



*CONSUMER PROTECTION DIRECTORATE
PRODUCTS AND SELLING PRACTICES DIVISION*

<i>Ref. to note n.</i>		<i>of</i>		To the insurance undertakings whose head offices are located in Italy
<i>Classification</i>	III.	2	1	To the insurance undertakings whose head offices are located in another Member State of the European Economic Area or in a third State carrying on business in Italy under the right of establishment or the freedom to provide services
<i>Encl. no.</i>				To the banks, financial intermediaries and other entities registered, as insurance intermediaries, in Section D of the Single Register of Insurance Intermediaries kept by IVASS or in the enclosed List
				TO THEIR PREMISES

Subject: Policies linked to loans (PPI) - methods of calculation of the refund of the premium not enjoyed in case of early partial or total repayment of the loan.

We have received some complaints concerning the methods adopted by insurance undertakings for calculating the part of the premium not enjoyed to be refunded in case of early repayment of the loan.

The complaints report about methods of calculation that are not clear and/or are unfavourable for policyholders. The preliminary examination of these complaints and of a sample of contract terms for some PPI products (Payment Protection Insurance) has highlighted critical issues in the calculation procedures and in the level of transparency towards policyholders.

We point out that in accordance with article 49 of Regulation no. 35/2010 (now article 39 of Regulation no. 41/2018), in case of early repayment or transfer of the loan the

undertaking shall return to the debtor/policyholder the part of the premium paid relating to the remaining period of insurance, calculated:

- a) for the pure premium on the basis of the years and yearly fractions remaining before the expiry date of the cover and of the residual capital insured;
- b) for loadings on the basis of the years and yearly fractions remaining before the expiry date of the cover.

Although many undertakings, in their contract terms, accompany the description of the methods of calculation with the indication of the relevant calculation formula and with concrete examples that enable clients to reconstruct those calculations, other undertakings provide only a general reference to the criterion established in article 49 of Regulation no. 35/2010 (now article 39 of Regulation no. 41/2018) without any example or with weak examples.

As regards the method of calculation, it has been observed that, in life assurance, the contract terms envisage, in accordance with the provisions in the Regulation, that:

- the pure premium to be refunded shall be calculated on the basis of the years and yearly fractions remaining before the expiry date of the cover and of the residual capital insured¹;
- the amount of loadings to be reimbursed shall be calculated on the basis of the years and yearly fractions remaining before the expiry date of the insurance contract.

To sum up, undertakings always state that they adopt the criteria envisaged by the regulation for the calculation of the refund of the two parts of the premium paid.

However, in those cases where the formulas are explained in the contract terms or where – in the absence of formulas - reference is made to the general criteria laid down in the regulation, it has come out that the formulas actually used, which vary a lot between undertakings, are not always in line with the afore-mentioned regulation and do

¹ According to the formula $P_r \frac{n-t}{n} \frac{D_r}{D_0}$ where P_r is the pure premium, n the duration of the insurance cover, t the time elapsed up to the repayment of the loan, D_r the outstanding debt, D_0 the initial debt.

not take into account the actual outstanding debt relating to the part of the pure premium to be refunded.

The amount to be reimbursed is in fact calculated only on the basis of the residual duration of the contract and of a correction factor, calculated only on the basis of the duration, which is an approximation of the actual ratio between the outstanding debt and the initial debt.

In this regard it has been verified that these approximated formulas, apart from not being consistent with the regulatory criteria and with the criteria set forth in the contract terms, penalise the policyholder.

Therefore each undertaking is required to:

- verify the correctness of the formulas used, also with regard to the portfolio in force, in the light of the above indications;
- where necessary, update, within 60 days, the pre-contractual information and policy conditions of marketed products by including a formula that takes account, for the part of the pure premium of life covers to be reimbursed, not only of the residual duration, but also of the actual ratio between the outstanding debt and the initial debt at the date of the early repayment of the loan, in accordance with the criteria established in the contract terms and with the regulations, accompanied by a clear illustrative example. The same criteria shall also apply to non-life insurance (for example in case of total permanent disability), whenever the benefits envisage the reimbursement of the debt outstanding at the date of the insured event;
- where necessary, for the contracts already in force, manages the requests for a pro-rata refund of the premium according to correct calculation criteria².

This is without prejudice to the application of the proportional criteria (*pro rata temporis*)³, adopted by some undertakings, as it is more favourable to the policyholder.

² It is understood that, where the policy conditions of the contracts issued do not indicate any calculation criteria for the refund of the premium a proportional criteria should be applied, as it is more favourable to the policyholder, according to the established opinion of the Banking and Financial Arbitrator (Decision no. 6167 of 22 September 2014 of the Coordination College, mentioned in the Decision of the College in Naples no. 451 of 20 January 2016 and confirmed by the Coordination College in its Decision no. 10035 of 11 November 2016).



By delegation
of the Joint Directorate |

³ According to the formula $P_r \frac{n-t}{n}$