COMMERCIAL LINES

HOW PARAMETRIC INSURANCE FILLS IN GAPS

With many carriers excluding certain natural catastrophe perils, brokers can fill coverage gaps for clients with parametric policies.

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Commercial insurance prices in the U.S. have been rising for a staggering 24 consecutive quarters. That's six years of relentless price increases. Worse, blameless brokers and agents must explain to their long-suffering clients that insurers now often exclude catastrophe perils from their standard property coverage. That makes it ever-more difficult to fulfil clients' fundamental risk-transfer needs.

Back to basics

One possible solution is to go all the way back to basics, rethink the way insurance works and give serious consideration to a different way of insuring. Many brokers are now doing so by offering their clients parametric coverage of excluded perils. It's a whole new kind of insurance product that might come off the shelf or be built from scratch specifically to meet affinity groups' specific risk challenges in this extraordinary insurance environment.

The process begins by thinking about your clients and identifying the coverage they are unable to get through regular insurance. For example, you may have built your niche structuring and placing comprehensive insurance for hotel owners. Those with properties in flood zones, or on a geological fault that places them at earthquake risk, or even those in a lovely forest that could be prone to wildfire, may find those specific perils are excluded from their traditional property insurance policies.

Perils excluded can usually be written back under conventional insurance, but only at great expense. Because conventional insurers find, say, the risk of wildfire so unattractive that they exclude it, it is understandable that they charge a lot of money to take it back, especially when the risk is severe. Unfortunately, that makes it very difficult for an broker to ensure their clients have the complete protection they need.

See also: Best of Both: Bundling Parametric, Indemnity

Parametric solutions

Parametric insurance provides a viable and incredibly straightforward alternative. This new kind of policy provides a fixed, predetermined claims payments when a third-party “computation agent” confirms it is due. That happens when data related to the specific peril insured at the precise location specified in the policy shows that a wildfire, flood or earthquake (etc.) of sufficient intensity has occurred at that location and triggered the coverage. The specified payment is then made within weeks, or even days.

Risk carriers are flocking to underwrite parametric insurance because so much uncertainty is removed from the process. The insurer behind a policy can be sure, for example, of the precise amount that a specific event will cost them. It is simply the total of all the policy limits they have exposed to that risk.

An event such as a flood will damage some insured buildings but not others. The severity of damage to those that do suffer will vary, perhaps drastically. Conventional insurers spend months and small fortunes deciding who will get paid, and how much. But a parametric policy requires no loss adjusting. All that uncertainty is removed, for the carrier and the insurer alike. If the flood happens, the policy limits are paid. No room is left for uncertainty.

See also: Solving Life Insurance Coverage Gap

Off the peg, or tailor-made?

If one or two of customers face a coverage shortfall due to the exclusion of a natural peril risk, intermediaries may choose to fill the gap with an off-the-shelf parametric product. More such solutions are reaching the market every day. Some are intended specifically to cover the gaps left by insurers’ exclusions. These innovative alternative products range from coastal flood coverage triggered by floating sensors that measure wave height, to niche business interruption policies that pay when third-party cloud computing services cease to function.

When the number of clients in need is larger, brokers may choose to work with a partner such as Skyline to develop their own parametric insurance products. Tailor-made products fill the coverage gap even more tightly, and the process of creating a product is surprisingly straightforward and potentially very swift. Skyline has helped brokers and insurers develop custom coverage for commonplace carved-out risks such as hurricane events but also for specialty risks such as lone-shooter incidents.

Any manifestation of risk that can be measured either on a binary basis or against a specially constructed index can be insured under a parametric policy. The policies are recognized by insurance supervisors world-wide as legitimate insurance, because policyholders must hold an insurable interest in the insured event.

The benefits of parametric are therefore enormous. It provides coverage where conventional insurers will not, removes the uncertainty inherent in traditional policies and delivers payments much faster than old-fashioned property all-risks insurance can. After six years of bad news, at last brokers have this positive proposition for long-suffering clients.