

ALTERNATIVE RISK TRANSFER

Parametric solutions

Alternative Risk Transfer (ART) creates innovative risk management solutions for a wide range of corporate clients. We specialize in building tailored, longterm agreements covering a broad range of risks, leveraging our expertise in alternative risk transfer and the global capabilities of the Allianz Group.



Standard & Poor's

AA

A.M. Best

A+

Often times traditional insurance solutions aren't sufficient to cover certain risks our clients face, either because there is no traditional insurance product available, or where the exact loss to the client is difficult to ascertain. Parametric solutions can help to fill gaps where traditional insurance may fall short. By addressing gaps in the cover such as non-damage business interruption, caused by severe weather or climate events, non-damage weather events that directly affect revenue, normally excluded assets and prevention costs, parametric solutions complement rather than replace traditional indemnity products.

Key components

The key components of parametric solutions are the triggering event and the pay-out mechanism. Instead of directly calculating the actual loss incurred by the client, parametric insurance covers the occurrence of a predefined event and pays out according to a predefined scheme.

Events may refer to an index-based trigger or threshold or an event within a defined area. This structure offers benefits beyond expanding coverage.

It also allows for non-damage weather events, such as lack of rain, wind or sun to be addressed since unlike traditional insurance solutions, physical damage is irrelevant for the cover to be affected.

The pay-out mechanism is driven by the event meeting or breaching the predefined threshold which results in payout of the predefined sum insured. It also reduces complexity from the loss investigation process and provides greater certainty of loss payment recovery compared to traditional insurance products.

Therefore, parametric insurance provides clients with confidence when it comes to liquidity and speed of payout where predictive loss methods fall short and allows clients to better align their risk management goals with their financial objectives.





Basis risk and bespoke benefits

Clients are increasingly asking to eliminate basis risk, which is the risk that the trigger index does not perfectly correlate with the underlying risk exposure. ART will assist our clients with analyzing the business and building an effective index that replicates the business with strong correlation. Additionally, ART can look into more sophisticated structures like double trigger events or staggered pay-out schemes.

In many cases, clients are using parametric solutions to reduce income volatility, however for some industries, for example the renewable energy sector, parametric solutions can generate an additional benefit by helping to obtain improved financing terms.

ART will assist clients & brokers to analyze business dynamics and tailor the index solution to minimize basis risk and maximize effectiveness. Ultimately parametric deals are very bespoke and have to be tailored specifically to each client's needs.

Key areas of interest

Whilst parametric solutions might offer benefits for almost all industries, there are some industries where we see significant interest, e.g.:

Property and Power/Energy - extreme weather events and natural catastrophes, such as hurricanes, cyclones, earthquakes, flooding, extreme heat, drought, wildfires, tsunamis or volcanic eruptions. Nondamage weather events, such as lack of rain, wind or sun for renewable energy companies and projects.

Events and Hospitality - low room occupancy levels due to impact of extreme weather events, warm winter protection.

Shipping and Manufacturing - financial impact of high or low river water levels, extreme weather events, supply chain disruption, increase of raw material costs.

Agriculture - extreme weather events with impact on crop yield and harvesting/ storage, supply chain disruption.

Financial Services - default risk for weather sensitive portfolios, e.g. loan portfolios in the agriculture or renewable energy business, acquisition or asset disposal scenarios.

High flexibility

Parametric index solutions are very flexible and the tailoring doesn't need to add complexity. Every solution can be structured around different triggers, a clients' risk location (single or multiple), term (few weeks or multiple years), limit, and payout structure (binary or proportional). Pricing can be adjusted to accommodate different budgets via retention levels.



Example 1

A grain producer is looking at a critical moment, or a short period of time, during the lifespan of the crop. It might be the final month before harvest where the quality of the grain is effectively decided. That is the period where crop failure can occur and will be compensated for. A renewable energy operator involved in long-term wind generation on the other hand knows they will face good years and bad years so is more concerned with ironing out the highs and lows to create a steady cash flow over time. In both cases ART will structure a business relevant index that represents how the underlying revenue changes. The style will differ as the grain farmer receives extreme protection from rainfall or temperature whereas the wind farmer will require balancing of fluctuations in wind and output. Regardless of the structure utilized the protection will be based around accurate recording of the weather that can be used to quickly pay funds to the client in the event of a loss.

Example 2

An investor in a major European football league is concerned about decreasing viewership and advertising revenues as a result of rule changes for the Champions, Europa, and Nations Leagues. A parametric index covering this risk may include the number of households buying pay-per-view national football league packages coupled with an increasing number of additional international games.

Example 3

Under Solvency II, our client was required to hold material amounts of capital against its book of lifetime mortgages. Looking through the book, ART was able to evaluate the underlying business and offer the client a tailored parametric solution to allow it to recognize the value of the AA-rated Allianz paper on its balance sheet thereby strengthening further its robust capital position.

Example 4:

A car company may entice potential buyers of convertibles with a "sunshine guarantee," protecting the consumer against a lack of sunny days to enjoy having the roof down. For example, between June 1st and September 30th, a customer may receive €100 as compensation for every rainy day after a defined threshold. Payouts would be triggered using data from a local weather station in the state where the car is registered. The cost of the cover might be subsidized in full or in part by the car company, or the cover might be offered to the customer as an option.

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About Allianz

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