

Insurance Industry Outlook and Issues 2014

This report provides growth projections in 2014 for the insurance industry as well as the Korean economy.

In 2014, the Korean economy is expected to grow by 3.3%, increasing by 0.6%p over 2013, due to a gradual recovery trend of the world economy and an increase in capital investment. Since economic growth rate is still lower than potential growth rate, consumer prices will rise by 2.3%, and the stable trend will be maintained.

In 2014, the economic growth rate and consumer price inflation rate are expected to rise slightly, and interest rate of treasury bonds (3-year) will be maintained around 3.2%, increasing by 0.4%p over 2013, due to the reduction of quantitative easing in the U.S. The won/dollar exchange rate will show an appreciation trend due to continuing foreign investment inflows and a current account surplus.

The global risk factors for the economy are the reduction of quantitative easing in the U.S., the possibility of the failure of Abenomics in Japan, the limited growth of emerging markets due to the expansion of the uncertainty of financial markets. The domestic risk factors for the economy are a continuing downturn in the real estate market, lack of demand due to de-leveraging of households and businesses, a decrease in the potential growth rate, and the possibility of a sudden increase in short-term interest rates due to quantitative easing policy reduction in the U.S.

In 2014, as the economic growth rate rises slightly and relative tax-free benefit is highlighted, the growth rates of both life insurance and non-life insurance will increase over FY2013, and premium

income will grow by 5.0%, increasing by 5.6%p over FY2013.

For life insurance, since premium income of saving type insurance increased dramatically as the result of tax reform in FY2012, the premium income of life insurance sector is expected to decline by 3.8% in FY2013 . However, in 2014, as the base effect will disappear and the economic growth rate will be slightly improved, premium income is expected to increase by 4.4%. Premium income of protection type insurance will grow by 4.3% due to a rising interest on health insurance and insurers' product portfolio adjustment. Premium income of saving type insurance will grow by 4.6% by reason of relative tax-free profits and the expansion of interest in income in old age. Premium income of group insurance is expected to be low growth of 2.9% due to the difficulty of the expansion of the retirement pension market for small business.

For non-life insurance, premium income will increase by 6.1%, which is 1.5%p higher than FY2013, due to a slight recovery of the economic growth, an increase in long-term non-life insurance premiums, relatively standing-out tax benefits, and increasing in demand for the products preparing elderly life. By product line, long-term non-life insurance premiums will increase by 7.4%, and private pension premiums will increase by 6.7%. Premiums of retirement pension plans, automobile insurance, and general non-life insurance will grow by 2.9%, 2.3%, and 6.2% respectively. In spite of an increase in the economic growth rate, automobile insurance premiums will show a sluggish growth mainly due to an increase in the products offering premium discount related to mileage discount or black box..In conclusion, the growth of the Korean insurance industry

will improve in 2014, however, it will be a restricted growth compared to the previous years. Also, continuing low interest rates will make the asset management of insurers difficult. Moreover, in 2014, improving the profitability of insurance companies seems challenging, and management of financial solvency will also become even more difficult due to changes in fee structure and prudential regulations.

This report suggest the management issues for insurance companies and the policy issues for regulators, given the changes in the market environment, such as increasing interests in preparing the income of old age, needs for profit-oriented growth, intensifying competition among/within financial sectors, and increasing importance of consumer trust; changes in the institutional environment such as changes in the system related to distribution channels and fee structure; and the changes in the supervision environment, namely strengthening of prudential regulations. The presented management and policy tasks are ① efficiently responding to the changes in insurance sales channel environment, ② improving consumer trust through expanding insurer's role as a safety net of society, ③ redirecting the focus of the management from expense margins to risk margins, ④ stabilizing the loss ratio of automobile insurance and re-establishing operations structure ⑤ presenting a roadmap to improve the financial solvency.

First, the report suggests that insurance companies should strengthen the exclusive agent channel and regulators should come up with the solution to the problems regarding independent channels such as bancassurance and GA.

Second, in order to meet the increasing welfare demand, the

insurance industry should play a role of social safety net. The report adds there is an urgent need to establish social safety net through the cooperation of the government and the insurance industry.

Third, the management system of insurance companies is recommended to be converted to risk margins focused from existing expenses margins focused. The premium rate regulations of regulators have induced the business structure focusing expenses margins, and it is one of the main causes of consumer complaints.

Fourth, as a negative trend in the loss ratio has continued, the deficit of automobile insurance will reach one trillion won level. Also, the report points out that conflict among stakeholders over insurance premium damages the stability of the non-life insurance and increases the social cost. To solve these problems, it is suggested that a task force for stabilizing loss ratios should be established, in addition, the management structure of the automobile insurance should be redefined in order to reduce the social cost.

Fifth, the Korean regulators have enhanced financial solvency regulations along with the global trend of strengthening capital regulations of the insurance industry since the global financial crisis. However, the report emphasizes that the influences of related policies, such as rate regulations, has not considered; therefore, a prudential regulations roadmap considering these influences, is needed.