

Filling the catastrophe 'liquidity gap' with parametric insurance

As natural disasters become more frequent and severe, the impact on homeowners and businesses can be devastating. While traditional insurance provides valuable protection for weather-related perils like flood, wind, and fire, it does not cover all economic losses tied to catastrophes, which can mean high out-of-pocket expenses and deductibles for insureds.

When disaster strikes, homeowners and businesses often require immediate funds to meet urgent needs, even before insurance claims can be settled. According to Munich Reinsurance America, Inc. (Munich Re US), this 'liquidity gap' can be filled by special insurance designed expressly for faster payouts – parametric insurance.

Parametric insurance pays out pre-determined sums, based on a series of event thresholds. The triggers are agreed to in advance and are based on transparent and objective data sources like the US Geological Survey for earthquakes, or the National Hurricane

Center for hurricanes. For example, a parametric insurance policy might trigger if a Category 3 hurricane tracks within 30 miles of an insured's location.

"Because the thresholds for parametric insurance are agreed to in advance, these solutions are very transparent in terms of when claims will be paid," said Waswate Ayana, Director, Product Development, Munich Re Capital Partners. "Those are the key strengths of parametric solutions: the speed of payment, the speed of settlement, and the objective nature of the product."

Quick remediation is what homeowners and businesses need after a catastrophic weather event. However, traditional insurance policyholders can still face delays in getting payments owing to an adjustment process and a formal loss assessment. And when they do pay out, traditional insurance policies will typically focus mainly on actual physical damages to property, not taking into account the extra expenses that homeowners and businesses will likely face.

"Parametric insurance makes pre-determined payments that are flexible. They do not come with contractual terms that dictate what type of losses these pre-determined payments can cover or reimburse. It's completely flexible," explained Ayana. "For example, before a hurricane strikes, a homeowner or a business owner might want to board up their property, secure their assets, buy extra supplies of food and water, and they might even want to evacuate their property. Traditional insurance does not normally provide reimbursement for these common mitigation expenses. If the hurricane ends up steering in a different direction, the money spent on those mitigation efforts would be an economic loss paid out of pocket."

"Small businesses, even if their properties aren't hit directly by the storm, could suffer economic losses caused by a reduction in business volume, or increased operating expenses and transportation costs, but none of those losses would be covered by a traditional insurance policy."

because there was no damage to their property. However, these are all losses that the parametric pre-determined payout could be applied to."

Even if insureds do suffer actual physical damage to their property, they still need to pay high out-of-pocket expenses, like the catastrophe deductible, which can range from 5-10% of the insured value in high-risk coastal zones, before their traditional insurance coverage kicks in. Parametric insurance, held independently from traditional policies, can help insureds meet some of these expenses.

Closing the 'liquidity gap' is extremely important. According to a recent poll from Bankrate, just four in 10 US adults have enough emergency funds to cover \$1,000 of unexpected losses following an event.¹ In a similar vein, Federal Emergency Management Agency (FEMA) asserts that nearly 40% of small businesses never reopen their doors following a disaster. The almost immediate economic relief provided by parametric insurance could help to mitigate some of these issues.

"Parametric insurance complements traditional insurance policies," said Neisha Jones, SVP, Client Manager,

Munich Re US. "It provides speed and flexibility to insureds through direct funds when they're needed the most. Homeowners and business owners can all benefit from the reduction in frictional costs and economic losses associated with an event.

"These solutions can also play a role before a natural catastrophe event even occurs. The advanced triggers, based on objective forecasts, can be designed to provide safety advisories and limited mitigation funding for homeowners and businesses in the run-up to a hurricane, for instance. These advisory messages can create additional touch points for insurers and their clients, and Munich Re US is able to work with our insurance clients to provide these kinds of opportunities and keep the touch points open."

Munich Re US is actively engaged in improving community resiliency, working to secure regulator buy-in to promote parametric solutions and improve education and awareness. The organization is also enabling insurance companies to offer parametric solutions to their customers, and it is seeking further relationships with clients to develop innovative solutions for closing the insurance protection gap.

"We offer a white label parametric endorsement, which we co-create and brand with our insurer partners," said Jones." Munich Re US has been offering parametric solutions for a long time, so we have many years of experience, and we can draw on that to help our clients kick off their parametric offerings. Our partnership includes full-service implementation, IT integration, training, underwriting guidance, pricing and claim support, as well as talking to State Departments of Insurance, and simply being an advisor for clients as they get comfortable with the product."

[**Learn more**](#) about the strategic products Munich Re US offers to address the challenges faced the world over and aid in closing the protection gap within our communities.

¹ <https://www.bankrate.com/banking/savings/financial-security-january-2020/>

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