

# PROVISION AND ACCEPTABILITY CAPITAL REQUIREMENT IN SUPERVISORY INSURANCE ACCOUNTING<sup>†</sup>

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## ABSTRACT

This paper aims at revisiting a well spread supervisory rule “initial asset value must be at least equal to provision plus solvency capital”.

It starts with a risk-adjusted assessment — given by a set of test probabilities — of the future cash-flows coming from a company business plan. Inspired by the notion of market consistent risk measure of Cheridito, Filipovic and Kupper, it defines the provision (or “liability”) attached to existing obligations by using among the test probabilities only the market-risk neutral ones.

The comparison between the initial (market) value of assets and the provision defines “solvency” with respect to existing obligations.

“Acceptability” is stronger than solvency. The former condition is based on the difference between the future asset values and the future obligation results, as assessed by the full set of test probabilities. Acceptability requires an additional amount over the one needed for solvency, which is the acceptability capital requirement..

It is shown that — under a natural additional condition, that of a market-prudent set of test probabilities — solvency allows for acceptability by passing to a modified (virtual) business plan resulting from an initial rearrangement of the asset portfolio.

The paper therefore emphasizes the implicit distinction between supervisory and market oriented accounting principles hinted to in the CEIOPS CP 20 consultative paper.

## KEYWORDS

Acceptability capital requirement, provision, set of test probabilities, solvency, supervisory accounting.

## REFERENCES

Cheridito, P., Filipovic, D. and Kupper, M. (2008), *Dynamic Risk Measures, Valuations and Optimal Dividends for Insurance*, Paper presented at the Oberwolfach MiniWorkshop on the Mathematics of Solvency, February 15.

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