The Italian insurance market:
opportunities in the land of the Renaissance

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Executive summary

The financial crisis has accelerated the rise of Italian sovereign debt ...

Italy is the world’s 8th-largest economy. It rests on a large manufacturing and service sector, and is buoyed by a wealth of small and medium-sized enterprises that export its high-value products. However, Italy currently faces a number of serious challenges. Long-standing sovereign debt (at 120% of GDP, with high interest rates) and slow growth are bringing Italy under financial duress, as highlighted in the recent financial crisis. In July 2011, investor confidence plunged and the Euro crisis spread to Italy, sending the cost of public finances soaring.

... and the implementation of unpopular fiscal tightening.

In an attempt to restore market confidence and financial stability, and despite a looming recession, the newly appointed government has taken on a series of tight fiscal austerity measures.

Addressing structural weaknesses is key to reviving growth.

To avert a downward spiral into recession and further deterioration of public finances, not only has the government instituted fiscal tightening, it has also implemented competition-enhancing measures. The aim of these large-scale initiatives is to revive growth by addressing embedded structural weaknesses that have long put a damper on Italy’s economic potential, including the rigidity of its labour legislation and the limited competition of its services. Tackling high current unemployment, particularly for the younger generation, is also a key priority geared towards alleviating the social cost of the recession.

The Italian pension system has been heavily revised to reflect the rapidly ageing Italian population.

The demographic trend in Italy can be characterised as nothing other than critical. In the next few decades, longer life expectancy and a low birth rate will lead to a substantial decline in the labour force, exacerbated by low female participation in the workforce. The state pension system, once one of the most generous in the world, has been trimmed to reflect the demographic imbalance, thereby relieving the public sector of one of its fast-growing financial burdens but shifting the risks back to individuals.

Further reductions in the welfare system are expected.

Further reductions in the welfare system are expected, as the government embarks on additional rounds of spending cuts. The healthcare system, which is financed mainly through taxes, is likely to require an overhaul in an attempt to curb public spending.

Protection, pension, and healthcare products are projected to grow fast.

Italy’s life insurance industry is mature and insurance density is high, with the main products being with-profit and unit-linked savings policies. Although protection, pension, and healthcare products generate low volumes, they are growing fast and are expected to continue to do so as people are increasingly forced to assume more responsibility for their own pension and healthcare protection.

New regulatory changes are tackling fraud.

A cap on small bodily injury indemnification and other new regulatory changes aimed primarily at tackling fraud in motor insurance are expected to address the historically poor profitability of third-party motor liability segment. If the regulatory measures succeed in improving this line of business, an eventual reduction in product prices can be expected, which would be greatly welcomed in the current recessionary environment.

The increasing protection gap in natural catastrophe coverage will pave the way for a greater role to be assumed by the private insurance sector.

With the exception of motor lines, the non-life industry in Italy is – in comparison to its European peers – less developed. However, new demand is likely to emerge for general liability and natural catastrophe coverage. The ongoing financial crisis has put the government’s role as “insurer of last resort” in question, now that the state budget can no longer be the main source of post-disaster loss financing. The Italian government will need to find new solutions to fill the widening protection gap. The recent earthquake in Emilia Romagna provided a stark reminder that Italy is highly exposed to damaging earthquakes and floods. All such changes call for greater involvement of the private insurance sector.
Introduction

Italy has a rich economic and cultural history. It is home to the Renaissance and the birthplace of great thinkers, artists, and architects such as Leonardo da Vinci, Michelangelo, Botticelli, and Brunelleschi, all of whose achievements have had a great influence on Western culture. Italy is also the country with the world’s oldest bank (Monte dei Paschi di Siena) and the world’s oldest known insurance contract (Genoa, 1347).

Today, Italy is the fourth largest country in Europe, in terms of both economic output and population. The country, as we know it today, is the product of momentous change that occurred in the 1950s and early 1960s, when the country transformed from a poor, mainly rural nation into a major industrial power. Today, the country faces multiple macroeconomic and demographic challenges. The way these challenges are resolved will shape not only Italy’s future and the well-being of its population, but also the future of the euro area.

The Italian insurance industry is well developed and is expected to play an increasingly important role in the future...

In the future, individuals will be increasingly responsible for managing their own life, health, longevity, and natural catastrophe risks...

Structure of the report.

Italy has a well-developed insurance industry. Assicurazioni Generali S.p.A, established in 1831, is the second largest insurance company in the world (in terms of net premiums written). However, there are areas where insurance can play a more prominent role than it does today, one being in supporting the government to address the country’s economic and demographic challenges. The financial crisis and resulting fiscal tightening and spending cuts are accelerating the reduction and rebalancing of the welfare system, leaving a significant protection gap not only in healthcare and old-age provision but also in natural catastrophe coverage.

The insurance industry must brace itself to take charge of its new, expanded role in Italy.

The structure of this report is as follows. A discussion of the country’s macroeconomic environment and demographic situation is followed by a section on the role of the state. It explains why insurance needs to be developed further if the country is to cope with the challenges that lie ahead. The subsequent sections primarily address insurance and reinsurance and include an international comparison of insurance penetration and density, a description of specific products in Italy, and an overview of the market structure. The final section draws some conclusions.

1 Best Statement File – Global, A.M. Best Research, as reported on ‘Top Global Insurers’, Best’s Review, July 2012, p. 45.
With a GDP of EUR 1 600 billion in 2011, Italy is the eighth-largest economy in the world. It has a well diversified, industrial and service-based economy (2010: agriculture: 1.8%; industry: 24.9%; services: 73.3%). The backbone of its manufacturing sector consists of a plethora of mainly family-owned, small and medium-sized enterprises (SMEs). The entrepreneurial dynamism of these SMEs greatly contributed to Italy’s impressive economic expansion in the post-war period. To this day, they continue to export high-quality consumer goods, engineering services, and construction know-how. The economy also rests on a high degree of household savings.

However, Italy is afflicted by historic, chronic issues. A deep and unresolved north-south divide continues to trouble the country. The north has a thriving and well-developed, largely private sector. Meanwhile, the economy in the south is less-developed, depends heavily on state-subsidies and suffers from high unemployment, particularly among the younger generations. In addition, there is a sizable underground economy. All these factors have acted and continue to act as impediments to economic development. Some of the latest developments and challenges include that:

- real annual growth was about 0.3% between 2000 and 2011, making Italy the slowest-growing country in the EU15. Italy also fell to position 12 in the EU15 in terms of per capita income (GDP per capita of EUR 26 400).
- between 1999 and 2007, Italy’s productivity increased a mere 0.3% compared to 7.2% for the euro area. The lack of growth in labour productivity over the last decade has been the key element behind Italy’s deteriorating competitiveness.
- the World Economic Forum (WEF) Global Competitiveness Report for 2010 and 2011 ranked Italy 48th out of 139 countries in terms of competitiveness. This is the result of structural weaknesses in the labour market (ranked 118th in terms of labour market efficiency), weak public finances (ranked 131st in terms of public indebtedness) and a poor institutional environment (ranked 92nd). Moreover, Italy’s expenditure for research and development (as % of GDP) was less than half the average among the other G7 members over the last decade.
- in 2010, Italy came in fourth to last in Europe (ahead of Romania, Bulgaria and Greece) in the Corruption Perceptions Index.

Italy has neglected much-needed structural reforms over the last decade, but the Prime Minister Mario Monti’s government has recently initiated a set of reforms in different areas:

- Labour market reforms are among the key priorities needed to boost Italy’s productivity. The parliament has recently approved a set of measures aimed at increasing labour market flexibility and reducing the dual nature of the labour market that severely disadvantages the young. The reform includes measures that make it easier for businesses to restructure their labour forces, reduce the duration of labour court cases, discourage the abuse of short-term contracts and reduce the fragmentation of the current unemployment benefit system. The reform also contains incentives to increase the employment rate among women. Although the reform was watered down during the parliamentary approval process, it represents significant progress.
- The parliament has also approved a set of liberalisation reforms aimed at augmenting domestic competition that should help improve Italy’s competitiveness and long-term growth. The measures affect a large number of sectors, such as energy, commerce, transport, local public and financial services, and closed professions. Although these reforms are useful, they fall short of a quantum leap.
- The acceleration of the pension adjustment process – one of the most significant reforms – will bring forward the increase in the retirement age to 67 by 2022 rather than 2026.
- In addition, the government has pushed through several measures to improve public finances. These include more stringent instruments to fight tax evasion, a shift of taxation away from productive factors to unproductive ones, and the inclusion of a balanced budget rule in the constitution. In addition, the number of provinces has been drastically reduced to increase efficiency.

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3 Some estimates place it at as much as 15% of GDP.
4 Published by Transparency International.
Further reforms are needed in several areas. For instance, the efficiency of the education system and the public administration need to be improved. In addition, there should be incentives to boost firms’ size and to increase expenditures on research and development.

**Italy’s debt crisis**

With a gross government debt to GDP ratio of 120%, Italy has the second highest government debt burden in the EU, second only to Greece. The market for Italian government debt is the third largest sovereign debt market in the world (behind the US and Japan).

Italy’s debt problem is a cumbersome legacy from the exuberant spending of the 1970s and 1980s. From as far back as in the 1990s, Italy consistently ran a primary surplus in its bid to join the euro in 1999. In fact, Italy reported a cyclically adjusted primary surplus for each year after 1992 – even during the financial crisis. The recession and the high debt interest payments eventually led to a 20 percentage point surge in the debt to GDP ratio between 2007 and 2011.

However, in contrast to Belgium, another highly indebted country within the EU, Italy has not been particularly successful in reducing its debt burden despite the decline in interest rates prior to and during the initial years of euro membership. Between 1995 and 2007, Belgium reduced its debt to GDP ratio from 130% to 84%, whereas Italy reduced its ratio from 121% to only 103%.

![Sovereign debt levels in Italy, Belgium and Greece](image)

Until mid-2008, Italian 10-year government bonds were trading at a small spread to 10-year German government bonds (a mere 30 basis points at the beginning of 2008). The spread remained below an average of 100 basis points until the outbreak of the euro debt crisis in spring 2010.
The macroeconomic environment

In July 2011, the markets started to take fright at Italy’s high debt levels. During the first week of August, the 10-year yield climbed above 6%, with spreads to German yields increasing to 370 basis points. Despite the European Central Bank’s intervention in the market to purchase Italian sovereign bonds, yields on Italian bonds had reached new record levels of 7% by the end of 2011, while German yields had declined to 2%.

Looking ahead, more than fiscal austerity will be needed to reduce the public debt burden. Italy must also implement structural reforms that support GDP growth over the medium term. The government has been effective in tackling the most acute phases of the crisis. However, its longer term success hinges on successful structural reforms, which are proving to be politically more difficult to push through.

![10-year government bond yields for Italy and Germany](chart)

Demographic outlook

With almost 61 million inhabitants, Italy has the fourth-largest population in the EU15 and the second highest old-age dependency ratio in the world\(^5\), ranking just behind Japan. Its total fertility rate\(^6\) started to drop relatively early in the 1980s and has since remained very low (less than 1.5 children per woman, whereas 2.1 per woman would keep the population constant in the long term). At the same time, Italians have a high life expectancy at over 81 years for both sexes.

\(^5\) The old-age dependency ratio is the ratio of the population aged 65 years or over to the population aged 15 to 64.

\(^6\) The fertility rate is the average number of children that would be born to a hypothetical cohort of women throughout their lifetime if they were to experience the exact current-age specific fertility rates throughout their child-bearing years and were not subject to mortality. It is expressed as the average number of children per woman.
According to the UN World Population Prospects (Revision 2010), Italy will continue to have one of the most aged populations in the world. In the longer term, its low fertility rate will put an increasing strain on its potential economic output: the working population is projected to be 2% smaller by 2020, 8% by 2030, and 22% by 2050 (compared to 2010).

**Long-term macroeconomic outlook**

Not surprisingly, Italy’s low competitiveness and demographic challenges will limit its growth outlook. Italy is expected to grow a mere 1.2% annually (inflation adjusted) in the coming decade, just ahead of Portugal and Greece. The subdued economic outlook and constrained debt situation make it all the more crucial for Italy to increase its competitiveness and improve its fiscal situation.

**Figure 3**

*Old-age dependency ratios in European countries*


**Italy’s labour force is expected to decline.**

**Figure 4**

*Projected annual real growth rates (2012 to 2022)*

Source: Swiss Re Economic Research & Consulting

**Italy’s macroeconomic outlook is subdued due to a shrinking working population and low productivity.**
The role of the state in providing pensions and healthcare

The expansion of the social welfare system in the 1960s and 1970s created an unsustainable fiscal burden for the Italian state.

In 1960s and 1970s, the state expanded Italy’s social welfare system tremendously, extending both the scope and size of benefits provided. The Italian state pension system became one of the most generous in the world. Health cover was made universal and the increase in welfare spending helped to ease social and industrial conflicts, but put an unsustainable financial burden on future generations.

Cuts in social welfare spending started in the 1990s.

The full scale of this fiscal burden began to rear its head in the 1990s. Widening public-sector deficits, combined with lower economic growth and a rapidly ageing population created pressure to reduce benefits in order to keep state expenditure affordable. The current financial crisis has exacerbated the need for further cuts in public spending.

The Italian state pension system has been revised to improve its sustainability in the long-term.

Italy’s pension system

In recent years, the Italian state pension system has undergone a series of revisions designed to make the system less vulnerable to demographic changes and to partially relieve the public sector from its rapidly increasing financial burden. The urgency of the reform is reflected in the very high share of public pension spending, which was 14.1% of GDP in 2008, compared to the OECD average of 7%.

The reforms will provide an opening for more insurance products oriented to supplementing the state pension.

The new Italian state pension system is based on notional accounts that operate along similar lines to a defined contribution system. Contributions paid by employers and employees (one third by the former, two thirds by the latter, with the total contribution varying by industry but averaging 33% of salary) earn a rate of return related to GDP growth. At retirement, the accumulated notional capital is converted into an annuity, taking into account the average life expectancy at retirement. Pensions in payment are inflation-indexed, with low pensions fully compensated for inflation and higher pensions only partly indexed. The contribution-based method was designed to apply in full to labour market entrants from 1996 onwards only. However, it was extended to all workers with effect from 1 January 2012 (even retroactively). This put an end to the current mixed system in which pre-1996 employees were enrolled in generous final salary/defined benefit schemes (pensions based on the average salary of the last few years of their working lives).

Under the new state pension system, the retirement age has been increased and will be linked to further improvements in longevity.

The retirement age is variable under the new defined contribution system. Men and women can both retire between the age of 58 and 65, but with lower pensions if they opt for early retirement. A recent reform will increase the early retirement age to 62 for women and 66 for men. By 2018, the retirement age will be 66 for both sexes. It will still be possible for men and women to retire at any age once they have contributed 42 and 41 years, respectively, to the system. Starting in 2013, the normal retirement age will then be increased in line with improvements in life expectancy, with male retirement age foreseen to increase to 68 by 2050.


One of the reforms under the “Save Italy” decree, which was designed to improve Italy’s debt situation by increasing revenue and cutting expenditure, introduced a freeze on inflation-linked pension increases in 2012 and 2013 (with the exception of minimum pensions).
The compulsory end-of-employment contract indemnity, Trattamento di fine rapporto (TFR), is a pension vehicle that is less of a retirement plan than a form of deferred compensation for employees. It used to be payable on leaving employment for any reason and at any age, including retirement, death, or disability. Employers are required to set aside money in an account for each employee and to make a one-time TFR payment, upon retirement or departure from work. Employers currently pay 6.91% of salary into the TFR. In addition, employers pay interest of 1.5% plus 75% of the inflation on the TFR account. Since 2007, all TFR contributions must be made to a second pillar pension fund or third pillar personal private pension. However, the TFR accrued up until 2007 remains on company balance sheets.

There are also voluntary, supplementary occupational systems consisting of open and closed, collectively agreed fund memberships that are open to civil servants, employees, and the self-employed. Closed funds may be established by a national organisation, a region, or an employer. A few of the largest organisations have their own funds. Open funds, which provide an annuity based on contributions, are for individuals who are not entitled to join a closed fund and are operated primarily by insurance companies (with mutual funds, banks, and investment advisors playing a minor role). The number of employees enrolled in private pension funds continues to be low. Moreover, life insurance companies offer supplementary pension products that are not related to employment (see section on life insurance).

The reforms to the state pension scheme are intended to make the pension system less vulnerable to demographic changes. This goal might be reached as the new Italian pension system is viewed as being very sustainable. In an international comparison, the Italian system has the lowest implicit debt level (with implicit debt being understood as future discounted unfunded pension liabilities). This may come as a surprise given the turbulence that the Italian debt situation in 2011 and 2012 caused to the financial markets. 9

<table>
<thead>
<tr>
<th>Country</th>
<th>Explicit public debt (as a % GDP)</th>
<th>Implicit public debt (as a % GDP)</th>
<th>Total debt (as a % GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Italy</td>
<td>118</td>
<td>28</td>
<td>146</td>
</tr>
<tr>
<td>2 Germany</td>
<td>83</td>
<td>109</td>
<td>193</td>
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<tr>
<td>3 Finland</td>
<td>48</td>
<td>147</td>
<td>195</td>
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<td>4 Austria</td>
<td>72</td>
<td>226</td>
<td>298</td>
</tr>
<tr>
<td>5 France</td>
<td>82</td>
<td>255</td>
<td>338</td>
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<tr>
<td>6 Portugal</td>
<td>93</td>
<td>266</td>
<td>359</td>
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<tr>
<td>7 Belgium</td>
<td>96</td>
<td>330</td>
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<td>9 Spain</td>
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<td>10 Greece</td>
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<td>872</td>
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</tr>
<tr>
<td>11 Luxembourg</td>
<td>19</td>
<td>1,097</td>
<td>1,116</td>
</tr>
<tr>
<td>12 Ireland</td>
<td>93</td>
<td>1,405</td>
<td>1,497</td>
</tr>
</tbody>
</table>

Source: Stiftung Marktwirtschaft

While these reforms are positive for the sustainability of public finances, they are shifting some of the burden of financing retirement to individuals. The gradual reduction in the state old-age pension and the move from a defined benefit (DB) to a defined contribution (DC) system is raising the importance of supplementary private pension plans, especially for the younger generations as they seek to supplement their dwindling state pensions with annuities provided by life insurance companies.

The role of the state in providing pensions and healthcare

Healthcare

As shown in Figure 5, from 1990 to 2010, Italy’s share of healthcare spending from GDP rose from a little over 7% to 8.9% of GDP in 2010, amounting to EUR 140 billion or about EUR 2,320 per capita. This was a slower increase compared to other countries and, as a result, Italy now has a lower share of healthcare spending than France, Germany, Portugal, or Spain.

![Figure 5: Total healthcare expenditure](image)

In Italy, 8.9% of GDP was spent on healthcare in 2010.

Healthcare is financed by a system that is public-private in nature. The public part is organised as a national health service (SSN = Servizio Sanitario Nazionale), with universal coverage for all citizens and residents. The national health service is run by the Ministry of Health and administered on a regional basis. As in other countries with national health services (like the UK and Canada), a large proportion of healthcare is financed by the government (77.5% of total healthcare expenditure).

![Figure 6: Sources of healthcare financing](image)

In Italy, the national health service offers universal coverage to citizens and residents.

Source: OECD Health Data, 2012
Although the Italian state health service is extensive, the private market provides about one-quarter of total healthcare expenditure, with 95% of private healthcare expenditure taking the form of out-of-pocket payments. The private medical insurance (PMI) market is hence very small, with less than 5% of private healthcare expenditure insured in 2010. In 2011, PMI accounted for about EUR 2.2 billion or EUR 40 per capita, which is significantly less than many other European countries.

According to AXCO\textsuperscript{10}, life insurance companies add healthcare riders to many basic life policies, with benefits taking the form of lump-sum payments (hospital cash and disability). Non-life companies and two specialist health companies write hospitalisation or major surgery private medical plans and medical expenses. Health funds (self-insured, employer-based PMI) and mutual societies (special associations for individuals who have no employer health provisions) also provide PMI. Approximately 70% of the privately insured population is covered by group health plans.

The comprehensive national health service and the demographic outlook will continue to put a strain on public finances. In addition to efficiency gains, the government will also seek to cut the services provided. This is where PMI could step in and play a more prominent role in the future.

The Italian insurance market at a glance

With a total premium volume\textsuperscript{11} of EUR 115 billion in 2011, the Italian insurance market is the seventh largest in the world and the fourth largest in Europe behind the UK, France, and Germany.\textsuperscript{12} Total premiums written amounted to 7% of GDP at the end of 2011, behind UK (11.8%) and France (9.5%), but ahead of Germany (6.8%) and Spain (5.4%). Worldwide, it ranks 17th in terms of insurance penetration and 23rd in terms of insurance density.\textsuperscript{13} Per capita, an average of EUR 1 826 is spent on insurance in Italy, of which EUR 1 218 is spent on life insurance and EUR 614 on non-life insurance.

The Italian insurance industry has grown by 7% annually since 1991, especially supported by growth in the life segment which represented 68% of the total market in 2011, up from 27% in 1991.

Life insurance

With a total premium volume of EUR 75.5 billion in 2011, the Italian life insurance market is also the seventh largest in the world and the fourth largest in Europe, again behind the UK, France, and Germany. Life premiums written amounted to 4.7% of GDP, well behind France (7%), but ahead of Germany (3%). An average of EUR 1 218 per capita is spent in life insurance, the great majority of which is spent on savings products. Protection products, pension and annuities, and long-term care and health products play a secondary role in terms of premium income.

The stellar growth of the Italian life insurance segment was triggered by the development of bancassurance in the early 1990s. The Amato legislation, introduced in the 1990s, enabled banks to take equity stakes in insurance companies (and vice versa), create joint ventures with insurers, and sell insurance products provided by partner insurers. As a result, Italian banks, which are characterised as having high branch density and high headcount, started pushing life insurance products. In the late 1990s, bancassurers captured much of the incremental growth as investors sought higher returns.

\textsuperscript{11} In terms of gross written premiums.
\textsuperscript{12} Swiss Re, sigma No 3/2012, World Insurance in 2011: non-life ready for take-off.
\textsuperscript{13} Insurance penetration = premiums as a % of GDP; insurance density = premiums per capita.
Bancassurers distributed easy-to-sell, single-premium and especially unit-linked products, which quickly became very popular. Booming stock markets also contributed to the success of these products. By 2000, the share of unit-linked premiums had peaked at 56% of total premiums.

Premium income almost tripled from about EUR 26 billion to EUR 73 billion from 1998 to 2005. However, a phase of great volatility followed until 2008 as a result of weak bancassurance sales. Unit-linked products lost market share and fell to less than 12% of total premiums in 2009. Yet after the subprime and subsequent financial crisis, in stark contrast to other markets, Italy’s insurance industry posted stellar growth, both in 2009 and 2010, driven by very strong demand for traditional, with-profits policies.

Bancassurance as a distribution channel caused a significant shift towards unit-linked products.

After 2005, unit-linked products lost steam and made way for the stellar growth of traditional, with-profits products.

Single-premium business contributes strongly to premium income, but is volatile by nature.

Figure 8
Life insurance premium income and share of unit-linked business in Italy

Figure 9
New life insurance business and share of single-premium products in Italy

Single-premium business plays an important role in Italy, accounting for between 56% and 71% of premiums written (see Figure 9), and makes Italian life insurance premium income volatile.
From 1998 to 2005, the Italian life industry saw significant annual net cash inflows ranging between EUR 20 billion and EUR 37 billion. As of 2006, surrenders began to increase, while at the same time a large amount of policies matured and premium income declined, resulting in a temporary fall in life insurance cash flows.

Strong net inflows of money increased life insurers’ assets under management. By 2010, however, as a result of a resurgence in cash inflows in 2009, life insurer assets under management had increased to almost EUR 450 billion, which meant that overall between 2000 and 2010, assets under management increased 9% per year.

Life insurers are playing an increasingly important role in Italian household savings. In 2000, about 6% of household financial assets were invested in life insurance savings products, and by 2010 this figure had almost doubled to 12%. The additional features in savings products such as embedded returns guarantees, offer an attractive way for Italians to protect the value of their financial assets.
Life insurers offer a rich range of products which encompass protection, savings and pension solutions.

**Italian life insurance products**

The global life insurance product range is very rich, and virtually every market has its own country-specific products. Life insurance product features are influenced by regulation (eg level and flexibility of guarantees), tax legislation (eg tax exemptions), and social security (compulsory plans run by insurance companies that complement social security). Italy has the following lines of life business, or “rami”:

- Class I/Ramo 1: traditional non-linked products, such as endowment, whole life, and term life insurance
- Class III/Ramo 3: unit or index-linked/tracker products;
- Class IV/Ramo 4: long-term care insurance;
- Class V/Ramo 5: capitalisation products, ie pure investment products offered by the life companies; and
- Class VI/Ramo 6: pension/retirement products.

**Ramo I: traditional non-linked products, such as endowment, whole life, and term life.**

Ramo I is the traditional and most important insurance product group, accounting for nearly 75% of Italian life insurance premium volume in 2011 (see Figure 13). Within Ramo I, with-profits policies (polizze rivalutabili) are the dominant product type.

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14 Class II/Ramo 2 is related to natality and nuptiality, but is omitted here because these lines have never been active.
Primary insurance

With-profits savings products (polizze rivalutabili) are the main pillar of the Italian life insurance industry.

With-profits savings products are an important pillar of the Italian life insurance industry, accounting for 71% of premium income in 2011. They are typically mixed products, such as endowment policies with a savings and protection element, and usually offer a death benefit equaling the benefit at maturity. As a rider, they can also cover other risks such as total permanent disability, and they are available as single, annual, or recurring single premiums (though most of this business is single-premium in nature). The maximum guarantee by law equals 60% of the average Italian 10-year government bond yield. Average guarantees on in-force books of business are estimated at around 3% to 3.5%, with policies sold pre-1999 typically carrying guarantees of 4% while new more recent policies carry guarantees of around 2% or less (well below the current maximum allowed guarantee of about 3% as set by the regulator). The interest rate guarantee cannot be changed throughout the lifetime of the policy. Bonuses in addition to the guarantee are credited depending on the investment return.

In recent years, Italian life insurers have optimised the guarantees and the profit-sharing schemes they offer.

Over time, insurers have increasingly switched from annual guarantees (the cliquet mechanism) to guarantees at maturity only. This requires less capital and gives insurers greater flexibility in dealing with low returns in any particular year. In addition, insurers have replaced the traditional investment profit-sharing with a fee-based remuneration that secures more stable earnings. Surrender penalties are very common nowadays. They are meant to reduce the reinvestment risk and protect insurers’ balance sheets.

Ramo III: unit- and index-linked savings products.

Ramo III is unit-linked products, which were popular in the late 1990s but have dropped in market share since then because they have lost their fiscal advantage and because of financial market volatility. They are either unit- or index-linked, with the vast majority of unit-linked sales in the form of single-premium payments, although agents and advisors also sell regular premium products. Premiums are typically invested in mutual funds, with the possibility of switching between funds over time. A limited life-cover element is included in the policies, corresponding to either a fixed death benefit or a 101% fund share that is guaranteed in case of death.

Ramo IV: long-term care insurance.

Ramo IV is long-term care insurance. It has a negligible market share, but has been growing strongly in the past decade and is likely to gain in importance in coming years. As of 1 April 2010, health funds are required to provide at least 20% of their benefits in the form of temporary disability, long-term care, or dental benefits in order to qualify for tax relief. To the degree that health funds will rely on insurance for their long-term care plans, this may present a growth opportunity for the life insurance industry.

Ramo V: investment products without life risks.

Ramo V consists of pure investment products that bear no life risks. Their profit-sharing structures are similar to Ramo I with-profits products and also offer a minimum guaranteed return, but are generally of shorter duration. Aimed primarily at corporate clients rather than individuals, they can be sold on either a single-premium or a recurring-premium basis.

Ramo VI: pension products.

Ramo VI is pension products. This class has grown more than 30% annually in the past ten years although they still accounted for only about 2% of premium income in 2011. Given the radical changes in the state retirement scheme, this segment is set to grow rapidly in the future.
Key risks for life insurers in Italy

Whereas low interest rates are the greatest challenges for life insurers in many countries, the biggest risk for life insurers in Italy stems from sovereign debt write-downs or default. As long as there are no defaults, and given the high returns on Italian government bonds (high credit spreads), delivering the guarantees seems to be manageable. However, increasing credit spreads led to the lower valuation of GIIPS sovereign debt, resulting in heavy, unrealised losses in 2010 and 2011. These negatively impacted life insurers’ operating margins in 2010 and 2011 (see section on profitability towards the end of this chapter). Also, the depressed market values of Italian sovereign bonds could become a problem if a large number of policyholders were to surrender their with-profit policies. Since surrender values are not adjusted to market fluctuations, insurers would have to realise substantial losses to meet their obligations.

Italy has a well-developed term insurance (mortality risk) market. Measured in annualized premium equivalents\(^1\), sales amounted to EUR 225 million in 2011. Most of this business is single-premium, open group term insurance and, to a lesser extent, individual term life insurance. Term insurance has been growing by about 11% annually since 2005.

### Table 2

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>2 003</td>
<td>2 103</td>
<td>2 208</td>
<td>2 186</td>
<td>2 164</td>
<td>1 904</td>
<td>1 790</td>
<td>–2%</td>
</tr>
<tr>
<td>Canada(^2)</td>
<td>249</td>
<td>255</td>
<td>258</td>
<td>283</td>
<td>307</td>
<td>325</td>
<td>306</td>
<td>3%</td>
</tr>
<tr>
<td>UK(^3)</td>
<td>784</td>
<td>811</td>
<td>770</td>
<td>710</td>
<td>717</td>
<td>687</td>
<td>658</td>
<td>–3%</td>
</tr>
<tr>
<td>Germany(^4)</td>
<td>860</td>
<td>754</td>
<td>718</td>
<td>751</td>
<td>635</td>
<td>556</td>
<td>753</td>
<td>–2%</td>
</tr>
<tr>
<td>Spain(^5)</td>
<td>281</td>
<td>354</td>
<td>398</td>
<td>387</td>
<td>388</td>
<td>407</td>
<td>386</td>
<td>5%</td>
</tr>
<tr>
<td>Italy(^4)</td>
<td>123</td>
<td>143</td>
<td>137</td>
<td>206</td>
<td>200</td>
<td>222</td>
<td>225</td>
<td>11%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>271</td>
<td>251</td>
<td>268</td>
<td>276</td>
<td>285</td>
<td>249</td>
<td>236</td>
<td>–2%</td>
</tr>
<tr>
<td>Ireland(^6)</td>
<td>160</td>
<td>156</td>
<td>134</td>
<td>123</td>
<td>104</td>
<td>101</td>
<td>86</td>
<td>–9%</td>
</tr>
<tr>
<td>Australia(^7)</td>
<td>416</td>
<td>425</td>
<td>523</td>
<td>656</td>
<td>736</td>
<td>796</td>
<td>851</td>
<td>16%</td>
</tr>
<tr>
<td>Total of sample</td>
<td>5 086</td>
<td>5 251</td>
<td>5 415</td>
<td>5 548</td>
<td>5 634</td>
<td>5 246</td>
<td>5 292</td>
<td>0.7%</td>
</tr>
<tr>
<td>Growth rate</td>
<td>3.2%</td>
<td>3.1%</td>
<td>2.4%</td>
<td>–0.3%</td>
<td>–5.2%</td>
<td>0.9%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 In constant 2011 exchange rates. May include a significant amount of health rider business, such as critical illness in the UK or disability in Germany.
2 Based on EUR.
3 Includes critical illness written on a standalone and rider basis.
4 Includes open group business.
5 Total premiums written.

Note: Sales are annualised premium equivalents.
Sources: LIMRA; Association of British Insurers; GDV; Australian Prudential Regulatory Authority; ISVAP; Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones; DEXX&R; Verbond van Verzekeraars

The mortality risk is seen as moderate and a reliable source of profit for insurers.

Mortality risk is seen as moderate, with insurers’ conservative mortality assumptions generating strong profits from mortality experience (which, in contrast to other countries, are not shared with policyholders).
Many with-profits savings products (polizze rivalutabili) provide the option of transforming the final benefit into an annuity. However, Italians tend to favour cashing in lump sums rather than receiving an annuity stream when their policies mature. Pension products (Ramo VI) carry rather low longevity risk despite the fact that at least 50% of the accumulated funds have to be annuitized. This is because annuitisation rates\(^{16}\) are set at retirement, thereby removing the longevity trend risk during the accumulation phase of pension contracts. Moreover, as the life insurance pension business is still insignificant in size, the Italian insurance industry’s overall longevity exposure remains very limited at present.

\textit{Life insurance product distribution}

The extraordinary growth of life insurance business in Italy over the last twenty years was to a large degree driven by banks. In 2011, banks sold 55% of life products, up from 1% in 1990, thereby gaining a dominant market share over time, at the expense of the traditional agency channel.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{life_insurance_distribution_channels_in_italy}
\caption{Life insurance distribution channels in Italy}
\end{figure}

The bancassurance model appeared in Italy in the early 1990s in response to the Amato Law, which permitted banks to hold a stake in insurance companies. Montepaschi di Siena was the first bank to take advantage of the new law, when Montepaschi Vita and Ticino Assicurazioni became direct subsidiaries operating within the MPS Group.\(^{17}\)

\(^{16}\) The annuitisation rate, also known as the conversion rate, is defined as the annual annuity payment as a percentage of accumulated funds.

Several competitive advantages have favoured the rise of bancassurance in Italy. For one, banks could leverage their high headcount (personal banking has historically been on a face-to-face basis, requiring a larger sales force which could also in turn be deployed for insurance product sales). Also, double gearing, where multiple companies belonging to the same group use shared capital to buffer against risk occurring in separate entities, reduced the cost of capital for bancassurers and helped boost their profitability. Finally, banks’ regional brand strength and high branch density gave insurance sold via bancassurance more muscle. The cost structure of Italian banks and their difficulties in reducing headcount may have also played an additional role in the development of bancassurance.

The positive trend in bank-led sales was reinforced by the growth of unit-linked savings products. An equity market boom heightened consumer interest in unit- and investment-linked products. Banks capitalised on this boom by promoting single-premium unit-linked or capitalisation products and other products that are easy to bundle or cross-sell with mortgages, loans, or deposits. In 2010, banks accounted for 70% of unit-linked premiums.

Banks remain the most popular distribution channel for all individual life insurance products, including most recently, long-term care policies, which up until 2010 were mostly sold through agencies or brokers. However, banks play a limited role in the sale of individual pension products, whose greater complexity requires face-to-face assessments with clients. Also only 17% of group life policies are sold via bancassurance, while 50% of them are sold directly.
Primary insurance

Non-life insurance

With EUR 39.8 billion in premium income in 2011, Italy’s non-life industry is the ninth largest worldwide and the fifth largest in Europe, behind Germany, the UK, France, and the Netherlands. Total premiums written amounted to 2.3% of GDP, with around EUR 607 spent per capita on non-life insurance (see left panel of Figure 15). In terms of insurance penetration (premiums as a % of GDP), Italy is on par with Portugal at the lower end of the spectrum in a peer comparison. Italy’s overall non-life market penetration and density, in fact are low, with individuals purchasing either compulsory or minimal coverage only.

The low penetration of non-life insurance in Italy stems from seemingly underdeveloped non-motor lines. Accident, disability, and health insurance\(^{18}\) as well as property insurance penetration are very low in Italy compared with its European peers. This low penetration may be due to the lack of an insurance culture in Italy, where the state still provides significant benefits in the event of casualty and thereby restricts the perceived need for private property, accident and health insurance. However, as the welfare system continues to shrink due to be under pressure due to severe state budget constraints, private insurance penetration is expected to grow.

\(^{18}\) These lines have been combined because not all countries report premiums in a way that permits separate comparisons to be made.
Figure 16 shows that, in contrast, motor insurance penetration and density are very high in Italy, partially because the country has one of the highest motor vehicle densities among its European peers (673 motor vehicles per 1000 people).

Motor insurance penetration in Italy is very high.

Figure 16
Vehicle ownership versus motor insurance density in Italy

The Italian insurance market has shifted its weight from non-life to life in the past 20 years.

Since 2000, the Italian non-life insurance market has shrunk in real terms (nominal CAGR was 1.3%) and its weight has diminished as result of the stellar performance of the Italian life insurance market.

Figure 17
Share of non-life and life insurance

Source: World Bank, 2009

Source: ISVAP
Motor insurance accounts for 57% of Italy’s non-life market.

Primary insurance

Italian motor insurance has retained its sizeable market share over the years and in 2011, it accounted for 57% of the non-life market and, as Figure 18 shows, was only slightly down from its share in 1999.

Figure 18
Non-life insurance premium split

Motor insurance is by far the largest non-life segment, driving both overall premium volume and profitability.

… but has seen a recovery since 2010.

Motor insurance premium volume has stagnated and even declined during the past decade ...

Non-life insurance products in Italy

Motor insurance is by far the most important segment in the Italian non-life insurance industry, accounting for 57% of the non-life market and generating EUR 21 billion in premium income in 2011. Of this, EUR 18 billion was generated from compulsory third-party motor liability insurance, and the remaining EUR 3 billion came from motor hull premiums.

After 2000, motor insurance stagnated in real terms and it even declined between 2005 and 2009 due to weak economic developments and declining premium rates. Profitability also deteriorated sharply due to increasing competition in pricing and distribution. Further complicating things, the Bersani Law and a Milan court decision in 2009 required insurers to increase their indemnification reserves for bodily injuries, deteriorating the claims ratio even more.

However, in 2009, market leaders increased pricing in order to restore profitability. As of 2010, premium volume growth has resumed and its upward trend is expected to continue.

Source: ISVAP
Despite the recent recovery of its profitability, the motor business in Italy suffers from structural issues, including a high number of suspected fraudulent claims, especially in southern Italy. Italy has the highest number of bodily injury claims as a percentage of total claims in Europe (22.7% in 2010), including a high proportion of whiplash claims. A recent law passed on March 2012 as part of the general “Grow Italy” decree, aims at fighting fraud. It imposes, among other things, a cap on the fixed parameters for micro-indemnity compensation. It also increases the requirements for small bodily injury indemnification, particularly for minor permanent disability claims such as whiplash, by requiring objective medical proof. This reform is expected to address some of the structural issues that have historically affected third-party medical liability (MTPL). If it proves successful in reducing losses in this line of business, it would eventually result in improved profitability for the insurance sector and a reduction in tariffs that would be greatly welcomed in the current recessionary environment.

Non-motor insurance in Italy includes accident and health, liability, and property insurance. Non-motor lines of business are underdeveloped in Italy. Non-motor insurance in Italy includes accident and health, liability, and property insurance. Non-motor insurance growth rates have been higher than motor insurance growth rates over the last fifteen years in Italy, but the non-motor sector is still underdeveloped compared to the rest of Europe. Poor economic performance and other factors weigh on its growth potential.

The accident and health insurance market is limited due to generous state benefit programmes (INAIL and SSN). Accident and health lines account for 14% of non-life premium income (EUR 5.2 billion). However, because the state provides healthcare through its national health service (SSN, Servizio Sanitario Nazionale), and covers all work-related accidents through INAIL (Istituto Nazionale per l’Assicurazione contro gli Infortuni sul Lavoro21), the potential insurable market is restricted to complementary coverage. As a result, Italy has one of the lowest accident and health insurance penetration rates in Europe.

Accident insurance accounted for EUR 3 billion and healthcare for EUR 2.2 billion in premium income in 2011. Accident and workers’ compensation accounted for EUR 3 billion in premium income in 2011, unchanged compared to 2010. Health premiums amounted to EUR 2.2 billion in 2011, up by 1.3% in nominal terms from 2010. These premiums relate only to private medical insurance written by non-life companies. Many basic life policies also carry health riders (see section on healthcare). Companies also provide additional medical benefits to their employees through health funds.

**Table 3**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Direct premium growth (real)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Motor</td>
<td>4%</td>
<td>5%</td>
<td>5%</td>
<td>3%</td>
<td>0%</td>
<td>-1%</td>
<td>-1%</td>
<td>-2%</td>
<td>-6%</td>
<td>-4%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Hull</td>
<td>0%</td>
<td>2%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>-2%</td>
<td>0%</td>
<td>1%</td>
<td>-5%</td>
<td>-3%</td>
<td>-2%</td>
<td>-2%</td>
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<tr>
<td>Third party liability</td>
<td>5%</td>
<td>5%</td>
<td>6%</td>
<td>3%</td>
<td>0%</td>
<td>-1%</td>
<td>-1%</td>
<td>-3%</td>
<td>-6%</td>
<td>-4%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Total, non-life</td>
<td>4%</td>
<td>4%</td>
<td>6%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>-1%</td>
<td>-4%</td>
<td>-3%</td>
<td>-4%</td>
<td>0%</td>
</tr>
<tr>
<td>Profitability (combined ratio)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Motor</td>
<td>109%</td>
<td>103%</td>
<td>96%</td>
<td>94%</td>
<td>93%</td>
<td>93%</td>
<td>93%</td>
<td>96%</td>
<td>99%</td>
<td>106%</td>
<td>102%</td>
<td>102%</td>
</tr>
<tr>
<td>Hull</td>
<td>70%</td>
<td>67%</td>
<td>66%</td>
<td>66%</td>
<td>65%</td>
<td>70%</td>
<td>71%</td>
<td>75%</td>
<td>86%</td>
<td>94%</td>
<td>93%</td>
<td>95%</td>
</tr>
<tr>
<td>Third party liability</td>
<td>117%</td>
<td>109%</td>
<td>102%</td>
<td>99%</td>
<td>97%</td>
<td>97%</td>
<td>97%</td>
<td>99%</td>
<td>101%</td>
<td>108%</td>
<td>104%</td>
<td>103%</td>
</tr>
<tr>
<td>Total, non-life</td>
<td>105%</td>
<td>102%</td>
<td>97%</td>
<td>95%</td>
<td>93%</td>
<td>93%</td>
<td>94%</td>
<td>95%</td>
<td>99%</td>
<td>103%</td>
<td>102%</td>
<td>102%</td>
</tr>
</tbody>
</table>

SOURCES: ISVAP, ANIA

FRAUD SEEMS TO BE A MAJOR PROBLEM IN MOTOR INSURANCE IN ITALY.

A RECENT LAW AIMS PRIMARILY AT FIGHTING FRAUD.

NON-MOTOR LINES OF BUSINESS ARE UNDERDEVELOPED IN ITALY.

THE ACCIDENT AND HEALTH INSURANCE MARKET IS LIMITED DUE TO GENEROUS STATE BENEFIT PROGRAMMES (INAIL AND SSN).

ACCIDENT INSURANCE ACCOUNTED FOR EUR 3 BILLION AND HEALTHCARE FOR EUR 2.2 BILLION IN PREMIUM INCOME IN 2011.


20 Law 27/2012.

21 National institute for social insurance for industrial accidents and occupational diseases.
Workers’ compensation insurance

Italy introduced compulsory occupational accident insurance in 1898 and cover is provided by the Istituto Nazionale per l’Assicurazione contro gli Infortuni sul Lavoro (INAIL), a state organisation that covers employees against sickness, accident, or death arising from their occupation. All employees are covered, from executives to non-salaried workers who have a continuous operational function at a company, such as auditors or members of the board of directors. Workers’ compensation coverage pays out according to a prescribed list of illnesses in addition to silicosis and asbestosis. Non-specified diseases may also be covered if it can be proved that they were caused by a particular occupation.

Private medical insurance (PMI) in Italy is supplementary to the comprehensive national health service. It is estimated that approximately 4% of the total population is covered by individual health plans, contributing about 30% of health insurance premiums. Most of these policyholders are self-employed, or they are individuals or employees with medium to high salaries. The remaining 70% of the premiums come from group schemes. However, the role of the private sector is bound to increase if, as expected, the government reduces spending on healthcare following a review of its expenses.

One major protection gap not filled by the state is dental coverage. As of 1 April 2010, health funds are required to provide at least 20% of their benefits in the form of dental or long-term care or temporary disability (if they wish to retain the possibility to deduct such expenses from their tax liabilities). Insurers have so far been reluctant to write this business but there may be opportunities from health funds seeking to offload this risk.

General liability premiums in Italy totalled approximately EUR 2.9 billion in 2011. Liability insurance density and penetration are lower than in Germany but higher than in France. The segment encompasses general private household third-party liability (GTPL) insurance, frequently included as a part of homeowner packages, and commercial liability insurance. Also included are specialised covers such as professional liability, medical malpractice, directors and officers (D&O), product liability, employers’ liability, and environmental impairment liability insurance. Increased claims awareness has affected specialised covers, particularly the medical malpractice component, which has suffered heavy losses in recent years.

However, a law passed on 14 September 2011 made professional liability insurance compulsory for almost everyone whose work requires membership in a recognised professional body. The law, expected to affect over one million business professionals, is part of the general reform to stimulate competition among professional bodies while enforcing insurance coverage to protect the beneficiaries of these professional services. Professional bodies will be able to sign affinity schemes on behalf of each professional member and be required to inform clients about the insurance cover. However, coverage may not be universally available to every professional because the rising cost of medical malpractice claims, for example, has led to the exit of a number of medical malpractice insurers from the Italian market.

While workers’ compensation is covered by the state-run compulsory scheme INAIL, employers’ liability offers additional supplementary covers.

Law No.144 / 2011.
Among advanced markets\textsuperscript{24} in Europe, Italy has the lowest property insurance penetration, which may be due in part to the high tax rate imposed on fire insurance premiums, which, at 22.25\%, is one of the highest in Europe (for comparison the tax rates in the UK and Spain are 6\% and 5\%, respectively). An estimated 30\% of property premiums, amounting to EUR 5 billion in 2011, relate to residential insurance.

Natural catastrophe insurance coverage is even lower, especially for residential properties. According to ANIA, an estimated 44\% of private dwellings do have a fire insurance policy\textsuperscript{25}, with a huge discrepancy between the north and the south. However, despite the high risk potential, it is presumed that less than 0.5\% of private property policies have additional natural catastrophe cover (which can be purchased as an extension to fire policies) and only 0.3\% of the fire policies have flood cover. Among the reasons for such low natural catastrophe insurance penetration for residential properties is the over-reliance on post-disaster government intervention. There is a widespread, and likely currently unrealistic, belief that the state is ultimately responsible not only for providing contingency funds following a disaster but also for the full reconstruction of private dwellings and infrastructure, despite the fact that the state has never been under a legal obligation to do so.

The misguided belief that the state will provide as an insurer of last resort is well illustrated in the case of L’Aquila Earthquake in 2009. After refusing to accept foreign aid to rebuild L’Aquila, the government led by Prime Minister Silvio Berlusconi passed a bill guaranteeing 100\% payment of the reconstruction efforts. Three years later, the medieval historical centre of the city is still cordoned off and reconstruction has been slowed by severe budgetary constraints resulting from the worst financial crisis since post-war Italy.

In contrast to residential insurance, commercial property insurance penetration is high and virtually on par with other European markets, although according to a 2008 ANIA study\textsuperscript{26}, 14\% of companies with fewer than 250 employees buy no property insurance cover at all. An estimated 40\% of commercial and industrial policies are believed to include earthquake coverage.

\textsuperscript{24} The definition of advanced markets used here is based on the IMF classification and is further explained in Swiss Re, sigma No 3/2012, World insurance in 2011: non-life ready for take-off.


\textsuperscript{26} ANIA, ‘L’indagine Ania sulla domanda di assicurazione delle piccole imprese. Caratteristiche e risultati’, February 2010.
Italy is exposed to a variety of natural catastrophe risks including earthquakes, floods, volcanic eruptions, drought, hail, and avalanches. Earthquakes and floods are the most likely to cause substantial losses, with more than half of Italy’s municipalities exposed to landslides or flooding. Exposure is lowest in Sardinia (9.3%) and highest in Umbria (89%), and the latest earthquake in Emilia Romagna offered a stark reminder of Italy’s heavy exposure to earthquake risk. In fact, Italy is the most earthquake-prone country in the European Union, having recorded more than 400 damaging earthquakes in the last 2000 years. About 40% of the population lives in seismic areas where over 64% of buildings are not constructed in compliance with anti-seismic regulations.

Although natural catastrophe exposure is high, average insurance penetration for the various natural catastrophes is very low, owing to a lack of both demand and supply. It is presumed that only 0.4% of private property policies have additional earthquake catastrophe cover.

In fact, Italy ranks lowest in terms of residential earthquake insurance penetration rates among the advanced countries with high exposure to earthquake risk.

<table>
<thead>
<tr>
<th>Country</th>
<th>Premiums as a % of GDP</th>
<th>Non-life</th>
<th>Property</th>
<th>Commercial property</th>
<th>Residential property</th>
<th>Commercial earthquake</th>
<th>Residential earthquake</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>1.61%</td>
<td>0.51%</td>
<td>0.46%</td>
<td>0.05%</td>
<td>0.25%</td>
<td>0.03%</td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>5.09%</td>
<td>0.83%</td>
<td>0.36%</td>
<td>0.48%</td>
<td>0.09%</td>
<td>0.07%</td>
<td></td>
</tr>
<tr>
<td>California</td>
<td>2.89%</td>
<td>0.80%</td>
<td>0.44%</td>
<td>0.36%</td>
<td>0.03%</td>
<td>0.05%</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>0.99%</td>
<td>0.18%</td>
<td>0.16%</td>
<td>0.02%</td>
<td>0.08%</td>
<td>0.01%</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>2.11%</td>
<td>0.26%</td>
<td>0.06%</td>
<td>0.20%</td>
<td>0.01%</td>
<td>0.03%</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>1.06%</td>
<td>0.21%</td>
<td>0.14%</td>
<td>0.07%</td>
<td>0.01%</td>
<td>0.03%</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>2.32%</td>
<td>0.36%</td>
<td>0.18%</td>
<td>0.18%</td>
<td>&lt;0.03%</td>
<td>&lt;0.01%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Figures are from 2009 and 2010.
Source: Swiss Re ‘Lessons from major earthquakes’, January 2012

The government is currently considering alternative solutions for post-disaster funding.

Natural catastrophe risk awareness needs to be raised.

A more than a decade-long debate between the insurance industry and the state on the issue of making natural catastrophe insurance compulsory has not yet produced a legislative act. However, the government is pushing to find a solution to relieve the state of some of its burden especially since the ongoing financial crisis is leading to a rethinking of the government’s role as the main source of post-disaster loss financing.

The insurance industry has been reluctant so far to market natural catastrophe insurance due to the country’s high risk exposure and the possibility of adverse selection. However, it is clear that for premiums to remain affordable, they must be spread among as much of the population and corporate sector as possible. In the absence of a mandatory scheme, this will only happen if there is a rise in natural disaster risk awareness and/or the government creates financial incentives for voluntary cover. A private solution will therefore have to be accompanied by public campaigns to raise awareness about natural disasters.

27 According to data provided by the Italian Ministry of the Environment.
Distribution

Non-life insurance distribution has remained relatively stable over the last decade, with the agents consistently generating over 80% of non-life premiums. Up until 2007, insurance companies could enter into exclusive agreements with agents having territorial responsibility. On 1 January 2008, however, the Bersani Law put an end to exclusive agency agreements, thereby promoting more open competition.

Agents’ market share is even higher for motor insurance. In 2011, over 88% of third-party motor liability policies were sold via agents. As a result of the Bersani Law, agents are now free to offer products from different players and are no longer legally tied to any single company. Contrary to the intention of the law, however, it is still difficult for new players to enter this market because the top five non-life market players, with a market share of 70%, still dominate and have strong branding power. In addition, most Italian policyholders are reluctant to shop around for alternative motor policies (according to market surveys, only about 9% to 12% of policyholders do so).

Although still negligible, banks are slowly building up market share at the expense of the agency channel, especially in personal lines such as accident and health, but also in property and credit insurance. Such insurance products are easy to bundle or cross-sell with banking products such as mortgages and consumer credits. In addition, fire coverage is compulsory for mortgage applicants and more recently, there seems to be interest in selling motor policies.
What is remarkable is the growth of banks’ sales of pecuniary losses insurance. The vast majority of pecuniary insurance consists of “cessione del quinto”, a guaranteed loan in which the lender is secured by a preferential claim of up to 20% on the policyholder’s salary/pension. A compulsory insurance policy further secures the repayment of the loan in case of job loss or death. The main driver of the market for “cessione del quinto” has been the recent explosion of consumer credit in Italy. Once used mainly for relatively large-scale purchases, it is increasingly being used for lower value purchases, reflecting the lower savings trend and the increased use of credit to finance consumption as a result of deteriorated economic conditions.

The structure of Italy’s insurance market

Italy’s insurance market consists of 239 locally present players, 142 of which are domiciled in Italy, and 97 which are registered branch offices of foreign insurers (of which 95 are companies domiciled in another EU country, and the remaining two are in Switzerland). Not included in this overview are re/insurance companies writing business in Italy on a freedom-to-provide-services basis.

The number of domestic companies has declined from 199 ten years ago to 142 today. As in other markets, there is a trend towards higher concentration through mergers and acquisitions in the domestic market. The number of branch offices, in contrast, has increased from 50 to 95.

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239 local players are active in the Italian insurance industry. 142 are domiciled in Italy and 97 are registered branch offices.

Table 5

The insurance market structure in Italy (2011)

<table>
<thead>
<tr>
<th>Companies domiciled in Italy</th>
<th>Foreign-domiciled company branches</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Limited companies</td>
<td>Co-operatives</td>
</tr>
<tr>
<td>Composite</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>Non-life</td>
<td>69</td>
<td>2</td>
</tr>
<tr>
<td>Life</td>
<td>57</td>
<td>-</td>
</tr>
<tr>
<td>Reinsurers</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>138</td>
<td>1</td>
</tr>
</tbody>
</table>


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29 The amount of this business is normally estimated as being negligible. However, a number of life insurers sell substantial amounts of unit-linked business through subsidiaries domiciled in Ireland. For example, Fondiaria-SAI uses its Irish subsidiary, the Lawrence Life Assurance Company, to sell life insurance products through the Italian banking sector to Italian customers.
The characteristics of the domestic players are as follows:

- The market leaders in non-life insurance are generally well-established composite insurers. The only exception is Zurich, which is primarily a non-life player.
- Generali is the market leader in the life segment, followed by large Italian bancassurers such as Intesa San Paolo, Mediolanum Group and Poste Vita. There are only four mutual or co-operative insurance companies in Italy, with the largest, Cattolica (co-operative) and Reale Mutua (mutual), each with a market share of 1.4%.
- Since 2010, Zurich has been servicing the Italian non-life insurance market through a branch office of the Irish-domiciled insurer Zurich Insurance plc. Prior to this, business was written by the Italian branch of the parent company in Switzerland.
- There are no longer any domestic reinsurance companies, but branches of foreign companies include Swiss Re, Munich Re, SCOR, Mapfre Re, RGA and General Re.

<table>
<thead>
<tr>
<th>EUR millions</th>
<th>Non-life</th>
<th>Life</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic companies</td>
<td>35,848</td>
<td>75,869</td>
<td>109,817</td>
</tr>
<tr>
<td>Branches of non-EU companies</td>
<td>416</td>
<td>0</td>
<td>416</td>
</tr>
<tr>
<td>Branches of EU companies</td>
<td>3,840</td>
<td>1,163</td>
<td>6,004</td>
</tr>
<tr>
<td>Total</td>
<td>40,203</td>
<td>75,033</td>
<td>115,236</td>
</tr>
</tbody>
</table>

Source: ANIA

After the introduction of the Amato legislation, more than 40% of life insurance premium income is now collected by bank-owned insurance companies (including Poste Vita). Except for Generali, the leading life insurance groups are domestic bancassurers. The three bancassurers BNP Paribas Cardif, CNP, and Credit Agricole play a significant role in the Italian life insurance segment. In the non-life segment, where Carige Assicurazioni is the most important player, bancassurers’ market share is less than 4%.
Insurance groups can be categorised into four clusters.

1. The first cluster includes only Generali [no.1], the traditional local market leader, with a market share of 17%.
2. The second cluster includes the four major Italian composite insurers. Fondiaria-SAI [no.6] and Unipol [no.7] have recently merged into one group, with the merger currently awaiting approval from the authorities. Based on 2011 data, the new group will become the second largest in Italy and have a stronger non-life focus (compared to Generali). The combined market share in this segment would be 28%. The third peer in this cluster is the Cattolica Group [no.9], whose main company is Società Cattolica, a co-operative insurer (also a listed company). The fourth company is Reale Mutua [no.12], the most important mutual insurance group in Italy.
3. The third cluster is made up of four European composite groups. The most significant player in this group is Allianz [no.3], with its strong stake in both life (8%) and non-life insurance (10%). Aviva [no.8] and AXA Group [no.10] are more focussed on life insurance business, while Zurich [no.13] mainly offers non-life business.
4. The fourth cluster includes Italy’s large bancassurers and is focussed almost completely on life insurance products. This cluster includes the life insurance arm of the Poste Italiane Group, Poste Vita [no.4], two bank-owned domestic players, Intesa San Paolo [no.2] and Mediolanum [no.5], and three French bancassurers, PNB Paribas [no.11], CNP [no.14], and Credit Agricole [no.15].

Figure 21
Premium contributions from the leading 15 insurance groups in Italy (2011)

The profitability of the Italian insurance industry

Until 2007, the industry reported stable profitability for both the life (10.3% ROE on average) and non-life segments (12.8% ROE on average). However in 2008, in the wake of the financial crisis, massive unrealised capital losses drove down ROE. Except for the life segment, which recovered briefly in 2009, the profitability of the Italian insurance industry was zero or negative between 2008 and 2011.

In the non-life segment, profitability deteriorated from 2008 onwards (see Figure 23), due not only to poor investment performance but also to net underwriting results. In 2009, underwriting results worsened dramatically before gradually improving again. The investment and underwriting performance combined produced a technical result of about 1% on average from 2008 to 2011, in sharp contrast to an average of 8.4% from 2002 to 2007.

Return on equity (ROE) was strong before the financial crisis but deteriorated thereafter.

Non-life insurance underwriting results also deteriorated after 2007.

The level of ROE is likely to be overstated because shareholder equity is understated as assets are valued according to historical valuations and not market valuations. ANIA’s ROE includes unrealised capital gains/losses which are normally counterbalanced over time.
The profitability of Italy’s non-life business is strongly cyclical, mainly due to the high significance of third-party motor liability. This line – as in other countries – is highly competitive because terms and conditions are mostly dictated by law and because it is perceived as a door-opener for other insurance product sales. Other lines of business provide a more stable profitability.

Italian life insurance generally exhibits more stable profitability than non-life insurance, albeit at lower levels. Between 1998 and 2007, the average direct technical result was 1.9% of premiums. While unit-linked business has continued to perform well since the outbreak of the financial crisis, traditional life insurance business’ profitability has plunged (mainly ordinary life and capitalisation products or pure savings products). Performance was negative in 2008, 2010, and 2011, and positive only in 2009 as a result of the rebound in capital markets.

Generally, in with-profits contracts, policyholder capital grows with the retained investment income remaining after the payment of guaranteed interest rates. This policyholder capital can be used to bridge years of poor investment income and smooth results. However, the outbreak of the financial crisis in 2008 depressed asset values to such an extent that these could not be absorbed by policyholder capital and drove up insurance company losses. Although financial markets recovered briefly in 2009, asset values deteriorated severely again in 2010 during the euro crisis and continued into 2011, another year of heavy losses for life insurers.

The financial crisis has shifted demand for life insurance products. With-profits policies, which had lost market share and fallen to below 50% of new business by 2007, regained in popularity in the aftermath of the crisis because they offered security and attractive returns. With-profits policies now account for 75% to 80% of life insurance premium income in Italy.

Figure 24
Life insurance profitability in Italy

The outlook for primary insurance in Italy

The macroeconomic outlook and demographic developments are challenging. Italy, with one of the most aged populations in the world, will see its labour force shrink further while its elderly population increases. There is little hope that immigration will solve the demographic challenge since all European countries face similar, albeit less severe, problems and are all competing for a limited number of well-educated, productive workers.

While the Monti government is likely to succeed in reducing the fiscal deficit significantly (the current target for 2012 is 1.7%, in relation to GDP, down from 3.9% in 2011), fiscal austerity weighs on an already recessionary environment. Slow economic growth is not expected to return until 2013. By 2016, GDP growth should be back on track at 1.8% (inflation adjusted), and could even be higher if current structural measures are amended and implemented successfully.

The outlook for Italy’s non-life insurance market is slightly below average compared to other European markets, despite the significant catch-up potential in Italy’s non-motor markets and all the right conditions for market expansion. The low growth rate expectations mainly reflects sluggish overall economic development.

Demand for non-life insurance will be sluggish in the foreseeable future.

Fiscal austerity will open the doors for insurers to provide health insurance and natural catastrophe coverage.

Because fiscal austerity will limit the government’s ability to assign benefits and indemnification, it is likely to foster household and business demand for insurance. The highest growth rates are expected in the health insurance sector, which is already experiencing strong demand for supplementary medical expense covers. Property insurance will be positively affected by demand for natural catastrophe covers as risk awareness grows among the population or the state seeks private sector solutions for such risks.
The recent extension of compulsory professional liability insurance will provide general liability business with an extra boost and result in above-average growth. Motor and accident insurance are expected to expand again after a decade of stagnation.

Demand for life insurance will generally increase as risks are shifted to private households... but whether this will lead to higher sales is questionable since disposable income is limited.

Italy’s life insurance growth prospects are mixed. People will increasingly have to provide for their own retirement and healthcare as social schemes become less generous (the state pension system has been subject to a major overhaul). As a result, as people become more willing to plan financially for their future in an uncertain environment, demand for pension and health insurance products should grow. However, people are expected to become more selective when buying insurance. The challenge for the Italian life insurance industry will be to provide products that provide good value for money to policyholders.

The life insurance market is expected to grow by 1.5% annually in real terms between 2012 and 2022. The savings business, which accounts for 95% of premium income, is expected to grow by less than 1.5% per annum. Pension and health business will grow at around 5%, while protection is expected to grow about 3.5% in real terms.

Source: Swiss Re Economic Research & Consulting
Reinsurance

Since 2008, reinsurance has only been written through large global reinsurers’ branch offices.

In 2010, free cessions in non-life insurance totalled about EUR 2.5 billion in Italy. The free cession rate was 7%.

The Italian reinsurance landscape

Prior to 2008, international reinsurers Swiss Re, Munich Re, and SCOR operated in Italy through local companies. However, they have since been doing reinsurance business through branch offices. Mapfre Re, RGA, and General Re also have branch offices in Italy and there are a number of other reinsurers writing Italian business from abroad.

Based on the companies domiciled in Italy, total non-life reinsurance cessions amounted to EUR 3.8 billion in 2010. If intra-group cessions are removed, it is estimated that about EUR 2.5 billion is reinsured through the contestable, or free, market, resulting in a free cession rate of about 7%.

<table>
<thead>
<tr>
<th>EUR million</th>
<th>Non-life</th>
<th>Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums written</td>
<td>35,606</td>
<td>90,220</td>
</tr>
<tr>
<td>Risk premium</td>
<td>2,207</td>
<td></td>
</tr>
<tr>
<td>Total cessions</td>
<td>3,840</td>
<td>1,715</td>
</tr>
<tr>
<td>Free cessions</td>
<td>2,534</td>
<td>823</td>
</tr>
<tr>
<td>Cession rate</td>
<td>7.1%</td>
<td>0.9%</td>
</tr>
</tbody>
</table>

Source: Swiss Re Economic Research & Consulting

In 2010, free cessions in life insurance amounted to about EUR 0.8 billion in Italy. The free cession rate was 37%.

The vast majority of the EUR 90 billion in life premiums in 2010 refers to savings business, which is traditionally not reinsured. About EUR 2.2 billion in life insurance is estimated to be risk premiums, of which EUR 1.2 billion stems from individual and group term insurance while, the rest comes from riders and health insurance. The contestable life reinsurance market is estimated at about EUR 0.8 billion. Italy’s free cession rate is estimated to be about 37% (in relation to the risk premiums to EUR 2.2 billion).
Conclusion

Legislative changes are improving the prospects for insurance in Italy despite adverse economic conditions.

At the crossroads of important economic and social change, Italy offers interesting opportunities for the insurance industry, despite adverse macroeconomic conditions in the short term and negative demographic developments in the long term. These opportunities are supported both by untapped non-motor business potential, and by recent and expected legislative reforms, that should have a positive impact on the insurance industry.

A new law passed in 2012 aims at reducing the cost of fraud and micro-indemnity claims.

The March 2012 law capping small bodily injury indemnification, which aims at reducing the cost of micro-indemnity claims, is expected to address some of the structural issues that have historically accounted for an abnormally high share of third-party medical liability (TPML) claims. If claims losses can successfully be reduced, tariffs should eventually fall as well and relieve some stress in the current recessionary environment.

New demand for natural catastrophe insurance is expected to grow...

Another area subject to significant changes is natural catastrophe coverage. Given the current fiscal situation, the state can no longer afford to cover all financial losses arising from the country’s high exposure to natural catastrophes. Insurance can help fill this protection gap by accelerating, for example, the recovery process in the aftermath of a disaster, while providing much-needed post-disaster financing. Furthermore, by charging risk-based premiums, insurance encourages pre-disaster risk mitigation behaviour, thus lowering the overall public and private cost of catastrophes.

...as is demand for old-age provisions and healthcare.

The insurance industry may also come to play a more significant role in the pensions and healthcare market. State pensions have already been reduced significantly, and benefits are set to be decreased further. With Italy’s rapidly ageing society, the national health service is also under pressure and in order to prevent costs from spiralling out of control, resources and services are likely to be curtailed. People will increasingly have to take on more responsibly for their own pension and healthcare provisions, thereby paving the way for insurers to assume a more prominent role.

Insurance for non-motor lines has room to develop.

Compared to other European countries, the Italian economy is underinsured. Insurance penetration is below average in virtually all lines of business. Only motor insurance has above-average insurance penetration owing to high car ownership, a high claims ratio, and the fact that third-party motor liability insurance is compulsory. For non-motor lines, raising risk awareness among households and businesses and innovative products that focus on the specific protection needs of the underinsured should create new income streams for the insurance industry.