IFRS 9 and Implications for ALM and Asset Allocation of Korean Insurers

Beginning in 2021, all insurers should classify and measure financial instruments, recognize impairment and apply hedge accounting on the basis of IFRS 9. Under IFRS 9, the classification and measurement of financial instruments and the recognition of impairment are very different from current accounting standards IAS 39. Therefore, it is necessary to identify the impact of IFRS 9 on insurance companies, but there are few relevant studies. This study provides a quantitative analysis of the impact of IFRS 9 on insurance companies and suggests implications for insurance companies’ ALM and asset allocation.

The analysis shows that in order for insurance companies to reduce both duration gap and capital volatility, the portfolio weight and duration of assets measured as fair value through other comprehensive income (FVOCI) should be increased. In addition, insurance companies need to reduce their assets measured as fair value through profit or loss (FVPL) in order to mitigate volatility of both earnings and capital. The expected rate of return may decline due to the reduction in the weight of the assets measured as FVPL and the increase in the weight of long-term bond. This expected rate of return decline needs to be mitigated by the diversification of investment.

Insurance companies with high capital volatility under IFRS 9 need to concentrate on reducing their liability duration, but it is difficult to reduce liability duration in a short period of time. Therefore, they need to expand the proportion and duration of assets measured as FVOCI. Also they need to reduce the proportion of loans measured as amortized cost (AC) and increase
the proportion of bonds measured as FVOCI in order to decrease capital volatility under IFRS 9.

The financial authority needs to pay attention to changes in the asset allocation and risks of insurance companies in response to the shift in accounting standards.