Measurement and Evaluation of Guaranty Insurance Risks

Recently, financial industry regulators and supervisors are paying attention to risk-based regulation to help financial institutions attain sustainable growth based on soundness. According to changes in environment, banks, asset management firms, and insurance companies strive to break down risks, and reinforce risk management.

Especially, guaranty insurance is classified as property and liability insurance, however, in the aspects of business processes, product development, and payment their own characteristics are significantly different. Therefore, it is important to seek for effective and applicable risk management strategies, reflecting distinct features of guaranty insurance.

In this study, we quantitatively evaluate the specific risks of guaranty insurance company, different from other property and liability insurance companies, and then draw implications on effective risk management strategies. Our main results are as follows:

First, the failure of domestic guaranty insurance companies are caused by excessive risk-taking through inadequate underwriting processes. Board of directors should strengthen risk management to accomplish of a stable growth, and prevent risk concentrations on a specific guaranty insurance product.

Secondly, guaranty insurance companies need to manage insurance risks than interest risk. Insurance risks mainly consist of insurance price risk, however, reserve risk is also important to risk management and solvency assessments.
Finally, size of contingency reserve should be expanded to prepare occurrences of pro-cyclical loss and catastrophe risks. Except for extreme cases such as IMF bail-out, loss ratio after claims for compensation is comparatively low, however, the volatility of loss ratio is so high that guaranty insurance companies should calculate insurance price after considering these risks. Also, they should be ready for future catastrophe risk by accumulating some profits of premium.