I V A S S
ISTITUTO PER LA VIGILANZA
SULLE ASSICURAZIONI

Insurance Supervisory Authority 2022 Annual Report

Remarks by the President
Luigi Federico Signorini

Rome, 19 June 2023

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Authorities, Ladies and Gentlemen,

The tightening of monetary conditions that followed the rise in inflation continued in 2022 and in the first few months of the current year. Inflation, while having fallen from last year's peaks thanks to decreasing pressure from energy prices, remained well above the target set by the European Central Bank. While medium-term expectations appear to have stabilised, core inflation has not yet shown sufficient signs of decrease. As Governor Visco recalled in his Concluding Remarks a few days ago: "In line with the resolve to bring inflation back fairly rapidly to the target of 2 per cent, at the beginning of May, the ECB Governing Council confirmed its restrictive measures, though limiting the increase in the key interest rates to 25 basis points". The monetary policy action continued with a further 25 basis point increase decided at the 15 June meeting. Since July of last year, the interest rate on bank deposits with the Central Bank has been increased by 4 percentage points to its current level of 3.50 per cent. The Council reaffirmed its intention to base future decisions on the data as they become available.

Rising interest rates and prices have had significant effects on our insurance companies through a fall in the market value of financial assets and liabilities and an increase in the costs of claims. Owing to the principle of fair value accounting underlying prudential indicators, the increase in interest rates acted in a similar way, as it always does, on both sides of the balance sheets of insurers; solvency ratios, therefore, have only moderately decreased. However, the changed environment has contributed to an increase in the surrenders-to-premiums ratio in the Life insurance sector. Companies and the insurance supervisor have increased their focus on liquidity risk, the significance of which I discussed extensively last year.

By the end of 2022, the average solvency ratio for the insurance industry had decreased to 246 per cent, about five percentage points less than the previous year, but still a high level, in line with the European average. The decline was caused by the Life sector, and mainly reflected a substantial increase in the requirement relating to the risk of early contract termination. For companies specialising in this segment, the indicator was down by an average of more than 25 percentage points, to just over 200 per cent; for others

(Non-life and ‘composite’), there was, on average, no decrease. The adequate capitalisation of the companies was the result of both shareholder capital injections and lower dividend payments.

Profits declined significantly. On the whole, the Life business closed with a loss for the first time in ten years.

A temporary rule permitted companies implementing national accounting standards not to report the economic effects of unrealised losses on HTM securities in 2022 in their P&L account, by accumulating them in an unavailable reserve. This rule allowed for the limitation of the valuation losses reflected on the financial statements. Total unrealised losses of €17.7 billion were thus offset by 36 companies, accounting for approximately two-thirds of the market in terms of assets. A subsequent law, approved in January this year, permitted insurance companies, within certain limits and under certain conditions, to distribute a portion of these reserves as dividends. As we were called upon to establish implementation standards through secondary regulation, we asked companies not to make use of this option unless their Boards of Directors had carefully evaluated the solvency situation in a forward-looking manner, as well as the resilience of the liquidity position, including in stressed scenarios. We also sent letters to the top management of companies recommending that, in the current economic environment, the utmost caution be exercised in decisions concerning the distribution of profits or other capital elements. Companies took good note of this.

The average ROE of insurance companies dropped by more than five points compared with 2021, falling to 3.2 per cent. The Life business went from a profit of €4.3 billion to a loss of €0.4 billion. Non-life insurance profits, on the other hand, remained essentially unchanged (€2.7 billion); however, for the first time since 2011, motor insurance recorded a slight loss, due to the effect of inflation on the cost of claims and to a decline in premium income.

The trend in premiums was also clearly different between Life and Non-life. While premiums in the latter segment grew (with the exception, just mentioned, of motor insurance), in the former they declined sharply, both in 2022 (by 11 per cent) and through early 2023, especially for unit-linked products, which serve a similar function to pure financial investments. Rising yields on financial assets alternative to policies reduced premium income and contributed to early terminations of Life insurance contracts, particularly among holders of large policies.

The ratio of surrenders to premiums grew; it briefly exceeded 100 per cent in April, then stabilised at around 90 per cent in the following weeks. The increase was greater for companies that distribute their products through the banking channel or financial promoters.

Liquidity tensions can be a critical factor, especially when there are unrealised losses on the investment portfolio. At the end of 2022, the balance of unrealised gains and losses was negative by over €50 billion. It gradually improved over the following months and was less than €30 billion on 9 June.

Companies with the greatest exposure to rate and surrender dynamics have been subject to stringent oversight. The undertakings concerned have taken measures to mitigate the effects of the changed market conditions. Actions have been planned, and in many instances already implemented, in order to improve the solvency position (capital increases, reinsurance) and to address potential liquidity strains (opening of credit lines, asset sales). Where necessary, we expressly asked for the distribution of dividends to be waived. On the whole, risks appear to be adequately monitored. Since the future trend in interest rates cannot be predicted with certainty, insurers must remain vigilant.

A special case was that of Eurovita, a medium-sized company suffering from idiosyncratic weaknesses (inadequate risk management, limited capital endowment, and shareholder disengagement), which emerged from off-site and on-site supervisory activities, and, in changed market conditions, led to the company's crisis. In July 2022, following an inspection that had revealed (among other things) an overestimation of own funds and an incorrect calculation of the solvency requirement, we requested a radical change in governance, as well as a capital boost to be accomplished through the injection of own funds, which the shareholder did not follow up on in a timely manner. Nor has the search for a buyer materialised. As no concrete recovery action took place, in light of serious violations of insurance regulations and of the urgent need to prevent the company's situation from deteriorating further, on 31 January of this year, Ivass appointed a provisional administrator. Having observed a rapid increase in surrenders, on 6 February Ivass adopted a measure to suspend them in order to safeguard the company's stability and protect the rights of all policyholders. Upon our proposal, the Minister of Enterprises and Made in Italy ordered the extraordinary administration of the company on 29 March. At the same time, we extended the suspension of surrenders until 30 June, in order to facilitate the orderly management of the provisional administration and the search for a market solution.

As is well known, a market solution involving a group of banks and insurance companies is now taking shape. As supervisors, and in close coordination with government authorities, we have provided technical input for the definition of a sustainable, robust and balanced solution that is compliant with the regulatory framework. Negotiations are ongoing; I hope that an agreement can be reached, in the shortest possible time, that will ensure the full protection of the rights of policyholders, demonstrate the sector's resolve in dealing with an entirely new and unexpected situation, and send a strong

signal of strength and responsiveness, to the benefit of the system's overall stability and the public's trust in it.

The pathological case of Eurovita, as well as the overall physiological developments that the entire insurance industry is experiencing in a rapidly changing market environment, should prompt a reflection on the adequacy of the European and national sets of regulations governing life insurance, particularly for class I policies, which offer a guaranteed return.

If all policyholders hold on to their policies until maturity, there are no risks for companies and their clients that are not covered by prudential insurance regulations. As the maturity of the securities covering the policies approaches, the capital losses that are bound to emerge during a period of rising interest rates will progressively be recouped. Incidentally, this holds true also for the pathological case mentioned previously.

If, however, policies permit early surrenders at pre-set values, the issue arises of how to guarantee a matching between the liquidity of assets and liabilities, and how to hedge the financial-economic risk associated with the return promised to policyholders throughout the life of the contract.

The capital requirements rules of Solvency II, developed in quite a different economic and financial environment, should in my view be reconsidered for this specific aspect. Currently, the risk of early surrender is predominantly accounted for by the 'mass lapse' requirement, which takes care of the risks associated with rate and surrender developments when they actually occur. However, it does not adequately incentivise their prevention with safeguards applicable right from the start, i.e. from the moment an insurance contract is entered into that can be freely surrendered in advance without penalty and with a guaranteed return. A strengthening of the requirements against liquidity risk, including in Pillar 2, is already partly envisaged in the ongoing revision of the rules. Looking ahead, a more far-reaching reconsideration would, in my opinion, be in order.

The issue of the matching between surrender rules and the duration of assets has significant points of contact with that being addressed internationally by the Financial Stability Board concerning open-ended investment funds. There is, however, a difference: in the case of funds (as with class III policies), the market risk is borne by the investor and the necessary supervision is macro-prudential, whereas in the case of policies with a guaranteed return, there is also a micro-prudential risk associated with the company's obligations.

In re-evaluating the regulatory framework, it would be appropriate to emphasise the insurance function of the policy, as opposed to its increasingly prominent function as a substitute for purely financial investments. The issue is not unique to Italy; however, despite the lack of perfectly comparable data,

it appears that it is more significant in Italy than elsewhere, due to an overall regulatory framework and market practices that, directly or indirectly, enhance the liquidity of insurance liabilities in this country. Regardless of the outcome of the final phase of the European Solvency review process, national interventions for non-harmonised aspects (contract practices, civil law, and/or tax law) need to be considered. We are ready to offer to the Government and Parliament any technical assistance they may deem useful, and to involve industry and consumer representatives in the discussion.

The unprecedented developments of recent times represent a lesson for supervisors as well. In the last few months, we have significantly increased our focus on liquidity risk mitigation. As I have already mentioned, we have used both general and specific actions of persuasion regarding the distribution of dividends permitted by the temporary regulatory exemption mentioned above—the extension of which, in our opinion, would not be advisable.

The volatility of the solvency index for life insurance companies that was experienced during the first few months of this year requires company boards to consider re-defining warning thresholds, with a view to bringing forward the activation of corrective actions; we shall not fail to spur the market in this direction. We expect companies to conduct a forward-looking, structural review of their liquidity risk monitoring both at the product design stage and in their risk management practices, and to ensure that the potential implications of liquidity risk for their policies are carefully considered when drafting their underwriting risk guiding principles. Less liquid liabilities offer potentially more profitable medium- and long-term investment options also to savers that are inclined to hold assets for long periods.

In line with the objective of restoring life insurance's distinctive character and taking into account the recent experience, we are currently completing the process of revising the relevant secondary legislation. I shall soon return to this issue, at greater length, on another occasion.

At the European level, work has also continued on setting up crisis resolution schemes for insurance companies, based on the example of those existing for banks. A compromise text of the Recovery and Resolution directive for the insurance sector was finalised by the Council in December of last year; it will form the basis for the 'trilogue' with the European Parliament and the European Commission, which is expected to take place in the second half of this year. The Council's text includes provisions for Member States to define national financing arrangements, including policyholder protection schemes. I believe the moment has come to equip our market with guarantee funds, which have been in place for some time in other European countries, such as France or Germany.

The recent floods in Romagna, along with the heavy hailstorms in other regions of Italy and the drought that characterised the winter, have underscored the need to strengthen the protection that insurance can offer the population and the economy against the threat of natural disasters. Italy's agriculture, private housing, manufacturing and industrial facilities have in common a scarcity of such insurance coverage. As extreme events relating to climate change have become more frequent, the issue has become more urgent.

Specifically, in the primary sector, by the end of 2021, despite an increase in the total amount of premiums collected over the past few years, less than a quarter of the total production value and just over 10 per cent of the cultivated areas were insured.

On the topic of catastrophe risk, I have already discussed in the past the pros and cons of ex-post public interventions versus ex-ante private insurance, and argued for considering synergic initiatives. Ivass participates in the coordination roundtable on sustainable finance established by the Ministry of the Economy along with other authorities (the Bank of Italy, the Italian securities market regulator (CONSOB), the pension fund supervisory commission (COVIP) and the Ministries of Business and the Environment). We promoted the launch of a project aimed at enhancing the insurance protection of businesses and households against the physical and transitional risks relating to climate change and other catastrophe risks, with the goal of defining a scheme based on public-private collaboration.

For the concept to be successful, it is necessary, first, to ensure its technical viability and a reasonable economic attractiveness for companies; and second, to overcome the public's mistrust of insurance contracts in reference to the certainty and timeliness of benefits in the event of a claim.

Last year I emphasised the importance of clarity and transparency of information. "Insurance companies – I said – must play their part, also in their own interest. In relation to the wording of contracts, despite the efforts made in past years to make them simpler and clearer, there is still much room for improvement. We cannot delude ourselves into thinking that legislation on the subject will work miracles, not least because of the ineradicable difficulty of conceptually combining simplicity on the one hand and completeness and legal certainty on the other. The insurers themselves must be convinced that recognised transparency and acquired trust are the best competitive weapons. The obligation to establish good product oversight and governance is no bureaucratic harassment, but a key tool for healthy growth". "In non-life insurance – I remarked – contractual exclusions that are only revealed when the claim is reported, at the 'moment of truth', are not always clearly stated in the contract or emphasised at the time of sale".

I have little to add, except that next week we shall present the results of a study conducted with the assistance of independent experts on a sample of accident insurance contracts. The study attempted an objective evaluation of clarity in benefits and identified key areas for improvement. We plan to consult with industry and consumer representatives on this matter. There is no perfect solution and we shall see what improvements can be made in practice.

Recently, the European Commission published ambitious legislative proposals with its 'Retail Investment Strategy', aimed at facilitating and encouraging the access of small investors to the single market for financial services. The scope of the intervention includes amendments to MIFID, IDD and the PRIIPs regulations. This issue will have significant repercussions on the design and distribution of insurance products—a topic to which I shall also return elsewhere.

I believe it is useful to recall, meanwhile, that we are implementing several initiatives nationally aimed at promoting simplification in distribution and pre-contractual information standards. Following discussions with stakeholder groups, we have identified certain areas for rationalising the rules issued by Ivass, as we had promised. We shall launch a consultation on interventions that will simplify the requirements of Ivass Regulations 40/2018 and 41/2018 and make the information provided to policyholders more appropriate, simple and immediately comprehensible, thereby eliminating any redundancies in the large and complex documentation currently required. We intend to implement a modular scheme that provides the information that is strictly necessary at the time of subscription (i.e. regarding the protection and guarantee options that the consumer actually selects), and supplements it later if changes in contract terms make it necessary.

The ability to defend oneself remains the first and most powerful weapon with which citizens can equip themselves in order to participate in an informed manner in the insurance market and grasp all of its opportunities. Therefore, we continue to view insurance education activities – or, as I prefer to call them, "the promotion of information and awareness" – as a necessary complement to supervisory actions. Our multi-year action plan includes the publication of up-to-date tools (last autumn we published seven 'Guides in simple terms' and three educational papers for schools), an increasingly active role in the Committee for the planning and coordination of financial education activities ('Edufin'), close synergies with the Bank of Italy and a focus on schools for the dissemination of insurance knowledge and informed behaviour. We welcome the government-initiated bill instituting financial education as a subject to be taught in schools as part of civic education.

The Ivass Report for 2018 stated that, with the transposition of the European Insurance Distribution Directive, the establishment of an out-of-

court dispute resolution system was also planned for this sector, following the example of those already in place in the banking and financial sector and appreciated by the public (the banking and financial ombudsman, ABF, and the ombudsman for financial disputes, ACF); and that at the same time the definition of the regulatory framework had been activated, in which Ivass was involved, with the role of making proposals to the competent ministerial departments.

Differently from the two existing ombudsmen and the one in the process of being established in the area of supplementary pensions, for the insurance ombudsman the law has stipulated a highly articulated implementation process, including a variety of actors (Ministry of Enterprise, Ministry of Justice, Council of State) and preparatory steps (agreement, opinion). Surely the intent of the legislator was to regulate as effectively as possible a subject with many complexities and industry peculiarities. The fact is, however, that, despite multiple rounds of interaction, five years have passed since the law was enacted without its implementation having been concluded.

It is time for the insurance ombudsman to start working; we count on the government's determination in this regard. One cannot aim for a perfect instrument from the outset, not least because it is impossible to predict in advance all the conditions that will materialise, specifically, the case load to be examined: it may be very high and require ongoing adjustments, as was the case with the banking and financial ombudsman established at the Bank of Italy. Corrections or improvements to the rules can be implemented later, preferably with a streamlined process. They will be more effective if based on actual experience. In the meantime, we continue to prepare the structures with the staff envisaged by the law, mindful of the arduous task at hand and prepared to deal with any obstacles as best we can.

We have also strengthened the technological infrastructure that Ivass employs to manage the more than 20,000 complaints we receive annually, and we have started the implementation of a portal through which consumers will be able to submit both requests for information and complaints online.

Since the beginning of March, PreventIvass, the freely accessible online public price comparison tool for standard motor third party liability insurance contracts, on which insurers are required to submit offers, has been fully operational. With the entry into force of the obligation for intermediaries to consult this tool, the expected increase in the number of quotations requested has occurred: approximately 22 million were processed in the first three months, compared with just over 3 million in the previous four months.

By comparing the prices displayed on PreventIvass with those actually applied to motor liability insurance contracts on the same number plate, as extracted from our surveys, it emerges that, in a significant number of

instances, the premium actually paid is less than the offer submitted through PreventIvass by the company that issued the contract. The difference is primarily attributable to the trade discounts applied by the company or its intermediaries. Only eight companies, representing a 40 per cent market share, offer prices net of discounts on PreventIvass. In light of the transparency goals pursued by the law, it is reasonable to wonder why so many undertakings have chosen not to offer the lowest price in a place that will be visited (directly or through intermediaries) by millions of people. We shall continue to investigate the phenomenon, in a dialogue with the industry, in order to understand its causes and characteristics better and to determine whether initiatives are required to exploit in the fullest possible way a tool that we believe to be of great benefit to consumers.

In the first quarter of this year, the average price paid for motor liability insurance was €368, with a 4 per cent increase with respect to the same period last year. The average discount in relation to the premium rate is substantial, but varies depending on the policyholder's geographical area of residence. The minimum is reached in the North-West (30.9), the maximum in the South (40.3), where average basic premium rates are higher. Both percentages have risen sharply since 2014. The high discounts applied in the South are associated with a higher prevalence of the 'black box' (36 per cent, compared with the national average of 22 per cent), which is in turn linked with higher reference premiums, so that the more prudent drivers have a stronger incentive to use this option. On PreventIvass, undertakings can offer a discount for the black box in a transparent way, but until now this option has only been used in a few instances.

I am pleased to acknowledge here the excellent state of cooperation that is in place with other authorities at national level.

The Eurovita case demonstrated the importance of such cooperation in stressed conditions. We had continuous and fruitful discussions with the government, other national sectoral authorities and the numerous institutions involved. We offered and received full cooperation. The case, which connected a life insurance company to a multitude of bank distributors, validated the legislator's 2012 decision to strengthen the integration of banking and insurance supervision. The close relationship that exists between Ivass, which I preside over, and the Bank of Italy, of which I am privileged to serve as Senior Deputy Governor, enables the governing bodies to focus on prudential issues at an early stage from an integrated perspective, to assess the impact on individual operators and the system as a whole, and to coordinate the initiatives to be taken.

I greatly value our tried-and-tested relationship with the Guardia di Finanza in the investigation of violations of the rules governing insurance

products and distribution (fake websites), as well as in contrasting money laundering and the financing of terrorism. We are currently in the process of finalising a new memorandum of understanding that will further strengthen our mutual cooperation.

On the other hand, we continue to encounter in some cases difficulties in coordinating with other European insurance authorities for the supervision of cross-border operators, particularly companies operating on the Italian market under the freedom to provide services across the European Union. A recent incident, which we reported on our website, once again highlighted the limits of the current approach: despite the emergence of obvious critical issues from both a prudential and a market conduct perspective, the adoption of appropriate action took an inordinate amount of time, which was incompatible with adequate and timely consumer protection. We believe that the existing procedures, centred on the EIOPA, should be reviewed and strengthened to make them simpler and more effective. The perception of the functioning of the European single market is at stake.

Authorities, Ladies and Gentlemen,

The past year has presented us with some tough challenges.

I would like to conclude these remarks by thanking, on behalf of the Joint Directorate and the Board of Directors, the Secretary General, the management and the entire staff, who have dealt with both old and new difficulties with the professionalism and dedication to which they have made us accustomed. Their efforts have allowed Ivass to maintain a steady course during a difficult navigation in 2022 and the early months of 2023 and to take, in a timely manner and with all the necessary technical and legal support, the sometimes delicate and innovative decisions required to pursue our institution's goals with impartiality, knowledge and resolve; to make our voice heard in European and international fora.

As I stated last year, I am persuaded of the need to take another step in the process of integration with the Bank of Italy, by a reform of the institutional structure of Ivass that would rationalise its operations and further enhance its efficacy through a full sharing of support functions with the Bank of Italy, an increasingly close exchange between the respective institutional functions and the gradual integration of staff. When the new Government took office, we resumed discussions with the relevant authorities, first and foremost the Minister of Enterprises and Made in Italy. We have received signals that confirmed interest in and openness to the process.

Lastly, let me extend, with admiration and affection, a special greeting to Ignazio Visco, Governor of the Bank of Italy for the past twelve years and ex officio Chairperson of Ivass' Joint Directorate since its inception He has been a point of reference and a symbol of continuity throughout the varied and difficult phases that this institution has experienced.

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