Insurance Supervisory Authority
2020 Annual Report

Remarks by the President
Luigi Federico Signorini

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Ladies and Gentlemen,

the pandemic has left a deep mark on all of us, causing anxiety and suffering, suddenly changing social habits and behaviour. It also forced a sudden and radical reorganization of production processes. We had to learn, overnight, to work in a completely new way, using technology in ways we wouldn't have thought possible. We have accumulated human capital of an unexpected kind, which we will have to exploit. We'll return to some form of normality: but it won't be the same as before.

The investments in recent years in technological infrastructure - the result of increasing cooperation with the Bank of Italy - and the staff's ongoing commitment to adapting the organisation and digitalising work processes have enabled Ivass to respond efficiently to the effects of the crisis.

In order to maintain the distance required to safeguard the health of the staff and limit unnecessary mobility, Ivass has made extensive use of remote working. We have tried to minimise the impact of the emergency on institutional operations, guaranteeing the insurance system and its customers the regular fulfilment of our fundamental tasks, which are even more delicate in the exceptional operational and market situation caused by the pandemic.

Ivass is reflecting, in close contact with the Bank of Italy, on possible permanent innovations to the working model. We will seek the right balance between the benefits of working remotely (flexibility, both for the Institute and for the staff, reduction of environmental impact) and the undeniable value of working together in direct contact, exchanging information immediately and learning from each other. Dialogue with the staff is in progress.

This is the first time I have spoken to you as Chairman of Ivass. I owe to all those who preceded me. My thoughts go to Fabrizio Saccomanni, whose premature death still saddens those who knew his lively intelligence, open spirit and vast competence. I want to thank Salvatore Rossi, Fabio Panetta and Daniele Franco, whom I greet in his new, delicate role, and to whom I offer all my best wishes.

The Board members Alberto Corinti and Riccardo Cesari and the Secretary General Stefano De Polis have continued to support me in guiding the Institute. Without their valuable help, I would not have been able to face the responsibility I bear with such calm. The Bank of Italy's Directorate, integrated by the two Board members, ensured complete operational and decision-making continuity.

I have been able to count on the undisputed professionalism of all those who work in the institution; their commitment and dedication have enabled the Institute to adapt to the exceptional conditions of these difficult months. Before any other, credit is due to them for the consideration and appreciation we receive.

At the end of a constructive and honest dialogue with Trade unions, conducted under the sign of a substantial sharing of objectives and a common sense of belonging, we recently reached an agreement to renew the employment contract.

I am close to those who have suffered from the disease. My thoughts go in particular to the family of our colleague Maurizio Piselli, who did not make it.

The crisis and the Italian insurance system

Just over a year ago, between February and March, the world was beginning to realize the devastating economic effect the pandemic was about to cause. The change of scenario led to a sudden, sharp increase in the volatility of financial markets. The immediate intervention of the central banks and the economic policy measures soon taken throughout the world to limit the impact of the health crisis on the production system restored the conditions of orderly functioning in the markets in a relatively short time.

The cooperation between monetary and prudential authorities globally has been intense and continuous; the fiscal policy response has been unprecedented. The Financial Stability Board (FSB), to whose work the Italian authorities have made a constant contribution, has been the most important centre for coordinating action in the financial field.

This is not the place to review the events of this dramatic year or discuss the lessons to be learned from them in detail. The Italian G20 presidency has asked the FSB for a report on the crisis, which will be delivered in a few days to the summit of finance Ministers and central bank Governors in Venice. In addition to underlining the importance of the emergency interventions implemented, the report, which is the result of intensive discussions at the international level, will highlight the emergence of potential vulnerabilities, particularly in non-banking and non-insurance finance. Also, under the impetus of the Italian presidency, the FSB is working to address this with appropriate regulatory standards, particularly in the area of mutual funds.

Such a severe and sudden market turbulence could have had, if prolonged, significant repercussions on the assets and solvency of insurance companies worldwide. Insurance balance sheets are strongly affected by changes in prices, interest rates and spreads. The stabilisation that followed the actions taken since last spring has dramatically mitigated the effect of the crisis. However, uncertainty about the development of the pandemic and its potential economic and financial effects continued into the second half of the year.

In Europe, the European Systemic Risk Board (ESRB) has recommended, among other things, that banks and insurers strictly limit dividend payments to maintain the capital strength of the financial system under all circumstances and throughout the crisis.

The Italian insurance system is less exposed than others to the pure effect of interest rates and prices, thanks to a better matching of the financial duration of assets and liabilities; it is significantly exposed to sovereign risk spikes perceived by markets. Overall, it has been resilient to the crisis. In the first half of 2020, the decline in solvency ratios was significant due to the increase in the *spread* of corporate and government securities and the movements in the risk-free interest rate curve. In the second one, however, the average solvency ratio returned to growth, to a level slightly higher than before the pandemic, and in any case characterised by a wide margin over the minimum regulatory requirement (243 per cent at the end of 2020, compared with 235 per cent at the end of 2019). In early 2021, the improvement continued as financial stresses eased further.

During the emergency period, Ivass activated continuous monitoring of Italian insurance companies and groups' solvency position and liquidity risk. This monitoring made it possible to promptly identify individual situations of potential fragility, which were followed by requests to strengthen capital and the adoption of appropriate *capital management* policies.

Consistently with the decisions shared at the European level and with the Bank of Italy's action in the banking field, Ivass issued precise recommendations to temporarily limit the distribution of dividends by insurance companies. Although these recommendations were not legally binding, the domestic industry embraced them. In the midst of the crisis, we chose to adopt a prudent and firm attitude, in line with the European guidelines we had helped draw up. In other EU countries, however, there have been differences, sometimes profound ones, in the approach of supervisors to this issue; the importance of more coordinated action than that provided for by the current institutional framework emerges once again in the interests of the integrity of the single market and the protection of its overall stability.

The situation is now less dramatic. At the end of September, the current European recommendation on the restriction of dividends will cease to have an effect. Unless the economic, financial and health situation becomes seriously worse again (a possibility that we cannot yet rule out), we see no need to repeat it.

Italian insurance profits are almost stable; the average RoE remains high, although slightly down in 2019 (from 12.3 per cent to 11.6 per cent). The substantial overall stability reflects opposite trends in the two main sectors, Life and Non-Life.

In the Life sector, which contributes most to companies' profits, the latter fell by 20 per cent; premium income also declined, by about 4 percentage points. The drop in premium income was hefty for the more typical insurance products, class I policies (assurance on the length of human life: -9.5 per cent). Premiums in class III, in which the investment risk is borne by the policyholders (*unit linked* policies), increased (+6.2 per cent) but did not compensate for this decline.

Therefore, the composition of the Life portfolio continues to change in favour of products more similar to financial products such as mutual funds or asset management, from which class III products do not differ much in economic substance. The typical insurance element, i.e. the provision of financial and demographic guarantees, is reducing.

In the Non-Life business, profits grew by 45 per cent, thanks to Motor Third Party Liability (MTPL). In classes other than MTPL, premiums, claims cost and profits remained broadly in line with those of the previous year. In motor insurance, premiums fell by 5.5 per cent, but claims costs fell by almost 20 per cent, reflecting the reduction in road accidents caused by traffic restrictions.

Retrospectively, the statistical distribution of the damage events covered by motor insurance has radically diverged from that used as the basis for calculating premiums. With reference to the consequences of the pandemic, EIOPA stated that it expects companies, when identifying products that are no longer sufficiently aligned with the relevant market, to consider whether this results in an unfair treatment; and, where unfair treatment is found, to take appropriate measures, taking into account existing national laws.

Ivass embraces these expectations, to whose definition we contributed. Some companies have granted, on a voluntary basis, forms of compensation to their policyholders; not all of them, and not all of them in the same way or to the same extent. The differences are marked. Now that almost all the mobility restrictions have subsided, the laggards should urgently reconsider this issue. In the meantime, consumers will be able to inform themselves and assess the companies' behaviour.

This phenomenon has not manifested itself in the same form throughout Europe. For insurers in some other major European countries, France and Germany in particular, the exceptionally positive return from the motor sector was largely offset by equally exceptional claims costs related to other risks, directly linked to economic trends; among these, business interruption .

It may seem strange that a colossal damaging event such as the pandemic has had, on the whole, economically positive consequences in Italy for those who, by trade, insure against damage. One of the reasons for this is the low level of Non-Life insurance cover in our country, excluding motor insurance. While the impact on GDP of Life insurance premiums is not low, the incidence on GDP of Non-Life insurance premiums is less than half the OECD average. Insurance to cover risks in the small and medium-sized business segment is not widespread, as is insurance against natural disasters, such as earthquakes and floods, to which our country is more prone than many others; despite progressive growth in recent times, even the most common covers such as health and property protection policies are not very popular.

Insurance culture and consumer protection

The issue of under-insurance in Italy, whether it is the result of conscious consumer choices or is affected by insufficient information or other undue obstacles, is not new in the Remarks by the President of Ivass. Last year in this forum, Daniele Franco stated that *"There are a number of strategic levers to be activated, involving institutions, the business world, consumers. They concern the rules and models of public-private cooperation, technology, the production offer, the distribution networks and insurance education itself".*

Therefore, the reasons are complex; we will return briefly to this point later, and certainly on other occasions. I would now like to turn to the last aspect, insurance education, on which we now have some more information.

Ivass has recently commissioned a survey on insurance literacy in Italy. We presented the conclusions on 20 May. This is the first attempt, and as such, it has its limitations; we can try to repeat and refine it in the future, making the results comparable over time and (if others take similar initiatives) with other countries. Even now, however, we can deduce a fact that leaves no room for doubt: the knowledge of some basic concepts in Italy is definitely unsatisfactory. Many people misunderstand basic concepts such as 'premium', 'deductible' or ‘maximum amount of cover’. Many get lost in assessing probability and risk or are misled by common mistakes.

I believe it is necessary to improve the insurance culture if we want the insurance market to function better and be driven by a more reasoned, aware and attentive demand, not only by the companies' more or less far-sighted supply policies. Even the rules on transparency of contracts lose much of their effectiveness if consumers do not have the information and conceptual tools to make the best use of them.

Doing what we can to strengthen the promotion of insurance education is, therefore, a commitment we make. Ivass will coordinate with the Bank of Italy's initiatives on financial education, drawing on its experience. We invite public institutions and associations of consumers, intermediaries and insurers to join us in this effort.

I cannot help but add, however, that in order to make decisive progress in the future, it will be necessary for mastery of the basic statistical concepts to be rooted in the school, in curricular programmes at various levels; to become, over time, everyone's heritage. It's not just insurance education that will benefit.

Another area where progress still needs to be made is in the simplification of rules to protect customers. Some simplifying rules introduced in response to the crisis may provide an opportunity for permanent streamlining. For the emergency period, in particular, contracts were allowed to be concluded through the use of simple e-mail; the rule has been welcomed by operators, who would like to make it structural. Together with the other authorities in the sector and with the support of the relevant ministries, we are working to assess how, by leveraging the use of digital tools, we can simplify procedures without weakening consumer protection. We will review the legislation on pre-contractual forms, following the spirit and the letter of the European provisions, to eliminate the superfluous and focus on the essential.

One sensitive issue relates to requests for simplification of insurance product distribution processes. The Lazio Regional Administrative Court recently annulled some of the provisions issued by Ivass, amending the Regulation on insurance and reinsurance distribution. These amendments aimed to strengthen consumer protection safeguards by introducing certain obligations, which intermediaries opposed as excessive. Obviously, we will comply with the ruling; we will carefully study the procedural and substantive reasons for it. In any case, we will reconsider the matter to minimise, even more courageously than in the past, the bureaucratic requirements that are not strictly necessary; without, however, losing sight of the fundamental objective, which is to ensure the protection of customers and transparency in the placement of products.

Since 3 May, the new MTPL "quotation service", introduced by the legislator, has been available to consumers, albeit still on an experimental basis. The tool allows anyone to compare offers from all insurance companies concerning a basic standard contract and some simple variations. The consultation on the draft implementing regulation, which will govern the obligations of companies and intermediaries and the system's operation, has been completed. We received a significant number of comments, mostly from market participants; we will evaluate them carefully, ready to take on board those aimed at simplifying the implementation of the rule in harmony with the letter and spirit of the law and promoting an efficient use of the instrument. By increasing the transparency and comparability of offers, the "quotation service" is intended to facilitate the decisions of policyholders and significantly increase the dynamics of competition. We expect prompt and loyal cooperation from all those concerned.

The definition of the rules for the functioning of the Insurance Arbitrator, which will be entrusted to a regulation of the Ministry of Economic Development in agreement with the Ministry of Justice, should arrive soon. The Arbitrator, whose structure has been defined bearing in mind the existing models in the banking and financial investment sectors, will have to offer effective and rapid protection in an industry where there has always been a lively debate between businesses and consumers. If it works as it should, it will deflate litigation and strengthen consumer confidence in the insurance system. We are working, with the collaboration of our colleagues at the Bank of Italy who have been involved in the same field for years, to put the Insurance Arbitrator in a position to operate rationally and efficiently, providing concrete responses to the need for consumer protection within a framework of operational sustainability, taking into account the limited human and technological resources available.

With a specific funding from the European Commission, we have launched a project to integrate "*mystery shopping*" into our monitoring of distributors' conduct. This is an assessment of compliance with the principles of fair-trading by our representatives who present themselves as new customers and negotiate real contracts. In 2020, through specialised companies, we carried out 140 pilot visits at banks, post offices, agencies and online comparators to test the technique and define a methodology. For experimentation to become an effective activity, Parliament needs to lay down the legislation that will regulate its use for supervisory purposes in accordance with a European directive.

The activity carried out in Italy by operators with head offices in other European Union countries is quite significant. Substantial protection of European policyholders also requires closer cooperation between supervisors, a gradual convergence of market conduct supervisory practices and a strengthening of the institutional conditions for a single insurance market; we support EIOPA's efforts in this direction. Unfortunately, cases of unreliable operators, or those offering products that are detrimental to the legitimate interests of subscribers, are not uncommon, and Ivass has few instruments to intervene, since supervision is the responsibility of the home country. The European Commission is examining the situation as part of its ongoing reflections on the role and functioning of the European supervisory authorities.

Three key issues on digital transition

A reference here to the rapid development of digital technologies may seem ritualistic; there is no authority today, and there is no observer who does not mention it, whatever the context of reference. That is why I want to be concise and focus on three points, at least two of which, despite the popularity of the subject, in my opinion, are not receiving enough attention in public opinion.

I take for granted the premise that technology opens up considerable possibilities for both companies and customers; that it makes it possible to make the management of the business more efficient, improve risk control, ensure compliance with the increasingly complex and stringent protection rules, also due to the extension of the European regulatory body; that it facilitates communication between companies and customers and that it can, if properly targeted, increase competition through comparability of offers.

The first specific point to which I intend to draw attention, well known to the interested parties at least in theory, is that the full exploitation by companies of all these potentials requires not only the adoption of latest generation tools but also the reorganisation of the entire company information system based on a rational, integrated and flexible architecture.

Both on-site and off-site monitoring shows that many companies have fallen far behind in this area. It is necessary to overcome the fragmentation of information systems, integrate applications and archives. Addressing these shortcomings lays the foundation for fully exploiting the technology, while also strengthening the industry's ability to respond to the entry of non-traditional competitors.

The second point concerns operational risk management. One thing, I think, is clear to everyone: the need to continuously strengthen defences against cyber risks, including those arising from malicious attacks, also involving the insurance sector. But the fact to which I want to draw attention is the rapidly growing role of the use of external providers to perform many functions of financial and insurance operators. Outsourcing does not change the company's responsibilities for the proper and efficient functioning of operations; it increases, not reduces, the need for fully adequate and functioning governance, organisational and operational safeguards. Above all, the concentration of external activities in a small number of prominent players, while it may improve efficiency and reduce costs, intensifies the systemic risk associated with the possibility of an operational breakdown of one of these providers, i.e. the exposure of individual information to misuse, as a result of deliberate attacks or even simple errors or fatalities. The subject, which is relevant not only to insurance but also to the entire financial system and beyond, is at the heart of a Regulation currently being defined at the European level (the so-called *Digital Operational Resilience Act,* DORA). The Institute is closely following this work; we invite everyone's proactive and informative contribution.

The third and final point concerns the *governance* of artificial intelligence algorithms, which in the insurance industry is becoming more widespread. Companies need to be careful to avoid the risk of introducing undue discrimination, both implicit and explicit, and provide customers with open information about the behaviour of models using personal data. We intend to investigate the use by companies and intermediaries of advanced algorithms in their dealings with policyholders. The processes we are familiar with range from personalised pricing, customer profiling, *robo-advisory* and claims management. The initiative aims to detect how and how much these instruments are used, not to curb them, but to prevent the risk of abuse; and to raise awareness among insurance industry players of the importance of their careful governance and control.

Green finance

Climate change is the challenge of the century, and the world is finally realizing it.

Between 2020 and 2021, initiatives to promote and accelerate the transition to net zero carbon emissions have multiplied internationally. The Italian G20 Presidency, recognizing the global dimension of the task, has made it one of the so-called *Finance Track* priorities. The transition will require substantial investment, only part of which will come from public programmes; the role of private finance, broadly understood, is therefore essential.

Central banks and supervisors are moving with great determination. I believe there are two most important objectives that financial authorities should pursue. The first one is to promote appropriate climate risk assessment by financial institutions; the second one is to create the conditions to mobilize private finance effectively and efficiently. For both objectives, it is essential to increase the availability of reliable and comparable information, both in terms of statistical indicators and rules for disseminating knowledge at the company level.

The issue is being addressed by the FSB, through the *Task Force on Climate-related Financial Disclosure*, and by the G20, through the *Sustainable Finance Working Group*, which was recently made permanent on the initiative of the Italian Presidency. The European Union is taking several initiatives to steer the European financial system towards a sustainable economy to make Europe climate neutral by 2050. Ivass is closely following the completion of the European regulatory framework and the ongoing work within EIOPA.

For insurance companies, the assessment of climate factors is necessary for the risk management of the investment portfolio and the orientation of insurance product offering strategies.

The first aspect, largely common to banks and other financial institutions, is to assess the physical and transitional risks of the issuers of the financial instruments in which the companies invest and integrate this assessment into the overall *risk management* process. Most climate risks are long-term and therefore highly relevant in the context of the insurance business. Scenarios and stress tests, which companies will have to take into account, are being developed at the international and European levels; last April, EIOPA invited insurance companies to include climate risk assumptions in their scenarios.

The second aspect is specifically related to the activity of the sector and concerns both the risk assessment of existing covers and the development of the offer of environmental risk covers. Regarding this last point, Ivass is participating in a pilot project that EIOPA is developing, with the support of the European Commission, to identify the main areas of climate risk and the critical factors in the insurance protection *gap*; to varying degrees, they affect many EU countries.

Italy, it is worth remembering once again, is among the countries most exposed to the risk of natural catastrophes and among those where the degree of insurance penetration is lower.

In my opinion, from an insurance perspective, climate risk, and more generally, physical risks arising from the environment will only be successfully addressed by a combination of public actions (investments, regulations, incentives) and by the development of the Non-Life insurance market. I hope that in our country, too, we will open a debate on the possibility of introducing, as elsewhere, forms of compulsory, semi-compulsory or more effectively incentivized insurance for risks associated with natural disasters: earthquakes, floods, droughts, large forest fires and similarly damaging events. This is certainly not about giving the insurance system a gift; proposing it would not be part of my role. The aim is to consider how best the community can respond effectively to these risks by minimizing ex-ante public and private costs, encouraging responsible behaviour, avoiding as far as possible the so-called 'moral hazard', increasing the likelihood of efficient use of funds made available to victims, and ensuring a sufficient degree of mutuality and solidarity between citizens. The fact that it is not a gift for anyone, neither insurance companies nor anyone else, must be ensured by competition, including European and international competition, which we must preserve with scrupulous care when designing any measure on the subject.

The climate challenge involves many institutions; financial regulators and supervisors have an essential role to play. However, it is up to government institutions to determine the how, the how much, and the when of policies for transition through rules, taxes, and incentives. Prudential regulation must remain risk-based. We should only introduce reductions in capital absorption for "green" investments and emissions based on evidence of reduced risk associated with them. Let each one do what it does best.

* * *

For Ivass, as for everyone, 2020 was exceptionally demanding. The Italian insurance sector has experienced a challenging year but leaves it behind in a relatively satisfactory situation. The solvency of the companies, which we have discretely but insistently monitored during periods of turbulence, was ultimately confirmed and strengthened. The restrictions on dividend payments, which we strongly recommended despite being aware of the resistance to them, including from within the industry, helped to avert the risk that greater capital fragility would hinder the full functioning of the sector within the economy. We intervened where necessary.

Profits remained stable overall; the significant *windfall* in motor third-party liability business on average compensated, if not entirely to a large extent, for the decline in Life business profitability. For the latter, in an environment characterized by very low interest rates for years now, longer-term strategic issues arise. We will come back to this.

Consumer protection has always been in Ivass's DNA. In the progressive integration between the two institutions, the Bank of Italy has profitably availed itself of the experience gained in the insurance sector for its action in the banking sector.

Citizens are increasingly turning to Ivass. Complaints are still increasing. Our Customer Contact Centre has received an unprecedented amount of reports of irregular websites, allowing us to intervene and report many scam attempts to the police.

We have made progress with the new public quotation service, the *mystery shopping*, the insurance arbitrator.

We have seen confirmation of the importance of increasing insurance education, both among the younger generation and adults. We are committed to intervention: however, we know that we cannot do it alone. The development of an insurance culture requires the active participation of the insurance industry, consumer associations, civil society and schools.

The emphasis on the transparency of product placement and insurance education derives from the conviction of the irreplaceable role of competition in ensuring the efficiency of the insurance system and adequate consumer protection. Competition between manufacturers is the first protection for consumers. In order for it to work well, consumers must be informed and have the means to make effective use of the information available, which must become clearer, simpler and more accessible. As we lay down the rules falling within our remit, we will continue to promote ever greater transparency and comparability. We will make every effort to eliminate obligations which have become unnecessary as a result of market developments and to remove the bureaucracy for both policyholders and operators.

The moment I took office as Chairman, just over three months ago, I became immediately aware of the vast work that lies ahead. The exploitation of synergies with the Bank of Italy should continue to be strengthened; I will pursue, while respecting institutional constraints, more effective forms of integration. In any case, I am counting on the formidable staff of the Institute.

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