CEO Brief

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CEO Brief is a report highlighting key current issues the insurance industry faces.

Issues and Suggestions on Foreign Currency-Denominated Life Insurance

ABSTRACT

The foreign currency-denominated life insurance sales have sharply increased since 2017 due to an increase in long-term demand for foreign currencies and higher interest rates than KRW-denominated insurance. However, foreign exchange losses may cause consumer complaints if consumers do not understand foreign exchange risks. Therefore, insurers need to improve the sales force education and prepare a code of conduct. Financial authorities should provide market conduct guidelines and keep a close watch over the market to prevent mis-selling and market overheating.

1. Issues on Foreign Currency-denominated Life Insurancef

Foreign currency-denominated insurance is an insurance product of which premiums and benefits are in a foreign currency. The AIA Life introduced the foreign currency-denominated life insurance to the Korean market in 2003 for the first time. Eleven life insurers currently sell US dollar-denominated life insurance; two of them also sell Chinese yuan-denominated life insurance.

The foreign currency-denominated life insurance sales have sharply increased since 2017 due to higher interest rates than KRW-denominated insurance and expectations of foreign exchange gains as well as long-term demand for foreign currencies as the funds for education abroad or safe assets. The balance of resident foreign currency accounts increased from $10.23 billion in 2016 to $19.81 billion in 2020 (with a CAGR of circa 18%) - especially it rocketed to $16.08 billion in 2017. Insurers

generally credit higher interest rates to foreign currency-denominated life insurance policies than KRW-denominated ones because long-term foreign investment yields are generally higher than those of domestic investments. A rise in the foreign exchange rate between 2018 and mid-2020 could also increase the demand for foreign currency-denominated life insurance.

However, if consumers are not aware of taking foreign exchange risks by holding the policies, they may complain about foreign exchange losses at the time of claim payments. The policyholders must be fully informed of the foreign exchange risk even if they buy the insurance to use foreign currencies.

Since the policy period of a life insurance contract is longer than that of a bank deposit, buying foreign currency-denominated insurance for foreign exchange gains is not advisable. If a policyholder terminates the insurance policy due to volatile exchange rates, the surrender value could be less than the premiums paid; and it may also affect the foreign currency liquidity of insurance companies.

2. Suggestions

Insurers should help consumers better understand the foreign exchange risks embedded in the products and prevent mis-selling.

In Japan, the lack of understanding of foreign exchange risks, mainly among the elderly, caused consumer complaints in the foreign currency-denominated life insurance market. To remedy the problem, Japanese insurers implement qualification tests for the foreign currency-denominated insurance salespersons, identify the essential facts about the customer - such as investment experience, financial status, and the purchasing objective - and improved the product disclosure.

In Taiwan, since foreign currency-denominated life insurance policyholders are relatively young and better understand foreign currencies, and foreign currency-denominated insurance earns higher returns than Taiwan dollar-denominated insurance; there are few consumer complaints in the market. However, Taiwanese

life insurers implemented several measures to prevent mis-selling. The Life Insurance Association of the Republic of China adopted a self-regulatory scheme for foreign currency-denominated insurance: qualifying the foreign currency-denominated insurance sales, fully explaining foreign exchange risks, and requiring customer suitability assessment.

Likewise, Korean life insurers should educate the sales force and prepare a code of conduct, assessing consumers' insurance needs and investment propensity to minimize potential consumer detriment. The insurers and salespersons should fully explain risks embedded in foreign currency-denominated insurance and pay additional attention to policyholders whose main purchasing objective is foreign exchange gains. However, the possibility of mis-selling is unlikely if salespersons clearly explain foreign exchange risk, as most foreign currency-denominated insurance policyholders in Korea are in their 30s to 40s. For the elderly consumers, insurers could consider additional measures like Japan.

Financial authorities need to monitor the foreign currency-denominated life insurance market and establish guidelines regarding the sales force education and duty of explanation.

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