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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



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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



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Risk Margin 101

$$RM = \underset{\substack{\uparrow \\ 6\%}}{CoC} \cdot \sum_{t \geq 0} \frac{\overset{\substack{\downarrow \\ \text{"Non-hedgeable"}}}{SCR(t)}}{(1 + r(t+1))^{t+1}}$$

Swaps

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

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Right question?

£44bn across UK
life industry

100bps fall in rates:
27% increase in RM

Wrong answer!

CHEAP
EXPENSIVE



The Debate: Keep the Risk Margin unchanged



The Debate: Change Parameters



The Debate: A Fundamental Overhaul



Industry suggestions (EIOPA & TSC)

Proposal	What needs to change
Lower cost of capital from 6%	Level II Delegated Acts
Management action of reinsurance	PRA acceptance
MA or VA used for SCR	EIOPA Guidelines
Higher discount rate	Level II Delegated Acts
Non-independence of lifetime risks	Level II Delegated Acts (or internal model?)
Diversification (groups, life/non-life)	Level II Delegated Acts
Change method from cost of capital	Level I Directive

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What do you think?

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Speakers' Responses



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Vote



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Thank you

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