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CEO Brief

Diagnosis of the Korean Insurance Industry and Its Suggestions (Ⅰ) - Financial Soundness

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ABSTRACT

As insurance companies are continuously exposed to emerging risks, it became crucial to establish risk governance. Therefore, the financial authority should consider the following measures: ① to eliminate the uncertainty of regulation, ② to increase the risk management incentives for insurers, ③ to improve internal control and market discipline by enhancing risk management monitoring and market disclosure, and ④ to strengthen consumer protection by implementing contingency plans and improving resolution schemes in preparation for a crisis.

1. Diagnosis of the Insurance Industry

As the environment surrounding the insurance industry is rapidly changing, risk management becomes more important for insurance businesses to maintain their financial soundness. With prolonged low interest rates and population aging, intensified market competition and enlarged outsourced distribution channels make insurance companies exposed to various risks related to asset management and product sales. However, a delay in K-ICS implementation slows down the establishment of insurers' risk governance and market discipline.

First, insurance companies having difficulty in accumulating internal capital cannot but finance only through the capital market, as low growth and low interest rates as well as intensified market competition have weakened their growth and profitability. As a result, they are expected to face difficulties in managing the costs of capital.

Second, in terms of asset management, Korean insurance companies with high interest rate risk have expanded foreign long-term bonds and alternative investments to manage interest rate risk and compensate for declining investment returns. However, if market volatility increases or the economy declines, their assets could be at risk.

Third, in the low interest rate environment, most insurance companies actively sell protection-type insurance products, however, overcompetition and lack of internal control can negatively affect the soundness of insurance companies and the credibility of the insurance industry.

Fourth, the fact that most of insurance companies compete in the same market segment leads to competition by volume through distribution outsourcing rather than product and service differentiation, which raises concerns about consumer protection and financial soundness.

2. Suggestions for the Insurance Industry

Above all, it is necessary to minimize the regulatory uncertainties about the implementation date of K-ICS, which can increase the incentives for effective risk management. For this, K-ICS can be implemented together with RBC and the financial authority can reduce the confusion by providing interim measures including allowing various capital management methods.

Diversifying capital management channels allows insurers, whose capital management bear more importance coping with interest rate risk,not only to finance through the capital market, but also to manage insurance liabilities through portfolio transfer, buyback, or coinsurance in the insurance market. This will also mitigate the surge of cost of capital during the introduction of K-ICS.

More fundamentally, it is necessary to keep in mind that the purpose of implementing K-ICS is to establish the risk governance in which risk management strategy influences decisions on the business plan, capital management, and product development and design. Concerns about the soundness of some of the insurance products currently

offered are due to the lack of insurers' decision-making based on a sufficient risk assessment in developing insurance products and calculating premium rates, and the lack of supervision on the risk management process. Therefore, it is necessary to improve the qualitative evaluation in addition to the quantitative evaluation of capital regulation.

On the other hand, market discipline should be strengthened by providing the market with information about profitability and financial soundness so that insurance companies pay more attention to risk management. In addition, strengthening market disclosure could mitigate the stakeholders' overreaction to negative news. Therefore, it could be considered to disclose the impact assessment results until the introduction of K-ICS.

Lastly, the financial authority should prepare emergency measures for a crisis and enhance consumer protection by improving insurance resolution to maintain the continuity of insurance contracts and establish market discipline.

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