XIV CONGRESSO NAZIONALE DEGLI ATTUARI

L'ATTUARIO GLOBALE PER UN MONDO SOSTENIBILE TRA TRADIZIONE, INNOVAZIONE E RISCHI EMERGENTI

MILANO
15-17 Novembre 2023
Hotel Quark

Consiglio Ordine Nazionale degli Attuari

CONSIGLIO NAZIONALE DEGLI ATTUARI

Overview of the Life Insurance Industry in 2023

How is the Insurance Industry reacting to the changing market and regulatory environment?

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Ordine degli Attuari

How is the Insurance Industry reacting to the changing market and regulatory environment?

2023 has been a very turbolent year for the insurance industry due to financial market volatility and a challenging regulatory environment

1

MARKET FORCES

Rise in Interest rates

Solvency Volatility

Life Product Proposition

High Inflation

Bond Losses

2

REGULATORY LANDSCAPE

IFRS17 Adoption

RIS & IDD Regulation

ESG culture

1 Market forces

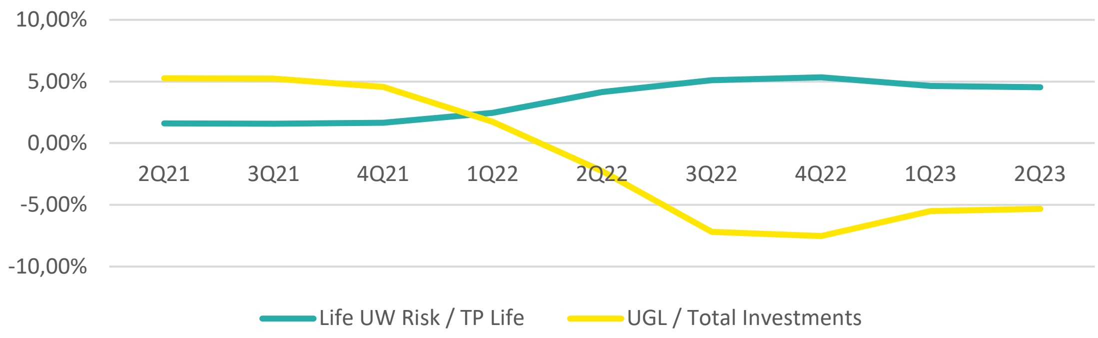
How is the current financial climate affecting the life insurance industry?

The **current financial climate** has been characterized by a steep **rise in interest rates**, with the following impacts on the life insurance industry:

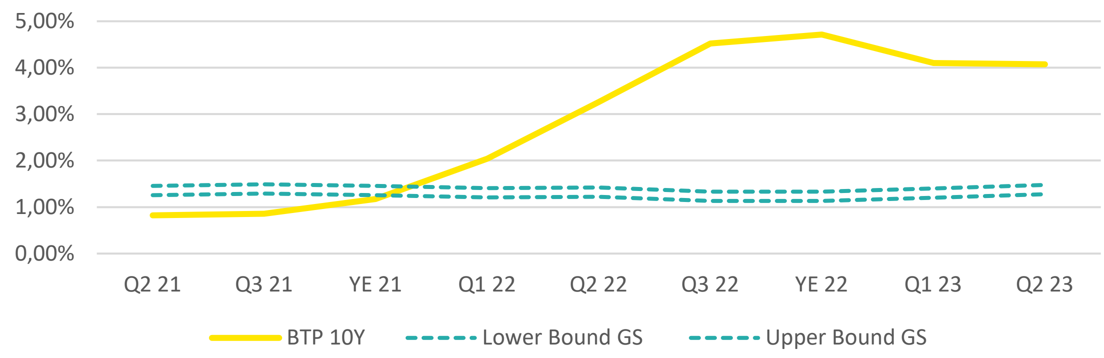
- Fall in market value of bonds, leading to **Unrealised Capital Losses** (UGL) in Segregated Funds and a consequent reduction in Own Funds. This in turn generated a strong increase on the **Lapse Mass SCR**

- Fall in the **competitive power of Life Investments Product proposition** compared to alternatives (e.g. BTP) leading to **negative net inflows** for the industry

UGL vs SCR Lapse



BTP 10Y vs Credited Return on Segregated Funds

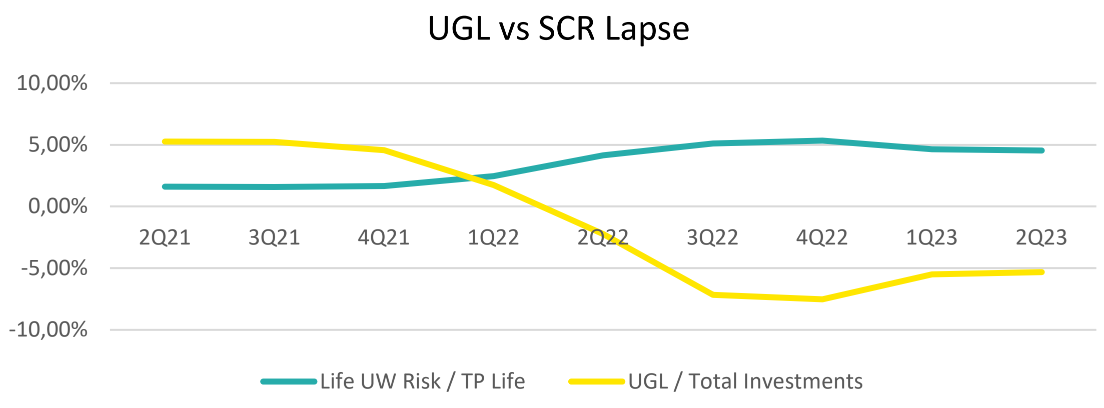


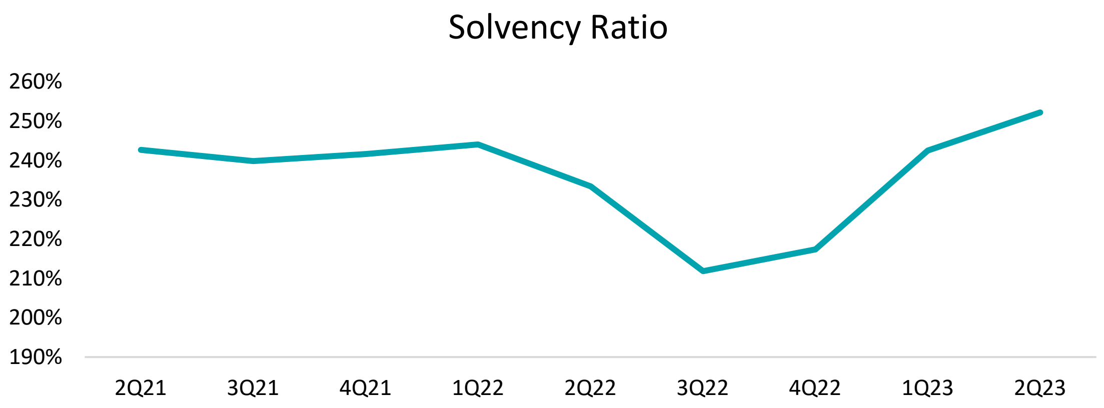
Gross and net inflows by line of business (€bn)

Source: EY SCR Benchmarking 2023, ANIA Statistics

1.1 How has the industry reacted?

What solutions has the Industry implemented to restore the solvency position?

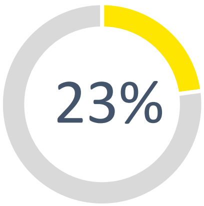




SOLVENCY CAPITAL SOLUTIONS

Capital Injection

23% of companies in the EY survey **recapitalised their Balance sheet**

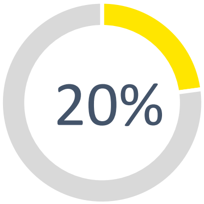


+42%

Solvency Ratio

Mass Lapse Riass

The solution **provides cover for «lost VIF»** incase lapse rates go above the trigger threshold (generally around 20% above best estimate rates)



+46%

Solvency Ratio

Internal Models

The development of an IM allows the company to better reflect its **own risk profile**, thus leading to a **customised risk management** framework

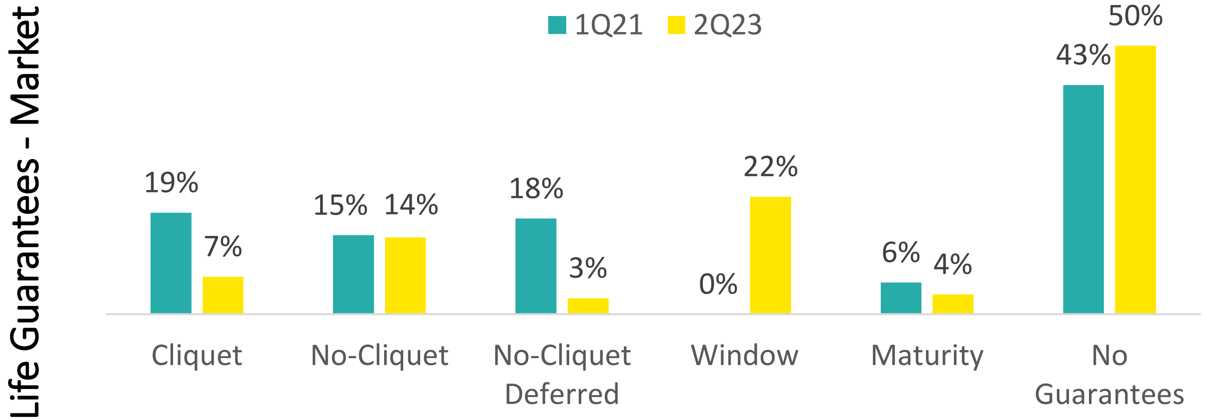
5 Approved Internal models

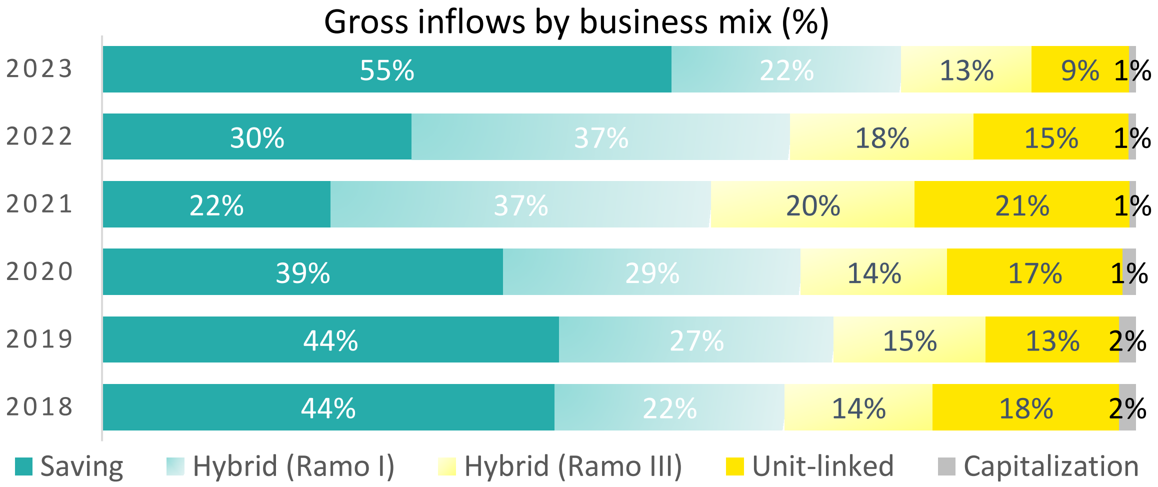
3 under construction

Source: EY SCR Benchmarking 2023

1.2 How competitive is the Life insurance product proposition?

A close look at how life insurance products have evolved over the recent past and why they have lost appeal



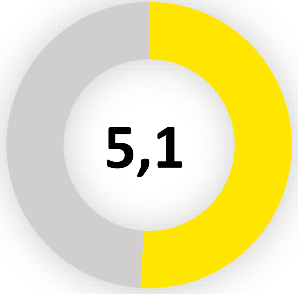


Risk Protection

Performance

Value For Money 1Q21

Value For Money 4Q22



Source: EY OPV Benchmarking 2023

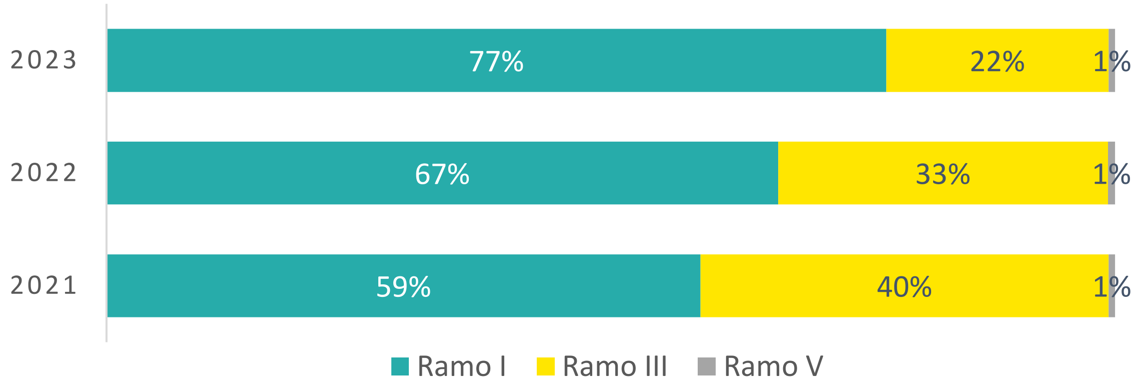
1.2 How competitive is the Life insurance product proposition?

New Product strategies for 2023

The Life Insurance industry has responded proactively to try and improve the competitiveness of the product offering via a number of **tactical interventions**:

- **Increase** in the **proportion of Ramo I GWP** in 2023
- The introduction of **innovative product features** with the aim of **improving product performance for the customer**

GWP % trend in 2023 by LoB



Source: EY OPV Benchmarking 2023

REVISED VALUE PROPOSITION

Upfront bonus

18 products were launched with an **upfront bonus** of between **1-2% of the premium** invested in the Segregated Fund

+20bps

KID Expected Return

Attivi Specifici

3 products were launched with the premium initially invested 100% in a **specific asset** fund that offer an expected return of **2% - 3% for a set number of years**; after these years the capital is reallocated to another Segragted Fund

+30bps

KID Expected Return

Double Segregated Fund

5 products were launched with the **premium invested in two Segregated Funds**. A **new Seg Fund with a higher expected return** is set up and offers an expected return of **3% - 4%**.

+100bps

KID Expected Return

Minimum Guarantee

6 product were launched with a **minimum guarantee** between **0,50% - 2%** for a set number of years.

+10bps

KID Expected Return

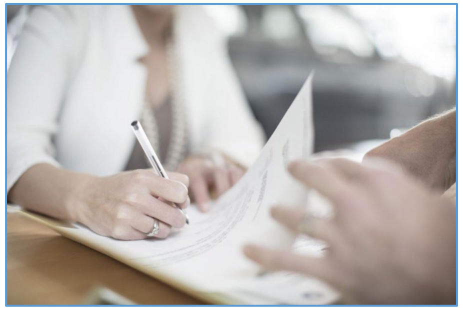
2 Regulatory Landscape

What are the main regulatory aspects driving process change in the insurance sector?

1

IFRS17 Adoption

2



RIS & IDD Regulation

3

ESG Culture

2.1 IFRS17 Adoption

The new accounting framework was introduced in 2023 but there are several challanges facing the industry

Pain points towards a full implementation of **IFRS17**

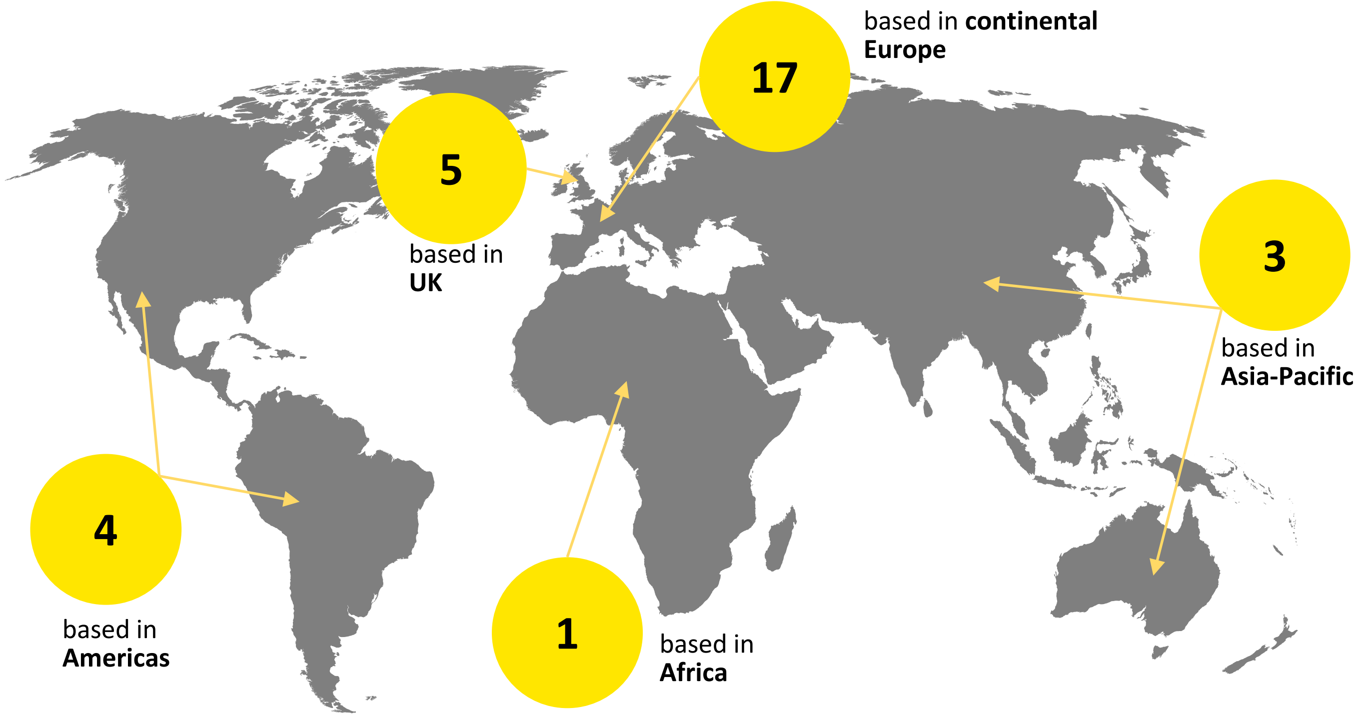
Methodology

Reporting

Processes

Planning

To support the following considerations has been used a benchmark conducted by *EY* on 30 international insurance groups as of 30 June 2023



P&C	L&H	Composite
3	8	19

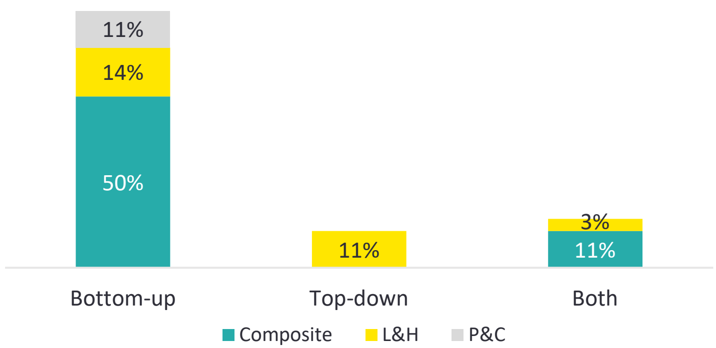
2.1 IFRS17 Adoption

Methodology: a close look at the various approaches used for defining the Discount Rate and Risk Adjustment

Methodology

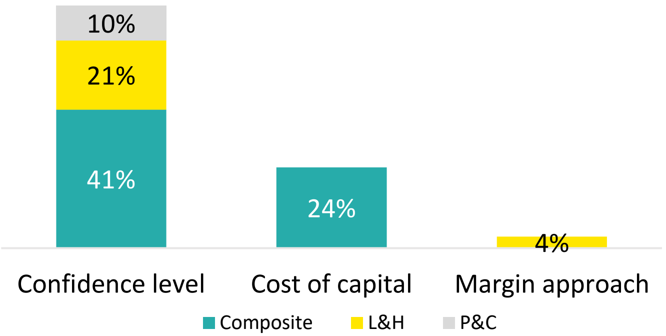
The discretion allowed by the principle has made the **definition of methodologies a source of issues** when comparing different players

DISCOUNT RATE METHODOLOGY



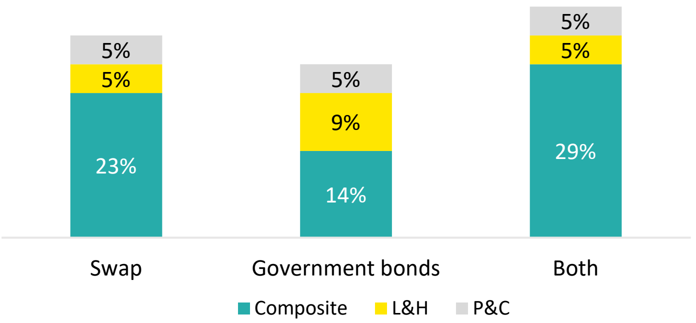
The majority of the analyzed companies use a **bottom-up approach** for defining the discount rate. However, **different approaches are used to define the illiquidity premium**.

RISK ADJUSTMENT TECHNIQUE



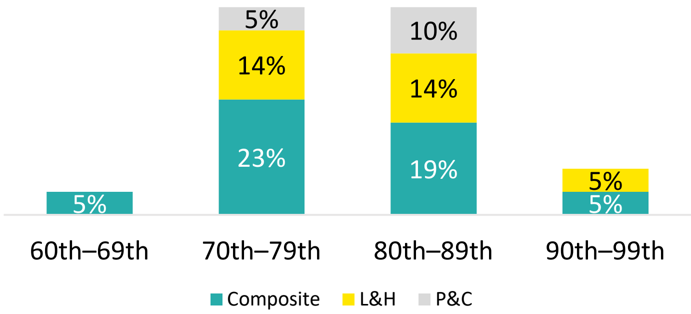
The large majority of Composite and L&H insurers, as well as all P&C insurers, disclosed the use of a **confidence-level technique** for determining the Risk Adjustment, predominantly employing the VaR approach.

DISCOUNT RATE CURVE



Most insurers revealed the use of both **swap rates** and **government bonds** in determining risk-free rates for deriving the discount rate through the bottom-up approach.

RISK ADJUSTMENT CONFIDENCE INTERVAL



However, there is divergence regarding the chosen **confidence interval**.

Moreover, there are other issues about the **perimeter of risks** to be considered (such as **lapse mass**) and the **time horizon** (whether to use a **one-year or ultimate view**).

Source: EY IFRS17 Global Benchmarking 2023

2.1 IFRS17 Adoption

Methodology: Several other methodological issues are still to be addressed

Methodology

METHODOLOGY

Granularity of data

- The calculation of **non modeled liabilities** is performed at entity level and **doesn't fit with IFRS 17 granularity**
- For Actual non distinct investment component **driver approaches are often used.**
- Unit Fund actual investment returns usually **allocated to the VFA UoA via proxy**

Onerous Contract Test

The onerous test is performed **via a simplified calculation** and not performed at a contract level

Reinsurance

The topic of reinsurance is not thoroughly explored, particularly in the life insurance, **where simplified actuarial models such as the PAA model are commonly used**.

Reporting: Understanding the results can still be a major challenge, mainly due to their volatility

Reporting

REPORTING

Understanding

Challenge to **explain the results** (CSM movements vs P&L overall results) due the increase in the **complexity of the income statement** and also due to **the limitation on the granularity of the actual data** (generating offset of the Actual vs Expected and artificial losses)

Volatility

- **Increase in the volatility in the results** of the segregated funds valuated with the VFA, because the **liability valuation moves from a PVOCI method to FVPL liability** (similarly to SII).
- Possible focus on the volatility mitigation: better and more specified **calibration of the Illiquidity Premium**, use of **the risk mitigation option**.

2.1 IFRS17 Adoption

What are the challanges facing the Insurance Industry regarding calculation processes and planning?

PROCESSES

Processes

Extraction of data from source system

Loading of data and processing by the actuarial model

Loading of actuarial model outputs into sub-ledger

Analysis and validation of results

Data Management

The complexity of IFRS 17 reporting requires the accurate collection, storage, and analysis of a **vast amount of information** related to insurance contracts

Operative Risk

Insurance companies need to **automate** most processes to **minimize errors**, **decrease processing time** and reduce **operational risks**. Integration of automated solutions poses a challenge when fusing legacy and new systems

Fast Closing

Due to reporting time pressure many companies rely on **fast-closing processes** to provide actuarial valuations in advance to group parent companies. This enables the parent companies to make informed decisions and react promptly to any issues that may arise

PLANNING

Planning

Integrated Planning Software

New accounting and actuarial tools needed to project IFRS17 valuations with what-if market and commercial strategies scenarios

Methodology

Planning valuations require consistency with other valuations, thus the development of methodologies for reliable forecasts are key

Proxy Calculations

Defining methodologies and proxies to reduce processing times

KPIs

New KPIs and targets to integrate Solvency and local metrics

Competencies

Integration of actuarial competencies within company structures

2.2 Retail Investment Strategy

The Retail Investment Strategy aims is to empower retail investors to make investment decisions that are aligned with their needs and preferences

CURRENT INDUSTRY ISSUES

Retail investors struggle to access **relevant, comparable, and easily understandable information** to make informed investment choices

Retail investors increasingly at risk for being unduly **influenced by marketing** on social media and new marketing channels

Financial advice not always in the best interest of retail investors

Some investment products do not always offer **value for money** to retail investors

RIS FOCUS AREAS

Enriched Disclosure

- **Modernise disclosure**
- **Develop benchmarking methodologies** to better represent product value

Enhanced Supervision

- **Improve investor categorisation**
- **Enhance supervisory cooperation** between national and European supervisory authorities

Better Financial Advice

- **Improve retail investors' and financial advisors' knowledge**
- Address potential **conflicts of interest**
- Carefully examine the **retail investors' financial situation**

Higher Value For Money

- **Compare the value of the product to market benchmarks**
- Advisor must offer the retail investor a **suitable financial product**
- Carry out **more controls on inducements**

2.2 IDD Implementation

IVASS issued Consultation paper 8 in order to address weaknesses in IDD implementation across the industry

IVASS INSPECTIONS

IVASS carried out a series of checks on **the implementation of the POG legislation** through requests for documentation, meetings and inspection visits. The activities carried out have highlighted **progress in the product approval processes and related control systems implemented by companies** since the entry into force of the IDD, the Delegated Acts provided for by the IDD on POG and national legislation.

However significant weaknesses persisted.

The consultation document **lists 15 supervisory expectations**, covering **3 areas** where these shortcomings have emerged.

IMPROVEMENT AREAS

Improve the governance Systems of the POG process

- Improve the **governance systems** of the POG process
- A **product validation committee** should be set up to approve new products
- Integration of **Conduct risk** into the RAF management process

Identification of the Target Market

- For **MOPs**, more **granular definitions of the target market** are required
- **IBIPs Product Complexity**: must depend on risk aspects, liquidity, number and complexity of the underlying. The scale of complexity must be integrated into the sales process

Product's value for the customer

- Product Testing must be aimed at determining **sufficient value for the customer** and a **fair distribution of the overall value** of the product between the company and the customer.
- The Product Testing from the company's and customer's perspective should be performed with the same underlying assumptions
- **V4M measures based on quantitative analyses using absolute measures**

2.3 ESG and POG process

What are the main Regulations regarding ESG implementation?

REGULATORY FRAMEWORK

EU Reg. 2019/2088 (SFDR)

- Requirement for **transparency** in terms of ESG aspects at entity and product level on all disclosures (website, contractual documentation, periodical communications)
- Specific requirement to disclose any **negative sustainability impacts** relating to financial products
- New **classification** of ESG products

EU Reg. 2021/1257 and EIOPA Guidelines

- For **target market identification**, integration of sustainability preferences into the **suitability/adequacy verification process**

IVASS Provision 131

- Amendment to IVASS Regulations n. 24/2016, n. 38/2018, n. 40/2018 and n. 45/2020 to align to the new European requirements adopted on sustainable finance, for the insurance sector and directly applicable from 2 August 2022

MAIN PHASES OF THE POG PROCESS IMPACTED BY ESG REGULATIONS

Target market

Integration of sustainability factors of the insurance product **in the target market**

Product design

Integration of ESG factors in the development phase of ESG Products also with reference to pre-contractual information

Product testing

Update of quantitative and qualitative tests aimed at **evaluating the product** with reference to ESG issues

Monitoring

Integration of the information to be collected to evaluate the performance of the product and **evaluate interventions**

Distribution

Definition of **specific distribution strategies for ESG products** and evolution of sales processes

2.3 ESG Consumer preferences

In a society that is more and more aware of environment impacts, how are consumer preferences changing?

CURRENT PURCHASING BEHAVIOUR

Most consumers agree that they **do not engage in the purchase of sustainable products due to higher prices**. Further, while customers are willing to engage in smaller eco-conscious efforts to drive sustainability, few are open to making permanent lifestyle changes.

13% use solar power in my home

12% pay extra for electricity from renewable sources

11% follow a plant-based diet

Insurers have an opportunity to **shape environmentally conscious behaviour** among customers by offering premium discounts or additional coverage **for alternative products**

FUTURE PURCHASING BEHAVIOUR

Sustainability is being considered a key factor influencing consumers' purchase decisions in the near future

69% Agree that **brands have a responsibility to make positive change** in the world

59% Customers will pay more attention to the **environmental impact** of their consumption

25% Agree that products being **"good for the environment"** will be a key purchase criteria for them in 3 years

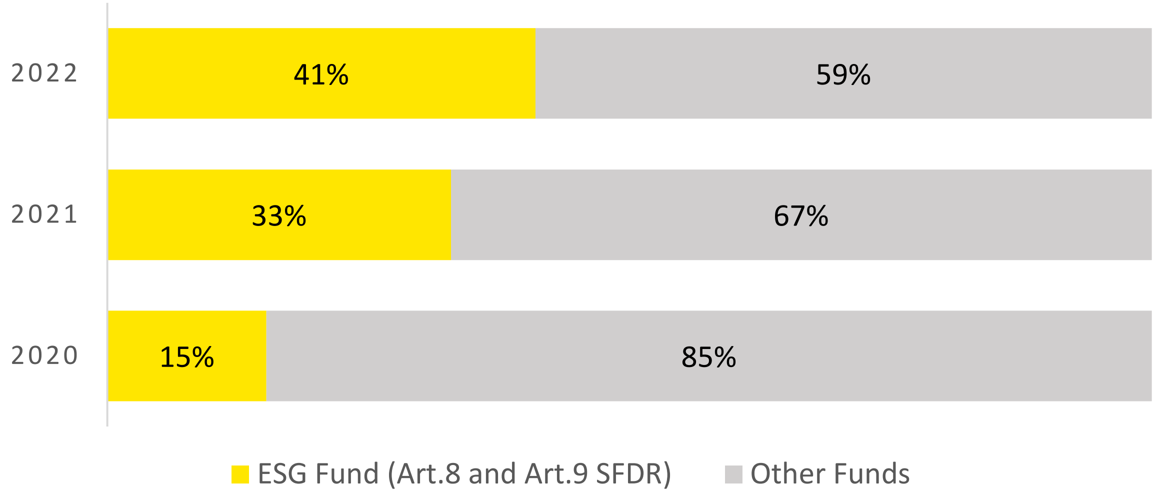
Proportion of people who are willing to pay premium for sustainable goods and services

Source: EY Future Consumer Index 2023

2.3 ESG Investment Fund Evolution

How is the market evolving in terms of green investments?

In response to greater emphasis being placed by society at large on sustainable finance, the relative proportion of **ESG labeled funds** being offered as part of UCITS fund offering has **grown steadily over the past few years**



ESG PRODUCT CLASSIFICATION

«Dark Green» (Art. 9) Products	Financial product that **promotes environmental and/or social characteristics** provided that the companies in which it is invested **comply with good governance practices**
«Light Green» (Art. 8) Products	Financial product that has **sustainable investments as its objective**
Non-ESG (Art. 6) Products	Other products **not covered** by Article 8 or Article 9

Source: «La sostenibilità nel settore assicurativo italiano», 2022, Forum for Sustainable Finance and Ania;

3 Conclusions: What are main challanges facing the Life Insurance Industry?

What are the key areas of attention for the life Insurance industry going forward?

MARKET FORCES

- Expect **volatility on solvency ratios** and recourse to solutions to manage volatility
- **Life investment products proposition** is **under threat** due to competition with other investment products such as BTP

REGULATORY LANDSCAPE

- **IFRS17 implementation challenges** still lie ahead
- **Regulator demands** that **IDD principles** be adopted to a higher standard
- The **ESG social revolution** needs to be embraced by the industry in order to match regulator and consumer expectations