

DRF Analytics 101

Glossary of key terms

This note provides a quick reference for some common terminology used in risk, risk financing, and insurance.



Antecedent Conditions

Pre-existing conditions that impact how hazards develop. For example, several seasons of low rainfall can impact soil moisture and absorbency and thus affect the sensitivity of future droughts and floods are to rainfall.



Average Annual Loss (Aal)

The average one-year loss observed across a historical time period, or projected expected loss in a model = $\frac{\text{total loss across all years}}{\text{number of years}}$



Basis Risk

The risk that payouts from a parametric risk finance product do not match the losses they are designed to proxy.



Catastrophe Bond (Cat Bond)

A capital market instrument that provides for payment of interest and/or principal to be foregone in the event of a specified catastrophe, such as an earthquake of a certain magnitude that occurs within a predefined geographical area.



Catastrophe Risk Modeling

The practice of using computer programs to mathematically represent the physical characteristics of natural catastrophes. Such modeling is used by (re)insurers, financial institutions, and public agencies to evaluate and manage natural and man-made catastrophe risk from perils ranging from earthquakes and hurricanes to floods and wildfires.



Contingent Liability

A potential payment obligation (or future expenditure) that may be incurred, depending on the outcome of a future event. In the case of disaster risk for governments, the expenditure may be to pay for emergency response or reconstruction in the event of a natural hazard impact.