Index Insurance Training

Glossary of terms

Aggregate Excess of Loss: a form of reinsurance that stipulates participation by the reinsurer when aggregate excess losses for the primary insurer exceed a certain stated retention level.

Aggregators: groups or institutions that aggregate the risk of households either through the services they provide or through informal risk-sharing arrangements for example, banks, microfinance institutions, agri-businesses, agricultural lenders, firms in the value chain, and farmer associations.

Basis Risk: in index insurance, basis risk is the risk that there may be a mismatch or difference between the actual losses suffered by the insured party and the measurements used by the underlying index to trigger insurance payouts.

Bundling: index insurance can be bundled with other insurance products (health insurance, funeral insurance etc.) and with non-insurance services (such as loans, farming inputs).

Burn Cost: the amount of premium it would take to cover only the average historical losses or historical payouts.

Co-insurance pools: an arrangement where the risk or risks covered by one insurance policy are shared between a number of insurers. Each insurer accepts a percentage of the risk and receives a corresponding percentage of the premium.

Concentration risk: a concentration of risk can occur if many similar risks are underwritten, where the same or similar loss events could involve multiple subjects of insurance insured by the same insurer or reinsurer. For example, a severe cyclone could result in significant damage for most policyholders in the same area, leading to many claims occurring at the same time and in the same area, due to the same risk event.

Covariant risks: a type of risk that exhibits high correlations between different insured risks. A risk or risks affecting many individuals, households or businesses in the same area and/or at the same time.

Deterministic: a deterministic pricing method approach implies pricing based on the historical risk data only for estimating the payout frequencies and severities.

Excess of Loss: a specific type of reinsurance where the ceding company is compensated for losses that exceed a specified limit. The purpose of an excess of loss reinsurance is to assist insurance companies with managing risk. It is a form of non-proportional reinsurance that is centrally focused on loss retention.

Source: Excess of Loss Insurance (corporatefinanceinstitute.com).

More information: What is Excess of Loss Insurance? | Allianz Trade (allianz-trade.com)

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IAIS - the International Association of Insurance Supervisors: is a voluntary membership organization of insurance supervisors and regulators from more than 200 jurisdictions. It is the global standard-setting body responsible for developing and assisting in the implementation of principles, standards and guidance as well as supporting material for the supervision of the insurance sector.

Indemnity Insurance: insurance that compensates the beneficiary on losses or damages incurred.

Index: a quantification or measurement of the potential risk or loss event for the insured party. The index should be based on relevant underlying parameters, which are relevant for the risk or loss event experienced by the insured party, such as rainfall, temperature, windspeed, crop yield, livestock mortality etc. The index should also take into account the time period over which the risk or loss event may occur. The index could be generic (e.g. measuring severe dry spell in general) or be value-chain specific (e.g. measuring dry spell relevant for a specific crop and variety). The index should be relevant for the underlying business activity being insured e.g. farming, trading, generating renewable energy etc.

Index Insurance: an insurance scheme that makes payments to the insured when a predetermined index is triggered.

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Insurable Interest: when an insurance policyholder has a clear financial interest in preserving the insured subject such as crops, livestock. The policyholder should not want the insured risk event (bad weather, cattle death etc.) to take place.

Micro, meso and macro-level insurance: micro level implies where the end-beneficiaries (e.g. farmers) are insured directly. Meso level implies where the other value-chain players (e.g. Microfinance Institution) is insured at the corporate level. Macro level implies where the government insures itself (e.g. Ministry of Finance) in order to use index insurance payouts for financing disaster relief, for example.

MSMEs: types of businesses that include micro, small, and medium enterprises.

Natural hazard: is a geographical event that occurs naturally and has the potential to cause injury/loss of life or property/environmental damage.

Source: UNCDF - Climate and Disaster Risk Finance and Insurance: 25 key terms you need to know

Premium floors: minimum premium rates for a product generally applied to avoid products being underpriced due to competitive pressures.

Profit shares: insurers may share profits with intermediaries such as distribution channels for selling their products.

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Quota share: a type of proportional reinsurance, whereby the premium and claims are shared in the same specified proportion between the insurer and the reinsurer. It is the most commonly used type of reinsurance for index insurance products as of 2023.

SMEs: small and medium-sized enterprises or small and medium-sized businesses are businesses whose personnel and revenue numbers fall below certain limits.

Standard Deviation: a statistical measure of the range of historical payouts for a given index.

Stochastic: a stochastic pricing method implies pricing based on a statistical approach whereby the payout frequencies and severities and/or the underlying index is modeled using suitable statistical distributions.

Stop-loss: a type of excess of loss reinsurance wherein the reinsurer is liable for the insured's losses incurred over a certain period (usually a year) that exceed a specified dollar amount or percentage of some business measure, such as earned premium written, up to the policy limit.

Value at risk: the size and likelihood of potential risks over a defined period of time.