

# Financial authorities introduce rules to prevent insurers' inflation

2024.11.05 10:55:45

(Yonhap)

South Korean financial authorities have come up with regulatory measures to address controversies surrounding insurance companies inflating their earnings after the adoption of the International Financial Reporting Standard (IFRS) 17, a new accounting standard.

These measures were unveiled during a meeting chaired by Financial Services Commission (FSC) Vice Chairman Kim So-young on Monday.

The meeting was attended by representatives from the FSC, the Financial Supervisory Service (FSS), academia, research and development (R&D) institutions, insurance associations, and major insurance companies.

A key agenda item was how to change the risk calculation method for no-surrender and low-surrender products, aiming to reflect their risk more heavily when calculating insurers' solvency ratios (K-ICS). This will take effect for this year's year-end results.

No-surrender and low-surrender insurance refers to products where there is no refund or only 30-40 percent of the standard refund if canceled mid-term.

The authorities believe that many insurers have been overstating their accounting profits by setting excessively high cancellation rates for no-surrender and low-surrender products in order to boost their policy margins.

Generally, the higher the cancellation rate, the more favorable it is for an insurer's net assets, while a lower rate has the opposite effect.

Insurance companies initially recognize premiums paid by consumers as liabilities.

For no-surrender and low-surrender products, however, there is no need to return the premiums paid if a policyholder cancels mid-term, allowing them to recognize these premiums as assets.

Since IFRS 17's implementation, insurers have been free to set cancellation rates according to their own judgment.

In this situation, insurers have been setting high cancellation rates in an effort to improve their short-term results, resulting in a larger portion of paid premiums being recognized as assets.

They have also aggressively marketed these no-surrender products. This has sparked criticism that earnings have been overstated.

Under the latest measures, insurers will be required to separate the risk calculations for general insurance and no-surrender products.

A distinct standard for cancellation rates will be applied to no-surrender and low-surrender products based on the understanding that policyholders are more likely to delay or avoid cancellation than predicted.

The cancellation rate for calculating the risk of no-surrender products will also be set 40 percent lower, applying only 60 percent of the optimal cancellation rate for the first year to prevent excessive estimates.

Authorities also discussed penalties for unreasonable business expenses to prevent insurers from engaging in aggressive competition on business expenses.

Starting next year, insurers will be required to submit operational reports on actual cash inflows and outflows, including premiums, claims, and business expenses.

Guidelines will be established to ensure that insurers pay commissions within the business expense limits set in their underlying documents, and non-compliance will lead to penalties.

The authorities also plan to require insurers to disclose segmented details and changes in insurance liabilities along with their optimal assumptions from this year's year-end settlement.

For external verification by actuarial and accounting firms, the authorities will require the submission of supervisory evidence and data to verify against inadequate validation.

Penalties will be imposed for poor validation to enhance accountability.

The insurance industry, in the meantime, is raising concerns over the measures.

“We expanded no-surrender product offerings to stabilize the K-ICS ratio as directed, but now authorities are asking us to reduce these products due to alleged inflated earnings,” said an industry official. “This seems contradictory.”

The K-ICS ratio, calculated by dividing available capital by required capital, indicates the financial soundness of an insurer's capital.

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