Solvency II harmonizes insurance supervision across the European Union (EU). Primarily, it concerns the amount of capital that EU insurance companies must hold to reduce the risk of solvency. Determining this risk involves a best estimate of insurance liabilities and a associated risk margin. There are two approaches to determining the risk margin. The percentile approach involves setting a margin above best estimate liabilities so that, to a specified probability, the provisions will eventually prove to be sufficient to cover the run-off of claims. The cost of capital approach determines risk margin in a way that enables the insurance obligations to be transferred. It involves computing a fair value, being the amount for which liabilities may be settled, between knowledgeable, willing parties in an arm’s length transaction. In our contribution we propose how such a fair value may be computed based on Von Mises’ Economic Value theory: value intrinsically related to the worth derived by a risk receiving third party. This approach is base on a differential equation which can be used in any continuous stochastical Loss Reserving method (e.g. in the software application Integral Financial Modelling (IFM) for paid an incurred loss triangles).

Keywords: loss reserving, yield curve discounting, cost of capital surcharge, paid an incurred loss triangles.