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Italy's Property/Casualty Sector Carries A Moderate Insurance Industry And Country Risk Assessment

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Italy's Property/Casualty Sector Carries A Moderate Insurance Industry And Country Risk Assessment

Rationale

Standard & Poor's Ratings Services assesses the industry and country risk for the property/casualty (P/C) insurance sector in Italy as moderate. The assessment, which covers personal and commercial lines, including health, reflects our views of risks that P/C insurers operating in Italy generally face. We derive it from our view of moderate country risk in Italy and intermediate domestic P/C industry risk.

Country Risk: Moderate

Our moderate assessment of country risk mostly reflects our views of Italy's weak real and nominal economic growth prospects, and high financial system risk owing to the difficult conditions in which the Italian banking sector operates. We also view payment culture and rule of law as high risk.

Our overall assessment of country risk combines our view of four country-risk related factors: economic risk, political risk, financial system risk, and payment culture and rule of law.

Most Italian insurers are large institutional investors in the domestic sovereign and the financial sector. In our opinion, they are consequently highly exposed to domestic sovereign credit risk and domestic financial market volatility, which has been higher than in most European countries in recent years. Furthermore, the Italian insurance industry's growth and earnings prospects are correlated with Italy's wealth levels, fiscal policy, and economic policy.

The Italian insurance industry is supported by our view of Italy's wealthy and diversified economy and its relatively strong international investment position compared with peers rated in the 'BBB' category. We also consider that the government is gradually implementing several important reforms, most recently in the labor market, "popolari" banking sector, and electoral law. We view the steady increase in the current account surplus as indicative of the economy's ability to pay down net external debt. The economy is constrained by weaknesses we see in Italy's real and nominal GDP performance and its eroded competitiveness, which are undermining the sustainability of its public finance position and the large government debt it bears. In addition, the government's aim to reduce the general government deficit appears to now rely substantially more on the expected reduction in interest payments rather than an improvement in the primary balance. We think this demonstrates a less rigorous approach to implementing measures following the 2014 spending review.

The high net general government debt burden influences fiscal policy choices. A non-recurring additional corporate tax reduced Italian insurers' domestic profits by more than 10% in 2013. We estimate gross debt--excluding European Financial Stability Facility (EFSF) guarantees--will peak at above 131% of GDP in 2015 (with net general government debt at about 125% of GDP), and slowly decline thereafter.

We assess financial system risk as high, reflecting the tough conditions for banks operating in Italy. Our opinion of Italy's high banking industry risks incorporates our view that the cost of funding in Italy remains higher than in most other banking markets in the eurozone, and banks still have limited access to affordable capital market financing. We also think that Italian banks' profitability is weak, hampered by persistently low interest rates, reduced business volumes, increased cost of funding, high loan-loss provisions, and a still-large, though declining, cost base.

We view the Italian payment culture and rule of law as high risk. Our view is supported by the findings of Transparency International, which measures the perceived levels of public sector corruption in 175 countries and ranks Italy 69th in its Corruption Perception Index. Our view of payment culture and rule of law is also supported by the World Bank's corporate indicators. As of 2014, Italy ranked well below its Western European peers for the rule of law and control of corruption indicators. These capture, among other factors, confidence in the quality and timeliness of contract enforcement and courts, and the transactional costs that these impose on businesses and investors.

Table 1

Sovereign Risk Indicators: Economic Data					
Italy	2012	2013	2014	2015f	2016f
Nominal GDP (bil. US\$)	2,075	2,134	2,144	1,805	1,778
Per capita GDP (US\$)	34,900	35,800	35,300	29,500	28,800
Savings / GDP(%)	17.4	18	18.2	18.9	19
Investment / GDP (%)	18	17.3	17.4	17.7	18
Real GDP (% chg)	-2.8	-1.7	-0.4	0.8	1.3
Real investment (% chg)	-9.3	-6.6	-3.5	1.1	2
Unemployment rate (% of workforce)	10.6	12.2	12.7	12.1	11.8
General government debt/GDP	121.5	126.6	130	131.3	130.7
General government net debt/GDP	115.9	120.8	123.6	125	124.6

f--Forecast. Source: The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources.

P/C Industry Risk: Intermediate

Our assessment is based on an evaluation of five industry-related subfactors: neutral profitability, negative product risk, positive barriers to entry, neutral market growth prospects, and an intermediate institutional framework.

Profitability (Neutral)

We regard the profitability of the Italian P/C insurance market as adequate, with a projected combined ratio of 95%-96% in 2016. This should translate into a return on equity between 7%-10%, in line with most European peer countries.

At the same time, we believe P/C profitability peaked in 2014 and will likely deteriorate modestly, pressured by the following trends:

- Sluggish premium growth, impacted by expected continuing declining tariffs in the dominant motor segment;
- A decline in motor segment technical profitability, linked to rising competition and an expected rise in claims frequency driven by recovery in traffic, car sales, and GDP growth;

- Stabilization of the combined ratio of the non-motor segment, which has limited potential for further improvement; and
- The average cost of motor claims remaining at a relatively high level.

We forecast the average combined ratio for the P/C sector will deteriorate modestly to the 95%-96% range in 2016 from the 93.1% recorded in 2014 (see table 2). The combined ratio is the industry's most closely watched underwriting profitability metric; the lower the combined ratio, the more profitable, and a ratio above 100% signifies an underwriting loss. We do not assume any major catastrophic events. We believe that the latest major catastrophe--the earthquake in the Emilia-Romagna region in May 2012--weakened the industrywide combined ratio by about two percentage points.

Table 2

Property/Casualty Net Combined Ratio Trend								
(%)	2009	2010	2011	2012	2013	2014	2015f	2016f
Premium volumes (mil. €)	36.7	35.6	36.4	35.4	33.7	32.8	32.2-32.5	32.5-33.0
Year-on-year change	(2.05)	(2.94)	2.11	(2.60)	(4.83)	(2.68)	-1%-2%	1%-3%
Net combined ratio	106.53	104.22	101.48	95.92	93.51	93.10	94%-95%	95%-96%
of which :								
Motor net combined ratio	107.04	104.92	102.34	93.01	89.83	90.90	93%-94%	94%-95%
Non-motor net combined ratio	106.15	103.32	100.36	99.76	98.23	95.70	96%-97%	96%-98%

f--forecast. Source: Standard & Poor's, IVASS, ANIA.

The forecast deterioration in technical profitability is relatively modest with regards to the historically weak performance of the Italian P/C market prior to 2012. We attribute this resilience to the following:

- Our expectation that insurers will maintain underwriting discipline;
- Our view that the decline in motor claims frequency is largely structural; and
- Our forecast that non-motor contribution to premium and profit will continue to grow.

One demonstration of insurers' increased underwriting discipline has been higher segmentation of motor premiums by type of driver and risk area. This is leading to a growing use of so-called black-boxes in vehicles in high-risk areas, which has contributed to lowering claims frequency. We also note that the average cost of paid and reserved motor claims has declined in 2014, for the first time since 2008. They remain about 20% higher than in 2008, however.

The sharp 30% drop in the number of motor claims between 2009 and 2014 has been a major driver of the improvement in the industry's combined ratio. The decline in claims frequency stemmed mainly from the recession and changes in customer habits, which have reduced disposable income and motor vehicle usage. In addition, a law was passed requiring policyholders to provide medical evidence for light bodily injury claims, which account for about 80% of injury claims. We estimate that this last measure has reduced the combined ratio by about 2%.

At 6.1% of insured vehicles at year-end 2014, the frequency of motor incidents in Italy is now in line with that of other main European markets. We expect a gradual rise in claims frequency in the coming years, driven by a recovery in traffic, car sales, and wider economic growth.

We also observe a significant improvement in the profitability of the non-motor market, driven by the sharp reduction in technical losses that have plagued the general liability segment in the past eight years (see table 3). Although

non-motor retail lines are profitable, professional lines remain quite volatile.

Table 3

Breakdown Of Trending Non-Motor Net Combined Ratio								
(%)	2008	2009	2010	2011	2012	2013	2014	Five-year avg
Non-motor net combined ratio	102.9	106.2	103.3	100.4	99.8	98.2	95.7	99.5
Of which:								
Accident	82.0	86.0	85.0	83.0	81.0	76.0	79.0	80.8
Illness	102.0	104.0	101.0	97.0	98.0	95.0	91.0	96.4
General third party liability	111.0	116.0	121.0	122.0	121.0	114.0	98.0	115.2
Property fire	102.0	107.0	91.0	87.0	118.0	80.0	87.0	92.6
Other property	103.0	104.0	102.0	94.0	98.0	97.0	99.0	98.0

Source: Standard & Poor's, IVASS, ANIA.

Product risk (Negative)

In our opinion, high P/C product risks in Italy stem from relatively unpredictable claims settlements, particularly in motor third-party and general liability, which accounted for 46% and 9% of total P/C premium, respectively, in 2014. The difficulty for Italian insurers to accurately assess the ultimate cost of claims in cases involving recourse to both civil and penal courts, results in frequent reevaluation of claims reserves for previous accident years. Given the generally very slow judicial system in Italy, reserves can be adjusted even for accident years beyond 15 years, increasing the tail risk for Italian insurers.

In addition, Italy still lacks clear, national tables for severe bodily injury claims approved by law. Bodily injury claims settlements currently rely on that of the courts, which are subject to interpretation on a case-by-case basis. We also observe that the civil justice system has been awarding a relatively high and rising amount of bodily injury claims, particularly with regards to mortal accidents, thereby giving policyholders an incentive to take their claims to court.

A current draft law proposes the introduction of a national table for severe bodily injuries, but also allows for a potentially significant level of discretion on the value of potential claims to be awarded by the individual courts. In addition, the draft national table does not include the award for mortal accidents. As such, we do not see a material improvement in the predictability of settlements.

We consider the level of fraud in Italian motor insurance to remain higher than in other countries, particularly in large urban areas in southern Italy. Nevertheless, insurers have taken ad hoc measures to combat this, which have resulted in significant improvements. In particular, Italy boasts the highest share of vehicles using blackboxes--at about 15% of insured vehicles.

We regard the Italian P/C sector's exposure to natural catastrophes as intermediate. Catastrophic events such as landslides occur frequently in Italy. Italy is also exposed to events that occur less often, but are much more severe, such as volcanic eruptions and earthquakes. Coverage against these types of risk forms only a minor part of insurers' overall risk exposures. Such coverage remains generally underdeveloped in Italy. The government is generally expected to cover these risks, but has no formal, structured approach to do so.

Barriers to entry (Positive)

Our assessment incorporates two main factors: legal and regulatory, and operational barriers.

We view legal and regulatory barriers as low. Licensing processes and procedures are extensive and stringent, but are no stricter than those in peer countries, in our opinion. Due to the EU's Freedom Of Service regulation, EU-based insurers can open a branch in Italy and operate through it.

In our opinion, operational barriers are high because of the structure of the market. The market is relatively concentrated, with the top five insurance groups accounting for two-thirds of the market. Distribution is mostly through tied agents, which accounted for 80% of the total P/C premiums in 2014. The telephone and Internet may be the fastest-growing distribution channels, but they still accounted for below 5% of the total market in 2014.

Market growth prospects (Neutral)

We view P/C insurance growth and penetration trends in Italy as neutral. We expect Italian P/C premiums to decline by 1% to 2% in 2015, and recover between 1% and 3% in 2016. With P/C insurance premiums at 2.1% of nominal GDP in 2014, we believe Italy holds significant long-term growth potential compared to the European average P/C insurance penetration of 2.8%.

We expect motor insurance volumes to continue to decline in 2016, driven by lower tariffs, which will weigh on P/C sector growth. Unlike the motor segment, we expect the recovery in GDP growth to significantly support the growth of the non-motor segment, which only represented about 50% of premium in the first half of 2015. This follows a weakness in non-motor commercial lines because Italian corporate bankruptcies have risen with the crisis. Non-motor market features low penetration, and its growth should accelerate in 2016. The 2.6% growth recorded in non-motor lines in the first half of 2015 is higher than GDP growth and signals the willingness of Italian individuals and corporations to positively consider this coverage, for which most products remain optional.

Table 4

Italy Property/Casualty Insurance Premium Trends							
(Bil. €)	2009	2010	2011	2012	2013	2014	2015 1H
Motor	20.1	20.0	20.7	20.2	18.7	17.6	9.2
Growth rate (%)	(3.45)	(0.83)	3.64	(2.23)	(7.64)	(5.77)	(5.90)
Other P/C	15.6	15.7	15.7	15.2	15.0	15.2	9.2
Growth rate (%)	(6.32)	1.18	(0.44)	(3.09)	(1.09)	1.17	2.60
Total	35.7	35.7	36.4	35.4	33.7	32.8	18.4
Growth rate (%)	(4.72)	0.04	1.84	(2.60)	(4.83)	(2.68)	(1.80)

Source: Standard & Poor's, IVASS, ANIA.

Italians are also increasingly purchasing personal health and accident coverage to offset rising public health care costs and reduced government involvement. This is in the context of an ageing society, with higher than Western European average numbers of people over 65.

Institutional framework (Intermediate)

We regard the Italian insurance institutional framework as intermediate. We base our view on our assessment of an intermediate regulatory framework and a still-weak regulatory track record. We consider Italian insurers' governance

practices to be in line with those of European peers. This is progress compared to four years ago, backed by domestic consolidation in the industry and integration within the wider European market and industry regulations.

Regulatory framework. We regard regulatory oversight as intermediate. Since the start of 2013, all insurance undertakings have been regulated and supervised by IVASS (Istituto per la Vigilanza sulle Assicurazioni), which replaced ISVAP (Istituto per la Vigilanza sulle Assicurazioni Private). IVASS operates as a division of the Central Bank of Italy. We believe that IVASS is materially involved in supporting changes to Italian regulation to prepare for the Solvency II regulatory framework, which will apply to Italian insurers from Jan. 1, 2016.

According to the International Monetary Fund's Financial Sector Assessment Program, the Italian insurance regulatory framework benefits from strong risk management and consumer protection. Regulatory solvency requirements are still based on EU Solvency I rules, with more stringent requirements compared to some peer countries, as investments are conservatively considered at the lower of their acquisition cost and market value. Some forbearance measures have been introduced at end 2011, in light of the significant drop in value of Italian government bonds at that time.

Regulatory track record. We assess the regulatory track record as weak given the relatively recent move to IVASS from the ISVAP supervisory framework. Our assessment of the regulatory track record as weak is also still based on the single, but nevertheless highly visible, case of Fondiaria-SAI, which highlighted insufficiencies in the prompt and strict supervision of claims reserving practices and related party transactions by ISVAP. Although we consider that IVASS' oversight on insurers' reserve adequacy, supported by extensive on-site controls, is stronger than that of ISVAP, the robustness of the insurance sector's reserves has not been tested through a full cycle yet.

Governance and transparency. We consider that Italian insurers have significantly reduced cross-shareholdings and conflicts of interest that have constrained Italian insurers in the past.

Italy's largest insurers have generally cancelled the shareholder pacts that limited their flexibility to manage equity stakes. IVASS, in our opinion, is also placing increasing emphasis on explicit accountability of board of directors' responsibility for setting insurers risk appetite, which in our view is an incentive for sound governance.

We also expect the upcoming new Solvency framework to enhance transparency, notably through the ORSA report (Pillar II requirement) and comparable reporting standards (Pillar III).

Listed insurers report their individual and consolidated accounts under International Financial Reporting Standards. Unlisted insurers mostly report under Italian generally accepted accounting principles.

Related Criteria And Research

Related Criteria

- Insurers: Rating Methodology, May 7, 2013
- Country Risk Assessment Methodology And Assumptions, 19-Nov-2013

Related Research

- Ratings On Italy Affirmed At 'BBB-/A-3'; Outlook Stable, Nov. 13, 2015
- Insurance Business Enhances Italian Banks' Profit Potential In The Current Low Interest Rate Environment, June 11, 2015

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating

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committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.

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Rationale

Country Risk: Moderate

Life Industry Risk: Intermediate

Related Criteria And Research

Italy's Life Insurance Sector Carries A Moderate Insurance Industry And Country Risk Assessment

Rationale

Standard & Poor's Ratings Services assesses industry and country risk for the life insurance sector in Italy as moderate. The assessment reflects our views of the risks that life insurers operating in Italy generally face. We derive it from our view of moderate country risk in Italy and intermediate domestic life industry risk. We believe Italian life insurers are sensitive to domestic country risk, as a large share of their investments is held there.

Country Risk: Moderate

Our moderate assessment of country risk mostly reflects our views of Italy's weak real and nominal economic growth prospects, and high financial system risk owing to the difficult conditions in which the Italian banking sector operates. We also view payment culture and rule of law as high risk.

Our overall assessment of country risk combines our view of four country-risk related factors: economic risk, political risk, financial system risk, and payment culture and rule of law.

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Table 1

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F--Forecast. Source: The data and ratios above result from Standard & Poor's own calculations, drawing on national and international sources.

Life Industry Risk: Intermediate

Our assessment is based on an evaluation of five industry-related subfactors: neutral profitability, neutral product risk, positive barriers to entry, neutral market growth prospects, and an intermediate institutional framework.

Profitability (Neutral)

We regard the profitability of the Italian life insurance market as a neutral factor in our assessment of industry risk. We expect industrywide return on average assets to be in the 0.5%-0.6% range over the next two years, in slight decline compared to the 2012-2014 period.

We base our expectation on an erosion of margins due to lower interest rates, though we believe that declining life expense ratios and the rising share unit-linked insurance policies should mitigate this. We estimate return on assets (ROA) of unit-linked policies of about 0.8% on average for the Italian market, making them more profitable than traditional policies. Rising premium and insurers' actions to reduce commission expense, which represent 60% of operating expenses, also support profitability. Our forecast also assumes an absence of major market shocks, such as those in 2008 and 2011, which have crimped ROA (see table 2).

Table 2

Italian Life Insurance Profitability Trend								
	2009	2010	2011	2012	2013	2014	2015 F	2016 F
Life insurance profit	3.2	-0.3	-3.4	6.9	3.3	2.8	2.7-3.0	2.8-3.1
Life technical reserves	393.1	426.3	427.8	437.2	466.1	514.9	545-560	565-580
Year-on-year change (%)	11.70	8.45	0.34	2.22	6.61	10.46	6%-9%	2%-5%
Return on assets (%)	0.85	(0.08)	(0.79)	1.59	0.73	0.60	0.5%-0.6%	0.5%-0.6%
Of which:								
Life savings ROA	0.76	(0.29)	(1.10)	1.96	0.80	0.54		
Life UL ROA	0.86	0.50	0.26	0.73	0.55	0.78		

f--Forecast. Source: Standard & Poor's, IVASS, ANIA.

We view that traditional insurance products provide stable gross margins but also expose insurers to investment risk. Profitability also benefits from unit-linked products (about 30% of the total market volumes expected in 2015) and regular premium products (about 10% of premium), which generally benefit from high loadings and protection content, and long duration. Nevertheless, both of these product types, although rising, are still dwarfed by the book of traditional guaranteed life savings contracts (over 75% of life insurance reserves). As such, we do not expect a material benefit to margins in the short term.

Italian long-term government yields remain well above the guaranteed rate of new life policies production. The management fee insurers take on life contracts are consequently relatively resilient. We estimate the average guaranteed rate on new production of participating life policies at between 0% and 0.5% in 2015. In addition, we consider that the significant amount of unrealized gains accumulated by Italian insurers on their investments (over 10% at end-2014) provides them with a degree of financial flexibility in managing their profitability, particularly given that the structural surrender rate remains higher than in most other Western European life markets.

Product risk (Neutral)

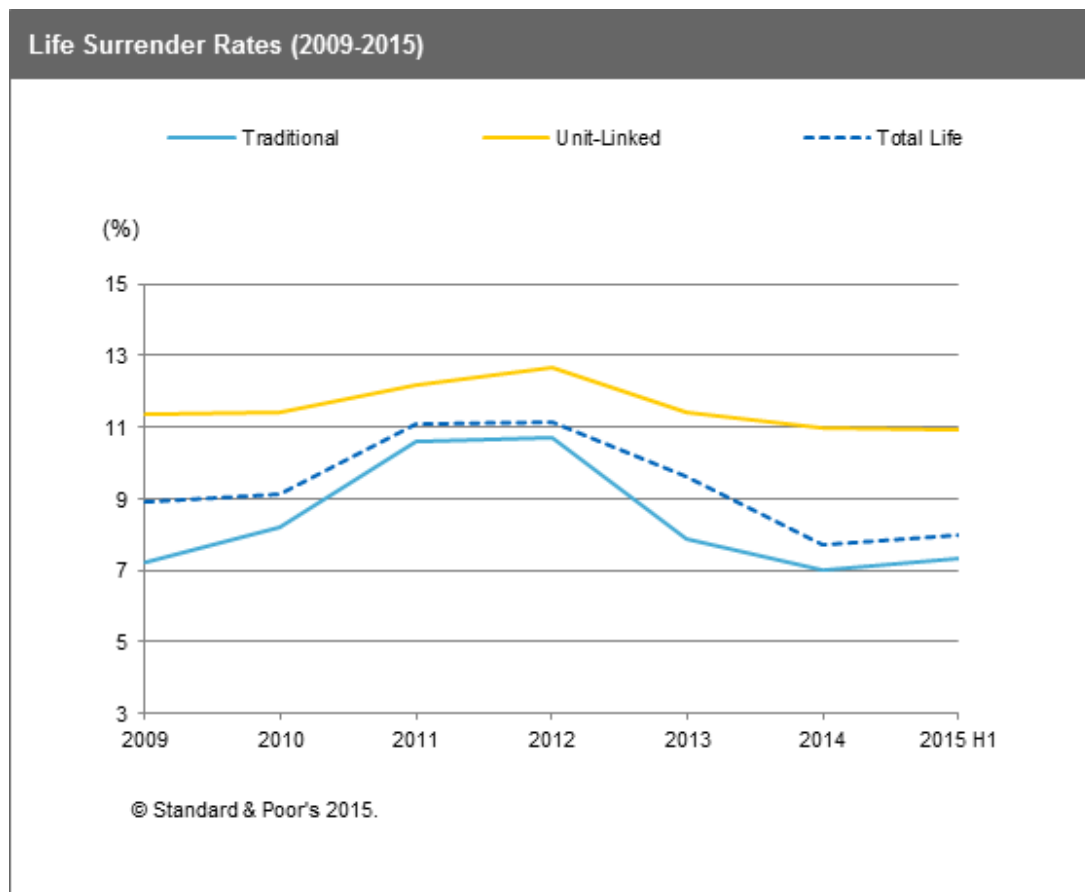
We assess the potential that product risks would trigger earnings volatility as neutral. In our opinion, Italian life insurers' assets and liabilities are generally well-matched in duration. Fixed-income assets represent about 85% of investments, exposing Italian insurers to high interest rate risk, but allowing them to more effectively manage the risk deriving from the book of guaranteed interest policies, which accounted for about 80% of total life technical reserves at end-2014. Italian insurers are optimizing their capital allocation in the current low interest rate environment. Since end-2014, they have mostly eliminated minimum guaranteed rates from their product proposition, offering them at-maturity-only and on the most profitable policies.

We estimate the market average guaranteed interest rate on participating life reserves to have declined by about 20-30 basis points to close to 1.7% at end-2014. The guaranteed rates are well covered by returns on segregated funds (about 3.8% in 2014, slightly down but close to its 3.9% average over the past five years). Life insurance policies' average effective maturity is generally between five and seven years, with surrenders and lapses at roughly 10%. Given the very low rate environment, the pace of surrenders has significantly decreased compared with the peak of 2011-2012.

We expect the average guaranteed rate on life policies in-force to decline regularly in the coming years, given the new production largely without guarantees and a structural surrender rate of about 7%. As such, while the rapid decline in

government bond yields since 2014 may limit profitability, we don't expect a marked increase in product risk in the coming two years.

Chart 1



We consider that Italian insurers remain vulnerable to a potential sudden rise in surrenders. Product structures in Italy exacerbate potential losses when lapses spike, because most savings products guarantee accumulated capital and return, with guaranteed surrender value in case of early redemption. Furthermore, surrender penalties and tax disincentives do not appear to act as a strong impediment to surrenders, exposing Italian life insurers to the risk of losses on their bond portfolios when yields and surrenders spike.

The widespread use of bancassurance distribution exposes life insurance volumes to changing strategies at banks. After having prioritized banking product sales over life insurance policies in 2011-2012, banks have heavily pushed for the subscription of life insurance policies.

Barriers to entry (High)

Our assessment incorporates two main factors: legal and regulatory, and operational barriers.

We view legal and regulatory barriers as low. Licensing processes and procedures are extensive and stringent but are no stricter than those in peer countries, in our opinion. Furthermore, due to the EU's Freedom Of Service regulation,

EU-based insurers can open a branch in Italy and then operate through it.

In our opinion, operational barriers are high because distribution agreements are generally exclusive and the sector is fairly concentrated. The five largest groups account for about 60% of the market. Bancassurance, agencies, and the post office accounted for 74% of total premiums. The weight of financial advisors has regularly increased in recent years, partly at the expense of tied agents. We expect advisors to continue to account for between 15% and 20% of the Italian life market in the coming years, up from 10% in 2008. Financial advisor networks belong either to banking or insurance groups, which could weaken those insurers that do not have strong links with financial advisors over the long term.

Market growth prospects (Neutral)

Growth in the Italian life insurance market has been very volatile in the past decade, owing to economic and capital market developments, changes in operating conditions for banks, and the increasing weight of shorter-term, often annual, single-premium products (see table 3).

Table 3

Italian Life Premium Trends							
(Bil. €)	2009	2010	2011	2012	2013	2014	2015 H1
Traditional	64.7	67.8	56.7	51.2	65.0	82.6	40.7
Growth rate	106%	5%	-16%	-10%	27%	27%	
Unit Linked	9.7	15.4	12.5	13.8	15.5	21.8	17.8
Growth rate	-48%	58%	-19%	10%	12%	41%	
Long Term Care	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Capitalization	5.1	5.2	3.1	2.8	3.3	4.7	2.3
Pension Funds	1.5	1.7	1.5	1.9	1.3	1.4	0.8
Total	81.1	90.1	73.9	69.7	85.1	110.6	61.6

Source: Standard & Poor's, IVASS, ANIA.

After strong premium rises in 2013 (+30%) and 2014 (+30%), we expect growth to slow down more in line with the pace of growth in households' financial assets.

The market is demonstrating an ability to renew and adapt to the changing interest and regulatory environment, demonstrating growth trends above the European average.

The market is mature, with life insurance premiums well exceeding 7% of GDP, above the European average.

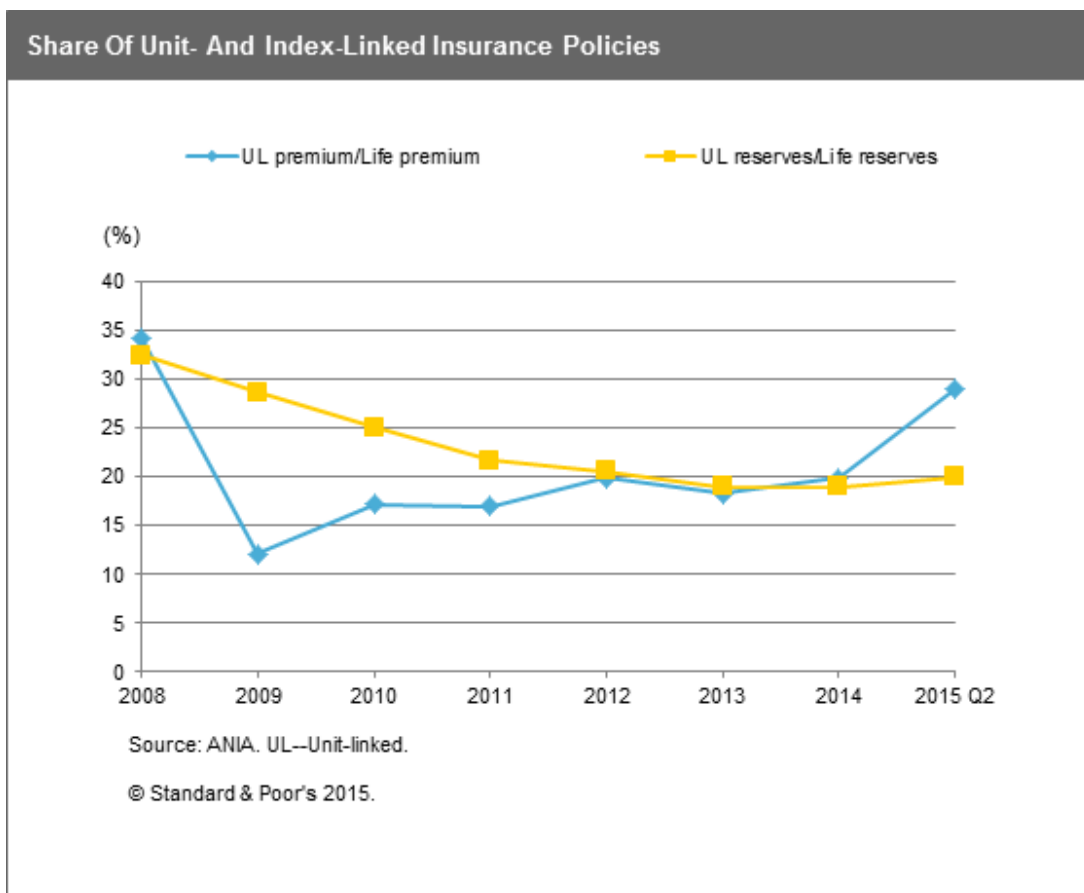
Traditional life insurance policies still benefit from a perception of safety, because they have accrued their value on a stable path through the recent crisis years.

On the other hand, Solvency II may result in increasing capital requirements on such policies, and has limited the incentive for insurers to push for growth.

We estimate that life premium will grow by 5% to 6% in 2015, as dropping interest rates have dampened the attractiveness of traditional savings products. At the same time, competing savings products remain unattractive, and insurers' banking partners remain keen on developing the fee income generated from life insurance policies. As such,

we have seen a marked development in unit-linked policies in the first half of 2015 (see chart 2). We expect this trend is sustainable and will continue in the coming years, as it mainly rests on the sale of hybrid life policies which mix guaranteed savings policies with a share (usually between 30% and 40%) of unit-linked policies.

Chart 2



Reserve development has also been significant in 2014 (above 10%), as asset revaluation and premium growth has offset structurally elevated lapses (see chart 1). Compared with life premiums of €10 billion, net life inflows totaled €6 billion in 2014, following two successive years of net outflows.

Institutional framework (Intermediate)

We regard the Italian insurance institutional framework as intermediate. We base our view on our assessment of an intermediate regulatory framework and a still-weak regulatory track record. We consider Italian insurers' governance practices to be in line with those of European peers. This is progress compared to four years ago, backed by domestic consolidation in the industry and integration within the wider European market and industry regulations.

Regulatory framework. We regard regulatory oversight as neutral to our assessment. Since the start of 2013, all insurance undertakings have been regulated and supervised by IVASS (Istituto per la Vigilanza sulle Assicurazioni), which replaced ISVAP (Istituto per la Vigilanza sulle Assicurazioni Private). IVASS operates as a division of the Central Bank of Italy. We believe that IVASS is materially involved in supporting changes to Italian regulation to prepare for

the Solvency II regulatory framework, which will apply to Italian insurers from January 1, 2016.

According to the International Monetary Fund's Financial Sector Assessment Program, the Italian insurance regulatory framework benefits from strong risk management and consumer protection. Regulatory solvency requirements are still based on EU Solvency I rules, with more stringent requirements compared with some peer countries, because investments are conservatively considered at the lower end of their acquisition cost and market value. Some forbearance measures were introduced in late 2011, in light of the significant drop in value of Italian government bonds at that time.

Regulatory track record. We assess the regulatory track record as weak given the relatively recent move to IVASS from the ISVAP supervisory framework. Our assessment of the regulatory track record as weak is also still based on the single, but nevertheless highly visible, case of Fondiaria-SAI, which highlighted insufficiencies in the prompt and strict supervision of claims reserving practices and related party transactions by ISVAP. Although we consider that IVASS' oversight on insurers' reserve adequacy, supported by extensive on-site controls, is stronger than that of ISVAP, the robustness of the insurance sector's reserves has not been tested through a full cycle yet.

Governance and transparency. We consider that Italian insurers have significantly reduced cross-shareholdings and conflicts of interest that have constrained Italian insurers in the past.

Italy's largest insurers have generally cancelled the shareholder pacts that limited their flexibility to manage equity stakes. IVASS, in our opinion, is also placing increasing emphasis on explicit accountability of board of directors' responsibility for setting insurers risk appetite, which in our view is an incentive for sound governance.

We also expect the upcoming new Solvency framework to enhance transparency, notably through the ORSA report (Pillar II requirement) and comparable reporting standards (Pillar III).

Listed insurers report their individual and consolidated accounts under International Financial Reporting Standards. Unlisted insurers mostly report under Italian generally accepted accounting principles.

Related Criteria And Research

Related Criteria

- Insurers: Rating Methodology, May 7, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19,-2013

Related Research

- Ratings On Italy Affirmed At 'BBB-/A-3'; Outlook Stable, Nov. 13, 2015
- Insurance Business Enhances Italian Banks' Profit Potential In The Current Low Interest Rate Environment, June 11, 2015

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.

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