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# Capital Requirements and Claims Recovery: A New Perspective on Solvency Regulation

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## Abstract

Protection of creditors is a key objective of financial regulation. Where the protection needs are high, i.e., in banking and insurance, regulatory solvency requirements are an instrument to prevent that creditors incur losses on their claims. The current regulatory requirements based on Value at Risk and Average Value at Risk limit the probability of default of financial institutions, but fail to control the size of recovery on creditors' claims in the case of default. We resolve this failure by developing a novel risk measure, Recovery Value at Risk. Our conceptual approach can flexibly be extended and allows the design of general recovery risk measures for various risk management purposes. By design, these risk measures control recovery on creditors' claims and integrate the protection needs of creditors into the incentive structure of the management. We provide detailed case studies and applications, and discuss challenges for rare-event simulation.

The talk is based on joint work with Cosimo Munari and Lutz Wilhelmy.

**Keywords:** Risk Measures, Capital Requirements, Solvency Regulation, Recovery on Liabilities

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