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Wicked Winds: Exploring Parametric Insurance in Canada

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As climate change continues to cause severe weather events such as fire, flood, wind, and rain, with increasing frequency, we are starting to see an uncomfortable number of instances where insurers are forced to scramble to adjust claims within the time needed to serve (and pay) their customers the way they want. Think of the devastating 2016 Fort McMurray wildfires and the 2013 Calgary flooding, where foreign adjusters were granted permission to help insurers deal with the sheer volume of claims that resulted. Make no mistake, insurers like, welcome, and embrace valid claims as opportunities to demonstrate to their customers their level of service, commitment, and that they are there for them in their times of need. Do not let anyone try to convince you otherwise.

So, what if there was a way to speed-up claims payments to help insureds get their homes, businesses, and lives back in order? Well, there is – parametric insurance.

In short, an insurer is more likely to payout a claim faster under a parametric insurance policy than it can under a traditional insurance policy. Let's discuss why.

Opportunity

Parametric insurance is coverage that pays the insured a pre-determined amount on the occurrence of a pre-defined event, as measured or declared by a neutral third party on whom the insurer and insured agree. As a very simple example, a parametric insurance policy could pay an insured homeowner $10,000 if wind speed reaches 100 km/hr or more over their home. This is different than a traditional insurance policy, under which the insurer must take time to adjust (investigate) a claim to determine if it is covered under the policy and, if so, determine the amount of loss the insured has suffered, all for the insured to receive a payout. In our example, it would take some time for an adjuster to travel to the insured's house to assess the damage and determine the amount of loss, which delays the payout to the homeowner.

Under a parametric insurance policy, however, the insured is not required to demonstrate they sustained a loss under the policy in order to receive a payout, and the insurer does not have to take the time to investigate the claim to determine the amount of loss before paying out. Rather, the mere occurrence of a measurable event (the wind speed as determined by Environment Canada, for example) results in a payout to the insured much sooner than if the insurer adjusted the claim in the traditional sense. As a result, insureds are paid much quicker and are able to deploy the funds towards getting their homes, business, and lives back in order sooner.

While some insurers have offered parametric insurance outside Canada for a number of years, the availability of parametric insurance coverage in Canada remains in its relative infancy. This serves as an early-mover business opportunity for Canadian-licensed insurers inclined to take advantage and assuming it falls within their underwriting appetite. While there is currently no class of insurance in Canada specific to parametric insurance, depending on the subject of coverage, insurers may already be licensed for the appropriate class or may apply to the relevant regulator(s) to have the appropriate class added to their license(s).

As with any new product initiative, insurers' legal counsel should be consulted to help ensure that the parametric offering will be regarded by applicable regulatory authorities as an insurance product that can be properly underwritten and issued by the insurer in the applicable jurisdiction.

Risk

Certainly, there are downsides to parametric insurance, with "basis risk" being the most obvious – where the payout is not enough to cover the actual loss suffered by the insured or the insured suffers loss without the parametric coverage being triggered at all.[1]

It is almost certain that parametric insurance should not represent 100% of an insured's insurance coverage. Insureds should speak with their insurance brokers to determine what, if any, proportion of their insurance protection should be allocated to parametric insurance.

For risk managers, if parametric coverage becomes more widely available in Canada, it will be important to ensure that any parametric coverage forming part of their client/employer's risk coverage profile is reconciled against their client/employer's business reality on a regular basis.

Forecasting the Future – There's No Place Like Home

While we cannot predict the future, some things about parametric insurance are clear. For insurers, it provides an opportunity to expand their presence in the Canadian market and demonstrate their level of service and care to their insureds. For insureds, it likely means receiving claims payouts sooner and, perhaps, reducing the time to stare at a torn roof.

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[1] "Parametric Disaster Insurance", *National Association of Insurance Commissioners*, August 18, 2021 (https://content.naic.org/cipr_topics/topic_parametric_disaster_insurance.htm).

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