Interest rate risk management strategies of Insurance Company

Korean insurance companies have just realized the importance of interest rate risk, after observing that a number of foreign insurance companies went into bankruptcy because of negative interest rate spread. At the bottom line, it is impossible for insurers to pursue sustainable growth without taking interest rate risk. All the time, there exists a possibility that the return on assets drops below the return level guaranteed by insurance contract.

Once negative interest rate spread occurs, it is difficult to find ex post remedies by which insurers recover realized economic loss. The importance of prior interest rate risk management cannot be overstated. Insurers need to estimate the long-run equilibrium level of market interest rate, to identify causes of negative interest rate spread, to search affordable interest risk management tools, and to establish suitable interest rate risk management strategies.

In this study, we collect various interest rate risk management practices from both Korean insurance companies and foreign ones, compare pros and cons of each practice, and then evaluate the effectiveness of risk management strategies. Feasible approaches to manage interest rate risk could be classified as product portfolio adjustment, asset portfolio adjustment, and risk hedge. The pros and cons of each approach as well as actual experiences of Korean insurers are discussed by surveying relevant literature. Our main results are as follows:

First, Korean insurance companies have focused on coping with
interest rate risk through product portfolio adjustment. For example, insurers have increased the portion of interest-sensitive products or investment-type products instead of fixed-interest products.

Secondly, it is observed that foreign insurers tend to make use of more active asset management strategies. Insurance regulators and supervisors of a number of countries have relaxed asset management regulations on the insurance companies.

Third, it seems that Korean insurers had better pay more attention to the asset portfolio adjustment in order to maximize their firm values.