Guide for parametric insurance solutions

Plugging traditional insurance gaps

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LOCKTON

Introduction

Parametric insurance – or indexed-based insurance – is becoming an increasingly popular alternative risk transfer solution among insurance buyers.

Traditional insurance is struggling to keep pace with a fast-changing risk landscape. Increasing premiums for reduced cover or inability to get cover reflective of individual risk profiles has led to corporate insurance buyers calling for new and innovative ways to support their risk financing strategies.

Improvement in the collection and reliability of data and increased sophistication in risk modelling is allowing insurers and insureds to better understand their risks and exposures, leading to the creation of bespoke index-based insurance solutions that fill the gaps in their risk financing programs.

What's in this guide?

This guide will provide you with an overview of:

What is parametric insurance?

Traditional insurance policies indemnify the policyholder for an actual loss incurred from an insured event. By contrast, parametric insurance pays a fixed amount upon the occurrence of pre-defined parameters relating to a particular exposure. The nature of the parametric product means that no loss adjusting is required. When agreed thresholds are met or exceeded, the policy is automatically triggered and payment is made.

Parametric insurance solutions can be suitable for businesses that have identified:

01

A particular event that is measurable

02

The event would have a significant impact on their financial performance if it occurred

03

There are no easily available solutions in the traditional insurance market place

How does it work?

Parametric insurance products rely on two key elements:

01

A triggering event. The insurance cover is triggered if pre-defined event parameters are met or exceeded, measured by an objective parameter or index that is related to an insured's particular exposure.

02

A pay-out mechanism. A pre-agreed pay-out if the parameter or index threshold is reached or exceeded, regardless of actual physical loss sustained.

The client **chooses the index**, the **thresholds** and the **payouts** adapted to its risks

Adjustable

Thanks to an **independent source of data**, the trigger is monitored to **see if the cover is triggered**

Transparent

Once triggered, the client **confirms its losses** and **may receive the payment within hours**

Fast

What types of risks can parametric insurance cover?

A parametric insurance product is bespoke to its buyer, with the thresholds set to trigger payment aligned with the insured's own business continuity plans, risk profile and risk tolerance.

As long as there is an independent, reliable and verifiable source of data that can be accurately modelled and the dynamics of the threat are well understood, just about anything can be covered through a parametric product.

Common examples include:

Natural catastrophes

- Earthquakes
- Hurricanes

Weather

- Hail
- Wildfires
- Lack of, or excess rain

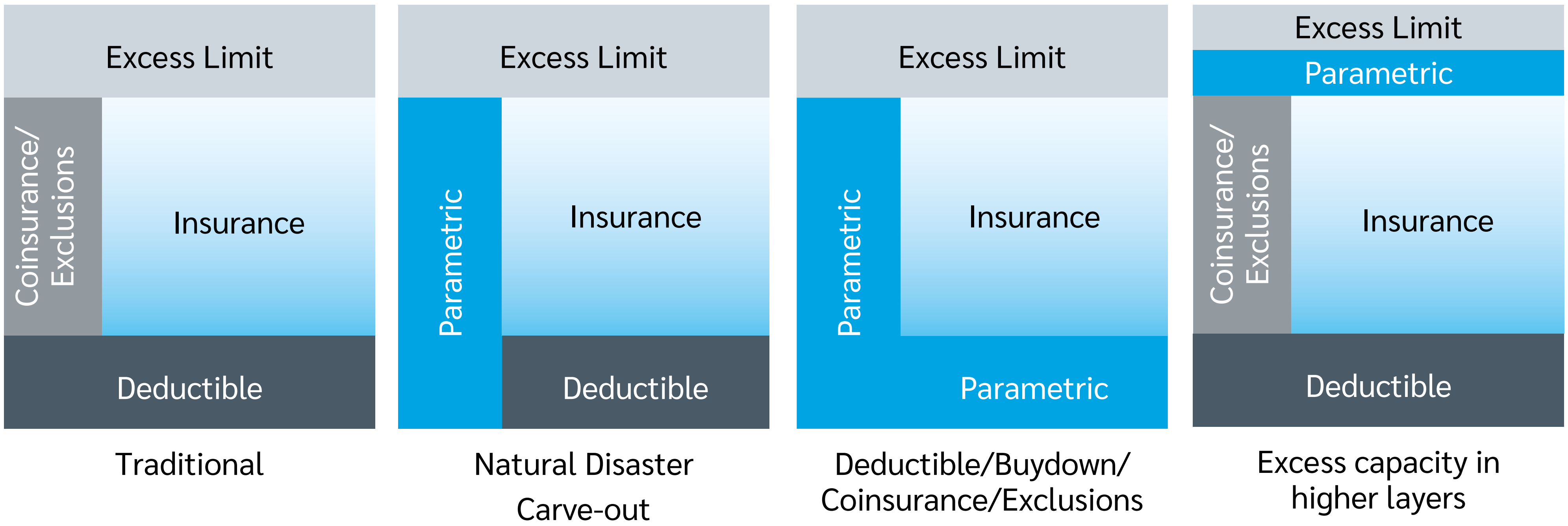
Non-natural perils

- Flight cancellation
- Hotel occupancy
- Pandemic operational risk
- Cyber
- Market indices
- Crop yields
- Power outages
- Non-damage business interruption

How parametrics can support traditional insurance

Traditional insurance includes a number of conditions and limitations, exclusions and self-insured retentions that are assumed by the insured. Where insureds want to reduce their exposure beyond what the traditional insurance market will offer, parametric insurance can supplement that cover and fill gaps left in the risk transfer program.

Examples of how parametrics can work alongside traditional insurance programs are detailed below:



What are the advantages of parametric insurance?

Traditional Insurance	Parametric Insurance
Physical loss or damage is required to trigger the policy and payment for business interruption	Payment is triggered by a pre-defined event exceeding a threshold, enabling financial loss to be covered with or without physical damage
Complex policy wordings, leading to ambiguity of intent and coverage uncertainty	Pre-agreed payment structure based on event parameters providing increased certainty in financial planning and lower risk of dispute
Deductibles and other retentions required	No deductible and product tailored to insured’s risk appetite
Limited appetite or ability to underwrite emerging risks	Cover is tailored to a specific risk, filling traditional insurance gaps
Claims process is complex and drawn out, involving loss adjusters and lengthy negotiation to prove loss	Quick payout when thresholds are exceeded, providing almost immediate financial support
Usually negotiated annually	Can be negotiated on a multi-year basis, supporting longer-term risk financing strategies

Case Studies

See four real-life examples of how industries and businesses across the globe are using parametric insurance to plug gaps in traditional insurance programs. Parametric insurance can be designed for a variety of triggers, some of which are mentioned below.

Providing $3.5m to Tonga in seven days

A parametric insurance policy provided quick liquidity to Pacific Islands countries following a tropical cyclone and earthquake.

Based on the magnitude and location of the Gita cyclone, the event triggered payment within seven days. Parametric insurance solutions can respond fast to pre-agreed events, getting organisations and communities back on their feet again.

Renewable energy and weather solutions

A renewable energy organisation was seeking to reduce wind volatility, therefore reducing risk to their wind farm. Traditionally, insurance excludes business interruption arising from non-physical damage of assets caused by weather, i.e. in this case, wind.

Lockton built an insurance product in response to risk – this protects the wind farm financially against natural fluctuations. The hourly energy generated was modelled according to wind speed, to secure the financial equivalent of reliable wind production.

Protecting a Power Electric Authority

A Power Electric Authority in the Caribbean was seeking to complete their traditional insurance placement and wanted to buy a sublimit to cover their transmission and distribution (T&D) exposure.

Lockton was able to place a parametric policy to cover not only the portion missing for catastrophic exposures for the client; but also, to cover the T&D lines exposure.

Protecting film, entertainment and travel

Parametric insurance is vital in protecting entertainment venues and attractions such as theme parks and stadiums against a sustained and severe drop in key operational data. This could impact credit card transactions, nearby footfall, or gate clicks/tickets sold. These innovative solutions can offer protection against terror attacks, COVID-19 resurges, natural catastrophes, or even economic fallouts.

Similarly, hotels and resorts can buy protection against a decline in guest volumes and room revenues, airlines and airports can insure against a drop in passenger volumes, and retailers can protect against a fall in transaction volumes.

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