

Basis risk in parametric insurance: what should we be asking?

Basis risk is one of the most common questions brokers raise about parametric insurance. The same question sits inside every traditional contract, under different names. What separates a good outcome from a poor one is the rigor of the index design.

● COMMON TO ALL INSURANCE

Every program raises the same question.

"How closely will my recovery track my actual loss?"

Uninsurable losses come from:

<p>. TRADITIONAL INSURANCE</p> <ul style="list-style-type: none"> • Sub-limits below the MPL • Exclusions revealed post-event • Ambiguous policy wording • Adjuster vs. insured disputes 	<p>. PARAMETRIC</p> <ul style="list-style-type: none"> • Data source fit • Index selection • Trigger calibration • Peril definition
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● WHAT GOOD LOOKS LIKE

Four principles of a well-engineered index

In parametric insurance, the **index** is the measurable trigger that determines how closely payouts will correlate with actual losses. The gap between the two is largely a function of how thoughtfully the index has been designed.

<p>.01</p> <p>Data source selection</p> <p>Matched to the peril and geography, requiring strong scientific expertise.</p>	<p>.02</p> <p>Historical validation</p> <p>Index performance is tested against past losses to ensure alignment and build confidence.</p>
<p>.03</p> <p>Continuous improvement</p> <p>Indices are regularly updated to reflect evolving client needs and advances in data and technology.</p>	<p>.04</p> <p>True partnership</p> <p>The best outcomes come from programs where brokers and carriers have engaged seriously with the technical detail.</p>

● *The aim is not to eliminate basis risk, but to find the right balance: broader coverage and lower triggers reduce mismatch, but each adds premium. The objective is well-priced protection with a negligible gap.*

● WHY IT MATTERS

What parametric actually delivers

<p>01</p> <p>Faster liquidity</p> <p>Payouts within weeks, critical for project finance.</p>	<p>02</p> <p>Lower loss adjustment and administrative costs</p> <p>No prolonged adjustment process, no protracted disputes.</p>	<p>03</p> <p>Reduced internal resource burden during claims</p> <p>The risk manager's time stays focused on the business, not the claim.</p>
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● THE BIGGER PICTURE

From basis risk to Total Cost of Risk

A client's true cost of risk is more than premium. It includes what they retain, what claims cost to manage, and how long they wait for a payout.

Retained risk

+

Premium

+

Admin costs

+

Speed of payment

● *That last one — **speed of payment** — is often the most overlooked. It's also where parametric is decisively better.*

Where does coverage uncertainty sit in your client's existing program, and how is it quantified?