



# Rethinking Parametric Insurance: A Hidden Investment Opportunity

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## INTRODUCTION

The ILS market's growth over the past 25 years has been driven mainly by indemnity-based transactions, despite the potential of parametric insurance. While parametric structures are simpler, more transparent, and resemble financial instruments like options, indemnity transactions have dominated due to the ILS market's original goal of providing risk capacity to insurers.

While indemnity transactions can create information asymmetries, parametric insurance typically provides greater symmetry and transparency, with payouts triggered by predefined events. Despite these advantages, parametric insurance has remained a niche market, constrained by fragmentation and limited scale. However, as technology advances and market dynamics shift, parametric insurance is becoming more accessible and attractive to investors.

## PARAMETRIC INSURANCE AS AN INVESTIBLE SEGMENT: WHY NOW?

Parametric insurance is addressing a critical need for hedgers by providing fast, transparent, and reliable coverage, complementing traditional indemnity (re)insurance. With predetermined payout triggers based on measurable parameters — such as wind speed

— parametric solutions eliminate the lengthy claims process. While basis risk — when triggers are not perfectly aligned with actual losses — is a concern, advances in data collection and risk modelling have mitigated this, making parametric insurance an increasingly useful hedging tool.

Over the past decade, efforts to educate the market have led to broader recognition of parametric insurance's value. Corporations and governments in disaster-prone areas have begun adopting it as a complement to traditional coverage.

Four key factors have driven the growth of the parametric insurance domain:

**Venture Capital:** InsurTech firms, backed by significant funding, have accelerated business development.

**Risk Capital:** (Re)insurers and MGAs see parametric solutions as a way to diversify portfolios.

**Technology:** Innovations in data collection and automation have enhanced accuracy and efficiency.

**Human Capital:** Brokers and other stakeholders now actively promote parametric insurance to various sectors, driving adoption.

The market is maturing, with the infrastructure in place for investors and asset managers to scale this growing sector.

## **ADVANTAGES OF PARAMETRIC INSURANCE**

Parametric insurance offers several distinct advantages, particularly from an investor's perspective:

### **Claim Management**

Losses are determined by predefined external parameters (e.g., wind), eliminating complex claims processes and reducing costs and uncertainties in loss adjustment.

### **Trapped Capital and Loss Development**

Capital is rarely trapped, allowing for re-utilisation and minimising opportunity costs.

### **Potentially Higher IRR**

With no capital trapped, parametric insurance offers the potential for higher IRR compared to other ILS transactions.

### **Asymmetry of Information/Data**

Risk assessment relies on external factors (e.g., natural catastrophe hazards), creating symmetry between the risk bearer and hedger.

## **Model Reliability**

By focusing on external hazard data rather than specific property impacts, parametric insurance simplifies models, reduces uncertainty, and enhances model reliability.

## **SUMMARY**

The parametric insurance segment is maturing, becoming more vibrant, and its benefits are increasingly recognised by stakeholders. Increased awareness among hedgers and decision-makers highlights its benefits as a complement to traditional indemnity products. For investors, parametric insurance offers unique opportunities for portfolio diversification and improved risk-adjusted returns. With predefined triggers and faster payouts, it reduces uncertainty and complements traditional ILS strategies. Leveraging partnerships, fronting facilities, technology, and advanced risk models, parametric solutions are becoming more scalable and accessible, marking a transformative moment in the ILS market and its future role in risk and investment strategies.



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