Fitch Ratings 2020 Outlook: Korean Insurance

Outlook Remains Stable; Pressure on Profitability

Fitch's Sector Outlook: Stable

Fitch Ratings maintains a stable sector outlook for 2020. Strengthening of capital adequacy in light of progressive tightening in the regulatory capital regime would be credit positive. Fitch expects Korean insurers to continue seeking capital-raising opportunities, such as subordinated debt or hybrid issuance and equity-raising via IPOs or rights issues, to boost their capital buffers in preparation for the adoption of K-ICS and IFRS17.

However, Fitch expects top-line growth in Korea to remain flat due to sluggish economic growth and saturation of the local market. In addition, we expect downward pressure on insurers' financial performance as underwriting profitability is likely to remain volatile, while investment profit will decrease amid the declining interest rates in the domestic market.

Rating Outlook: Stable

Fitch maintains a stable rating outlook for 2020. Fitch expects the key credit profiles of Korean life and non-life insurers to remain in line with our rating expectations in the near term. The majority of ratings in Korean insurance sector have a Stable Outlook.

Rating Distribution Weighting: Investment Grade

The IFS ratings of all Fitch-rated Korean insurers are investment grade. They are mainly among the 'A' (Strong) and 'BBB' (Good) rating categories, depending on the business profile, capital strength, and leverage level relative to its capital base. Major players with significant presence in the domestic industry tend to have stronger business profiles, including large business franchises and robust capital buffers with lower leverage, compared to mid-sized peers, in both the life and non-life sectors.

What to Watch

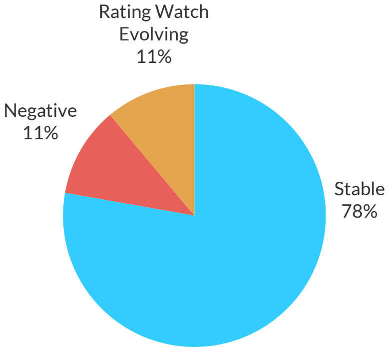
- Continued slowdown in domestic market growth
- Business strategy to focus on value or bottom line amid unfavourable and volatile market conditions
- Negative spread still a challenge for major life insurers; non-life players' underwriting profitability under pressure due to high loss ratios in the auto and long-term businesses
- Capital strength to improve by issuing bonds – mainly in onshore market, despite tightening regulations
- Understanding and managing asset risks is the key as we expect the exposure to alternative and overseas investments to remain high

Wan Siew Wai, Senior Director

"Fitch expects life and non-life insurers in South Korea to continue seeking capital strengthening opportunities to build up their resilience ahead of tightening regulatory regimes, while striving to maintain profitability amidst a challenging operating environment."

Ratings Outlook/Watch

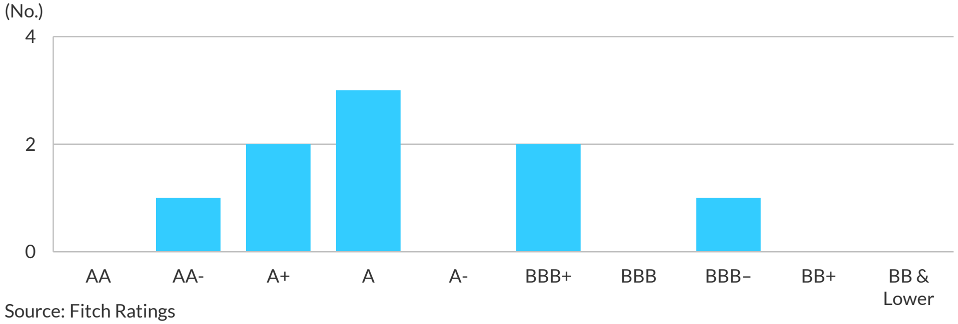
(As of November 2019)



Source: Fitch Ratings

Korean Insurance Ratings Distribution - International Scale

(As of November 2019)



Source: Fitch Ratings

What to Watch - Continued Slowdown in Market Growth

Fitch expects overall premiums for both life and non-life to continue to increase modestly in the near term due to persistent global economic uncertainties and sluggish domestic GDP growth, along with the decline in savings-type product sales. The Korea Insurance Research Institute (KIRI) expects premiums for the Korean insurance industry to rise by 0.3% in 2019 and by 0% in 2020.

Life insurance premiums are likely to decline in the next few years as the moderate increase in sales of protection-type products is not enough to make up for the drop in sales of savings-type products. However, non-life insurance premiums will increase, driven by sales of long-term protection-type products, although the growth rate in 2020 would be lower than that in 2019.

What to Watch - Focus on Value or Profitability

Fitch expects insurers to shift from top-line growth to more sustainable growth by enhancing their risk management and focusing on products with high value of new business margins.

For life insurers, protection-type products increased by 10pp to 41% of premium income in 1Q19 from 2015. Long-term business made up the largest share of 59% of non-life insurers' direct premiums written in 1Q19, followed by automobile at 19%. Both types of insurers also optimised the use of capital to maximise their enterprise value. We expect insurers to continue to shift away from savings-type to protection-type products.

What to Watch - Negative Spread Still a Challenge for Major Life Insurers

The Bank of Korea cut its base rate by 25bp each in July and October 2019 to a record-low 1.25%, citing weakening exports and private consumption. Therefore, the negative spread burden, which stems from legacy policies with high guaranteed rates mainly sold in the 1990s, will continue for life insurers. The negative spread for the major Korean life companies was more than 100bp on average in 1H19. We expect this to put pressure on profitability, although the life insurers are shifting towards floating-rate products with low or non-guaranteed benefits, and away from fixed-rate ones.

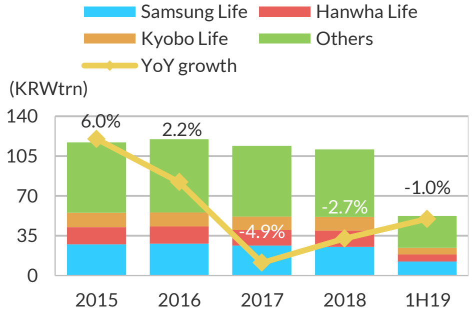
The companies' thinner bottom lines, which are mostly backed by their investment returns, could have a negative impact on their capital adequacy as well as interest burden if they continue to increase bond issuance amid the volatile market environment.

What to Watch - Non-Life Insurers' Underwriting Results Still Squeezed

Korean non-life insurers' underwriting earnings are likely to stay under pressure due to their high loss ratios in the automobile and long-term businesses and increased spending on the agency channel to meet stronger competition in light of product shifts. The loss ratio of the non-life industry rose to 83.5% in 1H19 from 81.8% in 2017, and the expense ratio also climbed to 21.6% from 20.3%.

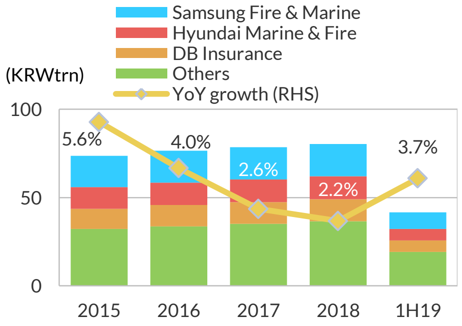
However, motor premiums increased twice in January and June by 3%-4% and 1%-2%, respectively, in 2019 across the industry, and insurers are considering another premium hike in 1H20. Fitch believes that improved pricing in 2020 will start to benefit insurers' profitability, although it may take time to for the price adjustments to be fully reflected in their results.

Premium Income - Life



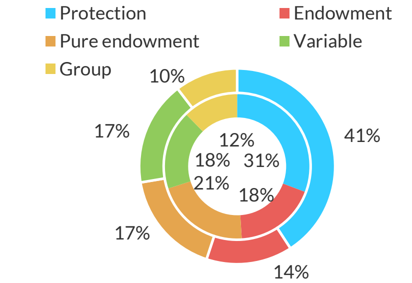
Source: Fitch Ratings, FISIS

Direct Premiums Written - Non-Life



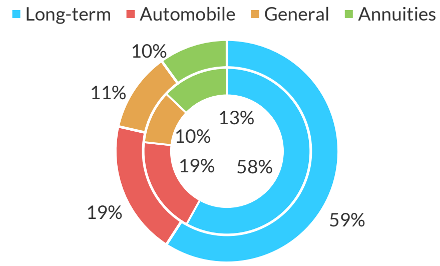
Source: Fitch Ratings, FISIS

Product Mix[a] - Life



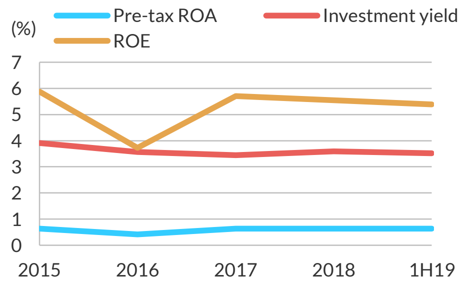
Inner ring: 2015. Outer ring: 1Q19
[a] By premium income
Source: Fitch Ratings, KIRI

Product Mix[a] - Non-Life



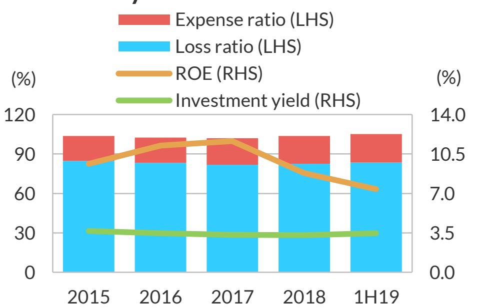
Inner ring: 2015. Outer ring: 1Q19
[a] By direct premiums written
Source: Fitch Ratings, KIRI

Profitability - Life



1H19 figures are annualised
Source: Fitch Ratings, FISIS

Profitability - Non-Life



1H19 figures are annualised
Source: Fitch Ratings, FISIS

What to Watch - RBC Ratio to Increase despite Tightening Regulations

Upcoming regulatory changes for Korean insurers include the full recognition of credit and market risk charges for guaranteed retirement pensions and an increase in required capital to be held against interest-rate risk arising from variable-rate products that provide minimum guaranteed returns to policyholders. The strengthening of the existing risk-based capitalisation (RBC) framework aims to reduce the impact of a new solvency regime, K-ICS.

Fitch expects the local RBC ratio to gradually increase in the near term due to supplementary capital issuance, although this would be partly offset by the implementation of more stringent capital requirements under K-ICS. The industry's aggregate local RBC ratio increased to 282.4% by end- 1H19 from 257.9% at end-2017.

What to Watch - Bond Issuance to Shift towards Onshore Bonds

Korean insurers are likely to continue to enhance capital buffers ahead the implementation of IFRS17 and K-ICS by issuing bonds, mainly in the onshore market. Several life companies began to issue offshore debt in 2017, but insurers have favoured onshore bonds since 2H18 due to the increased cost of offshore debt after the US Federal Reserve raised rates. Nevertheless, this trend may change in the coming year due to volatile market conditions and the increase in economic uncertainties.

What to Watch - Alternative and Overseas Assets to Grow Conservatively

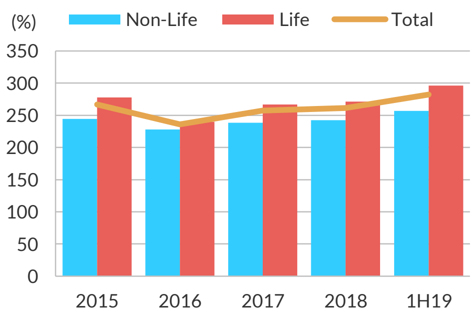
We expect both life and non-life insurers to continue to increase their exposures to alternative investments and overseas securities (mainly long-tenor bonds), although the growth could slow. This is because these assets still provide Korean insurers with higher yields. Insurers have shifted their allocation towards alternative and overseas assets steadily to 24% of their total investment portfolio at end-1H19.

Increasing liability duration due to the growth in long-term product sales has pushed insurers to increase their allocation to overseas securities - mainly in US dollars - to lengthen the asset duration, as the supply of bonds with longer maturity terms is insufficient in the domestic market. Investments in alternative assets, such as infrastructure, real estate, aircraft/shipping financing, and renewable energy, also increased as they offer good balance of risk against return, compared with traditional investment assets of bonds and equities.

What to Watch - Risk Management of Growing Importance

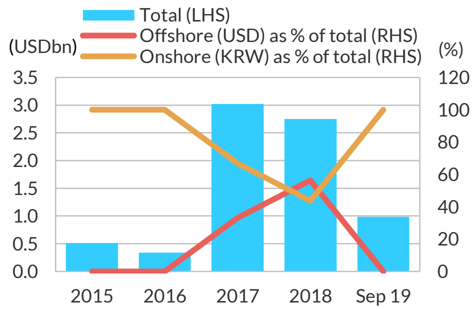
Fitch believes that the risk management is getting more important for insurers in a volatile global market. Korean insurers are likely to further diversify their investment portfolios into non-US dollar denominated assets as hedging costs for US dollar assets have increased to more than 100bp. Meanwhile, we expect insurers to be more cautious about investing in alternative assets, which carry higher liquidity and transparency risks, and pay more attention to their underlying asset risks.

Local Risk-Based Capital Ratio



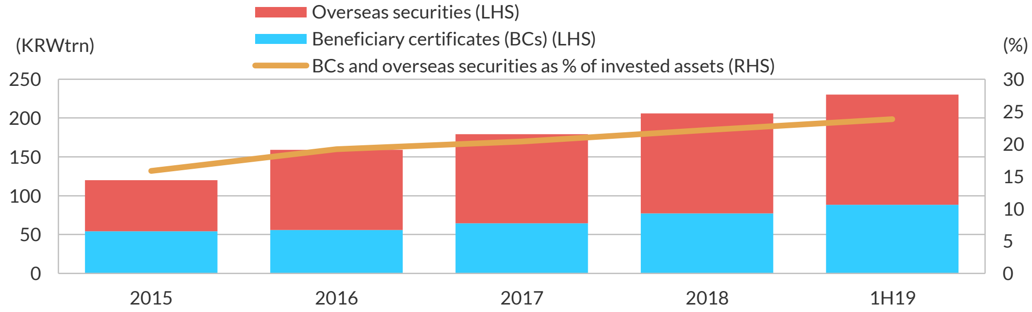
Source: Fitch Ratings, FISIS

Bond Issuance by Currency



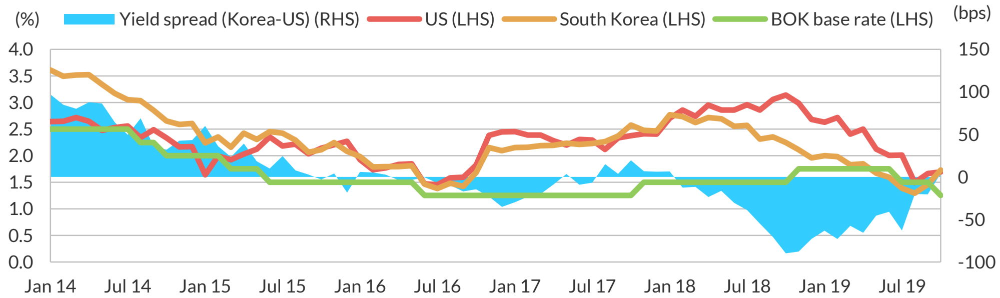
Includes publicly placed bonds only
Source: Fitch Ratings, Bloomberg

Alternative and Overseas Investments - Life & Non-Life



Source: Fitch Ratins, FISIS

10-Year Government Bond Yields



Source: Fitch Ratings, Bloomberg

Appendix

Fitch's Coverage List

Company name	Market Sector	IFS Rating	Outlook/Watch
Hanwha Life Insurance Co., Ltd.	Life	A+	Negative
Heungkuk Life Insurance Co., Ltd.	Life	BBB+	Stable
KDB Life Insurance Co., Ltd.	Life	BBB-	Stable
Kyobo Life Insurance Co., Ltd.	Life	A+	Stable
TONG YANG Life Insurance Co., Ltd.	Life	BBB+	Evolving
Construction Guarantee	Non-Life	A	Stable
Hanwha General Insurance Co., Ltd.	Non-Life	A	Stable
Hyundai Marine & Fire Insurance Co., Ltd.	Non-Life	A	Stable
Seoul Guarantee Insurance Company	Non-Life	AA-	Stable

Note: As of 31 October 2019
Source: Fitch Ratings

Outlooks and Related Research

Credit Outlooks 2020
Korea - September 2019 Global Economic Outlook Forecast (September 2019)
Major Korean Insurers' Earnings May Remain Under Pressure (August 2019)
Revised Expense Rules to Have Limited Impact on Korean Insurers (August 2019)
South Korea Insurers: Understanding Asset Risks (May 2019)

Analysts

Claire Lee
+852 2263 9618
claire.lee@fitchratings.com

Siew Wai Wan
+65 6796 7217
siewwai.wan@fitchratings.com