

Designing a Countercyclical Insurance Program for Systemic Risk

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Abstract:

This article proposes a framework for measuring and managing systemic risk. Current solvency regulations have been criticized for their focus on individual firms rather than the system as a whole. We show how an insurance program can be designed to deal with systemic risk through a risk charge on participating institutions. The risk charge is based on the generalized co-conditional tail expectation, a conditional risk measure adapted from conditional value-at-risk. Current regulations have been criticized on the grounds that their capital requirements are procyclical. They require extra capital in periods of extreme stress thus exacerbating a crisis. We show how to construct a countercyclical risk charge and illustrate the approach using a numerical example.

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