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The Morning Risk Report: Guidance Looks to Maximize Value From Risk Models

Insurers across the European Union have expended much time, money and effort to bulk up their risk models to meet pending Solvency II regulatory requirements that their capital reserves are large enough to protect their businesses and policyholders. Guidance released this week by the Institute of Risk Management–an independent, international professional body for risk management–is designed to help insurers use these same models to boost value in other parts of their operations. More than 300 industry experts worked together on the guidance, the first installment of which was released Monday. Solvency II takes effect Jan. 1, 2016.

Regulators want insurers to have sufficient capital to minimize their risks, while firms want to keep the capital reserve amount as low as possible so they can use the money in more profitable ways, said Carolyn Williams, the institute's technical director. "There's a balance to be had here, and to achieve that balance what you need is information. That's what the risk models do," she said. By looking at the different lines insurers are writing, the conditions they are operating in and their own particular operations and assigning probabilities, assigning exposures to those various aspects, Ms. Williams said the models can help in "coming up with a sensible figure both sides can agree upon." The models bring data and information into the "tug of war between the regulator and the providers of capital."

The initial guidance looks at what insurers can do to make sure their models remain up to date as circumstances change, said Ms. Williams. Changes that can affect the risk models —and by extension, the amount of capital reserves needed to stay in compliance with Solvency II—can be outside events such as the Ebola outbreak or internal events such as the changing of the chief executive or another top executive, said Ms. Williams. The guidelines will help insurers develop a "cycle of validation, recommending ways for the insurance community to keep their models fresh and fit for purpose," she said. Future guidance will look at how to make sure boards understand the models, the reason so much money is being spent on them and how they can be used to help assess other business risks, such as whether to proceed with a merger or acquisition, or to enter into a new market or region, she said.

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