Viewpoint: Now is the time for parametric insurance to go mainstream

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Covid-19's losses have brought into focus the limitations of traditional indemnity insurance

PARAMETRIC PRODUCTS OFFER A SIMPLIFIED FORM OF COVER: A PREDEFINED EVENT RESULTS IN A PRE-DEFINED PAYOUT

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The insurance industry is changing. Advances in technology are revolutionising every aspect of the insurance value chain, from product design to delivery, while customers are demanding greater customisation of product, convenience of transaction and speed of payment. New insurtechs are capitalising on these trends, while existing carriers know they need to keep up or be left behind.

It is within this context that parametric insurance has the potential to be transformational.

The idea behind parametric insurance is simple: a pre-defined event results in a pre-defined payment. It is this core simplicity that makes it so powerful. Payment is not linked to losses, so there is no need to value an asset being insured or assess the loss incurred. The customer has a clear understanding of the benefits of the product and the insurer knows exactly what its potential exposure is.

The more reliable, consistent data that is available, the more risks can be covered by parametrics. The applications are limitless, scalable and need minimal human intervention. The solutions that can be provided to customers are limited only by the imagination.

These solutions have been used for many years in very different spaces: direct-to-consumer accident and health business, weather derivatives trading and natural disasters. Yet, parametrics has never been mainstream. Now things are changing.

Traditional limitations

Traditional indemnity insurance relies on an insurable asset and a proof of loss. This is beginning to feel limited in an era where organisations are looking to cover hard-to-value assets and losses are getting more difficult to quantify and are often liable to creep. A form of insurance that does not rely on the loss to an asset suddenly becomes vital.

Last year brought into sharp focus the limitations of traditional insurance. Covid-19 disrupted the world and caused significant (but difficult to assess) losses. Natural disasters have become more frequent, and their impact increasingly more severe. It is becoming clear that, in this uncertain world, protecting the economic activity of customers is as important as protecting their assets and speed of payment is essential.

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Parametrics can help and technological consumer-focused start-ups are gaining traction. FloodFlash links in-home water level meters to provide flood insurance that pays out within hours. Blink provides app-based travel insurance that delivers benefits the longer a flight is delayed. Jumpstart sends immediate payouts to individuals if an earthquake occurs exactly where they are located. Other organisations like Descartes, Skyline and New Paradigm build state-of-the-art parametric solutions that cater to the much greater needs of commercial entities.

Even the large insuers and reinsurers are betting on the growth of the sector, with many establishing their own or investing in external parametric teams.

Finally, parametric insurance is gaining importance as a method of insuring some very unusual risks. When Hurricane Delta hit the state of Quintana Roo in Mexico in October last year, it triggered a parametric product that provided funds within days to repair the Mesoamerican Reef; in the same month, when drought hit northern Myanmar, a parametric product was triggered to enable local financial institutions to keep lending.

Proactive view

To remain relevant, the insurance industry must move from a reactive to a proactive view of risk, reducing losses rather than paying claims. Rather than fixate on an accurate value to replace what is lost to a risk – a task that is becoming increasingly difficult – insurers are beginning to understand what that risk means to a customer, providing the tools to reduce the chance of the risk occurring, and the ability to face it with positive actions.

To fully realise the benefits of parametrics requires a new way of thinking about risk mitigation. Purchasing products that link a condition to an action empowers an organisation to make positive proactive measures (by providing direct access to new capital), rather than negative reactive ones (recovery of some losses).

The scope and possibilities of these positive actions are endless and can only result in a stronger relationship between insurer and client. Existing market segments that have traditionally been untouched can be captured. Imagine the value of a product to a social media star that pays out when their "likes" drop below a certain number or to a hotel chain that pays out before adverse weather hits.

Non-tangible losses, non-asset-based business interruption, immediate liquidity – these are just some areas that are being addressed by parametric products. A tool forged in the past that has been reinvigorated as a solution for the future.

The insurance industry has always innovated. Now it has the opportunity to actively empower organisations to think more deeply about their relationship with risk, and the opportunities it can bring. That is the power of parametrics.

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