



# ITALY

## TECHNICAL NOTE ON INSURANCE SECTOR

December, 2013

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# ITALY

## FINANCIAL SECTOR ASSESSMENT PROGRAM

March 2013

# TECHNICAL NOTE

## INSURANCE SECTOR

Prepared By  
**Monetary and Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Italy. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at:

<http://www.imf.org/external/np/fsap/fssa.aspx>.

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## Glossary

AIBA	Insurance Brokers Association
ANIA	National Association of Life and Non-Life Insurers
ASSIREVI	Italy League of Auditors
BOI	Bank of Italy
CONSAP Spa	Concessionaire for Public Insurance Services
CONSOB	National Commission for Listed Companies and the Stock Exchange
CNA	National Council of Actuaries
CPA	Certified Public Accountant
CPD	Continued Professional Development
COVIP	National Supervisory Authority for Pension Funds
EEA	European Union Economic Area
EDFs	Expected Default Frequencies
EIOPA	European Insurance and Occupational Pensions Authority
ERM	Enterprise Risk Management
ERSB	European Systemic Risk Board
EU	European Union
FSAP	Financial Sector Assessment Program
FSC	Financial Stability Committee
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
GFSR	Group Financial Service Regulators
GWP	Gross written premium
IAS	International Accounting Standards
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IBNR	Incurred but not reported claims
ICP	Insurance Core Principles
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
IMF	International Monetary Fund
ISVAP	Former Institute for the Supervision of Insurance in Italy
IT	Information Technology
IVASS	Institution for the Supervision of Insurance in Italy
MCR	Minimum Capital Requirement
MoU	Memorandum of Understanding
MMoU	Mutual Memorandum of Understanding
MPTL	Mandatory Motor Third Party Liability
OIC	Italian Accounting Board
ORSA	Own Risk Solvency Assessment
QRS	Quarterly Reporting System
SCR	Solvency Capital Requirement

TP	Technical Provision
UK	United Kingdom
USA	United States of America

## INTRODUCTION<sup>1</sup>

1. **This technical note covers the insurance sector supervised by IVASS.** The analysis was carried out as part of the 2013 Financial Sector Assessment Program (FSAP) of Italy, and was based on the regulatory framework in place, the supervisory practices employed, and other conditions as they existed in March 2013.
2. **The resilience of the insurance sector was analyzed using standard tools, ratios and supervisory data.** While no stress test was carried out, existing stress test results were reviewed. Also the expected default frequency of publicly traded insurers was calculated using recent market data and also including a market capitalization shock. Further, insurance data was examined to determine correlations with economic variables and sovereign debt pointing to possible future vulnerabilities.
3. **The assessment has been supported by discussions with IVASS and market participants.** The analyst is thankful for the outstanding collaboration received by IVASS and the management of interviewed insurers.

## EXECUTIVE SUMMARY

4. **IVASS has reached international best practice in several areas of supervision.** IVASS actively exercises group supervision since 2000. Reinsurance reporting is comprehensive and contains details that allow tracking exposures to any given reinsurance, even at an individual risk level. IVASS collection of monthly data in key areas that allow for close monitoring of the liquidity risk in the insurance sector is commendable. IVASS has effectively enhanced its corporate governance and risk management supervision and is actively involved in the internal models pre-approval process in furtherance of preparations for Solvency II implementation. The supervision of conduct of business affords broad consumer protections.
5. **Notwithstanding the high level of compliance with the IAIS principles critical principles remain to be taken on.** Twenty one principles are fully or largely observed, however the remaining five principles that are partly observed are central to maintaining financial stability of the sector and preventing possible unexpected insolvencies. Valuation and the use of capital are based on the Solvency I framework and need to include stronger risk sensitiveness. Further clarification of appropriate margins, parameters and technical reserve calculation methodology is necessary to assure adequacy of technical reserves. The additional three partly observed principles required a complete overhaul of the supervisory structure and processes including quality controls, consistency checks and specialized onsite supervision.

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<sup>1</sup> The work was carried out by Rodolfo Wehrhahn, Technical Assistance Advisor in the Financial Supervision and Regulation Division of the Monetary and Capital Markets Department, IMF.

**6. The new structure that IVASS is establishing has a great potential to address shortcomings found in the recent FSAP, but at the same time operational and implementation risks are high.** IVASS has only been in existence since January 1, 2013, although some preliminary preparations have been occurring since September 2012 to implement the transition and is required to provide its new structure at the end of April 2013. Key challenges are current: IVASS is supervising a critical merger of major insurers, the failure of which could have a substantial market impact and undermine IVASS credibility. Also internal model pre-application continues and is a key process for the proper future capitalization of the sector. The transition into the new organization needs careful attention to avoid the loss of IVASS' institutional knowledge and possibly create supervisory gaps.

**7. The anti-crisis measures introduced for the insurance sector have helped the sector navigate through the recent sovereign debt volatility and created an effective early warning supervisory tool.** The measures in force since 2011 adopted in line with the anti-crisis law decree issued in 2008 allow now the difference between cost value and market value of EU sovereign bonds available for sale to be used as capital in the form of a "non-distributable reserve". The peak of its use was in 2011 when 69 insurers representing 65 percent market share applied these measures resulting in 8 percent solvency support (5.8 percent nonlife and 13.9 percent in life). In 2012 only 12 insurers took advantage of the anti-crisis measures representing 2.7 percent market share and having an insignificant impact on the solvency (0.04 percent). IVASS collects monthly data in key areas that allow for close monitoring of the liquidity risk and real solvency position of the insurers. As a result of this monitoring, during 2012 IVASS enforced capital injections in the order of EUR 2 billion. The series of requirements to monitor the use of the anti-crisis measures and the related supervisory triggers introduced allow IVASS to have an effective early warning tool. The anti-crisis measures will be in force until the introduction of Solvency II with a transition period of six months.

**8. The insurance market is suffering from the economic conditions as confirmed by the negative market reaction.** The reduced saving capacity of the population has impacted the life business demand and relative production has dropped by over 20 percent, in the last two years. Share prices of insurers are about half of their value in 2007, or less. The systematic high claims experience in MPTL together with the sluggish economy have negatively impacted on the profitability of insurers showing in 2010 and 2011 negative returns on equity, however, preliminary 2012 results show a change in the trend with decreasing loss ratio and positive operating results. Further, the large exposure to sovereign debt, in particular to the national bonds has created a significant rise in the spreads of the insurance sector CDS, that show a strong correlation with the sovereign debt volatility.

**9. Life insurance could run into liquidity strain as new production stalls, and lapses and claims augment.** Life insurance business production has been suffering in the last two years, with the premium coming from EUR 92 billion in 2010 down to EUR 71.6 billion in 2012. Further, lapses have increased since 2009 from 40 percent to 68 percent in 2012 resulting in worrisome total outflows of claims (payments for capital accrued and for death on premiums) and lapses above 100 percent of total premium since 2011. The liquidity problem however appears not to be



imminent as the fourth quarter 2012 vulnerability assessment carried out by IVASS indicates insurers are not engaging in liquidity swaps ; there is no abuse of reinsurance that could hide illiquidity issues; and no major delays in claims payments have been observed.

**10. Direct exposure to the banking sector remains low but distribution dependence is affecting the life sector.** The bank exposure through securities remains under 19 percent of the insurers' assets<sup>2</sup> with EUR 82.3 billion in the fourth quarter of 2012. Further, a third of the securities correspond to secured bonds. While the direct exposure to banks appears not to be a source of vulnerability, the strong dependence on the banking channel for the distribution of life insurance products is one of the reasons for the cut down of life production by 20 percent in the last two years as banks move in selling their own products.

**11. Urgent action to address fraud is needed to return the main line of nonlife business profitable.** Notwithstanding a slight improvement in 2012, a general deterioration of motor vehicle bodily injury claims experience has affected the insurers that are losing money since 2008. The main causes appear to be linked to fraud, and a more generous court awards that basically lacks of an indemnity level table, whose implementation is urgently recommended. In this context, the full development and effective implementation of IVASS anti-fraud database is a commendable step to be achieved.

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<sup>2</sup> Information refers to a sample of entities (quarterly vulnerabilities survey) including larger domestic groups (eight insurance groups—consolidated data) + selected individual undertakings (five solo undertakings).

# INSTITUTIONAL, REGULATORY, AND MARKET STRUCTURE—OVERVIEW

## A. Institutional and Regulatory Overview

**12. Responsibilities for supervision of the financial sector have been delegated to four independent authorities:** The Insurance Supervisory Institute (ISVAP, now IVASS) supervises the insurance sector; the Bank of Italy supervises the banking sector and collaborates with the National Commission for Listed Companies and the Stock Exchange (CONSOB) in supervising the securities sector; and the Supervisory Authority for Pension Funds (COVIP).

**13. Italy has mechanisms in place to promote coordination among the different regulators.** IVASS collaborates by exchanging information with EIOPA and the other European supervisory authorities, the Joint Committee, the ESRB, the institutions of the EU and the supervisory authorities of the individual Member States, in order to facilitate the exercise of their respective functions. IVASS regularly cooperates in regulatory matters with countries outside the EU and is signatory to the IAIS MMoU. IVASS also has a MoU with the Financial Supervisory Authorities, Central Banks and Finance Ministries of the EU on Cross-border Financial Stability.

**14. A Financial Stability Committee (FSC) chaired by the Minister of Economic and Finance was established in 2008.** The Ministry of Economic and Finance, the Bank of Italy, CONSOB, and IVASS have a MoU in place since March 2008 to cooperate, exchange information and assessments to strengthen financial stability, as well as to prevent and manage financial crises with potential systemic effects. The FSC analyzes financial stability issues, develops emergency plans, and conducts crisis simulation exercises. The FSC is mandated to meet at least twice a year, but has met more frequently on an ad hoc basis since 2008, particularly during periods of high tension in the financial markets.

**15. Primary insurance legislation is based on the Insurance Code enacted through Law 209/2005.** This code represents a complete overhaul and codification of the existing insurance laws and introduced a number of innovations. Certain aspects of the code requires IVASS to adopt separate regulations, which have been developed following public consultation and cost/benefit analysis from 2008 to the present.

**16. A new supervisory agency for insurance was created in January 2013.** Pursuant to Law 135/2012, ISVAP was transformed into IVASS, which now operates in close cooperation with the Bank of Italy to fully integrate supervision of the insurance sector with banking supervision. IVASS is now in a transition process, assuming all ISVAP powers, functions, objectives and judicial relationships; in particular: regulatory powers; offsite and onsite supervisory powers; and, sanctioning powers. When the IVASS transition began on January 1, 2013, full supervision on loss-adjusters—including the keeping of their Register—as well as the management of the Information Centre for motor insurance liability will be transferred to CONSAP Spa-Concessionaire for public insurance services.

**17. Italy's accounting and auditing professionals adequately support the regulatory framework and follow EU Directive standards.** The Italian Accounting Board (Organismo Italiano di Contabilit —OIC) is primarily responsible for issuing national accounting and auditing standards and for interfacing with international standard setters. If IVASS, the Bank of Italy, or CONSOB gives an adverse opinion on an OIC document, then an OIC qualified majority is required for formal approval of the document and the dissenting opinion must be publicly disclosed. There are approximately 50,000–60,000 accountants overseen by the Ministry of Finance. ASSIREVI (Associazione Italiana Revisori Contabili) is the private non-profit auditor association in Italy (established 1980). There are approximately 400 registered auditors for insurance and intermediaries and 100 auditors for insurance only. CONSOB is responsible for the supervision of audit firms and auditors on public entities and has the authority to impose discipline, fines and sanctions on auditors.

**18. The actuarial profession is a protected profession in Italy.** The National Council of Actuaries CNA (Ordine Nazionale degli Attuari) was founded in 1942 to oversee the actuarial profession, maintain a national code of conduct and professional discipline in accordance with international standards, provide continuous professional development (CPD) training, maintain relationships with supervising authorities and develop actuarial standards of practice, including standards for technical reserves (subject to disciplinary process, appealable to CNA and the courts). As of December 31, 2012, there were approximately 881 registered actuaries in Italy, with approximately 400–500 working in the insurance sector. There is strong demand for actuaries and CNA is encouraging the actuarial activity at university level.

**19. Well established broker and insurer associations support the regulatory framework.** The brokers' association (Associazione Italiana Brokers di Assicurazioni e Riassicurazione) AIBA was founded in 1969 to establish professional standards and code of conduct (professionalism, independence, transparency to customers) for brokers in the insurance sector. AIBA currently has approximately 1,100 members, representing approximately 70 percent of the profession and about 90 percent of the insurance market based on commission income. AIBA maintains relationships with IVASS on intermediaries' activities and supervision, CONSAP and operation of the National Guaranty Fund for motor vehicle liability and works with the technical committees of the Ministries involved in insurance matters. The insurance sector is represented by the Italian National Insurance Association, (ANIA). ANIA is the national association for life and nonlife insurers in Italy, maintaining industry-wide statistical analysis, including industry trends, particularly in motor vehicle insurance, claim settlements, regulatory requirements, corporate governance and risk management, anti-fraud measures, Solvency II preparations and other matters of interest to the insurance industry.

**20. The money and securities markets available to Italy are considerable and readily accessible.** A variety of instruments and issuers operate in the Italian financial market in addition to the deep and sophisticated EU markets that serve Italian investors' needs. No foreign investments restrictions are in place.

## B. Market Structure Overview

**21. The insurance sector in Italy is relatively large in a global context and the cradle of insurance.** The first known insurance contract dates back to 1347 and was done in Genoa. At present, the Italian insurance industry ranks seventh in the world in terms of premium income with 3.48 percent global market share or around EUR 113.5 billion in 2011 of which 67 percent correspond to life and 33 percent to nonlife. The provisional 2012 numbers indicate a reduction of 4.5 percent in premium. Life premium which is 5.5 percent down to EUR 71.6 billion and nonlife premium is down to EUR 36.7 billion or 2.7 percent. The total assets of the insurance sector amounted in 2011 to EUR 585.6 billion or approximately 37 percent of GDP of which over 80 percent correspond to life. The total technical provisions accounted for EUR 494 billion and the equity for EUR 48.2 billion in 2011. Preliminary numbers for 2012 point to a 3 percent increase in assets (Table 1), while technical provisions account for EUR 504 billion.

**Table 1. Italy: Insurance Sector Premium and Assets, 2007–2012 (\*)**

	2007	2008	2009	2010	2011	2012*
Gross premium						
Life	63,389	56,450	82,931	92,061	75,767	71,624
Nonlife	39,945	38,543	37,796	36,794	37,752	36,738
<b>Total</b>	<b>103,334</b>	<b>94,993</b>	<b>120,727</b>	<b>128,855</b>	<b>113,519</b>	<b>108,362</b>
Assets						
Life	423,318	397,795	450,095	481,433	480,637	496,731
Nonlife	107,520	107,566	110,685	105,382	105,030	106,997
<b>Total</b>	<b>530,838</b>	<b>505,361</b>	<b>560,780</b>	<b>586,815</b>	<b>585,667</b>	<b>603,728</b>

Source: Authorities' (\*) Data referred to 2012 are provisional.

**22. The number of undertakings in the insurance sector remains stable, but with an increased number of foreign branches operating in the jurisdiction.** At the end of the January 2013, 236 insurers and reinsurers serve the market, as compared with 242 in 2007. Currently, of the 236 insurance undertakings only 137 are domiciled in Italy and 99 are foreign insurer and reinsurer branches, whereas in 2007, 162 insurers were domiciled in Italy and only 80 operated as foreign branches (Table 2).

**23. Banks and post offices in life and agents in nonlife dominate the distribution of insurance.** IVASS maintains and updates a single electronic register of insurance and reinsurance intermediaries having their residence or head office in Italy. Although there is a diverse network of distribution channels, making use of virtually all established forms of insurance sales, life insurance is mainly sold through banks and post offices (54.5 percent in 2011 and 48.5 percent in 2012) and nonlife through agents (84 percent invariant over several years) that can have agreements with one or more companies. Also, brokers are active in the market mainly for corporate accounts. The number of agents has not experienced any significant reduction in the last 5 years and currently there are almost 37,500 agents and 4,700 brokers active in the market (table 2).

**Table 2. Italy: Number of Registered Insurance Undertaking and Intermediaries, 2007–2011**

	2007	2008	2009	2010	2011
<b>Domestic insurers</b>					
Life (long-term)	68	65	64	61	57
Non-life (general)	77	80	78	76	71
Composite	17	17	14	14	14
	162	162	156	151	142
<b>Insurance intermediaries</b>					
Agents	39,460	39,418	38,831	38,363	37,491
Brokers	3,888	3,954	4,204	4,459	4,747
<b>Supplementary information</b>					
Foreign branches *	80	84	85	91	97
Local insurers' branches abroad	N.A.	N.A.	18	19	20
Insurance groups	N.A.	35	39	36	34

\*Includes reinsurers

**24. The sector is highly concentrated and home of the third largest global insurance group.** Based on 2011 data, approximately forty five percent of the life and of the nonlife insurance business is provided by 5 companies and over 63 percent by 10 companies out of 142 insurers. The concentration is even higher if groups are considered, where 62.6 percent of the life business and 68.8 percent of nonlife business come from the top five groups. The consolidated accounts of the top 10 groups domiciled in Italy account for just over hundred percent of the Italian market and approximately 134 percent of the assets due to the consolidation of their global activities (Table 3 and 4).

**Table 3. Italy: Market Share of Top 10 Insurers, 2011**

Life sector—as percentage of total assets		Non-life sector—as percentage of total premiums	
1	12.43	1	10.04
2	10.42	2	9.98
3	10.14	3	9.35
4	8.15	4	8.35
5	4.54	5	7.04
6	3.85	6	4.83
7	3.62	7	4.59
8	3.53	8	3.76
9	3.36	9	3.63
10	2.90	10	3.53
<b>Total</b>	<b>62.95</b>	<b>Total</b>	<b>65.11</b>

Source: Authorities.

**Table 4. Italy: Assets and Premium of Top 10 Insurance Groups in Million Euros, 2011**

Group	Assets	Premiums
	Consolidated	Consolidated
1	423,057	65,666
2	83,744	10,850
3	58,611	9,548
4	50,181	9,267
5	41,477	8,836
6	39,578	7,660
7	33,972	6,145
8	23,973	3,753
9	17,922	3,495
10	12,996	1,923
<b>Total</b>	<b>785,510</b>	<b>127,144</b>

Source: Authorities

**25. The life sector offers mainly traditional products.** Almost 80 percent of the life net insurance premium is related to traditional life products that include with-profit endowments, whole life and term life (2011 data). Only 17 percent of the production is related to linked products (both unit and index linked products) whose risk is generally borne by policyholders (out of these only a smaller amount offer simple guarantees). The traditional products cannot guarantee a higher interest rate than the one published by IVASS, which is 60 percent of the 10 years Italian bonds' return (Table 5).

**Table 5. Italy: Life Insurance Products**

<b>Life Net Premiums written</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2011*</b>
Non linked life assurance	64,175	67,286	56,182	77
Linked life assurance	9,715	15,396	12,481	17
Capital redemption assurance	5,061	5,138	3,117	4
Group pension assurance	1,539	1,679	1,512	2
Other	26	27	32	0
<b>Total</b>	<b>80,516</b>	<b>89,526</b>	<b>73,325</b>	<b>100</b>

Source: Authorities. \*In percent of premium

**26. The nonlife sector is dominated by motor insurance that includes the obligatory MPTL.** The motor insurance is the dominant line of business in the nonlife sector representing 64 percent of the net premium (2011 data). Property is significantly lower, accounting for only 13 percent of the premium. Specialized lines of business like medical malpractice and professional liability insurance are mainly served by foreign providers through branches (Table 6).

**Table 6. Italy: Nonlife Insurance Products**

<b>Nonlife Net Premiums written</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2011*</b>
Motor	19,411	18,926	20,069	64
Fire and other damage to property	4,169	3,865	3,943	13
General Liability	3,050	2,705	2,722	9
Accident & health	5,048	4,852	4,804	15
<b>Total</b>	<b>31,678</b>	<b>30,348</b>	<b>31,539</b>	<b>100</b>

Source: Authorities. (\*) In percent of the premium. Residual class is missing but is almost negligible.

**27. Related party investments, reinsurance and other receivables are not significant assets.** IVASS oversight in this area has been stronger in the last two years and has resulted in a low exposure to these types of assets in the industry. Intra-group investments are closely monitored, underlined with strict limits and reporting requirements. Commission related receivables are settled every 2 weeks and reinsurance receivables are written off after 18 months (Table 7).

**Table 7. Italy: Assets of the Insurance Sector  
(in million euros)**

<b>Life</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Total assets	423,318	397,795	450,095	481,433	480,637
Receivables	8,349	9,559	9,447	10,836	11,664
Intra-group/related company receivables	362	328	459	84	85
Reinsurance recoverables	12,711	12,533	12,357	12,068	11,333
<b>Non-Life</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Total assets	107,520	107,566	110,685	105,382	105,030
Receivables	14,632	16,147	16,116	15,740	15,213
Intra-group/related company receivables	189	262	290	288	239
Reinsurance recoverables	6,838	6,878	6,926	6,669	6,213

Source: Authorities

**28. Asset composition is predominantly in fixed income instruments, in particular in Italian government bonds.** The regulation fixing the maximal guarantee rate in the life sector in relation to the Italian bonds as well as the need for a long duration matching has induced life insurers to prefer this type of investments. Holdings in sovereign debts in the life sector are around half of the investment assets and around thirty percent in the nonlife sector. Corporate bond investments which are around 50 percent issued by banks account for 20 percent of the insurers' investments. The exposure to equities is higher in the nonlife sector with 32 percent, while in life it accounts for only 6 percent. Exposure to real estate is almost 8 percent in nonlife and is insignificant in life (Table 8).

**Table 8. Italy: Investments of the Insurance Sector (in million euros)**

<b>Life</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012*</b>
Investments	388,507	358,205	410,827	442,574	437,347	451,257
<i>of which:</i>						
Government securities	137,225	119,339	150,326	183,063	201,215	219,456
Corporate securities	61,305	70,107	84,095	86,656	77,523	76,721
Equities	27,750	25,588	29,587	29,095	27,820	25,045
Real estate and real-estate related	1,051	1,105	1,186	893	998	576
Investments supporting unit-linked	137,322	116,980	117,211	112,144	98,911	97,521
<b>Non-Life</b>						
Investments	77,890	76,471	78,652	74,441	74,037	75,731
<i>of which:</i>						
Government securities	26,509	23,249	24,278	22,881	23,633	25,656
Corporate securities	12,173	14,171	15,055	14,297	13,658	13,730
Equities	28,435	29,388	30,048	27,656	26,527	24,561
Real estate and real-estate related	4,727	5,159	5,340	5,620	5,904	6,203

Source: Authorities—(\*) Data referred to 2012 are provisional.

**29. The reinsurance market in Italy is served by foreign branches.** Currently there are no Italy domiciled reinsurers; insurers purchase reinsurance from foreign entities. Over 80 percent of the reinsurance exposure is to A- or superior rated reinsurers. The exposure to non-rated reinsurers is minimal and mainly driven by affiliated entities' transactions.

**30. Under Solvency I requirements, as prescribed by IVASS, both life and nonlife industries have maintained on average adequate levels of capital.** The solvency margins dropped from 198 percent to 175 percent in the life sector between 2009 and 2011 while the nonlife sector experienced a minimal drop from 285 percent to 272 percent. The anti-crisis measures applied mainly in 2011 allowed, on average, for an increase margin of around 8 percent. Preliminary 2012 numbers indicate a increase solvency of 197 percent for life and 278 for nonlife (Table 9).



**Table 9. Italy: Insurers' Solvency Position (in percent)**

Available Capital over Min. Capital Requirement	(End-period, in percentage)			
	2009	2010	2011	2012*
Life (long-term)	594	560	525	na
Non-life (general)	889	893	839	na
Available capital resources over Prescribed Capital Requirement	(End-period, in percentage)			
	2009	2010	2011	2012*
Life (long-term)	198	187	175	197
Non-life (general)	285	288	272	278

Source: Authorities—(\*) Data referred to 2012 are provisional

## MAIN FINDINGS

### A. Regulatory and Supervisory Key Findings

**31. IVASS has reached international best practice in several areas of supervision that is carried out by highly qualified professionals.** IVASS actively exercises group supervision and by 2000, IVASS established the first college of supervisors. Intragroup transactions and related party participations limits are strictly monitored and enforced. Reinsurance reporting is comprehensive and contains details that allow tracking exposures to any given reinsurance, even at an individual risk level. IVASS collection of monthly data in key areas that allow for close monitoring of the liquidity risk in the insurance sector is commendable. IVASS handling of the licensing of undertakings is complete and comprehensive and assures appropriate considerations pursuant to regulations. IVASS has effectively enhanced its corporate governance and risk management supervision and is actively involved in the internal models pre-approval process in furtherance of preparations for Solvency II implementation. The supervision of conduct of business affords broad consumer protections and market-wide oversight of insurers to ensure the fair treatment of customers.

**32. Some areas of supervision need improvement and quality controls should be introduced.** IVASS has a general policy of conducting onsite inspections every four years, there are occasions where the onsite inspections do not occur within that time parameter. In addition, all supervisory staff perform inspections in all areas of supervision, without specialization of particular staff members in particular focus areas to ensure expertise and a sophisticated depth and granularity of analysis of specific areas of supervision. Upgrading the quality and focus of onsite inspections will ensure a full scope analysis of the market. Further, to enhance the quality and consistent application of best practice supervision, the creation of a task force of experienced supervisors is recommended. The supervision of intermediaries is reactive rather than preventive. IVASS conducted only 160 onsite inspections of intermediaries over the past 3 years, from

2010–2012. This number of inspections is insufficient to adequately and effectively assure appropriate levels of professional knowledge, experience, integrity and competence. IVASS Antifraud Division's onsite inspections on intermediaries and anti-fraud complaint activity require enhancement.

**33. The level of observance with the IAIS core principles is high.** Following the 2013 FSAP assessment of the observance of the IAIS principles, fourteen of the 26 principles are fully observed and seven largely observed including the new principles on macroprudential supervision and cross-border crisis management. Five principles are only partly observed and need urgent attention. Two of these partly observed principles are related to the use of Solvency I on valuation and capital determination. The remaining three partly observed principles including the central ICPs related to the supervisor structure, operation and process of supervision and the supervision of intermediaries. No principles were found not to be observed.

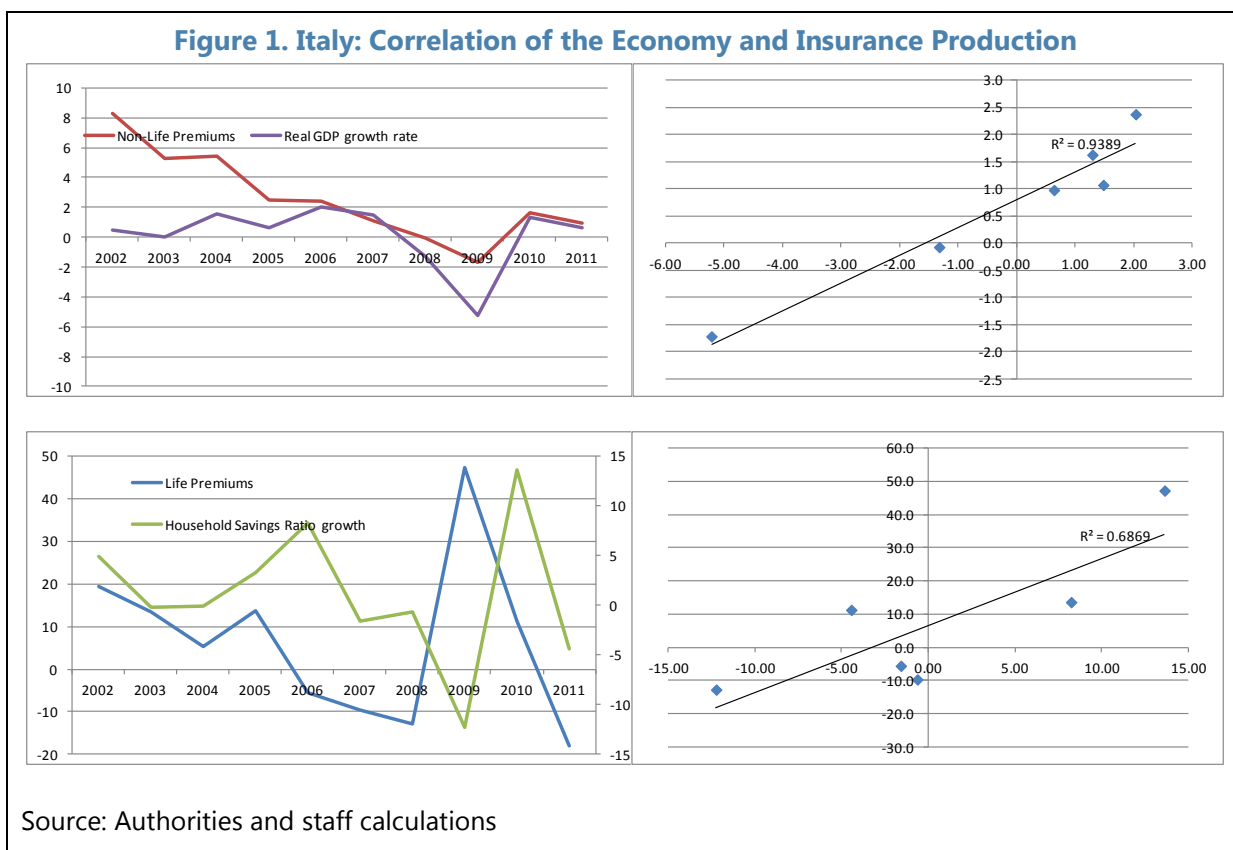
**34. The anti-crisis measures introduced for the insurance sector have helped the sector navigate through the recent sovereign debt volatility.** Following the financial crisis, Parliament introduced elements of asset evaluation in anti-crisis measures that are not market consistent and deviate from established accounting principles, this also to take into account IASB amendment in IAS 39. The measures in force since 2011 adopted in line with the anti-crisis law decree issued in 2008 allow now the difference between cost value and market value of EU sovereign bonds available for sale to be used as capital in the form of a "non-distributable reserve". The peak of its use was in 2011 when 69 insurers representing 65 percent market share applied these measures resulting in 8 percent solvency support (5.8 percent nonlife and 13.9 percent in life). In 2012, only 12 insurers took advantage of the anti-crisis measures representing 2.7 percent market share and having an insignificant impact on the solvency (0.04 percent).

**35. IVASS implementation of the anti-crisis measures has resulted in an effective early warning supervisory tool.** IVASS has maintained regulatory oversight of the insurer's financial position on companies applying the anti-crisis measures. IVASS requires three main disclosures when using the anti-crisis measures. Undertakings must disclose: (i) the criteria used to value the government bond; (ii) provide templates to compare book value and market value to demonstrate potential losses; and, (iii) the amount of reserve that is unavailable for distribution to shareholders and finally, undertakings must also show the benefit from utilizing this measure. Undertakings are also required to report on asset and liability matching/management and must report expected returns. IVASS collects monthly data in key areas that allow for close monitoring of the liquidity risk and real solvency position of the insurers. As a result of this monitoring, during 2012 IVASS required capital injections in the order of EUR 2 billion. The series of requirements to monitor the use of the anti-crisis measures and the related supervisory triggers introduced allow IVASS to have an effective early warning tool. The anti-crisis measures will be in force until the introduction of Solvency II with a transition period of six months.

## B. Market Key Findings

**36. Insurance penetration is high in global terms, but Italy remains underinsured.** With a total insurance penetration of about 7 percent of GDP, Italy is just below the EU insurance penetration average of 7.8 percent, but remains behind The Netherlands and France with insurance penetration of 13.3 percent and 10.61 respectively. Another indicator for the need of developing insurance is the significant amount of motor insurance, making over 60 percent of all nonlife premium, as compared with a 30 percent on more developed insurance markets like Germany, the U.K., and France.

**37. Insurance growth will require strong performance of the economy.** As evidenced in Figure 1, real GDP growth rate has an important impact on the growth rate of nonlife premium. A decline in nonlife premiums followed the economic downturn between mid-2007 to mid-2009. During 2010, nonlife premiums exhibited higher correlation with the GDP growth rate, but are less volatility than the latter. Simple regression of nonlife premiums on real GDP growth rate since 2006 gives a very high coefficient of determination R-squared of 0.94. Also life insurance is strongly linked to economic performance and appears to be a good predictor of the household savings ratio growth. With the lag of one year, new premium in life insurance is strongly correlated with the household saving ratio growth also indicated in Figure 1. Linear regression between new life premium growth and the household saving ratio growth of the following year indicates a high coefficient of determination R-squared of 0.69.



**38. Guarantees offered by the life insurers are under control.** Insurers have been able to manage the low interest rate environment by lowering the guarantees in their product offering during the last 10 years. Currently the market average return of the segregated funds is around 3.86 percent while the average guaranteed return is 2.09 percent (data referred to 2011). Also 80 percent of the mathematical reserve corresponds to business with guarantees less than 3 percent and over 19 percent offers return guarantees less than five percent. There is some minimal business (less than one percent) that guarantees higher return rates than 5 percent. These effective risk management measures have however diminished the attractiveness of life insurance.

**39. Domestic sovereign debt remains largest exposure for the insurance sector.** IVASS' quarterly monitoring of sovereign debt exposures<sup>3</sup> indicate an increased market value exposure to government bonds in the fourth quarter 2012 as compared with the second quarter 2012 equal to nearly 10 percent (from EUR 242.3 billion up to EUR 266.3 billion). The increment is mainly due to tightening of the spreads experienced by these assets during the quarters rather than a change in the investment strategy of insurers. The share of Italian government bonds over the total government bonds continues at around 80 percent (Table 10 and Figure 2).

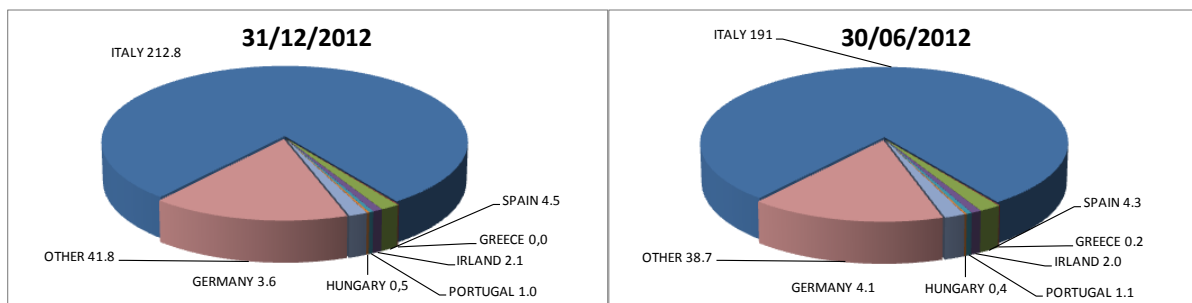
**Table 10. Insurers' Sample Country Debt and Bank Sector Exposure (Quarter 2-2012 and Quarter 4-2012 Consolidated Accounts—Data in billion euros)**

	Market value		
	12/31/2012	9/30/2012	6/30/2012
<b>Government bonds</b>			
Duration 0-2 years	40.1	37.7	33.5
Duration 2-10 years	145.2	138.1	135.2
Duration 10+ years	81.1	75.2	73.6
	<b>266.3</b>	<b>251.0</b>	<b>242.3</b>
<b>Bank sector bonds</b>			
Duration 0-2 years	15.2	16.8	15.4
Duration 2-10 years	50.0	49.6	46.9
Duration 10+ years	12.5	12.5	12.0
	<b>77.7</b>	<b>79.0</b>	<b>74.4</b>
<b>Bank sector shares</b>	<b>4.6</b>	<b>4.7</b>	<b>4.6</b>
<b>Other investments with bank exposure</b>			
Term deposits , loans	75.8	70.9	66.6
Call deposits	19.6	16.1	11.5
	<b>95.3</b>	<b>87.0</b>	<b>78.1</b>
<b>TOTAL</b>	<b>444.0</b>	<b>421.7</b>	<b>399.4</b>

Source: Authorities.

<sup>3</sup> Information refers to a sample of entities (quarterly vulnerabilities survey) including larger domestic groups (eight insurance groups—consolidated data) + selected individual undertakings, (five solo undertakings).

**Figure 2. Italy: Country Debt Exposure of the Insurers Sample  
(Quarter 2-2012 and Quarter 4-2012 in billion euros)**



Source: Authorities.

**40. Direct exposure to the banking sector remains low but distribution dependence is affecting the life sector.** The bank exposure through securities remains under 19 percent of the insurers' assets<sup>4</sup> and the increment from EUR 79 billion in the second quarter 2012 to EUR 82.3 billion in the fourth quarter was driven by the improved market value of these instruments rather than new investments. Further, a third of the securities correspond to secured bonds. Call and term deposits (incl. loans and fixed income) showed a larger increment of 22 percent moving from EUR 78.1 billion to EUR 95.3 billion in the fourth quarter 2012 reflecting the strategic change in asset allocation in order to improve the liquidity of the portfolio. While the direct exposure to banks appears not to be a source of vulnerability, the strong dependence on the banking channel for the distribution of life insurance products is one of the reason of the decrease in life production (by 20 percent in the last two years) as banks move in selling their own products.

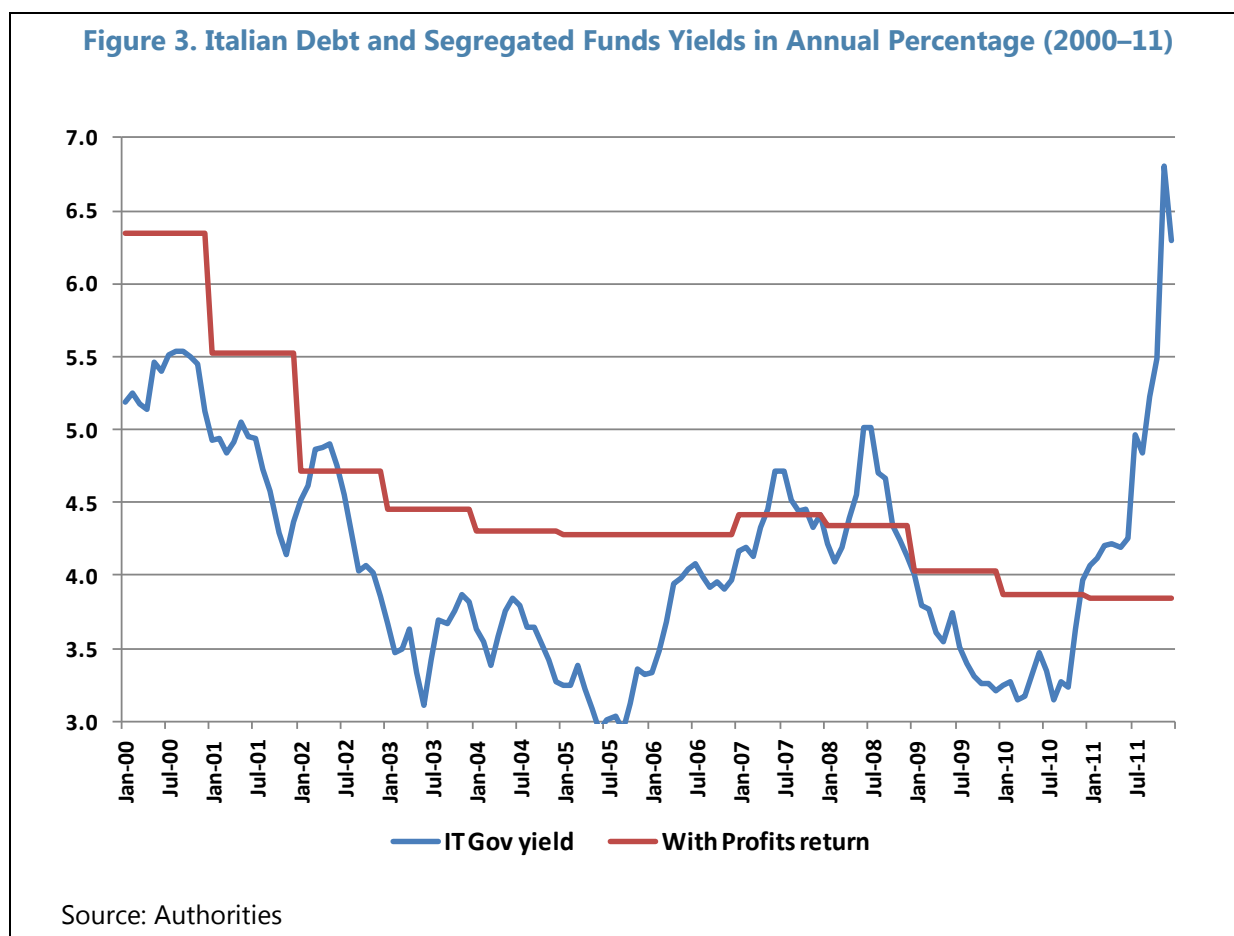
**Table 11. Italy: Bank Sector Bond Held by Insurers (December 2012)**

Type of Instrument	Dec. 2012 Percentage	
Secured Bond	27.5	35
Unsecured Bond	37.6	48
Subordinated Bond	12.6	16
Total Bonds Banking Sector	77.7	100

Source: Authorities.

<sup>4</sup> Information refers to a sample of entities (quarterly vulnerabilities survey) including larger domestic groups (eight insurance groups—consolidated data) + selected individual undertakings (five solo undertakings).

**41. Life insurance has partly lost its attractiveness and productivity is declining.** The double digit reduction experience by the life industry in 2008 recovered fast and in 2009 and in 2010 production maintained an important growth mainly driven by the perceived value in the guarantees provided by the products. The situation has reversed in the last two years and production has significantly dropped by 20 percent vis-à-vis 2010 as the with-profit business traditionally proving higher returns than government debt is now only able to pay a fraction of current Italian debt returns (Figure 3). The main distribution channels, banks and post offices accounting for over 50 percent of the production have now turned to sell primarily their own products.



**42. The insurance sector is experiencing losses under current fragile economic conditions.** In 2010–2011, negative roe of 5 percent resulted in nonlife and in the life business after a one percent positive roe in 2010, a significant 9 percent negative roe followed. Preliminary 2012 numbers indicate some signs of recovery with a positive roe for nonlife and a higher roe for life attributed to the reduction in new business strain typical of the life business (Table 12 and Table 13).

**Table 12. Key Figures of the Life Insurance Sector for 2007–12 (\*)**  
(in million euros, roe in percent)

Life	2007	2008	2009	2010	2011	2012*
Gross premiums	63,389	56,450	82,931	92,061	75,767	71,624
Net premiums	61,554	54,829	81,409	90,592	74,368	70,375
Investment income	14,523	14,164	16,496	15,853	16,242	21,925
Net claims incurred	74,376	65,684	57,342	66,999	74,177	75,305
Expenses	4,744	4,111	4,169	4,399	3,961	3,562
ROE (after tax)	10	-8	12	1	-9	15
Total assets	423,318	397,795	450,095	481,433	480,637	496,731
Share capital	25,278	21,986	30,040	29,302	28,232	33,692
Subordinated loans	3,296	3,468	3,740	4,191	4,142	na
Technical provisions	374,968	351,753	393,061	426,293	427,751	437,226

Source: Authorities (\*) Data referred to 2012 are provisional.

**Table 13. Key Figures of the Nonlife Insurance Sector 2007–12 (\*)**  
(in million euros, roe in percent)

Non-Life	2007	2008	2009	2010	2011	2012*
Gross premiums	39,945	38,543	37,796	36,794	37,752	36,738
Net premiums	34,608	34,063	33,812	32,458	33,590	33,270
Investment income	2,131	829	2,439	1,095	640	1,755
Net claims incurred	24,634	25,403	26,865	25,106	25,199	23,319
Expenses	8,647	8,462	8,465	8,141	8,322	8,018
ROE (after tax)	13	-1	0	-5	-5	4
Total assets	107,520	107,566	110,685	105,382	105,030	106,997
Share capital	20,406	18,946	21,763	20,958	20,019	20,813
Subordinated loans	2,584	3,456	4,634	4,562	4,609	na
Technical provisions	68,316	68,194	68,701	65,859	66,697	66,809

Source: Authorities (\*) Data referred to 2012 are provisional, and the investment income reported for the (provisional) 2012 financial year are net of investment expenses.

**43. The negative market reaction confirms the stress of the insurance sector.** Share prices of insurers are about half of their value in 2007, or less, and the CDS spreads are widening basically behaving similar to the sovereign CDS pointing again to the strong exposure to the domestic debt (Figure 4). When compared with other insurers in the EU and the U.S., the market continues penalizing the Italian participants (Figure 5). While the share price of publicly traded insurers in both the EU and the USA suffered during the 2008 crisis, their shares' market price appear to have recovered and currently are at the pre-crisis levels. The share price of Italian insurers however continues deterioration.

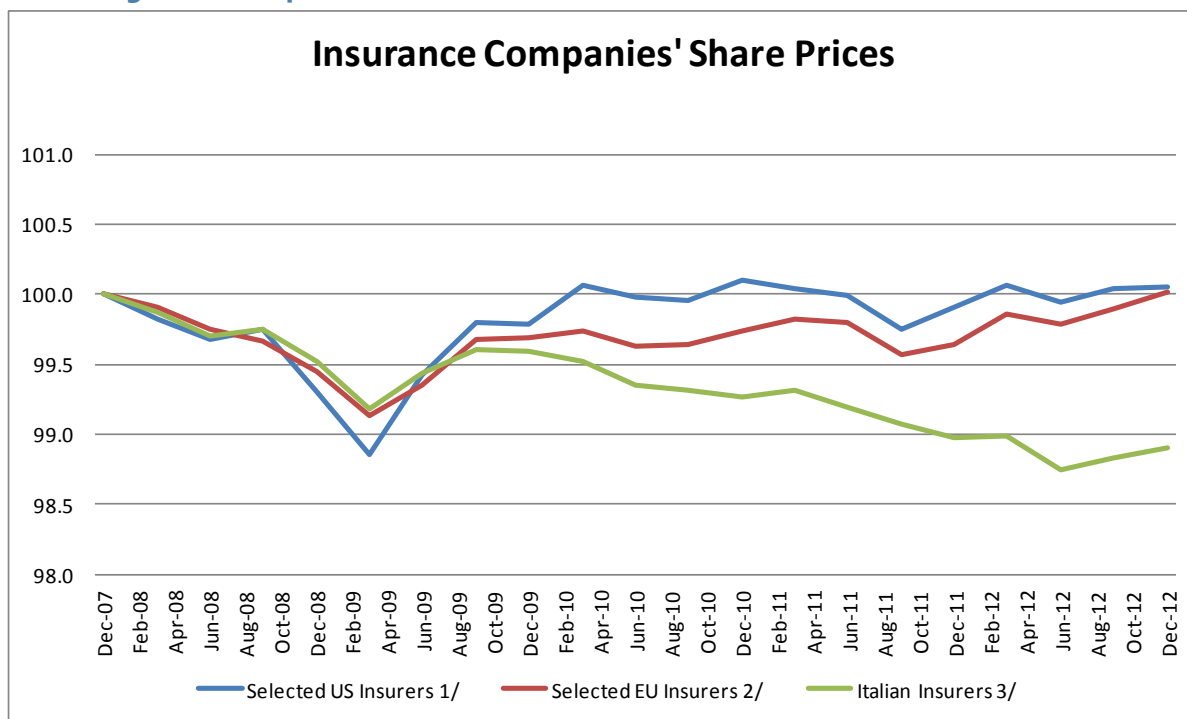
Figure 4. Italy: Selected Insurers' Share Price and CDS Development, 2007–2012



Source: Bloomberg



**Figure 5. Comparison of Share Price EU, U.S., and Italian Insurers, 2007–2012**



Source: Bloomberg

1/ Aflac, Metlife, Prudential, Hartford, Principal financial.

2/ Aviva, Legal & General, Prudential U.K., Allianz, Axa, Swiss Re.

3/ Generali, Unipol, Intesa Sanpaolo, Cattolica.

**44. Some Italian insurers’ expected default frequency calculated using the Moody’s KMV model are particularly high.** Following Moody’s KMV methodology publicly traded Italian insurers show expected default frequencies (EDFs) corresponding to companies below investment grades. While the absolute value of the EDFs calculated using Moody’s KMV methodology require significant adjustments, including adequate treatment of the technical reserves and their loss absorbance capacity to assess a realistic default frequency for insurers, nevertheless the relative higher values that result for Italian insurers is an indication of current challenges facing those insurers which is mainly attributable to their correlation with the national sovereign debt. With the exception of life insurers that show in general high EDFs, only after a twenty percent shock of the market capitalization of peer insurers in other EU jurisdictions lifts their EDF value to the current level of the Italian insurers (Table 14).

**Table 14. Expected Default Frequency Using Moody's KMV Methodology—Nov. 2012 (in percent)**

Company	Baseline	Shock	Increment
MEDIOLANUM S.P.A	1.53	2.34	53
ASSICURAZIONI GENERALI SPA	1.51	2.19	45
CATTOLICA ASSICURAZIONI S.C.A.R.L.	8.26	10.52	27
FONDIARIA - SAI SPA	8.13	10.42	28
MILANO ASSICURAZIONI S.P.A.	6.4	8.6	34
UNIPOL GRUPPO FINANZIARIO SPA	19.09	21.59	13

Company	Baseline	Shock	Increment
AEGON N.V.	4.43	6.04	36
ALLIANZ SE	1.96	2.94	50
AVIVA PLC	5.23	6.96	33
AXA	3.56	4.92	38
LEGAL & GENERAL GROUP PLC	3.33	4.71	41
MANNHEIMER AG	1.93	3.04	58
MAPFRE SA	1.02	1.58	55
MUENCHENER RUCKVERSICHERUNGS-GE	0.44	0.66	50
PRUDENTIAL PLC	1.57	2.34	49
SWISS RE LTD	1.03	1.64	59

Source: IMF Staff calculations

**45. The Italian insurance sector showed general resilience to the 2011 EIOPA stress test.**

At a solo level 144 undertakings participated with an aggregate minimum capital requirement (MCR) coverage ratio equal to 489 percent before stress. After applying shocks the ratio fell to 371 percent in the adverse scenario. In 23 cases, the MCR ratio dropped below 100 percent for certain scenarios, however, already 10 undertakings had an insufficient MCR ratio in the baseline. The average baseline solvency capital requirement (SCR) of the participants was 202 percent. The most significant impact was found in the adverse scenario and the SCR ratio dropped to 155 percent. The stress test was also performed at group level, including 11 Italian groups with an eligible capital before the stress test of EUR 44.5 billion at the year-end 2010. After applying stress scenarios, the ratio falls from 327 percent to 220 percent in the more severe adverse scenario. For only one group the impact of stress test reduced the own funds below the MCR.

**46. The QIS5 exercise shows well preparedness of the insurers for Solvency II.** Almost 100 percent of the market participated in this exercise. The capital requirement increased for all insurers (60 percent compared with Solvency I); at the same time the technical provisions—taking into account the illiquidity premium—decreased compared with solvency I requirements by 4 percent to 8 percent for life business and by 7.5 percent for nonlife. The solvency ratio slightly improved for the life companies but decreased for both the nonlife and composite firms; at market level there was a decrease of 7 percent as compared with solvency I. The main drivers

of the SCR come from market risks (72.6 percent of the basic SCR) and from the nonlife underwriting risk (37.5 percent of the basic SCR). The use of internal models showed mixed capital requirements. In 24 cases it was higher and in 28 lower than the SCR calculated using the Standard Formula. Work needs to be done to improving data availability and quality to calculate the liquidity premium, the reinsurance recoverable, expenses, and how to apply the new liabilities portfolio segmentation.

**47. Large companies have sophisticated ERM systems in place in accordance with the level of complexity of their business models.** Insurers have multiple ways of evaluating and pricing their risks and are aware of changes in the risk profile. There is a control cycle regarding the level of risk taken using metrics like risk appetite and concentration limits that include remedial actions, timely reporting, and feedback. The risk management assessments are incorporate into all processes of the company and decisions are taken based on the risk policy. For retained risks, several firms set aside reserves for expected losses and capital for excess losses beyond the regulatory requirements.

## C. Risks and Challenges

### Institutional risks and challenges

**48. Notwithstanding the high level of compliance with the IAIS principles critical principles remain to be addressed.** Twenty one principles are fully or largely observed, however the remaining five principles that are partly observed are central to maintaining financial stability of the sector and preventing possible unexpected insolvencies. Valuation and the use of capital are based on the Solvency I framework and need to include stronger risk sensitiveness. Upgrading the prudential requirements while waiting for the implementation of Solvency II is recommended. The additional three partly observed principles required a complete overhaul of the supervisory structure and processes including quality controls, consistency checks and specialized onsite supervision. The new structure that IVASS is establishing has a great potential to take on these shortcomings.

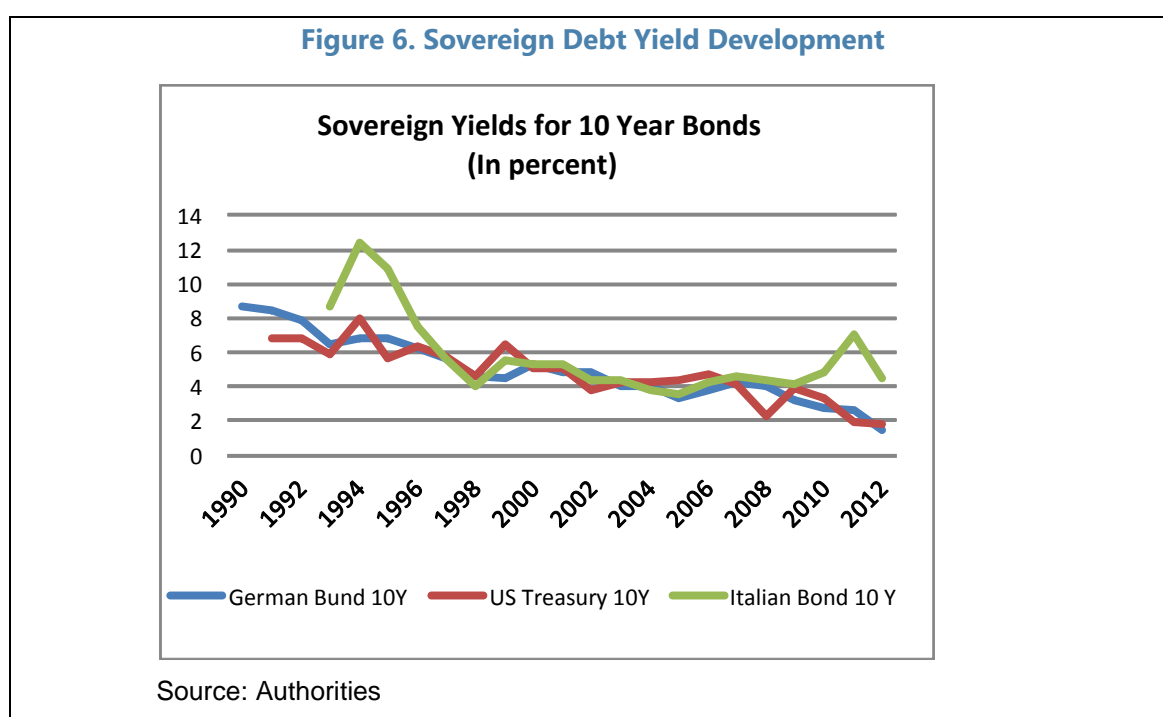
**49. Operational and reputational risks to IVASS are high, given the limited transition time available.** IVASS has only been in existence since January 1, 2013, although some preliminary preparations have been occurring since September 2012 to implement the transition and is required to provide its new structure by April 2013. Clear assignment of responsibilities and substantial operational delegation will be necessary to guarantee continuity in the duties of supervision. The transition into the new organization needs careful attention to avoid the loss of IVASS' institutional knowledge and possibly create supervisory gaps. Special attention will be required to address new developments in insurance regulation, particularly with the advent of Solvency II.

**50. The success of the pending merger of major insurers is critical to the insurance market.** IVASS is currently supervising a critical merger of major insurers in the market place, the success or failure of which could have a substantial market impact given the size of the

transaction and could affect IVASS credibility. The financial stability and resilience of the newly established company will require close monitoring and substantial resources from IVASS.

### Market risks and challenges

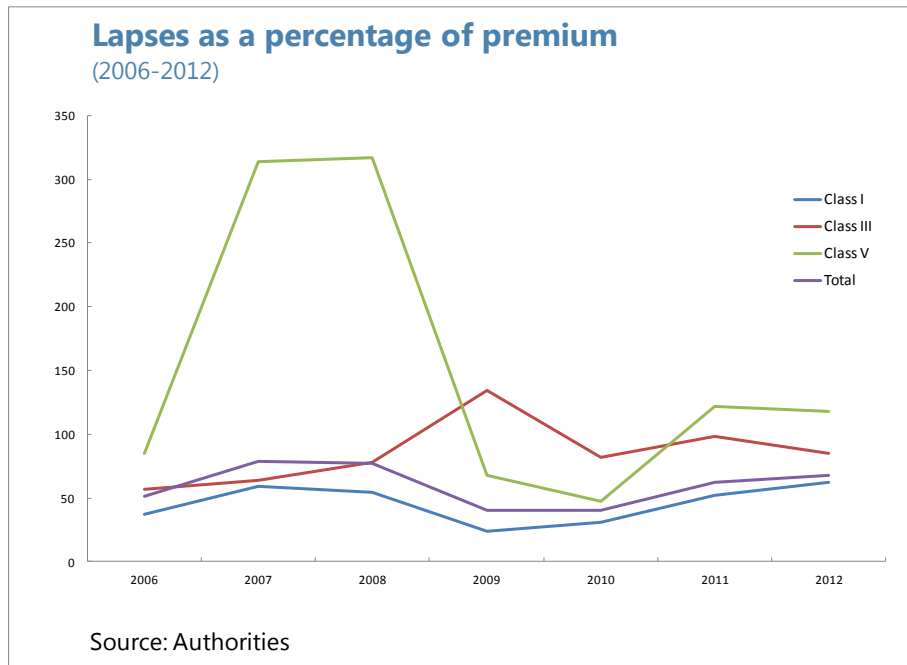
**51. The sophisticated risk management of the insurance industry will be severely tested in the coming years.** Strong risk management characterizes most companies in the country, however the current volatile and stagnated economic environment, the high exposure to declining or volatile sovereign debt (Figure 6), together with major regulatory reforms pending implementation in the coming years like Solvency II, IFRS, IMD2, PRIP are already negatively impacting the sector. Further, the institutional changes have added supervisory transitional risk to the industry.



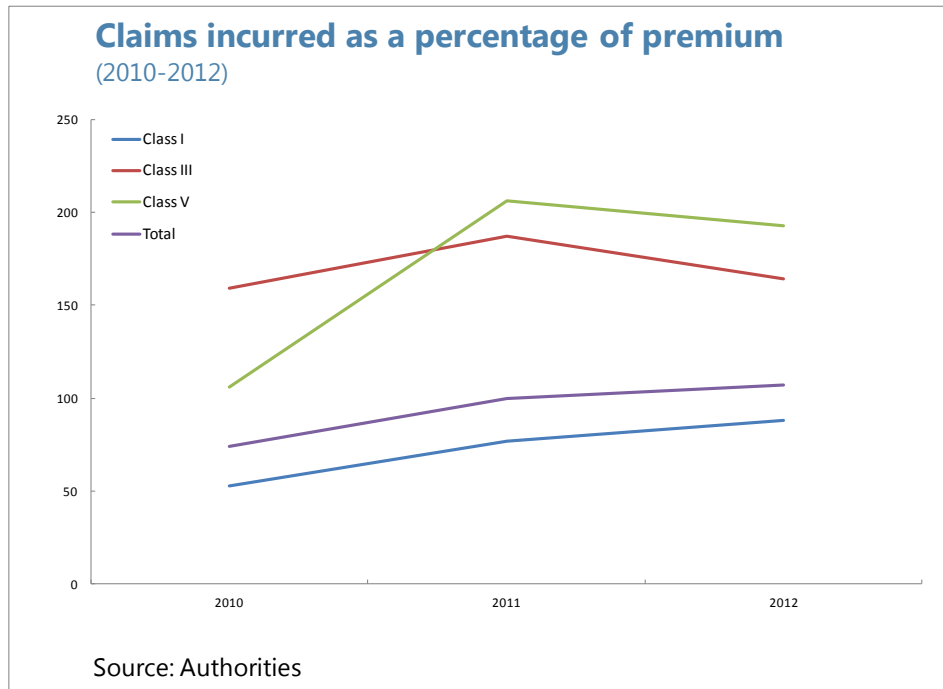
**52. Life insurance could run into liquidity strain as new production stalls, and lapses and claims augment.** Life insurance business production has been suffering in the last two years, with the major drop in the reported premium of 18 percent in 2011 and 5.5 percent in 2012. Further, lapses have increased since 2009 from 40 percent to 68 percent in 2012 resulting in worrisome total outflows of claims (payments for capital accrued and for death on premiums) and lapses above 100 percent of total premium since 2011. The problem appears not to be imminent however, as the fourth quarter 2012 vulnerability assessment carried out by IVASS indicates that insurers are not engaging in liquidity swaps; there is no abuse of reinsurance that could hide illiquidity issues; the improvement of the financial results in 2012 (as a consequence of the narrowing of Italian Sovereign spread) and their good contribution to the overall profitability have reduced the risk to sell impaired assets with a potential negative impact for the sustainability of the levels of guarantees offered in the life business; a larger increment of call and term

deposits (incl. loans and fixed income) reflecting insurer change in asset allocation in order to improve the liquidity of the portfolio and no major changes in the product structure have been observed (Figures 7, 8, and 9).

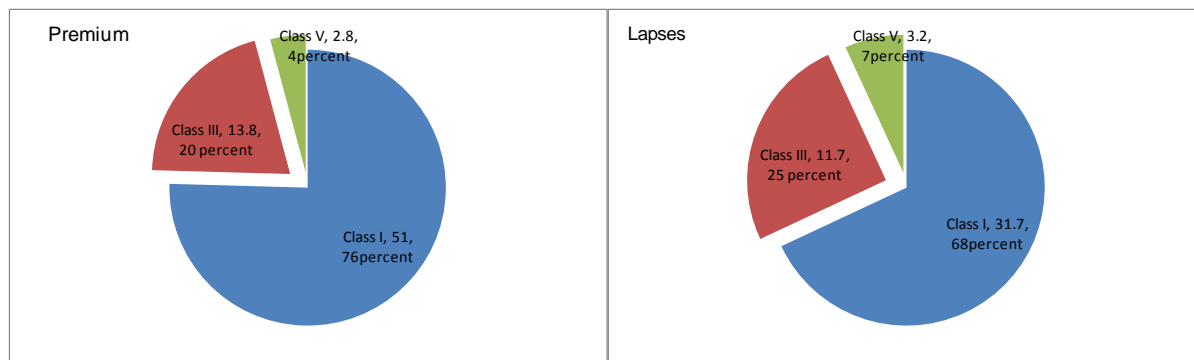
**Figure 7. Life Policy Lapses (2006–2012 in percent of premium)**



**Figure 8. Claims and Lapses of Life Policies (2010–2012 in percent of premium)**



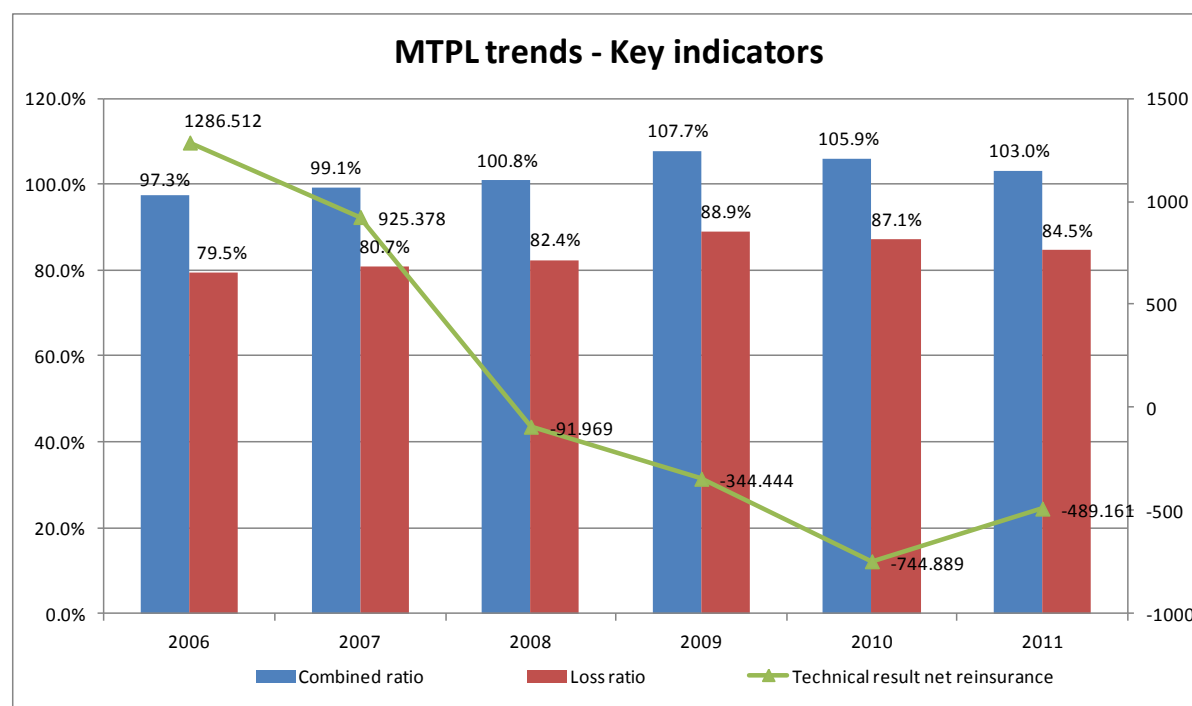
**Figure 9. Premium and Lapses Share of the Different Types of Life Policies  
(2012 in billion euros and as a percentage)**



Source: Authorities. Class I corresponds to non-linked products, Class II to linked products and Class V to capitalization products.

**53. The main line of nonlife business has been unprofitable in the last years and needs urgent action to address prevailing fraud.** As a mandatory line of business, MPTL has wide penetration and public awareness and is required to be sold by all nonlife insurers. Notwithstanding a slight improvement in the results in 2012, partly due to the new liberalization law of March 2012 (Decree Law 24/2012) that required a medical decision on disability claims of low severity, a general deterioration of the motor vehicle bodily injury claims experience has affected the insurers in the last years having 2007 as the last year with positive results (figure 10). The main causes appear to be linked to fraud, especially in the low disability claims (whiplash). The claim cost for personal injury that makes up on average 22.7 percent of total claims cost is by far the largest in Italy as compared with other EU countries like France or Spain where the average cost is 14 and 18 percent respectively. Further, in some provinces the one to two percent disability claims account for over 40 percent of the personal injury costs. The pure claim cost in Italy is 60 percent higher than in Germany or twice as that in Spain, hinting to a more generous court awards that basically lacks of an indemnity level table to fix the amount of court awards. To reduce uncertainty on the cost of claims and allow for equal treatment of similar injuries, the implementation of an indemnity level table is urgently recommended. Also in this context, the full development and effective implementation of IVASS anti-fraud database is a commendable step to be achieved.

Figure 10. Key Parameters in Motor Third Party Liability Insurance



Source: Authorities

## D. Recommendations

**54. A dedicated group supervisory approach for the national significant insurers and sophisticated offsite monitoring together with ad hoc inspections for smaller entities is recommended.** Individual knowledge, while currently sufficient will be challenged with the introduction of Solvency II. Higher standards on risk management and governance, ORSA requirements, internal model use, will all call for a higher degree of specialization. Further, the same level of specialization on offsite monitoring will be required for the onsite inspection to achieve a level of intrusiveness and intensity necessary to audit compliance with the extensive and detailed regulatory requirements and uncover potential vulnerabilities. Having a dedicated group of supervisors and following a formalized process appears to cope well with these developments. The supervision of smaller insurers could be done through sophisticated offsite monitoring, including market wide comparisons, and complemented with ad hoc onsite supervision.

**55. Further clarification of appropriate margins, parameters and technical reserve calculation methodology is necessary to assure adequacy of technical reserves.**

Communication with external auditors and actuaries to ensure consistent application of acceptable technical reserves calculations will provide uniformity and stability across the market. Reserve adequacy is critical and IVASS is asked to provide stronger direction and clarification of acceptable level of prudence in the reserving methodology to ensure a consistent framework for determining technical reserve adequacy for all insurers.

**56. The use of stress testing as a supervisory tool by IVASS is suboptimal.** IVASS annual industry wide stress test has been replaced by the EIOPA stress test in the last years. The main disadvantage of such an approach lies in lack of tailor made shocks for the Italian market conditions to appropriately test resilience of the industry. Using market analysis, the individual stress tests reported by the insurance groups, and the early warning system tools currently in development, IVASS should design market specific extreme but plausible macro scenarios and test resilience of the Italian market as a whole. Also reverse stress testing as a regular supervisory practice is recommended.

**57. Internal model approval is a major challenge and the quality work done on the preapproval process needs to continue.** The excellent focus dedicated to the preapproval process of internal models has provided important insight to IVASS on the risk management and risk appetite of the different insurers. The models are complex and only sufficient resources and expertise will allow understanding of the sufficiency of the resulting capital levels to warrant a solvent industry.