In July 2014, the Financial Supervisory Commission (FSC) and the Financial Supervisory Service (FSS) announced their roadmap for the advancement of solvency system, which aims to align with the IAIS Insurance Core Principles. The roadmap focuses on the strengthening of risk-based capital requirements and the capital adequacy test under IFRS 4 phase II which stipulates the economic valuation of insurance liabilities.

However, its impact of the IFRS economic valuation on the capital adequacy test of an insurer and its preparation period are not fully considered in the plan. Based on the results of liability adequacy test (LAT) in IFRS 4 phase I, the implementation of IFRS 4 phase II is expected to lead a majority of Korean life insurers to struggle against the significant decline of their RBC ratios. These effects are largely due to the first application of IFRS 4 phase II to existing contracts. Phase II requires insurers to immediately recognize expected losses from existing onerous contracts while profits expected from existing contracts should be retained in insurance liabilities before the transfer of service.

We suggest that RBC available capital be adjusted by the expected profits to the extent of the expected losses. Also we support the gradual strengthening of the LAT in the roadmap although it is not sufficient for the soft landing of the roadmap. Last but not least, we recommend the financial authorities try to strike a balance between market competition and the financial strength of insurers.