Classification III 2 6

To the insurance undertakings whose head offices are located in Italy

To the insurance undertakings whose head offices are located in another Member State of the European Economic Area or in a third State carrying on business in Italy under the right of establishment or the freedom to provide services

To the banks, financial intermediaries and other entities registered, as insurance intermediaries, in Section D of the Single Register of Insurance Intermediaries kept by IVASS or in the enclosed List

To their premises

RE: Policies linked to loans (PPI - Payment Protection Insurance). Measures protecting customers

The policies linked to loans granted by banks and other financial intermediaries (PPI – Payment Protection Insurance) are aimed to protect customers from unfavourable events which might undermine their capacity to repay the loan.

The supervisory activity conducted by IVASS and the Bank of Italy within their respective competences[1] has highlighted some critical issues in the supply of policies

[1] IVASS supervises over transparency and fairness in the behaviour of undertakings, intermediaries and other insurance market participants with regard to stability, efficiency, competitiveness and the smooth operation of the insurance system, to the protection of policyholders and of those entitled to insurance benefits as well as to consumer information and protection in accordance with the Code of private insurance (legislative decree no. 209 of 7 September 2005). Article 183 of the Code lays down that in the supply and execution of insurance contracts insurance intermediaries must behave with diligence, fairness and transparency towards policyholders and insured persons; acquire from policyholders the information necessary to evaluate their insurance or pension needs and act in such a manner that they are always appropriately informed.
The Bank of Italy supervises over compliance with the rules and principles of transparency and fairness in the relations with clients in accordance with the provisions of Title VI of the Consolidated banking law (legislative decree no. 385 of 1 September 1993). The implementing provisions issued by the Bank of Italy pursuant to Title VI on "Transparency of banking and financial transactions and services. Fairness in dealings between intermediaries and customers" (see Order of 29 July 2009 and subsequent modifications and integrations) state that the commercial policies relating to the combined offer of a loan contract with other contracts must be supported by particular safeguards and organisational and internal control procedures must be adopted with a view to ensuring, on an ongoing basis: clear and comprehensible information for the customer on the structure, characteristics and risks typically connected with the combined offer of more than one product; correct disclosure of costs; compliance with the principles of transparency and fairness when marketing products.

sold in combination with loans[2]:

1. insurance contracts envisaging exclusions, limitations and waiting periods which can considerably reduce the extent of the cover;
2. arrangements for proposing contracts not always based on transparency and fairness;
3. costs which might be too high or unjustified.

These issues have been confirmed by the complaints filed by a number of consumer associations which have, in particular, drawn the attention to the pressure exerted on customers by distribution networks, mainly banks and financial intermediaries, to sell optional PPI policies.

In addition to intervening on the single cases reported in the complaint, IVASS carried out inspections at various insurance companies as well as credit and other financial institutions acting as insurance intermediaries. These inspections confirmed the critical aspects highlighted, led to the adoption of corrective measures and sanctions and raised the need to issue the letter to the market of 17 December 2013, requiring distribution networks to correctly assess whether the contracts offered fit the customer's needs.

The Bank of Italy, as a result of the supervisory activity carried out vis-à-vis banks and financial intermediaries, intervened with regard to individual operators and urged the system to adopt behaviours based on greater fairness especially in those areas where critical issues had arisen in respect to policies sold in combination with banking and financial products. Specific provisions have been issued to ensure the fair presentation to customers of the characteristics and costs linked to these policies.

The issues highlighted with regard to both production and distribution are described below (sections 1, 2 and 3). Below are also some guidelines for intermediaries and insurance undertakings aimed at improving the quality of the products and services

[2] Covers are generally sold as “packages" including life and non-life covers. The loan products to which policies are more frequently combined are: consumer credit, revolving credit cards, personal loans and real estate loans. Policies are generally sold by banks and financial intermediaries pursuant to art. 106 of the consolidated banking law, registered in Section D of the Single Register of Insurance Intermediaries kept by IVASS.

offered (section 4), some considerations on the structure and level of costs (section 5) and the indication of procedures (section 6).

1. Issues regarding production (insurance undertakings)

1.1 *Characteristics of the products and adequacy of the contract in case of multi-risk packages with "shifting guarantees"*

The checks made by IVASS have revealed various problems related to the product design:

- in many cases the different insurance covers represent an "inseparable package" for which the client pays an overall premium not broken down; however they are effective only "on a rotational basis" according to the subjective conditions of the policyholder at the time of the claim[3];
- This means that the package is underwritten and the premium - of an unchanged amount - is paid also by those who will never benefit of one or more of the guarantees purchased;
- this conception, according to a "*one size fits all*" approach, renders meaningless any assessment of the adequacy of the covers compared to the client's specific needs.

1.2 *Duration, exclusions, recourses, waiting periods, deductibles*

It has been observed that the contract terms contained in the policy conditions often envisage a significant reduction of the cover, such as: the duration of insurance

[3] In these cases the covers generally provided are:
a) death: for all the policyholders;
b) permanent disability due to accident: for all the policyholders;
c) total temporary incapacity: for those policyholders who, at the time of the claim, are self-employed workers or public employees;
d) loss of employment: for those policyholders who, at the time of the claim, are private employees;
e) critical illness: for those policyholders who, at the time of the claim, are "non-workers".

covers not in line with the duration of the loan; extremely long waiting and/or deductible periods, often aggregated; a number of instalments repayable by the insurance undertaking which is lower than the total number of instalments of the loan; unclear procedures for calculating insured amounts; limitations of covers which, in substance, render insurance covers not applicable.

1.3 *Statement of good health (DBS)*

IVASS receives many complaints about accidents resulting in death or permanent disability, where the payment of benefits has been denied by the undertaking on the grounds that, when underwriting the contract, the policyholder has concealed previous illnesses which, if known, would have made the risk uninsurable (articles 1892 and 1893 of the Civil Code).

The above complaints show that aspects that would have made the customer uninsurable or the covers inapplicable - and which should have been taken into consideration when underwriting the contract - are on the contrary raised only during the settlement phase to deny the payment of benefits.

This issue is seemingly linked to the widespread use of a pre-printed "statement of good health" to be signed by the policyholder, instead of a health questionnaire allowing policyholders to give informed and more correct answers on their actual state of health.

This statement – used only for PPI and not also for life policies sold *stand alone* – appears to be particularly suited to the selling practices followed by distributors, who aim to achieve maximum simplification of negotiations and of the underwriting process.

In other cases, a more detailed health questionnaire was submitted to customers, but the answers were “pre-filled” by an IT application and submitted to the customer for signature by mere acceptance.

1.4 *Refund of premiums not enjoyed in case of early repayment of the loan*

In case of early repayment of the loan, despite legislative and regulatory interventions, a large number of consumers still complain about the non refund or the lengthy delays for obtaining the refund of that part of premium paid relating to the remaining period with respect to the original expiry of the policy and the lack of transparency in the calculation procedure adopted by undertakings, which does not allow to check its correctness.

2. Issues regarding both production and distribution

2.1 *Policies covering the loss of employment.*

Cases have emerged where undertakings have denied the payment of the benefit in case of "loss of employment", on the grounds that the policyholder did not meet the requirements to be entitled to the benefit. For example:

- public employee, while the insurance cover applies only to private employees;
- part-time worker, while the cover applies only to full-time workers;
- employee of an individual undertaking managed by relatives in the ascending line and descendants, while the cover does not apply in case of family businesses.

The supervisory activity conducted by IVASS has shown that neither the insurance intermediary, when selling the policy, nor the insurance undertaking, when accepting the relevant risk, have checked the existence of the insurability requirements, thus determining in practice the payment of a premium by the customer without a corresponding insurance coverage. This despite the fact that, when granting the loan, the insurance intermediary had the information necessary to check the *status* of the worker and therefore the fulfilment of the insurability requirements.

3. Issues regarding distribution processes (intermediaries selling the product)

3.1 *Tie-in (policies sold in combination with loans)*

The results of the supervisory activity conducted by IVASS and the Bank of Italy within their respective competences have brought to light cases when the granting of the loan has been made systematically conditional on the conclusion of a life assurance contract despite the optional nature of such contract. Some "insurance penetration" indexes[4] observed, which in some cases exceeded 80%, may be symptomatic of the fact that these policies are substantially compulsory.

Some consumer associations too have reported this problem on the basis of a mystery shopping survey carried out at several bank branches; this survey has shown that in a significant number of cases the policy continues to be offered to customers as a pre-requisite for obtaining the loan, presenting it as mandatory or indicating to the customer that it is strongly recommended for a favourable outcome of the examination preliminary to the granting of the loan.

Another issue concerns the premium of the policies which must be paid in full and in advance and is often added to the principal of the loan, thus generating interests. This commercial practice can be explained by the fact that in this way the commissions charged on the single premium are collected in advance by the intermediary, and sometimes exceed 50% of the premium.

3.2 *Information and assessment of adequacy before the conclusion of the contract*

As described in paragraph 2.1 above, IVASS has also noticed that intermediaries do not always verify the adequacy of the contract before its conclusion; as a result products are often sold to uninsurable persons not complying with the requirements envisaged by the policy conditions to gain admission to the benefits provided by the cover sold. Furthermore, aspects that make the customer uninsurable are not raised

[4] Measured as the incidence of the number of policies underwritten divided by the number of real estate loans and personal loans granted.

by the insurance company when underwriting the contract but only when a claim is made, to deny the payment of benefits.

It has also emerged that consumers often receive little information on the features of the insurance product; in many cases, when the policy was underwritten, the policyholder did not receive adequate information on the covers actually applicable and on the existing limitations and exclusions.

4. Guidelines for undertakings and intermediaries

On a more general note it can be observed that the benefits resulting from the conclusion of insurance policies covering the risk of failure to reimburse loans can only be achieved if the guarantees provided satisfy the actual need for risk cover and if the distribution of these products follows the ethical principles of substantive fairness.

IVASS and the Bank of Italy have started collaboration with a view to overcoming the existing problems and, in light of the need for improved consumer protection, operators are required to comply with the following guidelines.

4.1 IVASS – in accordance with art. 183 of the Insurance Code on fairness and transparency in the supply and execution of insurance contracts – expects that the aforementioned insurance undertakings:

4.1.1 Characteristics of the products and adequacy of the contract in case of multi-risk packages with "shifting guarantees":

- make a critical review of the products marketed, re-design them with a view to making them more tailored to the characteristics and needs of the specific target clients to whom they are addressed;
- grant the right of withdrawal, already envisaged by art. 177 of the Insurance Code for life policies, also for non-life covers; this would be in

line with a recent self-regulatory initiative[5] and with some best practices existing on the market which already envisage the right of withdrawal for all the life and non-life covers, to be exercised within 60 days[6];

- adopt an effective system of internal controls to verify that the sales network markets new products that are appropriate to the identified target and that there are adequate safeguards to prevent *mis-selling*;
- impart the necessary instructions to the distribution network so that the latter verifies the insurability of risks, the adequacy of the product compared to the customer's specific needs and precontractual information;
- envisage a specific timetable of controls and safeguards aimed to assess the standard and efficiency of the distribution network as well as compliance with the instructions given and the level of fairness, transparency and due diligence in the performance of distribution tasks;

4.1.2 *duration, exclusions, recourses, waiting periods, deductibles:* make a careful review of the products in the portfolio in order to remove the problems found in the policy conditions in relation to the terms indicated above, thus re-balancing the contents of the guarantees to the benefit of consumers;

4.1.3 *statement of good health (DBS):* envisage a specific interview to customers for the determination of their state of health. The burden of verifying whether the risk may be insured lies with the undertaking, before concluding the contract and collecting the premium. In particular the preprinted statement of good health must be replaced with a health questionnaire allowing potential policyholders to make an informed representation of their actual state of health and indicate any known previous illnesses. Safeguards must be adopted to avoid that the questionnaire is automatically filled in by an agent of the distribution network when the policy is sold.

[5] Memorandum of Understanding of 30 November 2013 between ASSOFIN, ABI and consumer associations part of the CNCU (National Council for Consumers and Users).
[6] A sample survey carried out on the information dossiers available on the websites of 5 leading companies in the PPI sector has shown that the right of withdrawal within 60 days for the whole "package" is a widely used contract term.

Whenever, for loans of very small amounts, undertakings decide not to assess the state of health by means of a questionnaire, they are expected not to include the assessment of the state of health among the conditions under which risks may be insured; therefore, no exclusions may be applied in case of previous illnesses. As regards the contracts already underwritten, in those cases where policyholders were not enabled to give a complete description of their previous state of health and this gives rise to disputes, undertakings are required to adopt a settlement policy promoting the payment of benefits;

4.1.4 *checks when the contract is concluded:*

- when accepting the relevant risk, undertakings must check the fulfilment of the insurability requirements and the adequacy of the product with respect to the customer's needs;
- whenever products have been sold to customers who were not insurable when they applied for the insurance cover, undertakings must find solutions aimed to the total refund of premiums and costs paid.

4.1.5 *refund of premiums not enjoyed in case of early repayment of the loan:*

- in case of early repayment or transfer of the loan undertakings shall autonomously proceed with the reimbursement of the part of the premium paid and not enjoyed, also without a specific request by the debtor/policyholder, and review their contract terms accordingly; this without prejudice to the possibility for the policyholder to request that the insurance cover be maintained;
- where they have not already done so, adjust the contracts sold before the entry into force of the law converting the so-called "Second Development" Decree-Law[7], to make them compliant with the provisions of paragraphs from 15-quater to 15-sexies of article 22;
- review their policy conditions to set out - in a clear manner - the

[7] Decree-Law no. 179 of 18 October 2012, converted after amendments by article 1 of Law no. 221 of 17 December 2012.

methods and procedures for the calculation of the part of the premium paid to be refunded; this part, as envisaged by article 49 of ISVAP Regulation no. 35/2010, must include commissions, since the undertaking can only retain the administrative costs of the contract.

4.2 IVASS and the Bank of Italy - in the exercise of their respective supervisory functions - expect that the aforementioned insurance undertakings and insurance intermediaries review their arrangements for selling policies to ensure that:

4.2.1 *tie-in (policies sold in combination with loans):*

- the precontractual documents for the financial relation are always distinguished from those relating to the insurance relation, and in each of them the relevant cost is shown separately; IVASS and the Bank of Italy believe that greater clarity in precontractual information can be achieved by providing evidence of the amount of the instalment due for the repayment of the loan and of that due for the payment of the premium;
- customers can better assess the characteristics of the policy with respect to their needs; to this purpose IVASS and the Bank of Italy call on intermediaries to define timing and terms for proposing contracts in such a way as to avoid any undue influence when negotiating the loan;
- the insurance documents clearly indicate that customers may withdraw from the insurance contract within sixty days of concluding it and that, in this case, they are entitled to the reimbursement of the premium (or, when the premium has been added to the principal of the loan, to the equivalent reduction of the instalment), net of that part of the premium referring to the period during which the contract was in force and of the costs actually sustained by the undertaking for the issue of the contract as indicated in the insurance documentation;
- after the contract is concluded, a notice is promptly sent to customers, describing the characteristics of the insurance covers underwritten and reminding them that they may withdraw from the insurance policy and obtain the reimbursement of the premium paid or, when the premium

has been added to the principal of the loan , the equivalent reduction of the instalment of the loan, and indicating the relevant amounts. This solution has already been envisaged in the above-mentioned self-regulatory initiative.

4.2.2 *Verification of adequacy before the conclusion of the contract and when entering into the policy: in addition to the requirements of point 4.1.4*

- the product shall be offered only to persons fulfilling the insurability requirements and to the target clients the product is intended for, properly identified by the undertaking;
- substantive and not formal checks shall be carried out to assess the adequacy of the policy to the customer's specific needs;
- the characteristics, duration, costs and limits of the insurance cover shall be clearly indicated;
- policyholders shall be provided with the necessary information enabling them to make informed choices corresponding to their needs.

5. Structure and level of costs

The analysis of the information dossiers relating to PPI products[8], published on the company websites pursuant to IVASS Regulation no. 35/2010, has shown that the costs borne by the policyholder remain high and that a significant part (sometimes exceeding 50%) of the premium paid by the customer is paid to banks and financial intermediaries as a consideration for the distribution activity performed.

The high number of complaints received by IVASS reporting the sale of policies not appropriate to the customer's needs, limited assistance when placing the policy and the lack of information on the characteristics and limits of the cover, are indicative of the poor quality of the service offered when distributing products, which does not seem to be in line with the level of commissions paid to the sales network. In

[8] The information dossiers examined were related to 44 PPI products, marketed by 42 undertakings.

particular on-site inspections have confirmed that distribution processes are extremely standardised and do not always envisage adequacy assessments, and this has raised the need for IVASS to issue the letter to the market of 17 December 2013.

Cost levels that do not reflect the economic nature of the underlying activities or which are not in line with the quality of the product or service provided are detrimental to consumers.

On this basis, IVASS and the Bank of Italy intend to better understand the cost structure of PPI policies.

6. Further aspects of the procedure

On account of the above IVASS expects that the administrative body of the insurance undertakings - in the management of the contracts concluded and of complaints, with special regard to claim settlement – adopts policies which take due account of the issues mentioned above and favour solutions based on the principles of fairness and transparency in the relations with policyholders according to art. 183 of the Insurance Code.

The administrative body of the undertaking is also required - within 90 days of receiving this letter - to adopt a plan, to be submitted to the supervisory body and implemented within the following 90 days, setting out what needs to be done to make the products and the arrangements for the supply and execution of contracts compliant with the foregoing guidelines.

A similar plan, to be adopted and implemented according to the terms and procedures set out above, is required from intermediaries registered in section D of the RUI, to ensure compliance with the guidelines provided by IVASS and the Bank of Italy when placing PPI products.

IVASS and the Bank of Italy will continue in their respective supervisory activity over

banks, financial intermediaries and insurance undertakings with a view to verifying compliance with the above guidelines.

The President of IVASS

firma 1

The Governor of the Bank of Italy

firma 2