



2019 AIBA National Conference

"Revolution? Evolution!"

Revolution of risks and evolution of the insurance market in an accelerated ecosystem, in the midst of climate, socio-economic and regulatory changes"

Speech by the Secretary General of the Insurance Supervisory Authority (IVASS)

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I would like to thank AIBA not only for the invitation to attend your annual conference but also for having placed the strategic perspectives of the insurance industry at the centre of the debate in an economic, social, market and technological environment that is undergoing profound changes of perspective. The digital challenge is unprecedented. It is therefore right to wonder about the impact of the current evolution on the insurance brokerage business.

My speech aims to provide a contribution on some aspects of the changing environment - in particular the digital and climate aspects - that have a profound effect on the insurance market, with a focus on the role and contribution of your profession.

However, I would like to mention, without discussing it in detail, the commitment that we all – insurers, intermediaries and authorities – are making to ensure the substantial transposition of the Directive on insurance distribution. This requires insurers and networks to make their customers the focus of their strategies and organisations and to manage potential conflicts of interest carefully and responsibly. The actions of insurance distributors – which are to be honest, fair and professional – must serve the best interests of their customers. With the IDD, the sales and after-sales methods of insurance products are now as important as the quality of the products distributed. The objective of prioritising customers is therefore associated with behavioural risk that must be carefully managed.

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At the end of 2017, 3,894 individual brokers and 1,670 brokerage firms were registered in the Single Register of Intermediaries. There are also about 270 companies with headquarters abroad operating in Italy. The companies are very heterogeneous in size. They also differ greatly in terms of number of employees and premiums among the top 10 companies in the sector. Alongside some brokerage firms that are similar in size to medium-sized insurance companies, there are many very small operators with a strong geographical focus.

In 2017 brokers intermediated 1.6% of life premiums and 13.8% of non-life premiums collected from Italian customers, for total premiums of 6.8 billion (+38%

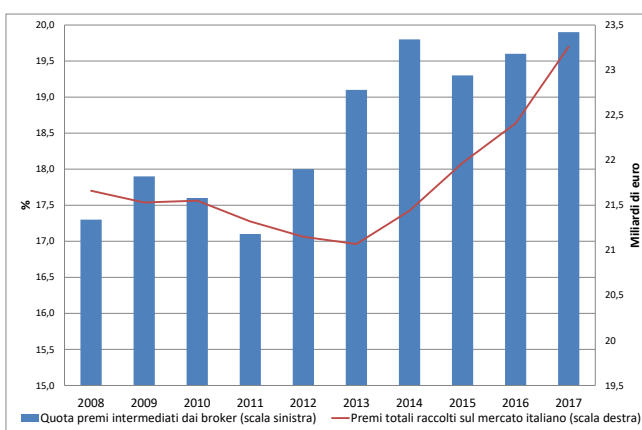
compared to 2008). Three-quarters of these premiums are related to non-life insurance products, the vast majority of which are in lines of business other than motor liability. Although modest, the share of life premiums in brokers' premium volume has been growing over the last 10 years (25% in 2017, compared to 15% in 2008) ¹.

There is a strong propensity to distribute the products of European Union companies operating in Italy under the right of establishment, which at the end of 2017 accounted for over 40% of the premiums intermediated by brokers in both non-life and life insurance business.

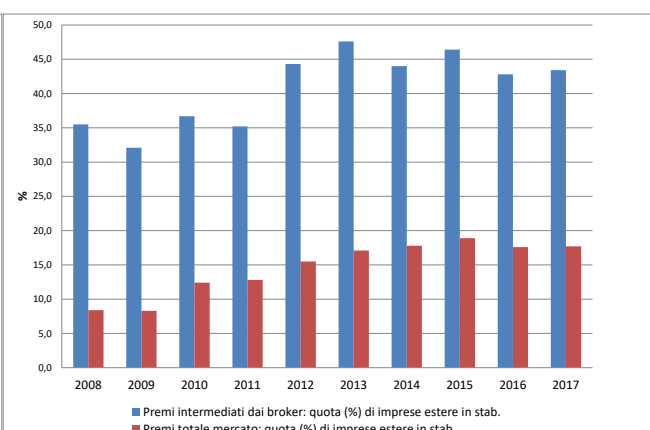
The strong drive to be present in international markets gives brokers an important role in serving companies – including state-owned enterprises – of all sizes and levels of complexity, which require a highly professional service tailored to their specific business, organisational and regulatory characteristics. At the same time, it also requires careful, responsible selection of partnerships in order to meet the expectations of quality and reliability of the service.

Non-MTPL non-life business, 2008-2017

Contribution of intermediation by brokers to the Italian market total



Share of premiums of EU companies under right of establishment for brokers and the Italian market as a whole



Source: IVASS.

¹These figures reflect the traditional underestimation resulting from business intermediated by brokers but channelled through agencies.

Digital insurance and big data

The digitalisation and related dematerialisation of the insurance business, together with an exponential growth of information regarding customers and risks, extracted and produced using artificial intelligence tools from the enormous volume of big data available, are changing the traditional approach to providing insurance. New market opportunities are being created, for example, in the offer of insurance coverage in push mode directly to customers' portable devices (mobile phones and tablets), in access to digital platforms and robo-advisory to formulate complex tailored insurance packages and in innovative after-sales assistance. In some lines of business, the new products will have to take account of the trend to move from ownership to use of the insured asset.

Automatic data collection and transmission devices are becoming widespread above all in motor liability, health and other non-life insurance, including through the use of parametric policies. Vehicle black boxes, present in one-fifth of private-use vehicles in Italy, enable custom rates based on driving style. Wearable devices combined with health policies make it possible to monitor the physiological parameters and lifestyle of the insured.

The association between traditional data and new sources of information (including assessments of the insured's creditworthiness, purchasing/payment behaviour or social network activity – data not typically associated with insurance) are changing the way risk is priced and reserves are quantified, as found in a recent EIOPA survey.

The EIOPA also considers insurance regulation at European and national level to be substantially adequate to support innovation and not obstructed by barriers to the diffusion of new technologies. Moreover, this is an ongoing assessment that needs to be updated in the presence of innovative solutions. Here today I would once again like to reiterate that IVASS is fully willing to engage in an open dialogue on these issues with all operators in the insurance world.

Insurtech is the forerunner of significant changes in insurance brokerage, reducing activities with less added value, identifying new customer relations channels, new professional roles and datasets and driving competition at the level of product quality, service quality, price and purchasing experience.

There is a growing tendency to offer insurance intermediation through platforms accessible to insurance companies and brokers – or even directly to customers. Business opportunities are being created for brokers to design insurance packages optimised to suit the risk profiles of their customers. There are signs of this occurring, with international brokers acquiring interests in instant insurance platforms, in some cases supported by block-chain technology.

In the US market there are synergies between brokers and IT start-ups specialising in the management of geolocalised big data. This information makes it possible, for example, to assess the natural or fire risk of homes, enabling an insurance premium that is not burdened by expensive direct appraisals of the property. Digital evolution allows the entry into insurance brokerage of new players such as start-ups that use combinations of innovative technologies, in some cases interested in operating as brokers in particular market sectors and in collaborating with other operators, managing their front and back end operations.

The availability of personal data from an increasing number of providers requires a greater focus on protecting customer privacy but also higher levels of IT security.

Insurance aspects of cyber-risk

There is growing concern among companies in all sectors regarding the threats to IT systems, which are increasingly complex and interconnected and which manage growing volumes of data, including confidential data. At the end of 2016 a survey conducted by the Bank of Italy had already found that at least one-third of non-financial companies with at least 20 employees reported having suffered damage from cyber-attacks.

Digital technologies bring new risks, including cyber-risk, linked to actions – and therefore not only to malfunctions, errors or excessive complexity – that exploit the vulnerabilities of information and communication technology (ICT) to disrupt its operation in order to obtain undue access to data or to compromise its integrity or use. The line of defence requires not only assessing and managing the risk of compromise of ICT systems,

but above all strengthening resilience to external hostile actions, which are often highly sophisticated, and limiting – including with insurance coverage – the damage that they can cause.

The costs of cyber-attacks can be enormous. One immediate expense is restoring damaged computer systems. Other costs, including reputational damage, may occur in the long term. A US study estimated the average loss for each information record at 58 cents.

A strong interest in cyber coverage is therefore to be expected, with a global market estimated in 2018 by *MunichRe* at annual premiums of around 4 billion. At the moment, such coverage is in the embryonic stage in Italy and not very widespread in Europe, due to the limited awareness of the risk among companies – especially small and medium sized businesses – and the difficulties for insurers in managing it.

A survey of major Italian companies conducted by IVASS identified three types of cyber-insurance contracts dedicated to: retail customers (about 2,000 contracts with an average insured amount of 300 euros and a maximum of 150,000 euros); small business customers (about 5,000 contracts with an average insured amount of 30,000 euros and a maximum of 250,000 euros); and large corporate customers (less than 50 contracts with an average insured amount of between 3 and 20 million euros and a maximum of 50 million euros).

The growth potential of this sector is clear; there are a total of 4.3 million companies in Italy, of which 3,600 with over 250 employees, 22,000 between 50-249 employees, 182,000 between 10-49 employees and 4.1 million with fewer than 10 employees.

The most critical aspects for potential insured and insurers include:

- the lack of clarity in the contracts currently on the market, and in indemnity clauses in particular, with reimbursement conditions that are generic and not always representative of the wide range of risks to be covered; it is important that exclusion of indemnity clauses be properly formulated, thereby preventing potential litigation between insurer and insured;

- the difficulty inherent in correctly pricing risk, which varies according to the complexity of the company's IT system and the level of the mitigation and security systems; extensive comparable time-series on this type of risk are not yet available from the various data providers; moreover, the types of attacks and damages that have occurred in the past may not be representative of the current situation;
- the speed at which cyber-attacks spread, which can cause extensive, highly correlated losses in an insurer's risk portfolio (known as accumulation risk, where a bug in widespread application software could make many of those insured by an insurer vulnerable at the same time, resulting in the insurer having to pay considerable overall indemnities in a short period of time, even where the contracts have limited coverage); this characteristic means that traditional risk assessment models based on assumptions of independence of the claims in the portfolio are of limited use. One consequence of this is the difficulty inherent in obtaining adequate reinsurance cover.

The critical issues mentioned on the supply and demand side open up opportunities for brokers, who have an important role to play in improving the perception and assessment of cyber-risks by companies, estimating their impact and assisting clients in finding satisfactory insurance coverage. However, specialist expertise and productive dialogue with insurance companies are required to identify appropriate solutions.

Some brokers – particularly medium to large brokers – already combine insurance and IT expertise. Other intermediaries may consider whether to invest in acquiring the necessary technological skills, including through arrangements and partnerships with specialised operators, in order to offer additional services, especially to small and medium enterprises, the backbone of the Italian economy.

Discussions with clients' IT departments should be held to identify the risks that are truly insurable and to adapt the insurance contract by carefully formulating its clauses. Brokers may also contribute to identifying additional services provided by insurance companies (such as recovery assistance) and monitor the evolution of exposure to cyber-incidents in order to propose ongoing adjustments to coverage.

The impact of climate change on the insurance offer

Climate change - now entirely evident in Italy as well - amplifies the frequency and catastrophic scale of extreme natural events such as floods and storms, making approaches to complementing public intervention increasingly necessary. The problem is global in scale, as in the case of the protection gap: there is a protection gap for many risks due to the lack of insurance tools, which appears to be growing for natural risks².

Looking at the Italian situation, insurance protection against natural risks affected by climate change is lacking, resulting in general under-insurance in the non-life business. Less than 2% of Italian homes have flood risk protection, as shown by a survey conducted by IVASS in early 2017. The situation with regard to the protection of industrial sites is better, yet still far from the levels of adoption in the major European countries. The small average size of Italian companies helps to explain this gap.

Italy's high exposure to natural risks makes it appropriate to reflect on the possibility of enhanced forms of collaboration between the public and private sectors, borrowing solutions widely used in other European and non-European countries. The perspective must be global, look at families and businesses, and take into account the set of natural risks, including seismic risk, which is very intense in Italy.

Here, too, the role of brokers is important. Major operators can acquire the know-how provided by natural disaster simulation models to assist companies in assessing the exposure of their assets to this type of risk. In some foreign markets, partnerships have become widespread, bringing together individual brokers and large companies with strong expertise in specific risks, such as natural and environmental risks.

The preferred point of contact for brokers in this activity will be the companies' risk managers, where this position is present, while in the case of small companies brokers' success will be measured by their ability to put themselves forwards as consultants to management in managing climate change risks.

² The phenomenon is so widespread and pervasive that it affects not only the adjustment of insurance coverage but also insurers' investment choices. Like other regulators in European Union countries, IVASS will strengthen actions aimed at verifying that companies' governance, risk management and investment monitoring systems are attentive to the correct assessment of climate risk, which must be fully disclosed to the market and insured.

The protection of public property – in particular that of high artistic and cultural value – may represent an additional market to be covered. Within the limits imposed by the constraints of public finance, government is increasingly interested in seeking solutions to protect both cultural assets that can generate income for their communities and public buildings (hospitals, schools, government offices).

Conclusions

Acting on behalf of clients requires, in terms of business skills and characteristics, awareness of the changes taking place, a constantly updated risk culture and continuous training.

The common denominator in these reflections leads to the clear identification of professionalism and the search for appropriate collaborative networks and alliances, including of a technological nature, as the response to the challenges we are facing.

Threats and opportunities obviously tend to differ within a professional category with operators of very different sizes and complexities. The risk of disintermediation can have various origins: technology, failure to measure risks with new tools and to offer effective solutions to customers and the emergence of new competitors, especially in the corporate segment.

It will be up to each intermediary, in view of its characteristics, to set objectives and formulate strategies for serving the chosen market. In any case, it is essential, in the interests of the economic system, that even in this new environment brokers retain the ability to act as a solid, reliable bridge between insured – and above all companies of all sizes and complexity – and insurers, bringing their professionalism to bear on contributing to the formulation of risk mitigation and coverage strategies through policies tailored to clients' needs.

IVASS will not fail to continue to monitor the sector as it evolves.