Life Insurers’ Capital Management under the Advancement of Solvency System

The prolonged low interest rate environment and advancement of the solvency system have become a big burden on life insurance companies in Korea. The continued decline in interest rates has weakened the economic capital of life insurers. The advancement of the solvency capital requirement will require more regulatory capital of life insurers. And the economic value of life insurers will be revealed more accurately and transparently due to the implementation of IFRS 4 Phase II. Conservative past practices of capital management are no longer sufficient in this new economic and regulatory environment.

The purpose of this research is twofold. The first is to suggest an efficient method of capital management for life insurers to respond to the advancement of the solvency system. The second is to propose policy options for the financial authority to make improvements to the capital management practices of insurers.

In order to minimize the cost of capital, insurers should be able to issue subordinated debt when they raise capital. However, the financial authority constrains financially strong insurers from issuing subordinated debt. We suggest that the financial authority should ease the constraint.

Large life insurers, in particular, need to manage interest rate risk with interest rate derivatives in order to respond effectively to advancement of the solvency capital requirement. To promote this, the financial authority should find ways to reasonably reflect the effect of using interest rate derivatives in the RBC system.