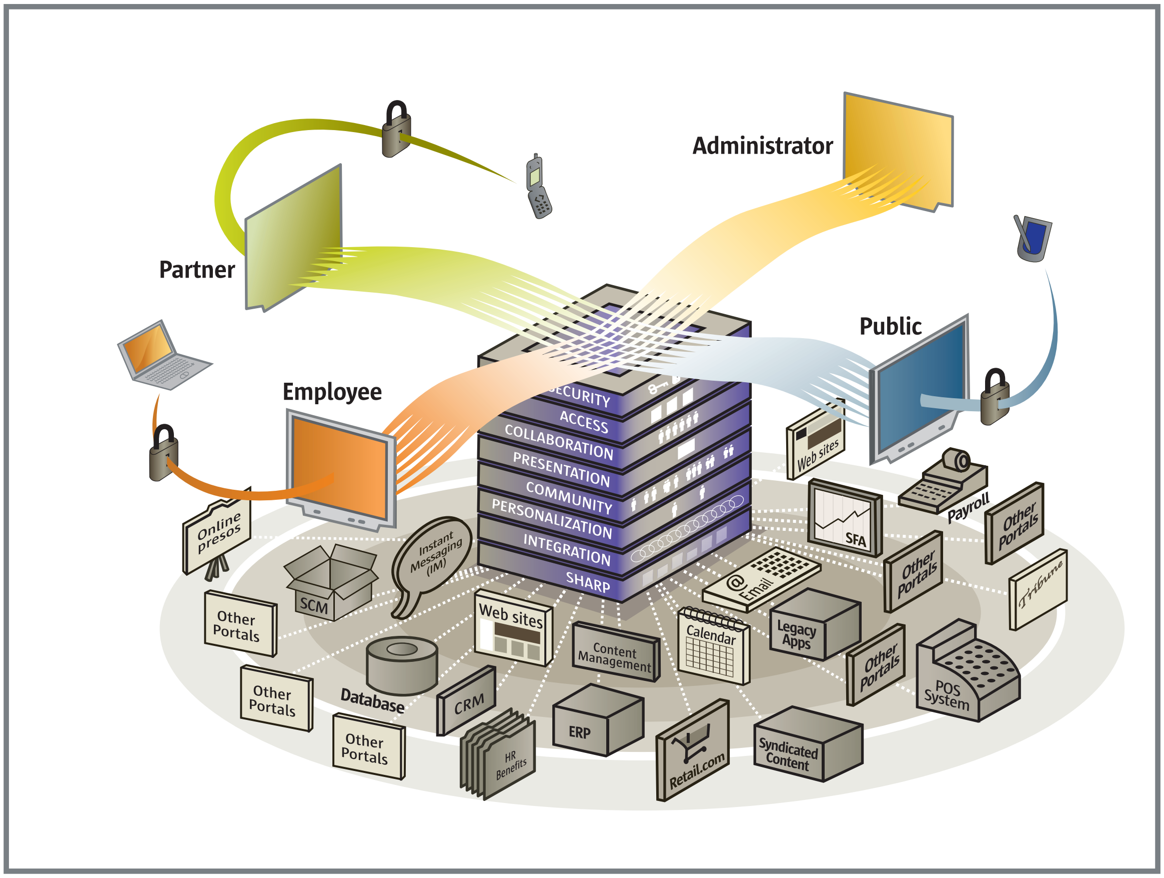

Figure 2 Distribution Channel Technology

Technology

Designed on a plug in/plug out basis using industry standards from Java, the technology easily links to existing client architectures. The use of portal here is essential as it ensures "stickability". CRM techniques in the portal tie together call centres, bank branches and retail outlets into streamlined operation. Identity management enables single sign on and security across the architecture from employees, customers, intermediaries, and anyone involved in the company extranet. Business driven processes using configurable workflow bring in straight through processing for intense insurance processes and links to legacy using pre-built adaptors which cover the legacy spectrum. It is then these processes that can have business and/or web services wired in to get a best of breed solution from a variety of vendors and Sun partners if necessary. Plugging in a rules or automated underwriting engine would prove to be such a case. This rules engine will enable regulatory changes to be configurable across any jurisdiction within countries or groups of countries i.e. the federated or the state model.

The hosting solution can be taken in house as a lease or outsourced to Sun and partners based on the same lease calculation generated from a bill of materials of number of users, transaction, storage, and so on. Sun see this as a utility computing model where we partner with the industry as opposed to an ASP (Application Service Provider) where we just hook up to Telecommunications Company or other third party environment. The concept of SAAS –Software As A Service – has been addressed here and this is practical part of that concept and will be full compatible with its maturity and growth over the coming years.

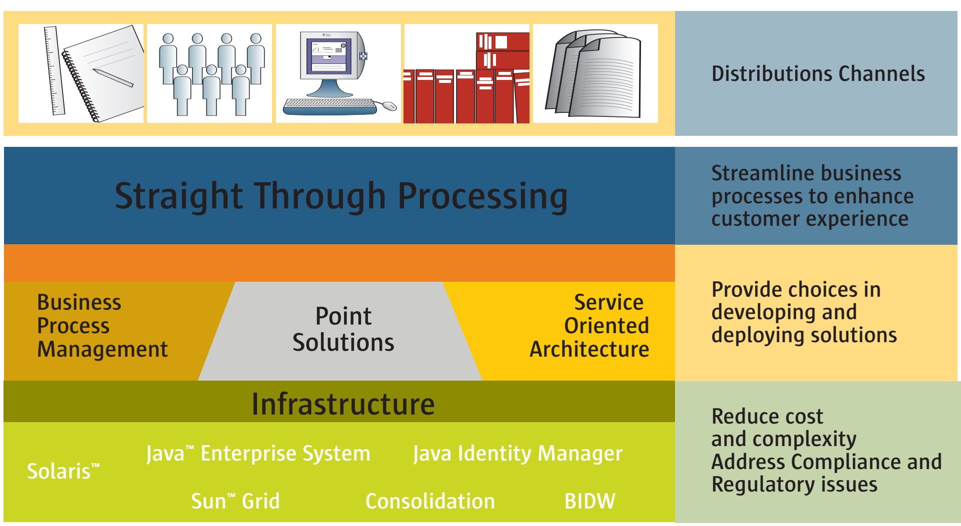

Illustration 1: Technology Stack

Conclusions

The insurance industry as a whole is leaning towards “pay as you go” computing.

This is a natural transition for the business model considering the way that execution is done across lines of business. Management looks for new accounting measures for IT expenditure. The move from capital expenditure to operating expense for its cost of ownership of distribution and administration cycles is key. Progressive trends put increasing pressure on product time to market issues and business users need to be in control of their product changes and channel distribution. Technology designed with transactions, distribution channels, and device size footprints is required to manage the change. Sun’s offering here is FOR – Finance On Request.

Sun Microsystems, Inc. 4150 Network Circle, Santa Clara, CA 95054 USA **Phone** 1-650-960-1300 or 1-800-555-9SUN **Web** sun.com