

Market Review
October 9, 2012

Italy's Non-Life Insurance Sector Faces Shifting Landscape

**Non-Life
Insurers Focus
on Technical
Profits.**

The Italian non-life insurance market faces changes as the sector is subject to new legislation and industry consolidation, while the country's ongoing economic challenges constrain demand for coverage.

Insurers are focusing on achieving technical profitability after some challenging years and an increasingly volatile investment environment. In 2011, rate rises continued for motor third-party liability (MTPL) risks, although a sharp decline in new car registrations has offset strong growth in motor premiums.

Italy's weak economy will continue to result in lower household spending and cuts in government expenditures. The global financial crisis caused the gross domestic product (GDP) to contract by 5.49% in 2009, although the economy returned to modest growth in 2010 and 2011 (see **Exhibit 1**). However, uncertainties over Italy's sovereign debt remain, with the Eurozone crisis prompting forecasts that Italy's GDP will decline by 1.9% in 2012 and the country's unemployment rate will increase to 9.5%.

The insurance sector was exposed to high levels of suspected fraud and claims even before Italy's economic downturn, and these continue to impact loss ratios. However, the recently passed law *Cresci Italia* (Grow Italy) aims to help reduce fraud, as well as increase transparency and competition in the insurance industry.

A successful completion to the proposed four-way merger involving Unipol and Fondiaria-Sai is expected to create a rival to Assicurazioni Generali. The two companies will merge with Premafin and Milano Assicurazioni. With three major players set to dominate the market after the merger, with Allianz remaining the third-largest non-life insurer, the insurance industry is looking for stronger governance from a new insurance regulatory body to protect the interests of smaller participants. The three biggest insurers would control almost 60% of the non-life market, widening the gap between the key players and the smaller companies.

Exhibit 1

Italy Non-Life & Life – Key Market Statistics (2007-2011)

Indicator	2007	2008	2009	2010	2011
Population (Millions)	59.13	59.62	60.05	60.34	60.63
Gross Domestic Product (EUR Billions)	1,554.20	1,575.14	1,519.70	1,553.17	1,580.22
Change in Real GDP (%)	1.68%	-1.16%	-5.49%	1.80%	0.43%
Inflation (%)	2.81%	2.35%	1.10%	2.09%	3.65%
Unemployment Rate (%)	6.12%	6.79%	7.79%	8.38%	8.37%
Insurance Penetration (%)					
Life	3.95%	3.46%	5.34%	5.80%	4.67%
Non-Life	2.42%	2.38%	2.41%	2.29%	2.30%
Total	6.38%	5.84%	7.75%	8.09%	6.98%
Insurance Premiums Written (EUR Billions)					
Life	61.44	54.56	81.12	90.11	73.87
Non-Life	37.65	37.45	36.68	35.61	36.36
Total	99.09	92.01	117.80	125.72	110.23
Change in Premium Volume (Total) %	-6.76%	-7.15%	28.03%	6.72%	-12.32%

Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Associazione Nazionale fra le Imprese Assicuratrici

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Motor Rate Rises Drive Non-Life Premium Growth

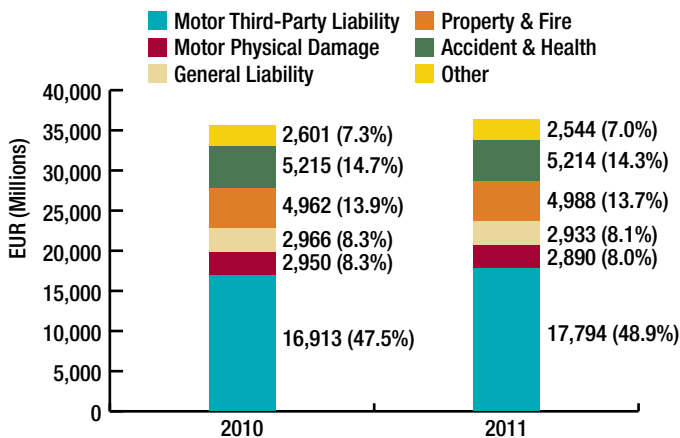
The Italian non-life insurance market returned to growth in 2011, with premium income rising 2.1% to EUR 36.4 billion, according to data from insurance trade association, the Associazione Nazionale fra le Imprese Assicuratrici (ANIA).

The motor segment, which accounted for 57% of non-life premiums in 2011, was the key contributor to renewed growth for the non-life sector, as premiums for MTPL and motor physical damage increased by 4.1% (see **Exhibit 2**).

Insurers began implementing tariff increases on MTPL insurance from the second half of 2010 to rebalance technical accounts on what has been an unprofitable line of business in recent years. Rates have been lifted by as much as 30%, and insurers have been attempting to increase prices in 2012, although to a lesser extent than in previous years.

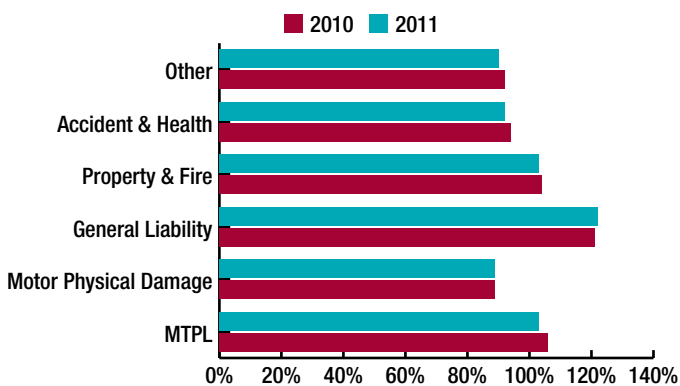
More appropriate pricing for motor risks has contributed to an improvement in combined ratios for MTPL. This line of business has been unprofitable from a technical perspective, although the combined ratio improved from 106% in 2010 to 103% in 2011, having been as high as 108% in 2009 (see **Exhibit 3**).

Exhibit 2 Italy Non-Life – Gross Premiums Written By Line of Business (2010-2011)



NOTES:
Market share shown in parentheses.
Source: Associazione Nazionale fra le Imprese Assicuratrici

Exhibit 3 Italy Non-Life – Combined Ratios (2010-2011)



Source: Associazione Nazionale fra le Imprese Assicuratrici

Other non-life risks, including medical malpractice, which has suffered from poor technical performance, have also been subject to major rate increases. However, there has not been a hardening across the whole of the non-life market because of the ongoing difficult economic situation and labour market in Italy. As **Exhibit 2** shows, gross premiums written (GPW) for general liability in fact fell in 2011. Insurers offering general liability coverage have additionally faced increased competition from the Italian branches of foreign insurers. General liability business (including medical malpractice, professional liability, directors and officers, and employers liability) has been unprofitable, with the combined ratio for this class of risk reaching 122% in 2011 (see **Exhibit 3**).

Property rates were broadly flat in 2011, although these are expected to increase for commercial property covers after the earthquake activity and aftershocks in the Emilia-Romagna region of Italy in May 2012, which significantly damaged manufacturing facilities and consumer goods inventories. Catastrophe modelling firm EQECAT has estimated insured losses could reach EUR 700 million (USD 875 million).

EQECAT'S estimate is particularly sensitive to the value of commercial facilities and their

contents. The Emilia-Romagna region had low insurance penetration – estimated between 3% and 5% for commercial and industrial lines of business and 1% or less for residential lines – as many people expect the government to cover them in the event of a catastrophe. Market participants expect catastrophe-exposed risks to see rate rises of up to 20%, with changes being made to reinsurance renewal programmes.

The implications of the planned four-way merger involving Unipol and Fondiaria-Sai are unclear. Some market participants believe the deal, which has regulatory approval but still carries execution risk, could lead to reduced competition, particularly for motor risks. The merger will create the largest insurer to rival Assicurazioni Generali, which has been the clear market leader. Generali accounted for 17% of total premiums and 19% of non-life premiums in Italy in 2011.

Italy’s Insurance Market Liberalised Under New Law

According to ANIA, the Italian non-life insurance sector had a solvency margin of 269% in 2011, down marginally from 288% in 2010. The trade association’s data also show non-life insurers collectively posted an improved combined ratio in 2011 at 97.9%, compared with more than 100% in 2009 and 2010 (see **Exhibit 4**). This was a consequence of an improvement in the claims ratio, driven by motor rate increases, while expense ratios have broadly remained stable at between 24.1% and 24.7% during the past five years.

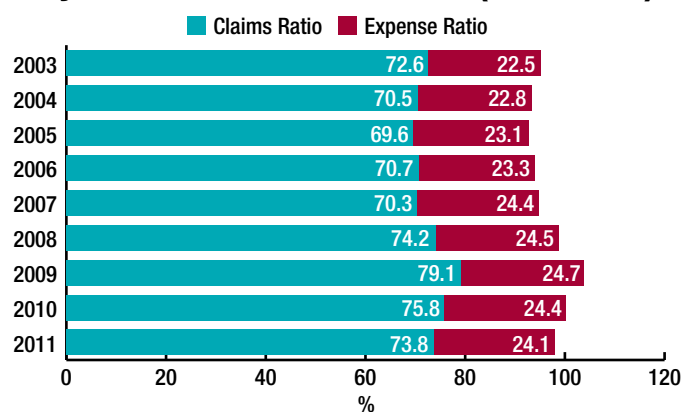
Cresci Italia, also known as Italy’s “Liberalization” law, aims to stimulate competition and enhance transparency in the insurance market by targeting areas such as fraud and the insurance distribution network to improve prices for the consumer. Tied agents remain the key distribution channel for non-life business, accounting for 82% of premium in 2011. Under Article 34 of the law, companies and agents selling motor insurance must provide quotes from three different insurers.

Article 34 is likely to be a positive development from a consumer standpoint, although it could create challenges for motor insurers, especially as they have been attempting to improve rates. However, insurers could benefit from other elements of the legislation, such as Article 32 on telematics. Discounts on premiums will be offered to motorists installing an electronic device (“black box”) in their vehicles to monitor their driving.

Suspected fraudulent claims are a particular issue for motor insurers, notably in southern Italy. In recent years, the government has attempted to reduce fraud, and one of the key objectives of *Cresci Italia*, which was enacted in March 2012, is to continue this drive. For example, the new legislation stipulates a certified physician’s signed document must be presented for minor bodily-injury claims. There are higher penalties for insurance fraud, and a new electronic system linked to databases is being introduced to replace paper insurance certificates and prevent the counterfeiting of these documents.

While *Cresci Italia* is likely to have an impact on the insurance market, the industry is looking to the insurance regulator to ensure that the wider details are enforced. The sector has been regulated by the Isti-

Exhibit 4
Italy Non-Life – Combined Ratio (2003-2011)



Source: Associazione Nazionale fra le Imprese Assicuratrici

tuto per la Vigilanza sulle Assicurazioni Private e di Interesse Collettivo (ISVAP), although oversight of the insurance market is being reviewed as part of a government spending review. A new supervisory authority for the insurance industry will be created. The Istituto di Vigilanza sulle Assicurazioni (IVASS), will work closely with the Bank of Italy.

Challenging Times Ahead

The Italian non-life market is likely to face a number of challenges, including recent legislative changes and the impact of the current Eurozone crisis. Italian insurers have significant investments in Italian government bonds, which have suffered from rising yields on the back of concerns about the government deficit. A.M. Best does not expect these bonds to default, but in the unlikely event of a default or write-down, Italian non-life insurers would suffer severe strains on capitalisation. The slowdown in economic activity also presents a challenge by reducing demand for insurance products; however, this is offset by a likely fall in claims activity.

Despite these challenges, there remain some positives for the sector, with the rating environment improving in 2012 and the market expected to show an overall underwriting profit in 2013. The merger of Unipol and Fondiaria-Sai may also benefit the larger players in the market, with the reduction in competition likely to improve the rating environment. Government measures to tackle fraud and reduce the cost of small claims are also expected to have a positive impact on the industry.

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