The Risk Margin on Trial

Members of the Risk Margin Working Party:
Andy Pelkiewicz (Chair)
Andy Scott
Paul Fulcher

8 May 2018

The Risk Margin Working Party

• Set up following criticisms of the Risk Margin in the Treasury Select Committee Inquiry into EU Insurance Regulation

• Two main strands:
  – What can be done to fix known issues with the RM, either now or post-Brexit?
  – What should be the purpose of the RM, and how can that purpose best be fulfilled?

• Members:
  – Andy Pelkiewicz (Chair), Waqar Ahmad, Paul Fulcher, Chris Marsh, Stuart Reynolds, Andy Scott
  – Life Research Committee representative: Richard Schneider

8 May 2018
The Debate

• Today’s session is a debate, which we hope will be an interesting and light-hearted means of examining the issues

• Each speaker will argue for a particular position:
  – The Good: Keep the Risk Margin Unchanged
  – The Bad: Change Parameters
  – The Ugly: A Fundamental Overhaul

• We may all be playing devil’s advocate!

• There will be an opportunity for contributions from the floor

• Each speaker will wind up, and there will be an informal vote

Risk Margin 101

\[ RM = CoC \cdot \sum_{t \geq 0} \frac{SCR(t)}{(1 + r(t + 1))^{t+1}} \]

“Non-hedgeable”

Transfer to a “reference undertaking”
• No other business and remains closed
• De-risk assets (as far as possible)
• Assume reinsurance transfers with business
• Future management actions consistent with those of original insurer

“Non-hedgeable risks”
• Underwriting
• Residual market risk
• Counterparty default risk
• Operational risk
Right question?

£44bn across UK life industry

100bps fall in rates: 27% increase in RM

Wrong answer!

CHEAP

EXPENSIVE

Source: “Solvency II one year in” – speech by David Rule, Executive Director of Insurance Supervision
Data as at 30 September 2016

The Debate: Keep the Risk Margin unchanged
The Debate: Change Parameters

The Debate: A Fundamental Overhaul
## Industry suggestions (EIOPA & TSC)

<table>
<thead>
<tr>
<th>Proposal</th>
<th>What needs to change</th>
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<tbody>
<tr>
<td>Lower cost of capital from 6%</td>
<td>Level II Delegated Acts</td>
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<tr>
<td>Management action of reinsurance</td>
<td>PRA acceptance</td>
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<tr>
<td>MA or VA used for SCR</td>
<td>EIOPA Guidelines</td>
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<tr>
<td>Higher discount rate</td>
<td>Level II Delegated Acts</td>
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<tr>
<td>Non-independence of lifetime risks</td>
<td>Level II Delegated Acts (or internal model?)</td>
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<tr>
<td>Diversification (groups, life/non-life)</td>
<td>Level II Delegated Acts</td>
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<tr>
<td>Change method from cost of capital</td>
<td>Level I Directive</td>
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</tbody>
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## What do you think?
Speakers’ Responses

Vote
Thank you

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