Global Sustainability Spotlight
From Wildfires to Travel Disruptions: The Growing Appeal of Parametric Insurance

A biweekly roundup of Sage's top sustainability news picks

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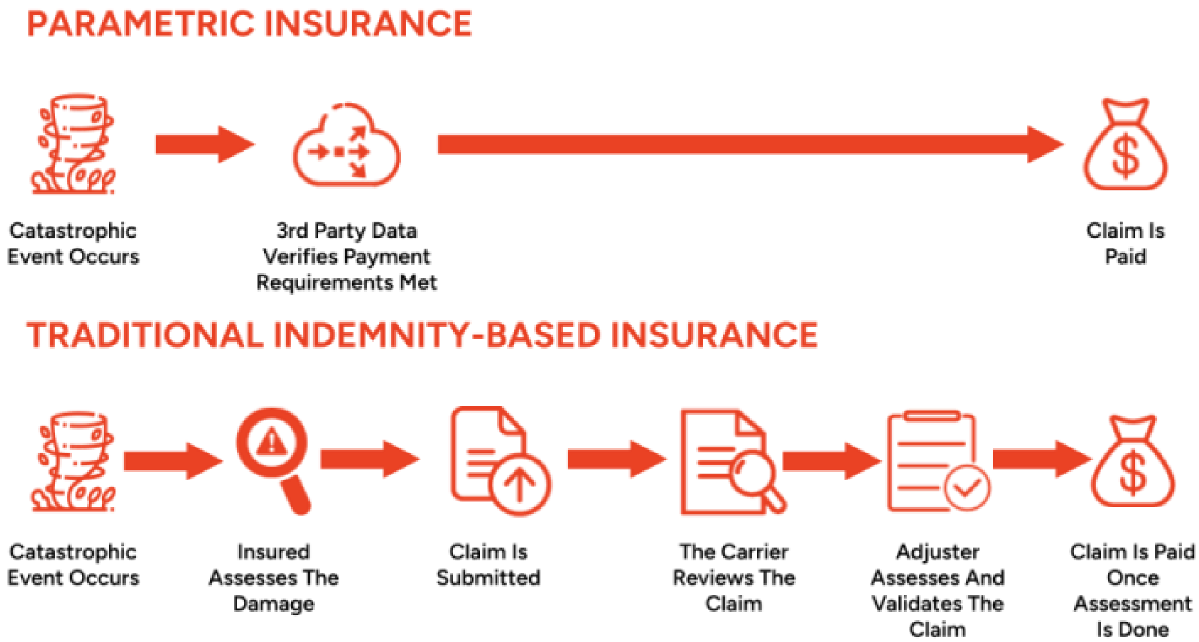
With wildfires still raging across California, discussing the long-term implications of this ongoing catastrophe — and the ones that came before — may seem premature. However, for homeowners in the Pacific Palisades, the road ahead highlights the growing challenges within California's homeowner's insurance system. Those who lost their homes may face months of waiting just for an adjuster, and over a year to settle with their insurer, only to discover that their coverage falls short of the full replacement cost. Even those who choose to rebuild may find their insurance policy dropped once the temporary, one-year moratorium on cancellations — imposed by the California Insurance Commissioner — expires.

Looking ahead, homeowners across the state will likely grapple with rising insurance costs, or in some cases, be forced to take on the risk of being underinsured or even uninsured. While various policy and regulatory solutions are being proposed to address California's insurance crisis, the broader reality is that climate-related risks — ranging from wildfires to mudslides and water access challenges — are becoming more severe. As a result, the cost of protecting homes from these threats will continue to rise. Are there ways to mitigate this growing financial burden? One potential solution is parametric insurance, which, rather than covering actual losses like traditional indemnity insurance, provides payouts based on predefined, measurable events. This approach can serve as a valuable complement to conventional coverage, offering homeowners a faster and more predictable means of financial recovery.

Parametric vs. Indemnity Insurance Payment Process

Source: Risk & Insurance Education Alliance



Parametric insurance is a much more streamlined process than traditional indemnity insurance.

Potential Advantages of Parametric Insurance

Policyholders in the property and casualty insurance space largely utilize indemnity insurance to protect their assets and revenue, but there are potential advantages to holding coverage based on "triggers," such as a payout based on reaching a certain wind speed threshold or an earthquake hitting a certain magnitude. As parametric insurance gains traction, it is poised to play an increasingly influential role in the industry, offering innovative solutions to complement traditional policies and, in some cases, even replace certain types of coverage. Below are some key benefits of parametric insurance.

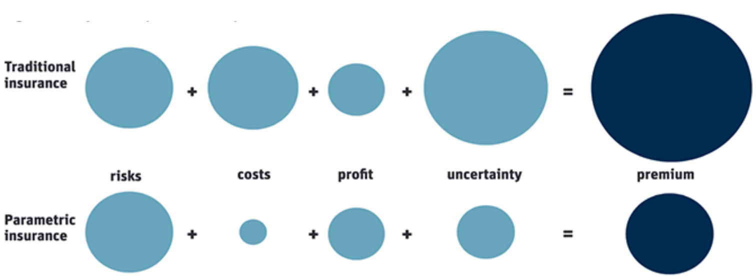
1. Fast payouts: Because parametric insurance only requires verification that a pre-defined event occurred, the claims process is relatively short. A quick payout allows funds to be deployed rapidly during a time of need (vice waiting months or years for a final decision).
2. No disputes: Parametric insurance triggers are designed with precise methodologies that rely on third-party data and verification, ensuring they are objective and indisputable. This approach eliminates ambiguity regarding payout amounts and timelines, providing policyholders with greater certainty and efficiency.
3. Flexibility: Not only are the possibilities for types of parametric coverage endless, so are the potential terms (e.g., a multi-year deal with tailored trigger parameters bespoke to the client).
4. Innovative Coverage Options: Parametric products can be structured for events that traditional insurance may exclude or find difficult to price accurately, such as catastrophic floods, pandemic disruptions, or agricultural risks.
5. Potential Cost Savings: For centuries, the insurance industry has remained profitable by effectively assessing risk. However, as certain risks put increasing pressure on insurers — reflected in key financial metrics like the combined ratio — premiums for many types of coverage have been steadily rising. Parametric insurance offers a distinct advantage by eliminating many administrative costs that burden traditional insurers, such as sales commissions, claims processing, adjuster fees, and dispute resolution.

Could Parametric Insurance Provide Lower Premiums?

Source: Midland Insurance Brokers, The Western Producer

Lowering Premiums

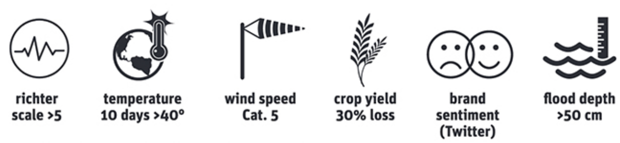
Removing part of the cost and uncertainty from traditional insurance in some cases can significantly lower parametric premiums.



Triggers and Payouts

Events: Based on an independent parameter, metric or index, parametric insurance provides a payout immediately following a pre-defined event.

Triggers: Claims payment is fixed and is triggered automatically once the agreed threshold is reached.



Real World Examples

Financial Protection for Small Coffee Growers

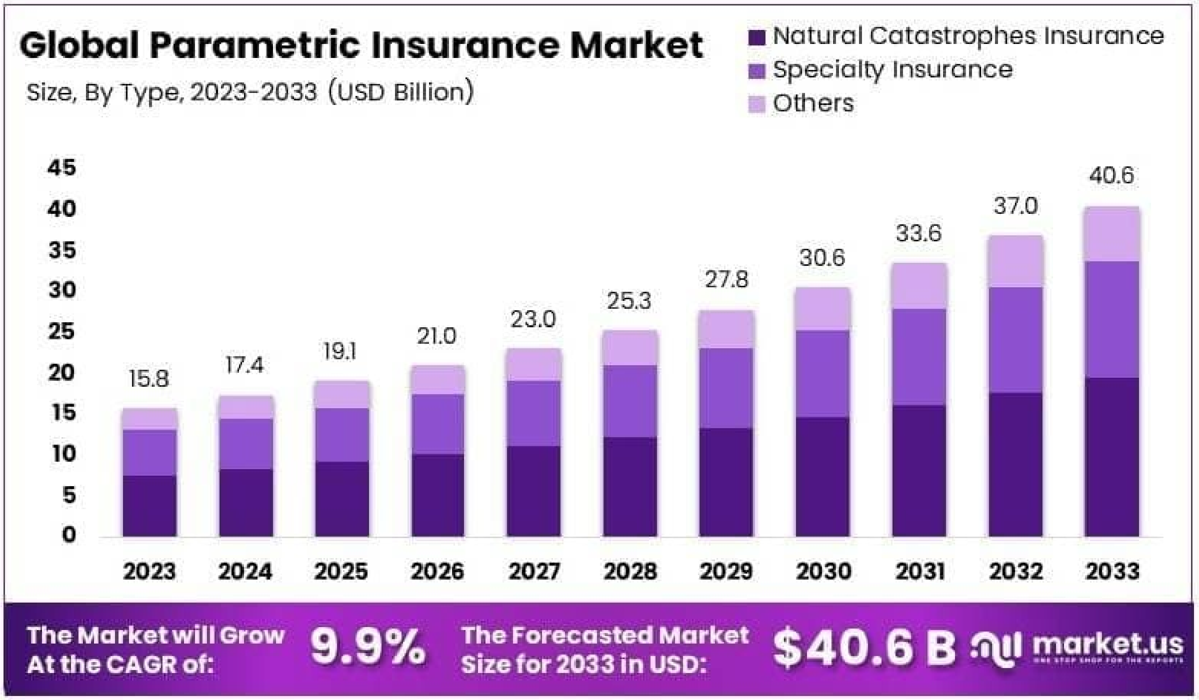
Extreme variations in weather patterns can be detrimental for crop growers around the world, and coffee farmers are particularly vulnerable to drought conditions. Blue Marble, a climate finance specialist, partners with major coffee producer Nestle to help provide financial protection through parametric insurance to the small growers that make up a sizable portion of its supply chain. The program is worldwide and provides coverage in places like Indonesia and Colombia. In the case of Indonesian growers, satellite data is used to confirm rainfall conditions during key phases of the growth cycle, and assessed payments are automatically distributed to famers.

Jamaican Catastrophe Bond
Atlantic hurricane seasons have been known to decimate the economies of many Caribbean nations every year. To provide a financial lifeline to help these nations when disaster strikes, the World Bank has been aggressive in brokering catastrophic bond (aka "cat bond") deals using parametric triggers to deploy rapid aid. In 2021, Jamaica issued its first cat bond, opting to base payouts on low air pressure (the lower the air pressure, the higher the winds). When Hurricane Beryl, a category 4 hurricane struck the island, the damage was extensive. Unfortunately, the low-pressure level was never hit, and thus Jamaica did not receive the specified $150 million payout.

Rainy Day Travel Insurance
Rainy weather can be a major disappointment for tourists, especially when they've spent significant money on non-refundable travel plans. To help ease these concerns, the InterContinental Singapore has partnered with an insurtech company to offer weather protection for guests. Their "Rain Resist Bliss" package provides a reimbursement for one night's stay if rainfall exceeds 120 cumulative minutes within any four-hour period during daylight hours.

The Future of Parametric Insurance

Source: Market.us



The global parametric insurance marketplace could nearly triple in size by 2033 (from 2024's estimate).

Though still dwarfed by traditional indemnity insurance, which remains the dominant player in what is roughly a $4 trillion market, many expect parametric insurance to grow rapidly in the coming years. Research from market.us estimates that the industry will grow from $14 billion in 2024 to $41 billion by 2033. As groundbreaking technology emerges (e.g., satellites' ability to better detect property damage and weather-related activity, AI's ability to help analyze copious quantities of historical and real-time data, etc.), the possibilities for parametric insurance to play a larger role in coverage are endless.

Continuously evolving and expanding climate risks will certainly help the development of the parametric insurance space, but we anticipate that other non-climate-related risks can also be efficiently managed through a parametric insurance vehicle (e.g., payouts for geopolitical risks or cyberattacks). Sage expects parametric insurance to be a widely discussed topic in 2025 and beyond.

Company Highlight
Aon

Ticker: AON (NYSE)
Headquarters: London, UK
Credit: Baa2/A-

The world's second largest insurer will likely be an instrumental force in shaping the trajectory of the parametric insurance market. The company already actively participates in the marketplace, offering solutions like the Government of Puerto Rico's program that protects against hurricane and earthquake perils, to help reduce its insurance obligations to FEMA. Aon is also the largest broker of cat bonds, where bonds with parametric triggers represent 4% of outstanding debt.

Municipality Highlight
City of New Orleans

Credit Rating: A2/A+

With the Super Bowl coming to town, the vibrant scene on Bourbon Street and elsewhere masks a growing problem that threatens the long-term viability of the city and the rest of Louisiana. Due to increasing climate risks (due to low-lying regions vulnerable to floods and hurricanes) and a litigation-heavy environment (the state has a unique legal system based on Napoleonic code), Louisiana residents and business owners have some of the highest vehicle and property premiums in the nation. Better climate risk mitigation and legislative reform are needed, or there will be severe long-term economic consequences for cities like New Orleans.

Other Stories Sage is Following

Gap Grows Between US and European Firms on Proxy Voting

The tectonic shift of US managers on proxy voting on environmental and social issues (US companies) has been well documented. But how do they compare to European firms or funds that claim to be sustainable? Morningstar's comparative analysis revealed that European firms have held very steady on E and S issues (voting in favor 96% of the time), US sustainable funds dropped a bit (supporting 62% of initiatives), and US firms had a more precipitous decline (down to 31%). When looking at the eight largest asset managers, Fidelity led the way (supporting 33% of the time), and at the bottom was Vanguard (which supported 0%).

Shifting Clean Energy Trajectory

As expected, the Trump Administration has been aggressive in trying to shape the future economy, targeting various aspects of the clean energy transition. Although some executive orders may not hold up to legal scrutiny, the multi-faceted attack on various aspects of the transition will certainly put a dent in its trajectory and speed. Big announcements have included the exiting of the Paris Agreement and the elimination of clean vehicle targets. Expect more announcements to come in the following weeks that will better shape this rapidly developing story (complex issues like how the US deals with Chinese trade are especially important yet remain unresolved). One industry that may prosper during this administration is domestic mining, which is critical to EVs, renewables, and nuclear power.