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Market Segment Outlook: South Korea Non-Life Insurance

We're maintaining our Stable outlook for the segment, owing to significant improvement in the auto line and steady investment earnings, as well as a potential rebound in auto claims, among other factors

AM Best is maintaining its Stable outlook on South Korea's non-life insurance market. Key supporting factors include the following:

- Significant improvement in auto line performance, driven primarily by recent rate adjustments and a decline in claims frequency during the pandemic, coupled with improving cost efficiency for growing online sales
- Gradual stabilisation of the ongoing deterioration in the long-term loss ratio due to the cumulative impact of rate increases for medical indemnity and tighter claims management
- Stable investment earnings, which could further benefit from a rise in interest rates and growth in alternative investments

The following factors partially counter the positives:

- Potential rebound in auto claims post-pandemic
- Recent pressure on capital position due to rapidly rising interest rates

Solid Premium Growth in 2021

South Korea's non-life insurance industry registered solid premium growth of 4% in 2021, with gross premium written of KRW89 trillion (USD72.1 billion). Premiums rose in all three lines of business, with general insurance showing the strongest growth of 9%, while long-term insurance increased by 4% and auto, by 3%.

Long-term insurance, the largest business segment in the non-life industry, maintained its solid pace of growth despite concerns about difficulties in face-to-face sales activities amid the pandemic. Although new business volume of long-term insurance was similar to the prior year's, the accumulation of recurring premiums supported overall premium growth in 2021. Premium growth in the auto insurance line was much subdued after two years of strong expansion in 2019 and 2020 driven mainly by a series of rate hikes. The general insurance segment continued to see strong growth, driven by emerging new products and the hardening domestic market in recent years.

AM Best expects South Korea's non-life companies to see stable top-line expansion over the next 12 months. Although growth in auto segment may be further subdued owing to the slight rate cuts across the industry in early 2022, overall industry growth will still be supported by stable development in the long-term insurance line, driven by insurers' continued efforts to increase sales of profitable health insurance and improve their persistency ratios.

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Record Profitability Due in Part to the Auto Line

The industry's net profits rose by 72% in 2021, to a record high of KRW3.7 trillion (USD3.0 billion), driven mainly by a material improvement in underwriting performance, especially in the auto insurance line. The combined ratio of the auto segment, which historically has been a loss-making business, improved from 110.7% in 2019 to 102.1% in 2020 and 97.4% in 2021. The industry benefitted from a drop in claims frequency due to low traffic volume during the pandemic, on top of a larger premium base. In addition, the auto segment's distribution cost efficiency improved, with the fast-growing share of online sales. The proportion of online distribution in the auto segment is estimated to have expanded from 23% in 2019 to approximately 30% in 2021.

Long-Term Insurance Profitability Improved, but Pressured by Elevated Claims

The industry is still under pressure owing to elevated medical claims in the long-term insurance segment, driven by an increase in moral hazard and over-treatment by clinics and hospitals in recent years. Despite annual rate hikes for medical indemnity coverage (a private insurance cover that supplements national health insurance), these were considered insufficient to reflect the recent surge in claims owing to a 25% regulatory cap on annual rate increments and the regulator's implicit control on pricing. As a result, the risk-loss ratio[1] for medical indemnity remained high, above 130%, in 2021. Still, AM Best expects that, given the long renewal period of legacy medical indemnity policies (generally three or five years), the cumulative effect of the recent rate adjustments will become much more noticeable over the coming years, as more policies are renewed.

Despite the ongoing pressure on the claims side, the overall profitability of the long-term insurance line improved slightly, mainly because of a decline in the expense ratio due to subdued market competition. Competition from new business, especially in the general agency channel, cooled down slightly after implementation of a regulatory restriction on agency commissions in January 2021. In addition, with the upcoming implementation of IFRS 17 (the new accounting standard for insurance contracts, which will provide greater transparency on the economics of sold policies), companies are now more wary of unrestrained growth.

Stable Underwriting Performance Expected

AM Best expects that the overall underwriting performance of South Korea's non-life segment will remain stable over the next 12 months, although the favourable impact of COVID-19 on auto insurance may fade gradually.

AM Best believes that, despite a likely rebound in auto claims—the government lifted most of its COVID-19 restrictions in April 2022—the larger premium base resulting from previous rate increases, as well as improving cost efficiency, will help the industry effectively manage its auto profitability over the next 12 months. Additionally, a number of new regulations that have been in the process of being implemented since 2021—such as a reduced speed limit in urban areas, a substantial increase in deductibles for driving under influence-related (DUI) claims, and the application of comparative negligence to minor injuries from car accidents—are expected to partially mitigate the potential rebound in claims.

AM Best also expects that the deteriorating trend of the loss ratio in the long-term line will stabilise gradually owing to cumulative effect of rate hikes over the past few years. Furthermore, factors such as tightened claims management by insurers, collaborative efforts between the industry and the regulator with regard to moral hazard and overtreatments, and the adoption of re-engineered medical indemnity coverage by the government (in July 2021) will also help the industry better manage the profitability of the long-term line.

[1] This loss ratio—defined as incurred claims divided by risk premiums—is widely used in South Korea to gauge the underwriting profitability of long-term insurance; savings components are excluded from the calculation.

Investment Earnings Up

Investment performance, which is a key source of earnings for non-life insurers, was largely stable in 2021. Despite a slight decline in investment yield, a continuously expanding asset base supported overall investment earnings, which increased by 4% from 2020.

Bond disposal gains declined materially in 2021. After reaching a high of 20% in 2019, the share of net disposal gains of financial assets to total investment profits dropped to 14% in 2020 and to 6% in 2021, as companies were less motivated to sell their bondholdings given the strong underwriting earnings and declining bond values due to the recent rise in market interest rates. Nonetheless, relatively higher returns from the gradual growth in alternative investments generated a stable investment yield, partially offsetting the decline in realised capital gains. Major types of alternative investments insurers are looking to expand include real-estate/infrastructure-related funds, corporate loans, and private equity funds.

Rising Market Interest Rates – A Double-Edged Sword Under Current Solvency Regime

Market interest rates in South Korea have been rising rapidly since the second half of 2020—the 10-year government bond yield has increased by 170 basis point over the past 18 months, reaching 3.2% as of April 2022. Although many insurers are actively purchasing long-term bonds for asset-liability management, they are unlikely to benefit notably from the recent rise for some time because of the small size of new investments relative to invested assets held. However, AM Best expects that the rise in interest rates will help slow down the ongoing decline in insurers' investment yields over the next 12 months.

Rising market interest rates can benefit insurers' investment performance, but they are currently adding pressure to insurers' regulatory solvency positions, as the size of unrealised gains from available-for-sale financial securities has declined.

South Korean insurers are facing the implementation of a new solvency regime (K-ICS) in January 2023, under which both assets and liabilities will be viewed on market value, unlike the current RBC standards, whereby assets are booked on market value and liabilities are booked on a cost basis. Due to this fundamental difference, the negative impact of rising market rates on capital is more pronounced under the current regime. However, once the new solvency regime goes live, this issue will be largely moot, especially for companies with effective asset-liability management. Regardless, AM Best will keep a close watch on market rate moves and their impact on insurers' capitalisation.

Potential Impact of Emerging Factors

Additional factors that could impact the industry's operating environment over the next 12 months include the entry to the market of new digital non-life insurers, as well as the insurance-related policies of the new government, which took office in May 2022. Although the immediate impact of these factors is not expected to be material, AM Best will continue to monitor market dynamics and regulatory moves and assess any impact on the credit fundamentals of the rated entities in South Korea.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies. Best's ratings take into account the manner in which companies manage these factors and trends.

A Best's Market Segment Outlook, like a Best's Credit Rating Outlook for a company, can be Positive, Negative, or Stable.

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We update our market segment outlooks annually, but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

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BEST'S MARKET SEGMENT REPORT

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