MARSH

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The ART of the Deal: Alternative Risk Transfer Gains Traction

Alternative risk transfer (ART) solutions — customized risk financing mechanisms that go outside the traditional insurance market to minimize the cost of financing risk — have been around for almost five decades. But for most of that time, such solutions have been reserved for large businesses with strong balance sheets and the means to depart from traditional insurance markets through self-insured retentions, captives, or insurance pools.

That is rapidly changing. Many ART solutions are now more readily available to small and midsize businesses, which can use them to optimize capital, better ensure budget certainty, and reduce the administrative burden associated with purchasing policies and endorsements. The list of alternatives for transferring risk is also growing, with some enhancing existing "traditional" forms of coverage and others allowing businesses to finance risks that have not historically been addressed to their satisfaction by commercial insurers.

WINDS OF CHANGE

Once available primarily in the reinsurance sector, ART solutions are now common in the primary insurance market. And as the nonstandard risk transfer marketplace grows, providers and financiers are developing innovative solutions to benefit companies of all sizes. This growth has been driven by several marketplace trends including:

- **Insurance capacity being limited, expensive, or unavailable:** 2017's catastrophes cost insurers $136 billion, according to Swiss Re, making it the third-costliest year on record. This led to an increase in insurance pricing for most catastrophe-exposed properties, especially for companies that experienced heavy losses or are in already challenged industries. Many businesses are looking for ways to find adequate coverage without breaking the bank.
- **More third-party capital in the marketplace:** Traditionally, alternative risk finance was typically obtained through the largest insurers, which could often provide coverage for riskier endeavors. But in recent years, the capital base available for ART solutions has expanded to include private equity funds, sovereign wealth funds, hedge funds, and pension funds.

- **Developments in risk modeling and technology:** Today's advanced predictive modeling and risk technologies provide higher quality data and analytics, enabling organizations to better manage risk. These systems also allow insurers and others to more accurately assess and price risk, giving them confidence to innovate.

- **A lack of innovation within traditional markets:** Some traditional "off-the-shelf" policies offered by insurers may not address changing business needs. Many organizations are seeking customizable or tailored solutions that insurers are often unwilling or unable to provide.

These trends have spurred the development of a host of ART products, creating a competitive marketplace and more access to nonstandard solutions.

NONSTANDARD SOLUTIONS GAIN POPULARITY

Alternative risk solutions include products that combine coverages, cover risks that are typically difficult to place, or allow for consistent, multiyear pricing. Large organizations, for example, are increasingly interested in nonstandard integrated risk solutions, which bring multiple lines of coverage into a single, multiyear contract with an annual or term aggregate. Such solutions can allow organizations to buy insurance effectively and efficiently and avoid surprises by providing a clearer view into long-term premium costs.

Parametric insurance is also gaining ground, due, largely, to improved risk modeling. Parametric policies are based on an agreed-upon index or some other measure. Payouts hinge on whether insured events meet pre-defined metrics — for example, a certain wind speed as measured at a defined spot or the magnitude of an earthquake at a given location. Such straightforward parameters can help streamline claims processes and can even accelerate payments. Parametric coverage can be used on a standalone basis or as a supplement to fill gaps in traditional policies.

Multiyear single limit (MYSL) line-specific policies are also gaining traction. Through such policies, buyers can purchase a single limit that applies over several years rather than buying a separate policy with its own limits each year. Such policies often feature a reinstatement premium that is agreed upon in advance should the limit be eroded due to significant aggregate losses, making these products more efficient and allowing for greater predictability of insurance annual costs.

These and other nonstandard solutions can offer insurance buyers superior coverage in areas including:

- Business interruption for non-physical damage.
- Pandemic and epidemiological risks.
- "Black swan" events.
- Weather risk.

BENEFITS FOR BUSINESSES

As alternative risk solutions increase in variety and accessibility, more leading businesses are introducing nonstandard policies within their organizations. There are three main benefits that these forward-thinking businesses are seeing:

- **Optimizing capital:** The more business organizations can do with one carrier, the more likely they are to receive concessions or discounts. Ultimately, being able to bundle coverages or renew on a multiyear schedule can help organizations benefit from economies of scale.
- **Reducing administrative burdens:** Multiple policies, endorsements, and carriers can lead to a lot of administrative legwork, and therefore, higher costs. In addition, chaotic renewals or frenetic claims adjusting can cause companies to underuse risk management staff as they fulfill time-consuming clerical activities rather than strategic or value-added work. Bundled and multiyear policies can not only result in economies of scale, but can reduce administrative work and costs. Parametric policies can simplify and speed up the claims process.
- **Ensuring budget certainty:** Alternative risk solutions can offer budget certainty for organizations seeking to forecast their insurance costs beyond the next year. Multiyear contracts for nonstandard solutions often allow organizations to know their insurance costs for three- to five-year periods. Budget certainty can also stem from integrated solutions that reduce an organization's number of insurance partners, and even from parametric solutions, which can allow businesses to better understand when coverage can be drawn upon.

As nonstandard solutions move from the reinsurance world into primary insurance — and are offered via an expanded array of platforms — competition and innovation will likely allow more businesses to take advantage of these products' many benefits. Overall, ART solutions present organizations with a number of options that can save them time and money, without sacrificing needed coverage. Businesses should work with their insurance advisors to determine whether alternative risk insurance is the right choice, keeping in mind that ART solutions should be part of a balanced insurance portfolio.

To learn more about ART solutions and whether they are a good fit for your business, contact your Marsh representative or:

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