



Italian National Association of Insurance Companies - ANIA

Annual Meeting

Speech by the President of IVASS

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Mr. Minister, Madam President, authorities, ladies and gentlemen,

I would like to thank ANIA for the invitation to this customary meeting. I offer my congratulations and best wishes to President Farina, whose important office has been renewed for the next three years. I listened with pleasure to her interesting and passionate report.

I would also like to thank her for mentioning the results, which I believe are not of small importance, that we just achieved at the Venice Summit. They are related, among other things, to the subject of environmental risk which, as I recalled few days ago on the occasion of the presentation of the annual report on the activities of Ivass, has many important implications for the insurance activity. But we'll have the chance to talk more about that.

I will return just very briefly to the other issues addressed in the remarks of the 1st of July, several of which were also discussed in the President's speech. Instead, I will ask you to have the patience to follow me on some regulatory and technical issues, which at this time I believe to be of particular importance for Italian insurance companies, and which are at the heart of the indispensable dialogue between the industry and its regulator.

As I pointed out few days ago, the Italian insurance system has proved to be capable of withstanding the pandemic crisis, thanks, among other things, to a good balance between assets and liabilities and to the good level of capitalisation achieved before the crisis.

During the most acute phases of the pandemic crisis and the market turbulence that went along with it, Ivass interventions were part of the normal process of prudential control, both off-site and through inspections. We have been monitoring closely the liquidity and solvency of the companies; individual cases of fragility were addressed by the Institute with targeted interventions.

The supervisory activity of Ivass is evolving together with the concrete evolution of risks in the insurance business. In addition to the adequacy of technical provisions and the

capability of capital requirements to adequately reflect companies' risk profiles, issues such as the effectiveness of corporate governance processes and the reliability of information systems are receiving increasing attention.

Yesterday, we issued a letter to the market reminding companies of the need to have in place appropriate safeguards in order to manage illiquid and opaque financial instruments. In recent years, Ivass inspections have highlighted an increasing presence of complex instruments within the portfolios of some companies. The growth of this class of assets, which is partly due to the search for yield in a low interest rate environment, has not always been accompanied by an adequate strengthening of the appropriate tools to identify, measure and manage the related risks. In some cases, weaknesses emerged from the methodologies of risk assessment and control, from pricing mechanisms, calculation of capital requirements, etc. The letter recalls the obligations to which companies are subject and the need to ensure the proper application of the relevant prudential rules at all times.

Major regulatory and supervisory innovations are currently being discussed. Some of them will have a significant impact on the procedures and business processes of European and, therefore, Italian insurance companies.

The revision of Solvency II is the most important dossier. The regulatory intervention will not distort its fundamental structure. The prudential regime, given the premises on which it was built, has worked well overall, even in a context of crisis.

Some of the areas to be reviewed, including the treatment of long-term guarantees and the group-wide supervisory regime, had already been identified from the outset of the Directive, which envisaged a first check-up on the standard formula in 2018 and a more extensive revision at a later date. Other revisions have been prompted by the experience of these early years of implementation; they concern aspects that didn't work as expected, in particular cross-border supervision and instruments to mitigate the volatility of the solvency position. Others have become necessary as a result of changes in financial market conditions, or due to the political need to pursue certain strategic objectives with greater determination: the transition to net zero greenhouse gas emissions, and a faster progress towards real capital market integration in Europe.

Ivass has actively participated in the preparatory work for the reform carried out at EIOPA, in some cases assuming direct coordination responsibilities. Overall, we give a positive assessment of the proposals formulated by EIOPA. However, we find it useful to refine some technical aspects, especially to improve the countercyclical effects of the volatility adjustment, and to establish rules for an orderly transition to the new standards. We are ready to give our contribution to the relevant Ministries during the political negotiations, which will start after the adoption of the legislative proposal by the Commission scheduled for the first week of September.

At the European level, we fostered the idea of ensuring that most revisions of Solvency II should take place without requiring an increase in capital resources at the aggregate level (“*balanced package*”). For the Italian insurance system considered as a whole, the analyses we performed on the revisions proposed by EIOPA to the European Commission did not reveal any significant increase in requirements.

However, we did not consider it appropriate to pursue the same principle of capital invariance for the interest rate risk. In this respect, the Solvency II framework is indeed based on formulas that are not very robust, both in theory and in practice. The significance of the problem was highlighted by the persistence of low or negative interest rates, a condition for which the current methodology does not provide adequate results. We have therefore agreed with the line proposed by EIOPA, which in this case does not exclude the possibility of an increase in the overall capital requirements at European level. We know that insurance companies are not in favour of this innovation, and that opposition is more pronounced in countries other than Italy, where the impact of the new rules is expected to be greater; however, we are convinced that an intervention is justified by balanced technical considerations.

We worked to improve the volatility adjustment included in Solvency II, and to make the risk-free rate curve more responsive to market values in the long-term segment.

With respect to the volatility adjustment, we helped identifying a solution that will make its activation more timely in the presence of sudden spread increases; that will correlate the benefit to the stability of liabilities; that will reduce it for those companies whose investment portfolio is less affected by market volatility. We consider the outcome all in all satisfactory, albeit imperfect. We have not succeeded in ensuring that an approach based

even more fully on the concrete situation of the individual company could prevail in the revision work: a choice that would have made it possible, among other things, to avoid the presence of a de facto national component in the methodology, even in the context of the European single market.

Regarding the interest rate curve, we agreed with the proposal to lengthen the time horizon of the regulatory reference to the rates observed in the market, in order to avoid results that, in the current context, would end up being unrealistic and inappropriate from a prudential point of view.

However, the challenge of simplifying a system that, perhaps rightly, is considered to be too complex, is still to be tackled. I am well aware, also on the basis of my long experience in the Basel Committee and given the similar considerations that have always been made regarding the banking regulation, of how difficult it is to simplify: difficult, especially in relation to a financial universe that is complex in itself; due to the continuous, rapid evolution of markets and products. Nonetheless, some considerations need to be made; above all, we shall consider the possibility of adopting a simplified, proportional approach for smaller companies with a simple, low-risk business model.

The European Commission has recently announced that the legislative proposal that will be presented in September for the revision of Solvency II will not contain a regulation of insurance guarantee schemes. On the other hand, a new regulatory framework for crisis management in the insurance sector will be part of the proposal, albeit in a different regulatory text, focusing on recovery and, if necessary, resolution actions. These are both important issues on which we will continue to reflect and make proposals.

In May, EIOPA launched a new insurance stress test. The test is based on a scenario characterized by prolonged low interest rates and a protracted pandemic situation; it includes both insurance and financial shocks, the latter developed in collaboration with the *European Systemic Risk Board* (ESRB).

The test is aimed at the largest European insurers (43 groups and one individual company), which account for approximately 75% of the EU market in terms of assets. In Italy, the test involved the same four groups who participated in the previous one, which represent more than 80% of the Italian market. In accordance with a well-established

approach, Ivass extended the test to eight other insurance entities with assets exceeding 2 billion euros: in this way, we will achieve almost total coverage of the national market.

The test will once again be conducted following the bottom-up approach, with careful checks by the authorities. This time the capital impact assessment will be supplemented by the liquidity assessment on a 90-day perspective. As in the previous exercises, the objective of the stress test will be to help the assessment of existing vulnerabilities and to guide supervisory activity: there are no minimum post-stress capital levels or predefined mechanical rules to trigger recapitalisation requests.

Taking into account the experience as well as the results of a special working group established within EIOPA, we made some requests for process improvements, to the benefit of the quality and comparability of the results. Compared to the test of 2018, the pre-validation process has been made much more effective, as this year it involved all 44 European groups, whereas previously it was conducted on a very small sample; this improved coordination at European level will make it possible to avoid, or at least mitigate, the inconsistencies or disparities in interpretation between supervisors that occurred in the past.

The execution of the test was preceded by a phase of dialogue with the industry, which was useful to clarify the expectations of the regulators and the expected quality standards. In Italy, we carried out about forty meetings with the national groups in the virtual form imposed by the circumstances. Extensive pre-validation and dialogue allowed Ivass to share with the industry some minimum qualitative criteria required for simplifications and calculation approximations; groups can now use them in their own calculations.

Defining the adverse financial scenario proved to be a complex endeavour, also because of the need to fully incorporate into the decision-making process of ESRB the peculiarities of the financial risks generated by the stress affecting the insurance industry, which are closely related to the business model and the structure of insurance balance sheets. We believe to have achieved positive results at a technical level, also with the collaboration of experts from the Bank of Italy.

Differently from the past, this time the narrative of the adverse financial scenario is the same for insurance companies and banks. In the future, the two stress test procedures

could be integrated even better, also in terms of timing, taking into account the interconnections between the worlds of banking and insurance.

The application of the new international accounting standard on insurance liabilities (“IFRS 17”), which is expected to be applied to consolidated financial statements starting from 2023, will overcome the drawbacks arising from the fact that the current standard (“IFRS 4”) essentially defers their measurement to local accounting rules. The new standard will bring significant changes to financial statement disclosures. There will be changes to the assessment of insurance liabilities, the performance representation and the information to be provided in the notes to the accounts.

As we all know, today insurance companies have to draw up three different types of financial statements: the consolidated one, based on international standards; the individual one, regulated by national rules; and the prudential one, based on Solvency. This makes compliance even more cumbersome and is not helpful for transparency. IFRS 17 has some elements in common with the criteria for the measurement of insurance liabilities underlying Solvency II. In principle, this should facilitate an approximation between the two standards.

It has not yet been possible to reach consensus on a European application of IFRS 17 that would allow this objective to be pursued without unduly discouraging the placement of certain products. Among other things, the possibility of admitting the exclusion of certain insurance contracts (including the Italian separately managed accounts) has been considered, imposing a qualitative disclosure, but no formal agreement has been reached on this matter. The discussion is still underway.

From 1 January 2023, almost all Italian insurance groups will also apply for the first time the new accounting standard on financial instruments (“IFRS 9”), which replaces the previous IAS 39. The insurance industry will thus align itself with the banking industry, where this standard - which, among other things, provides for a prospective devaluation of credits according to their riskiness - has been in force since 1 January 2018.

With the introduction of the new standards, the insurance sector will be able and will have to aim at improving the quality and overall usability of the information provided to the market, as well as favouring the comparability of the activities performed and of the related economic/asset and risk impacts. This will strengthen the market discipline; thanks to it, it

will be possible to open up new areas of access to the capital market, also to support development projects.

We are working to issue the necessary regulations within our competence in order to integrate the harmonised set of financial statement information provided by the IAS/IFRS with those required by the IFRS 17. We have already started the initial discussions with the industry, the auditors and the other supervisory authorities, bearing in mind the importance of sharing the lines of action as soon as possible, thus enabling companies to set up right away the necessary investments in terms of resources, processes and information systems. Discussions will also continue during the phase of implementation of the new standards, in order to promote their consistent application and solve the application problems that will undoubtedly arise.

Following the transposition in Italy of the Shareholders Rights Directive II, the Code of Private Insurance has been amended. Consistently with the new "*fit and proper*" banking regulations, also the primary rules applicable to directors and control functions within insurance companies now require, along with the traditional objective and mandatory requirements (professionalism, good repute and independence), assessments of competence and correctness and sufficient time availability. The former are minimum requirements to be met in order to hold the positions in question, valid for all companies, the lack of which results in ineligibility or disqualification; the latter are additional aspects to be considered while verifying the suitability. The framework is completed by criteria relating to the appropriate composition of the bodies as a whole.

This will further strengthen the design underlying the recent Ivass Regulation No.38, which aims to provide companies with a robust, dialectic and authoritative governance in line with the best market practices and the rules in force for banking operators.

The task of identifying in detail the implementing measures will be entrusted to a regulation by the Ministry of Economic Development. Preparations have already begun; Ivass is giving its contribution. We will assess whether there is a need to suggest, in harmony with what has been done for banks and on the basis of similar legal requirements, the introduction of a binding minimum threshold of female presence also for unlisted companies.

The motor liability sector has been affected over the years by various, layered interventions on primary and secondary legislation.

We have welcomed, among others, those that were able to better specify the treatment of some cases of personal injury (“micro-permanent injuries”), overcoming some uncertainties regarding the application. The dematerialisation of the claims history statement and insurance sticker, the digitalisation of the insurance certificate and the dynamic certificate have finally overcome the obsolete obligations for paper documentation, thus facilitating consumer choice and checks by the authorities. The adoption of the ‘black box’ for monitoring driving behaviour and the introduction of new instruments to combat insurance fraud have made it possible to better adjust premiums to the prudence and honesty of the policyholder.

Among the measures that, in our view, appear to be of doubtful effectiveness are those that basically had the effect of accelerating the obsolescence of the current rules for the *bonus/malus* system, making them no longer suitable for providing a reliable measure of driving risk. A complete overhaul has now become necessary. On this subject, we would like to reopen a discussion with both the industry and consumers, that should also be extended to the critical operational aspects of the Direct Compensation Agreement. The aim is to promote uniform practices that are fair from an insurance point of view and respect the rights of policyholders.

Another important element will be the rules for compensation of non-economic damages resulting from major injuries, which will also apply to medical malpractice insurance. A ministerial decree should soon be adopted which will introduce in the system new criteria for determining the compensation when the permanent disability exceeds 9%. Ivass collaborated with the Ministry of Economic Development in defining the relative national technical table and contributed to the examination of the remarks made by sector operators during the public consultation. The elimination of assessment uncertainties should improve the protection of injured parties and reduce litigation, which generates significant costs for the compulsory insurance system without providing consumers with a certain and quick benefit.

With the law on competition of 2017, the legislator wanted to promote the use of a public estimator that could reach every policyholder and allow easy comparisons. The

instrument is already available in a version that should still be considered experimental, pending the adoption of the Regulation that will govern its operation. Especially in the last couple of years, the industry and ANIA itself have made significant efforts for its implementation. And it must be implemented without reservation.

The Regulation has been subject to a consultation that registered a wide participation of the industry and a large number of comments. The finalisation of the text will be an opportunity to try to ensure the best possible functioning of the instrument, of which we will continue to promote the transparency, comparability and relevance, obviously in accordance with the legal provisions and taking due account of all the comments. In the long term, practical experience will enable us to check to what extent the aims sought by the legislator have been achieved; we will report to the Parliament and the Government, making specific proposals where necessary.

Still on the subject of motor liability, I take note of the initiatives, adopted or currently underway, that the companies and ANIA itself (with the valuable interventions just mentioned by the President) are carrying out following the exceptional events of 2020. Policyholders will be the best judge of the policies adopted by individual companies.

Also the regulatory and operational framework for the launch of the Insurance Arbitrator is currently being defined. The peculiarities that distinguish it from the two Arbitrators already existing in the financial system (banking and securities) will have to be considered carefully.

The most important regards the structure of the market, which sees, alongside the companies issuing the covers, a distribution chain made up of numerous subjects, which are different in their legal nature, operating models, as well as relationships with the company and the client. We will have to equip ourselves to handle appeals involving both the insurance company and the intermediary; based on the experience of complaints, they are likely to be much more frequent than in the banking and financial world.

Insurers, intermediaries and policyholders will be an integral part of the new mechanism. What we expect from everyone is an active participation in the proceedings, balanced and constructive guidance in the judgements, and some help in informing the public on the most effective way to use the new system. As it was the case for banks, we

expect that it will be possible to achieve a broad acceptance by companies of the decisions made by the Arbitrator.

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Authorities, ladies and gentlemen,

Today I focused on the most important technical issues involving the insurance industry. There will certainly be other opportunities for discussion with ANIA and with the companies on all the other topics.

I therefore close with the hope that the constant and loyal dialogue between the Supervisory Authority and all the components of the sector, each one for its own role - a dialogue to which I feel personally committed -, will contribute to make the insurance market even more solid, healthy, transparent and competitive; attentive and sensitive to the needs for protection of the community and the individuals; capable of providing concrete and effective responses to the needs of citizens and businesses, and a strong contribution to the country's economy.