



The Enron scandal was a bruising episode for corporate America, the largest bankruptcy in the country's history. Yet one positive legacy Enron left behind following its collapse in 2001 was innovations in weather derivative payments.

Enron had seized upon advances in computers abilities to produce high quality, reliable data. Enron weather derivatives agreed to pay \$10,000 for each degree it fell below average temperature during the winter. This helped American firms manage weather-related losses.

Insurance firms were slow to catch on. But by the middle of last decade, parametric insurance on weather-related losses was establishing itself. Parametric had three essential ingredients: an index for the cost of revenues for the insured, a threshold for the policy trigger and an agreed payment. Companies loved it. Claims were paid fast and disputes were rare.

### Inflection point

Fast forward to today, and parametric insurance is now reaching an 'inflection point', where it can grow rapidly. There are two developments.

Firstly, parametric insurance is growing fast in classes outside of weather-related risks. Insurtechs and forward-thinking insurance firms now offer parametric solutions for non-damage business interruption, cyber and transport and cargo.

Secondly, insurance firms are finding new ways to use parametric in deals. This is epitomised by the developments in cap-

Written by  
**Saxon East**

tives. At last year's Vermont Captive Insurance Association's (VCIA) annual conference, an insurtech called Arbol, a platform for adverse weather protection products, unveiled an innovative parametric solution for captives.

Arbol's 'Parametric+Captive' solution is set to help enable organisations to take immediate action towards climate change risk management by transferring climate risks into captives using a parametric structure.

### Parametric challenges

Is parametric insurance on an unstoppable path to growth and more widespread adoption? Not quite. There are challenges, not least basis risk. Basis risk is when someone purchases insurance, but the money they receive for a claim does not equal the full cost of that particular claim event.

In traditional insurance, this is not as much of an issue because the limits are typically high. If you pay £500 for your home insurance, you'll get a near full payout (hopefully) if your house burns down.

Parametric is quite different. The pre-agreed sums can be small compared to the actual loss. A good example could be a flood that causes damage beyond the original expectations of the customer.

So far, parametric insurance has coped with basis risk pretty well. We have seen few major disputes on this issue. Skilled brokers and knowledgeable corporate buyers can assess their risks accurately. However, as insurers and brokers find innovative ways to package parametric into the insurance deals, and new classes of insurance, there are likely to be more complaints.

Parametric is a robust solution to weather-related losses. It is tried and tested. But is it really going to work as effectively well for, say, a cyber event? Or what about a non-damage business interruption event?

There's even a parametric solution for late or cancelled airplane flights. It sounds like a magic bullet. The reality, though, is that these are still relatively unknown, untested areas. The jury is still out.

Insurers need years of data and claims losses to fairly assess new product lines and inventions. This is why they are so slow at innovating. Whereas the distributors such as Aon and Marsh, not carrying the risk, can be more inventive.

Certainly, there are challenges ahead. Yet parametric insurance feels like a breath of fresh air in a stale market. Risk managers and insurance buyers, who behind closed doors frequently complain about the service they get from insurance firms, are interested in clean, quick payments.

Insurtechs are springing up all over the place offering parametric solutions. The Lloyd's Lab has been a success in helping parametric start-ups. There's a buzz. An excitement. Long may it continue. 