Insurance Supervisory Authority
2015 Annual Report

Remarks by the President
Salvatore Rossi

Rome, 15 June 2015

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Ladies and Gentlemen,

Welcome to the presentation of the IVASS 2015 Annual Report.

Since June of last year there have been many changes to the European and Italian insurance systems and to the economic and financial landscape; some market trends, which were already apparent, strengthened or became more pronounced. I will focus my remarks on both of these in an effort to bring to light the regulatory and supervisory implications for the insurance sector.

Low for long?

I will start with what is currently the primary concern of insurers around the world: persistently low interest rates, or even negative rates for shorter-term maturities.

This phenomenon is generally seen as a consequence of the extraordinarily expansionary monetary policy measures implemented by the main advanced global economies with the use of sometimes unconventional tools and intended to bring inflation expectations in line with permanently positive, though moderate, consumer price dynamics.

This is certainly true in part and we will soon see the motivations and implications, but it is worth remembering that the downward trend in interest rates started long before the global financial crisis and the use of monetary policy to counter, with every means possible, a recession and the risks of deflation. It began towards the end of the 1990s and it involved real interest rates, i.e. net of inflation expectations, across all maturities but especially those with longer terms.

At the end of the 1990s, a US Treasury Inflation-Protected Security yielded 4.3 per cent; in 2008, on the eve of the Lehman Brothers collapse, the real rate had already fallen to 2.2 per cent; today it is below 1 per cent. In Europe, on a similar instrument the real rate stood at around 3.5 per cent

at the end of the 1990s and 2.1 per cent in September 2008; today it is at -0.8 per cent.

At the core of this 20-year decline in real interest rates are root causes that have nothing to do with expansionary monetary policy.[1] First, the greater propensity to save on the part of households, in turn due to both long-term demographic trends, such as the progressively ageing population, and China's integration in the international financial markets. Second, the decline in the propensity to invest, both on the part of public entities, often burdened by excessive debt levels, and private enterprises, which are sensitive to mounting insecurity in the volatile global markets and are unconvinced by insufficient growth in productivity.

These phenomena, the relative importance of which is still being debated by academics and analysts, simultaneously contributed to increasing the demand and reducing the supply of 'safe' financial instruments used for savings, such as bonds, raising their price and lowering their yield.

The strongly expansionary turn of monetary policy, in the United States, Japan and Europe, caused an acceleration of this trend, inverting the direction of nominal yields on shorter-term instruments. A condition with implications on the collective psyche that should not be underestimated. It is as if we were walking upside-down on the ceiling.

It is clear that this unnatural situation cannot last for long. The first to recognize this are those responsible for monetary policy in the main advanced economies. In a recent speech,[2] the President of the European Central Bank acknowledged that very low interest rates are not harmless because, by lowering interest margins, they put pressure on the business models of the main financial intermediaries – banks, pension funds, and insurance companies – just when profitability is already low and the regulatory framework is constantly in flux. The Governor of the Bank of Italy also spoke about these issues last week.[3]

However, a less expansionary monetary policy stance will not resolve the problem. Because the real problem is not the low rates but the risk of deflation, and expansionary monetary policy is the cure. What can really destroy a financial system is deflation which in the long run renders any form of debt unsustainable. In the short term antibiotics weaken the patient but save his life.

1 Bean, C., Broda, C., Ito, T., Krozsner, R., 'Low for Long? Causes and Consequences of Persistently Low Interest Rates', *Geneva Report on the World Economy*, 17, CEPR Press, 2015

2 Draghi, M., *Addressing the Causes of Low Interest Rates*, Panel on 'The future of financial markets: A changing view of Asia' at the Annual Meeting of the Asian Development Bank, Frankfurt, 2 May 2016.

3 Visco, I., 'Financial Stability in a World of Very Low Interest Rates', 9 June 2016, https://www.bancaditalia.it/pubblicazioni/interventi-governatore/integov2016/Visco_09062016.pdf.

The sooner we succeed in 'stabilizing' price dynamics in the euro area, within the meaning ascribed by the monetary authorities, the sooner we can suspend the use of the monetary antibiotic. This has far-reaching repercussions: apart from encouraging households and firms to hasten their consumption and investment decisions, it will increase the value of financial assets and, as such, the spending capacity of the private sector, and boost both the confidence of market participants and inflation expectations. In keeping with the healthcare analogy, in order to shorten the recovery time, urgent use of other appropriate pharmaceuticals and rehabilitative treatments is required: that is, fiscal policies, whenever and however they may be implemented without compromising the long-term stability of public finances, in particular, structural policies. Those policies that, by strengthening the productivity and growth potential of the economy, serve the dual purpose of restarting growth and increasing the profitability of investments, thereby increasing their chances of occurring, and contributing to the rise in real interest rates from their current low level.

In the meantime, the insurance industry must prepare itself for a transition to a new normal which will not be short-lived. We will see how Italian companies are less affected by low interest rates than other European countries and the ways in which they are nonetheless confronting the situation.

Premium income and investment

In Italy, the overall demand for insurance policies increased further last year. Premium income grew by 2.5 per cent compared to 2014, reaching €150 billion or 9 per cent of GDP; the life insurance segment accounted for more than three-quarters of the whole. How does this compare to the rest of Europe? In 2014, the last year for which we have comparable data, only in the United Kingdom does premium income represent a larger share of GDP, at 11 per cent. In France, the share is similar to Italy's while in Germany and Spain the share is lower, at 6.5 and 5 per cent, respectively. In the three continental European countries the composition of the premium income is different, as it is less skewed in favor of life insurance policies. I will return to this point shortly.

In 2015, leading the way in Italy were unit-linked life insurance policies which we already saw were growing in 2014: premiums reached €32 billion from €22 billion the year before. For traditional life insurance policies, bond-related with guaranteed minimum yields, premiums instead fell to €76 billion from €82 billion in 2014.

In the first few months of this year, the strong unrest that struck the markets has evidently dampened the appetite of clients for more 'financial-

ized' life insurance policies such as unit-linked policies. Between January and April, compared to the same period the previous year, unit-linked premiums fell by more than one third, while those for traditional policies increased slightly.

Premiums for compulsory motor vehicle liability insurance decreased by 6.5 per cent compared to 2014 due to a fall in prices, not volume, as the stock of registered cars remained stable.

Premium income for all other types of non-life insurance grew slightly, but remained a small segment of the market as a whole, accounting for only 12 per cent. In the other main European countries non-motor-vehicle liability insurance is much more developed: in Germany and Spain it accounts for more than 40 per cent of the market, while in France 30 per cent.

With regard to the structural problem of under-insurance demonstrated by this data, I already touched upon this last year. The causes are many, including public policies and incentives. Certainly, in Italy the non-motor-vehicle liability segment presents large margins for growth.

In some segments (medical malpractice, financial guarantees) the Italian market contains some less than trustworthy operators that are nonetheless protected by European legislation. We are trying to combat this problem at its root causes. We have already stopped some 'foreign-clothed' operators and forms of regulatory arbitrage, thanks in part to the strengthening of international cooperation. Together with ANAC, the Bank of Italy and the Antitrust authorities we have created a roundtable dedicated to preventing and combating fraud in the financial guarantee segment.

To cover their obligations towards policyholders, at the end of 2015 insurance companies had €630 billion in technical provisions, nearly 40 per cent of GDP. The total balance neared €700 billion. How are these resources invested?

Compared with the other main European countries, Italian companies have two distinctive traits: first, they invest a relatively large amount in government securities – nearly 45 per cent of their assets – and less in corporate bonds; second, in their purchases of government securities they demonstrate a pronounced home bias: some 94 per cent of the government securities in their portfolios were issued by the Italian government. Spain shares both traits: 43 per cent are government securities, and 9 out of 10 are Spanish. In France however, government securities account for 27 per cent, and 7 out of 10 are French while in Germany, only 16 per cent are government securities and 6 out of 10 are German. The comparison is inverted with regard to corporate bonds: they account for 55 per cent of total

assets in Germany, 47 per cent in France, 33 per cent in Spain and 23 per cent in Italy.

This breakdown is connected to the structural market feature I was referring to previously: the predominance of life insurance policies over non-life policies in the Italian market. In terms of premium income in 2014, the last year with available data, the ratio of life insurance policies to non-life policies was 3.5 to 1; in France it is 2 to 1, while in Germany and Spain it is about 1 to 1, with a balance that tips slightly towards non-life policies.

For an insurance company, a traditional life insurance policy entails average maturities and costs that are statistically well-defined. The natural way of covering these commitments is to invest a corresponding amount in a sufficiently safe instrument of equal maturity and, at a minimum, an equal yield. The market for Italian government securities is traditionally very liquid, offers all maturities and is adequately profitable. For at least three decades they have been the obvious source of coverage for Italian insurance companies active in the life insurance sector. The cross-check is this: looking at the non-life sector alone, the proportion invested in government securities falls sharply to 36 per cent.

There is fierce debate also in the European insurance sector as to whether government bonds should be considered risk-free when calculating capital requirements. The comments made two weeks ago by the Governor of the Bank of Italy about banks apply here too:[4] care must be taken not to increase systemic risks instead of reducing them, by dealing politically with a topic upon which not even the experts agree. In any case this is a global, not a European issue and needs to be addressed in global fora so as not to burden European firms with undue competitive disadvantages, and in a coherent way among the various sectors of financial intermediation.

Italian companies, however, are increasing their share of investments in instruments other than government bonds. The value of corporate bonds in their portfolios exceeded €120 billion at the end of 2015, up from less than €90 billion two years ago. The motivation is the usual one: searching for yields.

The growing inclination of insurance companies towards investing in corporate bonds clashes, however, with the limits of Italy's domestic supply as only a few large companies issue bonds. Our financial system remains firmly anchored to bank loans: at the end of last year, bank loans accounted for 62 per cent of firms' financial requirements, compared with 50 per cent in Germany, 46 in Spain and 32 in France.

4 Visco, I., *The Governor's Concluding Remarks, Annual Report*, Banca d'Italia, 31 May 2016.

Investment opportunities in instruments other than government or corporate bonds, such as minibonds and the related securitizations, see Italian insurance companies very cautious: last year this kind of investment only accounted for a few million euros. Direct loans to companies, another form of alternative investment, have yet to make their mark.

In last April's Report on Global Financial Stability, the International Monetary Fund (IMF) produced a long and detailed chapter on insurance.[5] The Report looks long and hard at the risks posed by persistently low yields and in a global-level sample survey finds empirical signs of quite an adventurous 'search for yield' by some firms, especially smaller ones. To the best of our knowledge, Italian companies have shown few signs of this behaviour. Yet we must keep our guard up: asset diversification is the best way to mitigate risks, as long as it is done gradually and with due caution.

Profitability, capital and solvency

The profitability of Italian insurance companies, measured by Return On Equity (ROE), came close to 10 per cent last year in the life insurance sector and was over 7 per cent in the non-life sector. In terms of absolute value we are talking about just under €6 billion, two thirds of which in life insurance, and it is the fourth consecutive year that profits in insurance have remained at those levels, which is a good result. ROE for banks was just over 3 per cent last year after four years of losses. According to OECD data up to 2014, while the profitability of Spanish insurance companies was more or less comparable with that of Italian ones, the results were far more modest in France and Germany.

In short, Italian companies have so far managed to avoid getting bogged down by interest rates and have proceeded at a fair pace. We must ask ourselves two questions: how has this happened and will it last?

There are various explanations behind Italian companies' profitability. It has partly to do with the market power inherent in an industry that is still highly concentrated and with the unique feature of compulsory motor vehicle liability insurance, to which I will return later. The reasons also lie in a better match between assets and liabilities, in terms of maturities and costs/yields, together with higher yields on Italian government securities. I dealt with this point last year, and am revisiting it because it is even more relevant a year later. I will summarize the situation using just one indicator, the 'mismatch' between the financial durations of assets and liabilities in

5 IMF, 'The Insurance Sector: Trends and Systemic Risk Implications', *Global Financial Stability Report*, April 2016.

the traditional life insurance policy sector: it is practically zero in Italy, 5 years in France and 11 in Germany! These clear 'mismatches' reflect the different prudential approaches of the three national systems to balancing the promises made to policyholders, which are more restrained in Italy, with appropriate investment policies.

However, the prolonged persistence of such low interest rates must also raise concerns for Italian companies in the long run and for IVASS too, as their supervisory authority. The insurance industry is considering how to reconcile the income stability of companies in the life insurance sector with the need to continue offering customers real 'insurance' products, not just asset management instruments lacking in guarantees. IVASS is more than willing to review its regulations, if it serves a purpose and does not compromise any prudential objectives or the protection of policyholders.

At the end of last year Italian insurance companies taken as a whole had 'eligible own funds' of almost €120 billion to meet the capital requirement, 2.4 times the minimum level allowed under Solvency II (Solvency Capital Requirement – SCR). We are talking about levels that are quite safe, although they are more volatile than before because of the new methodological approach, and therefore require accurate interpretation and constant checks.

We know that Solvency II aligns the regulatory framework for insurance in Europe to that of banking, and in some cases goes beyond it. On this same occasion last year I spent some time discussing the similarities and differences between banks and insurance companies as regards their nature, function and history. One very important difference lies in the function of capital. For banks it is the first line of defence against losses on assets, while for insurance companies, the sudden emergence of risks covered by policies initially affects technical provisions, the first to absorb the shock, and it is only when they run out that capital has to be reduced.[6] This difference on one hand plays down the function of capital compared with banking and on the other hand highlights the need for careful screening by the companies themselves and by the supervisors when calculating the technical provisions and how to invest them.

Indeed, the first of the three 'pillars' on which the Solvency II system is founded, which sets the quantitative requirements, does not just consider capital but also the correct valuation of all the obligations towards policyholders, the diversification of investments and their consistency with liabilities and with the 'risk appetite' defined by senior management, the profit-

6 himann, C., 'Insurance and Systemic Risk: No Easy Conclusions', http://voxeu.org/article/insurance-and-systemic-risk-no-easy-conclusions, 31 May 2016.

ability and sustainability over time of the products on offer, and the capacity to mitigate technical and financial risks.

The solvency of an insurance company is, however, an even broader concept. It is achieved by complying with the qualitative requirements as well – the second pillar of Solvency II – which concern corporate governance and the functionality of boards of directors, and with those of the third pillar: information requirements and disclosures to the public.

We knew that it would not be easy for firms to adjust to this set of demanding requirements, just as it was not easy for those of us who were responsible for understanding and enforcing them.

In this past year we have worked together to make a huge effort, and we can be satisfied with the results achieved so far, though problems remain and serious improvement is still needed. For example, we have clearly observed how difficult this new world has become for small companies.

Pursuing the objective of creating a risk-sensitive prudential regime for all and incentives for good corporate governance, Solvency II has introduced a minimum though still high level of organizational requirements, some very complex methods for calculating the capital requirement even in the standard formula, and a detailed information system over and above balance sheet reporting obligations.

Smaller firms are finding the investment needed in human, technological and organizational capital something of a burden.

The abovementioned IMF Report focuses a great deal of attention on small firms, seeing a tendency to run more risks on the asset side in an attempt to evade the stranglehold of low yields and the growing costs of compliance with rules that have become more stringent. Regulatory and supervisory authorities in all the advanced countries should therefore pay special attention to these firms, since even if just one small firm suffers an insolvency crisis, it could trigger systemic contagion.

We intend to focus on the topic of small and medium-sized firms. It is important not only because of the prudential repercussions, which should concern us most, but also for the general efficiency of the financial system. As part of our daily supervision work we will continue to discuss the ‘proportionality’ of the rules within the sector, although small firms should not think they are exempt from the highest governance requirements of the new regulatory regime. What is required, I believe, is a broad-ranging debate and dialogue with our European counterparts on small and medium-sized insurance companies, which are not exclusive to Italy. We are thinking of organizing a second international conference on this topic at the beginning of next year, encouraged by the success of last March’s conference on Solvency II.

The new stress test

On 24 May this year EIOPA launched a new stress test for the European insurance system. It will be carried out on data as at the end of 2015 and will evaluate the resilience of a broad sample of firms to two adverse financial scenarios: the first one, called *Low for Long*, is based on the hypothesis of a further dip in the yield curve compared with the end-of-year levels; the second one is called *Double-hit*, in which a sharp fall in the value of investments across all the main categories is added to the first hypothesis: bonds, shares, funds and property. The second scenario was designed together with the European Systemic Risk Board (ESRB).

The scenarios are highly unfavourable, which makes the test particularly exacting. The Chairman of EIOPA clearly pointed out that the aim is to measure systemic risk at European level, and not to identify individual companies that do not comply with the minimum capital requirements after the shock. Its goal is to assess the implications of the two scenarios for financial stability.[7]

For this reason, and because the data collected in accordance with Solvency II are not yet fully reliable, at the end of this year the results for the period will not be reported company-by-company, but by country and size.

This stress test, as it has been conceived and designed, complements the work that is being performed, mainly by the ESRB, on macroprudential supervisory methods and tools in insurance, a topic on which IVASS is increasingly focused.

Before the end of the year, we would like to host a meeting between the major groups and companies in order to discuss the implications of the macroeconomic situation, comparing the viewpoints of those who operate in the insurance market with those responsible for its supervision. This would be only the first of a series of meetings, similar to those that the Bank of Italy has held with the leading banks for many years now.

Possible technological revolution

In my remarks last year I touched upon the growing analysis and discussion on the opportunities, as well as the risks, posed to the entire financial industry by the latest technologies and big data, known collectively as Fintech. It now appears that this phenomenon stretches to include insurance companies, for which the acronym Instech has been coined.

7 https://eiopa.europa.eu/Pages/News/EIOPA-launches-the-EU-wide-Insurance-Stress-Test-2016.aspx.

The various applications of the digital technologies that are already on the market are numerous and range from common forms of online customer relations to portable devices that gather information on the policyholder's behaviour – such as black boxes on vehicles or wearable technology – and help insurance companies better personalize the prices of products and design coverage schemes more attractive to certain target markets. But this is all current technology, although the potential for developing it further is still high. What will happen in the future?

The universe of big data, the stream of information that flows through the internet, represents an immensely valuable resource for those who know how to access it sensibly in order to understand the public's needs and the latest trends.

A proliferation of start-ups exploring different approaches is occurring right before our eyes, even in the insurance field. The most disruptive are marketplace or peer-to-peer platforms. Unlike those that have sprung up in the credit market, which entirely cut banks out of the process by directly putting people who want a loan into contact with others who are willing to lend money, peer-to-peer insurance platforms resemble the old-style mutual aid societies, since pooling risk cannot be avoided in this business. The two systems are similar in their use of artificial intelligence devices to process the debtor/policyholder data available online, namely big data.

Is this science fiction? Perhaps. We have witnessed other times in modern history when technologies heralded as revolutionary were unable to find the right commercial application and ended up forgotten. But we know that the biggest players in the world, both banks and insurance companies, are investing huge resources in Fintech in an attempt to guide its evolution in ways that will not crowd out traditional operators. They, however, must evolve in turn.

The 'robotization' of the relationship between company and customer, if it proves to be truly as efficient as promised, will inevitably call into question the traditional distribution networks: bank branches, insurance agents. For the moment, existing market operators that are interested in incorporating these technologies into their organizational models are focusing on the complementarity between algorithms and flesh and blood employees, on the assumption that human contact, while scaled back or in any case changed from how it is currently conducted, will continue to be preferred by customers. In other words, it should not be taken for granted that the traditional distribution model is facing extinction: companies and customers still seem to want physical networks, provided that they evolve and adapt to an integrated strategy. By using digital tools and applications, companies can increase their business and profitability by simplifying sales procedures,

reducing ‘dead time’ on networks, monitoring key productivity indicators in real time.

These developments, potential or already underway, while offering customers extraordinary opportunities for finding more effective and less expensive financial services in the market, expose them to a variety of risks. Regulators and supervisory authorities have the duty to recognize, analyse and neutralize these risks.

The main risk is that, like shadow banking, a phenomenon that has been observed for some time, shadow insurance, which is still in an embryonic state, will be allowed to expand to excessive proportions. The primary cause of the 2007-08 financial crisis was that the regulation and oversight of the financial industry was insufficient and full of holes in the United States in the 20 years leading up to the crisis. Learning from that experience, the international community, particularly the G20, has made a strong commitment to bringing shadow banking back under the control of public authorities. It is a difficult task and is still in progress. We should therefore start to take steps now to get a handle on shadow insurance.

The customer centrality for insurance companies: corporate strategy, supervisory objective

The tendency of the insurance business model that we just described makes customer centrality, for insurance companies and their distribution networks, an even more key strategic cornerstone than it is already. At the same time, for supervisors, ensuring that this centrality is strong and stable is becoming an even more specific objective, whether they are autonomously responsible for protecting single policyholders, as in the case of IVASS, and in general, because they cannot avoid taking a forward-looking prudential view.

Customer centrality means, to give an example, shifting attention from short-term commercial needs, from distributing standardized products, to conceiving made-to-measure products that fit customers’ real needs.

In Europe, the focus has switched to various aspects of consumer protection. More than ten years after the first insurance mediation directive, a new directive called the Insurance Distribution Directive (IDD), saw the light of day in 2015. The IDD calls for a considerable increase in the level of consumer protection in the insurance distribution area; in many ways it consolidates at the European level principles and rules already in place in the Italian regulatory system.

IVASS actively participated in the preparatory work and, during the Italian Presidency of the European Union, it was instrumental in overcoming an impasse in negotiations that had been stalled for two years.

The EU framework that is being developed is clear and consistent in purpose, design and scope. Italy must implement rules, regulations and allocate supervisory duties in a way that is just as clear and consistent for consumer protection to be truly effective.

In an effort to facilitate dealings between insurance companies, intermediaries and consumers and in anticipation of European guidelines in this area, we have undertaken a radical rewrite of the disclosure statement that accompanies non-life insurance policies. The new statement is briefer, setting out just the information strictly needed to understand the product and to compare the various market offerings. For example, the statement is just three pages long for compulsory motor vehicle liability insurance and five pages for products with ancillary covers. The draft regulation, which is currently available for public consultation, is the product of a fruitful collaboration between IVASS and insurance industry players: associations representing consumers, insurance companies and intermediaries.

The guidelines that are being developed in Europe on investment product disclosures, in particular on how to draft the key information document (KID), instead raise more questions. I will cite just one: it is a good thing to provide maximum transparency to consumers, but it should be done in a balanced way across product categories; making it seem that some products, such as insurance policies, are riskier and more expensive than others with the same characteristics from the saver's point of view introduces dangerous distortions into the market.

For an insurance company, as I recently pointed out,[8] the 'moment of truth' comes when it has to pay damages or accrued capital. It is at this point that service quality is measured and retaining customer trust comes into play. We have bolstered our supervisory measures for this phase, calling on managers and directors of companies to discuss corrective actions to be taken with respect to settlement procedures to make them quicker and more efficient.

Simpler products, properly crafted and sold to well-defined target consumers, are key to consumer protection. Widespread losses in customer trust are disastrous for the reputation of the individual companies that endure them and for the system as a whole.

8 Rossi, S., 'La tutela del risparmio nell'Unione bancaria', 5 May 2016, https://www.bancaditalia.it/pubblicazioni/interventi-direttorio/int-dir-2016/Rossi_05052016.pdf (in Italian only).

A return to the ‘case’ of motor vehicle liability insurance: Integrated Anti-Fraud Database

Last year I called a section of my remarks: ‘The ‘case’ of motor vehicle liability insurance’. The case consisted, and still consists, in the combination of expensive policies, especially in certain provinces, and a high rate of insurance fraud. Policyholders and the associations that represent them have long complained about the former, and companies about the latter. A year ago we detected some signs of improvement in this regrettable situation. Can we now say that the case is resolved?

We cannot, unfortunately. We can, however, say that the signs of improvement have strengthened and become more widespread. In 2015 the average unit prices for policies fell further, by 7.5 per cent. Contracts with clauses for reducing premiums for policy holders that install ‘black boxes’ now account for one sixth of total policies.

We can compare the average premiums for mandatory insurance, excluding taxes and contributions, for four countries: France, Germany, Italy and Spain. In 2011 Italians paid €234 more than the average for the other three countries; we estimate that last year the gap narrowed to around €150.

How can we close this gap for good? We need a combination of legislative action and changes in the practices of the players in the system.

The draft bill on competition still under discussion in Parliament contains new provisions with objectives that we fully share: limiting the costs on the system, combating fraud, bolstering transparency and improving the comparability of insurance products. Some time ago we lent our technical expertise on these matters to Parliament. We now hope the issue will be settled quickly and properly, in the interest of the general public.

The fight against fraud will now benefit from the crucial support of the new Integrated Anti-Fraud Database (AIA) we launched a few days ago. This is an IVASS project that required a remarkable effort in terms of organization, technical resources, cooperation between multiple public and private entities, and the definition of a dedicated legal and regulatory framework.

The Database integrates the seven main archives deemed useful for its creation: it pools one and a half billion individual data on vehicles, vehicle registrations, driver’s licences, insurance policies, injured parties, witnesses, and claims adjusters. The first, fully operational phase now begins.

Every claim will now be matched in real time with an anomaly indicator based on a probabilistic assessment of potential fraud, accompanied by a specification of the explanatory variables. In addition to the general benefit

of pursuing justice, we expect there will be a practical impact in terms of lower costs for companies and, therefore, lower premiums paid by the policyholders. We estimate that insurance companies' anti-fraud activities, recently mandated by law and supervised by IVASS, have already reduced the cost of claims by 1.5 per cent of total premiums, and this despite the lack of adequate tools. Having the AIA at our disposal is like switching from a bow and arrow to a long-range cannon: we expect even greater savings in terms of costs and premiums.

But we will not stop there. We will improve data accessibility through the creation of a dedicated portal. We are working on the development of indicators based on the most advanced social network analysis theories and techniques.

We believe we can make progress on the judicial front as well. Our courts of law are already too overburdened to bear the weight of increased litigation between insurance companies and their clients, litigation marked by obvious anomalies. A survey we conducted on the five-year period 2010-14 highlighted not only the large number of cases pending, but also revealed that while the number of claims was decreasing, the number of cases before the courts was increasing as was their duration, and insurance companies had to increase their technical provisions to cover any unfavourable judgments.

These anomalies cannot be attributed solely to the sluggishness of the Italian judicial system. They are also the result of firms' internal inefficiencies, which must be tackled resolutely. Companies should adjust their own organisation and their system of internal controls to prevent or at least decrease the risk of litigation in compulsory motor vehicle liability claims.

This would be greatly aided by a streamlined and efficient arbitration system such as the one the Bank of Italy set up in the banking sector years ago. IVASS submitted a technical proposal to set up an insurance ombudsman. While aware of the organisational burden this would place on us, we are ready to do our part, if the Government and Parliament so decide.

Supervision

Ending this overview I would like to take a moment to highlight three important aspects of IVASS' supervisory activity in the last year: supervision of cross-border insurance groups under the new regulatory framework, methods to calculate the capital requirement, and the general approach to supervision.

We know that the responsibility to regulate and supervise the insurance market falls on the national level. The opportunities for discussion and collaboration at the European level have, however, increased and intensified. The main one, owing to its wider scope, is the establishment of Colleges of Supervisors overseeing cross-border groups.

The task of these Colleges is to exchange information and points of view, compare practices, develop shared methods of assessing risk and coordinate their supervisory activities, without prejudice to the national authorities' prerogatives and responsibilities.

It is a strenuous task, as is often the case with European institutions, but it is a very useful one-- at least in our experience -- because it levels the playing field to the greatest possible extent. Despite Solvency II and despite EIOPA's patronage and its numerous guidelines, significant differences remain in the national authorities' approach and interpretation of laws and regulations.

At IVASS we believe we must work towards the common goal of better supervision in the EU as a whole, rather than seek regulatory advantages for one's own national industry. This is, however, no easy task at a time when Europe's resurgent nationalism makes its way even into technical bodies; we must be vigilant to prevent protectionist attitudes from gaining the upper hand, even if disguised in specious technical arguments.

The main change brought forth by Solvency II was new methods to measure the riskiness of insurance companies and thereby calculate their share of 'solvency' capital: internal models, undertaking-specific parameters (USP), and standard formula. I have already touched upon the complexity of these tools and of the standard formula itself. Such tools demand that they be designed and operated by insurance companies, that they be verified by IVASS and, with regard to the USPs and the internal models, that IVASS discuss them in detail with the companies from start to finish, approve them, and ensure that they are effective and properly enforced over time.

This is dramatic progress compared with a system like Solvency I that was blind to the staggering variability of risk in the insurance business. We are now committed, both in our discussions at the European level and in our daily work, to avoid going from blindness to destabilizing farsightedness.

The supervisory approach that is materializing is based on a deeper and more frequent interaction with insurance companies and on a shift in the analysis from single firms to groups. The new quantitative reports that companies must submit as per Solvency II, i.e. the Quantitative Reporting Templates and the Own Risk and Solvency Assessment (ORSA), also require this approach. ORSA, a self-assessment exercise on the part of

firms regarding their risk and assets, will be the focus of intense discussion with IVASS on the adequacy of risk and solvency assessments but also on the human and organizational capital assigned to key corporate areas such as audit, actuarial, compliance, and risk management. More broadly, we will analyse firms' awareness of risk, beginning with their management bodies. To this end, we will also step up our onsite inspection activity.

Conclusions

Last year was one of hard work for IVASS and for the insurance industry as a whole. Together we had to adapt the system to the new regulatory reality ushered in by Solvency II. There is still a long road ahead of us, but the first steps were crucial. We had to implement deep changes in the way firms describe and organize themselves, the way they interact with the authorities tasked with their supervision, the way supervisory activities are carried out and communicated.

We still face many challenges ahead. Solvency II increases the complexity of the system, something that cannot be avoided when going from basic to sophisticated. Our modern world is awash in complexity: the secret to efficiency, and this also applies to a set of rules, is to use the minimum effective dose.

The new methods for balancing equity to risk enable many firms to display a higher solvency capital level than under Solvency I. This proves how crude the old indicator was. The new system could, however, lead to dangerous euphoria and the temptation to stretch the new rules, profiting from their complication in order to minimize the capital absorption required by every business activity. This would go against the spirit of the reform: we will do everything in our power, together with the European authorities, to prevent such distortions.

The year ahead presents us with new challenges, for example low interest rates, and continues to raise old ones, such as anomalies in the compulsory motor vehicle liability insurance market. We will take them on first and foremost by trying to grasp them: knowledge is the prerequisite for any effective action.

We are a relatively small organization, even though we can count on the support of the Bank of Italy. Our primary strength resides in the men and women who dedicate all their energy and enthusiasm to the job they perform in the building you just saw in the video clip we showed earlier. To them, and on behalf of the Governing Board of the Bank of Italy and of IVASS Directors Riccardo Cesari and Alberto Corinti, I extend my heartfelt thanks.

Thank you all for your attention.

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