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POWER
POINT

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Parametric insurance, also known as Index-based insurance, involves an agreement between an insurance company and the insured. Under this agreement, the insured and the insurance company agree on a payout that will be compensated if a certain event occurs. The event must be measurable and happen at the insured's location.

For the payout to be made, the event's intensity must meet or exceed a pre-agreed index. Unlike traditional insurance, parametric insurance does not involve risk assessment or a loss evaluation on an individual basis. Instead, it relies on trigger points.

The insurance company and the insured agree on a parametric index, assuming that when an event reaches a certain magnitude, there is a high likelihood of financial loss for the insured.

Once the event happens that meets the already determined parameter index, the insurer makes the claim payouts as outlined in the contract. This approach enhances transparency, accelerates claim payments, and provides immediate financial relief to the insured.

Let's understand this with an example

The Weather-Based Crop Insurance scheme, introduced by the central government is based on the principles of the parametric insurance.

The scheme aims to support farmers from financial losses caused due to extreme weather conditions related to rainfall, temperature, wind, and humidity, among others.

Suppose the index for heavy rainfall is set at 12 mm/hr. When the rainfall in the insured area exceeds this threshold, payouts are triggered. These payouts correspond to the parameters of the weather conditions affecting the area, with adverse weather conditions disbursing a higher claim amount, the scale of which is already determined at the time of the agreement.

Extreme Heat Income Insurance- To support underserved communities from income loss due to harsh weather conditions like heat waves and high temperature, parametric insurance is employed. When heat waves intensify to the level of a parametric trigger, workers are paid a daily wage without having to work on that day, protecting them from income loss and keeping them safe from harsh working conditions. This insurance solution has taken shape in Gujarat to support women workers in unorganised sector.

Other scenarios where parametric insurance is applied

Although parametric insurance is predominantly used in the weather-related and natural catastrophe scenarios, it is not limited only to these areas. It can also cover financial stress due to non-asset loss business interruptions, yield disruptions, excess or lack of solar and wind for green energy, cyber disruptions, and other measurable events.

The renewable energy sector, which is expected to grow significantly in the coming years, often relies on sunlight and wind as primary energy sources. Expected solar irradiance for a given period can be assessed using historical data.

Occasionally, unexpected shortfalls in solar energy production may occur, the reason for which can be anything thing from cloud movements to atmospheric attenuations.

The economic value for this shortfall can be compensated when this shortfall exceeds a parametric threshold. This coverage helps instill confidence in private investors, encouraging further investment in renewable energy and supporting environmentally friendly initiatives.

It can, for example, also be extended to cover for the reduction in customer footfall for traders, who experience reduced footfall due to curfews imposed by authorities to manage law and order. When the number of footfalls goes below the average number of

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people visiting the trader's brick-and-mortar outlets under normal conditions, a breach in the parametric threshold will trigger payouts as agreed between the parties.

Parametric insurance also offers a unique and innovative approach to risk management. By eliminating the need for traditional loss adjustment processes, it provides a more efficient and transparent solution for the businesses facing a variety of risks.

Its predetermined payout structure and reliance on the predetermined objective can trigger points ensure swift financial relief, enabling policyholders to recover quickly from adverse events.

As technology continues to advance, we can expect parametric insurance to expand its reach into new areas of risk, offering businesses greater flexibility and protection. With its potential to mitigate financial losses and foster resilience, parametric insurance is poised to become an increasingly valuable tool in the modern business landscape.

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