

Risks and opportunities of the external context

NFS The capacity of the Group to create value can be significantly influenced by certain factors in the short, medium and long term which then determine risks and opportunities.

Uncertain financial and macro-economic landscape

During the course of 2017, the **global economy** grew at a rate that was greater than expected due to the dynamic nature of domestic demand in developed economies. The Eurozone grew not only as a result of dynamic consumption but also as a result of increased investment. Within Eastern European countries, the positive economic trend continued, driven by consumption and a growing labour market, including salary increases which sustained inflation. Within Europe, significant events include the victory of Macron within the French presidential elections, the advance elections in the UK as well as the advance elections in Catalonia. On the global level, on the other hand, the year was characterized by significant political uncertainties (Russiagate, tensions with North Korea) which influenced the confidence levels of operators within financial markets. Within the USA, GDP growth compared to the previous year was 2.2% and the labour market continued to gain strength, with an unemployment rate that fell in November to 4.1%, the lowest level in the last 17 years. Significant uncertainty developed in relation to the abolition of Obamacare and tax reform; the primary point of the latter was the decrease in fiscal load for companies. Inflation remained, in any case, low despite increases in both the USA and Europe. Growth in Asia, in particular China, continued at significant levels.

With regard to the **insurance sector** in Italy, Germany, France and Spain (in a persistent environment of low interest rates and stringent capital requirements), the Life business was characterized by the sale of unit-linked policies, which however failed to offset the decrease in traditional products. P&C business continued to grow throughout Europe: in Italy the slight increase in the P&C business was mainly attributable to the health insurance business; in France, Germany and Spain the result was also positively affected by the motor business

Regulatory evolution

The insurance industry is characterized by a detailed regulatory system consisting of continuously evolving domestic and European regulations. Some of the most significant are:

- **European directive Solvency II**, the European insurance market supervisory framework which includes three pillars: capital measurements, governance and risk management systems and reporting
- **Common Framework of the International Association of Insurance Supervisors (IAIS)** on the development of standard qualitative and quantitative capital requirements based on risk for insurance groups operating globally
- **IFRS 9** (financial instruments) and **IFRS 17** (insurance contracts) that - as of 2021 - will be the new reference accounting standards for the valuation of the most significant items of the insurance financial statements, i.e. financial instruments and liabilities to policyholders
- **European directive on insurance distribution and regulations on investment product disclosure and transparency** guaranteeing an increasingly high level of consumer protection
- European regulations relative to **personal data protection**
- European directive on **non-financial information**, transposed into the Leg. Decree 254/2016.



Risk Report
for a detailed description on the risk profile and the main risks, p. 93 of the Annual Integrated Report and Consolidated Financial Statements 2017

Identified risk

Our response to risk

Financial risk

Credit risk

Strategic risk

The constraints imposed by the calculation of the capital requirement according to the Solvency II regulations, market expectations, the Group's profitability targets and the expectations of policyholders' returns are the main factors influencing the formulation of the **investment allocation strategy**. The regulatory system and the continued low interest environment - despite overall positive global growth - render it essential to manage assets in a rigorous and careful manner that is consistent with liabilities. Geographical diversification and selective focus on alternative investments and real assets (real estate assets and/or infrastructural assets, both direct and indirect) are important factors in investment activities which aim to contain portfolio risks and sustain current profitability. The creation of a multi-boutique insurance asset manager platform is part of the strategy to enhance the investment capacity in these market sectors.

Identified risk

Our response to risk

Strategic risk

Operational risk

We run our business in compliance with the law, internal regulations and codes and professional ethics, and we closely monitor the evolution of the regulatory environment, dialoguing with legislators and institutions. We regularly evaluate our exposure to the risk of non-compliance and assume prompt measures to adequately manage it.

We continue to apply the requirements of **Solvency II** and are engaged in the various tests carried out by the **International Association of Insurance Supervisors (IAIS)** in order to determine the final architecture and calibrations of the supervisory requirements.

We are making investments which aim towards the methodological and operational implementation of the new international standards IFRS 9 and IFRS 17 for the **evaluation of financial instruments and insurance contracts**, also by actively participating in specialized international and national work groups on the issues subject to implementation.

In accordance with our customer focus strategy, we have implemented the **transparency requirements for investment products** required by EU legislation by putting the best practices of the Group into common use. We are working to be ready to apply the **new regulatory requirements on insurance distribution and personal data processing**.

Finally, we monitor regulatory developments pertaining to **non-financial information**; the first reporting on this topic was implemented within this document.



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Technological evolution

We are facing **profound changes** caused by the interaction and cumulative effect of multiple technological developments: the Internet of Things, the constant growth of mobile networks, the adoption of cloud services, the development of cognitive computing and machine learning are all elements that contribute to creating a renewed environment in which to operate.

The unprecedented availability of customer data, combined with the **technological capabilities** of processing data quickly and efficiently in terms of costs, allows the insurance business to create customized prices and identify potential fraud (such as the development of programs for the prevention of losses) as well as develop new products and re-design operational processes. On the other hand, it creates potential challenges deriving from the management of personal data and the automation of decisive processes in addition to new challenges within the traditional risk management insurance model.

At the same time, elevated technological growth implies an exponential evolution in **cyber** threats, both in terms of volume as well as typology (i.e. targeted attacks which aim to steal information or block operational processes). Adequate management of cyber risk is therefore fundamental in order to limit potential effects of economic and operational nature but also to preserve, in particular, the confidence of customers in the processing of their data which are frequently sensitive. This issue is also increasingly relevant for regulators which are requesting the introduction of specific safety measures as well as reporting processes in the case of violation of the data (Regulation on personal data protection).

Finally, technology as an enabling element of the processes may also impair business continuity, representing a potential threat (malfunction of equipment and systems, etc.) if appropriate measures are not applied.

Identified risk

Our response to risk

Strategic risk

Operational risk

We have implemented a **cloud analytical platform** (with EU server) for the management and analysis of data derived from our business units. Each of these has a dedicated and exclusive area available to them where the data are initially uploaded and processed in an absolutely anonymous manner; at the end of the process, the results/models which are attained are made available to the requesting operational units. The platform takes advantage of the currently most innovative technologies which were also essential to define a series of applications available to all business units, thereby ensuring superior user experience so as to increasingly meet customer requests for greater digital interaction. This development is based on a hybrid architecture that offers the latest mobile technology.

In order to protect ourselves from new threats we are continuing to enhance our ability to prevent, detect and respond to potential cyber attacks while implementing the most **innovative security solutions** and continuously improving our response processes. In particular, we acquire and analyse threat intelligence from multiple external and internal sources so as to increase our prevention capacity while adopting the best market solutions to detect and prevent potential attacks. We have also strengthened the Group's security governance model, defined a policy and implemented effective awareness campaigns for our employees in relation to the management of security risks.

To protect our trustworthiness, reputation and survival from threats of natural, human and technological origin, we have also implemented a **Business Management Continuity process** that identifies critical processes and operational risks that may interrupt business operations, as well as risk mitigation measures and solutions to recover and resume vital business processes as soon as possible and with limited financial impact.



New customer needs

In this currently uncertain economic environment, consumer attitudes to insurance products and services are changing in light of two global trends:

- **digitalization**, which has introduced new selling options and more diverse insurance product management
- **economic uncertainty**, which has changed spending on savings and other insurance products.

Customers currently place greater focus on service quality: they no longer rely only on an agent to acquire an insurance product; rather, they have a more independent approach to the decision-making process, which includes visiting the websites of insurance companies, reading customer reviews on social media and checking comparison websites.

Identified risk

Our response to risk

Strategic risk

Insurance risk

We aim to become the **top choice of clients and distributors**. We aim to offer insurance solutions and services that are simple, tailored and even more innovative to meet their needs, also digital ones, and to improve their customer experience. The digital transformation taking place in our business units allows us to increase the efficiency of our distribution network across the world: our aim, in fact, is for the interaction with customers to be increasingly based on a consulting approach, i.e. based on an understanding of the needs of individual customers and on the offer of a personalized solution.

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Environmental challenges

Global warming caused by the emission of greenhouse gases has resulted in an increase in the volatility of climate events, particularly extreme conditions such as hurricanes, floods, heat waves and droughts. In addition to an increase in physical risks, there is also growing awareness at the political level, even international, in relation to these issues. This has strategic and regulatory repercussions on activities affected by climate risk, particularly in Europe. For example, there is the emergence of new financial risks (creation of stranded assets) as well as risks connected to the transition to a low-carbon economy due to unknown factors generated by the use of new technologies and business models with reduced emissions. These factors are increasingly affecting the economic and social system, including the insurance sector, which is thus facing new risks and opportunities. Opportunities arise from a new or increased demand for coverage which needs to be met with innovative products. For this to be sustainable, however, appropriate countermeasures must be prepared at the same time. These are necessary in order to avoid increased damages and greater volatility which would negatively affect the price dynamics of the policies, also due to the greater absorption of capital deriving from underwritten business. If they are not present, access to insurance would be excessively costly or, in extreme cases, the offer would not be feasible.

 **Glossary available at the end of this document**



Demographic and social change

Modern communities are affected by distinct demographic and social phenomena with a strong impact on their socio-economic balances. In Europe, the continual process of **population aging**, driven by an increase in life expectancy and a decrease in birth rates, is only partially counterbalanced by **international immigration**. The non-European area is affected by similar phenomena, albeit of a distinct nature with respect to local socio-political characteristics. Younger age groups are affected by a reduced and often discontinuous capacity to generate average income; this is strongly influenced by a flexible but precarious labour market that does not ensure reasonable certainty for financing the public welfare system. The result is increasingly unbalanced communities where higher post-retirement pension and healthcare requirements are no longer properly financed and covered by the public system, in addition, the limited economic and financial resources produced by the younger categories of the population, or from private savings in general, have to be directed and valued more carefully.

Identified risk

Our response to risk

Underwriting risk

Emerging risks

Operational risk

We constantly monitor the main perils and territories where we are exposed, using actuarial models to estimate the damage that could result from natural phenomena and thereby optimizing our underwriting strategy. **Re-insurance** plays a fundamental role: we manage our protections on a centralized basis in order to take advantage of economies of scale and pricing thanks to the size of the Group, with the aim of leveraging on business diversification. In accordance with our commitments to favour the transition to a low-carbon society and the global targets established at the COP21 conference, we continue to monitor and **reduce our direct impact** through a responsible management of key activities; we also incentivise the adoption of environmentally sustainable behaviour within our spheres of influence through our **insurance solutions** as well as our **investments** in order to reduce indirect impact of our activities. We develop and distribute increasingly innovative products along with a high level of services in order to meet the potential request for more and improved protection against catastrophes, in addition to products that reward virtuous and environmentally sustainable decisions and behaviour. Also in partnership with other public and private stakeholders, we work to support initiatives that help to expand access to insurance products, for example through more favourable taxation for catastrophic coverage, which would decrease the impact of reconstruction on the public sector, as well as initiatives aimed at preventing and mitigating environmental risks. We invest responsibly, excluding from our investment universe those companies that cause serious harm to the environment. We support research and studies on environmental risks. We adopt **sustainability criteria for the underwriting of new insurance policies** that are in line with the best and universally recognized sustainability standards, even through the use of specific third-party tools while analysing in detail and potentially excluding business opportunities that are not consistent with principles of environmental, social and governance sustainability. In particular, we utilize internal and external monitoring processes of environmental emissions associated with the activities in our investment and insurance portfolios. As a result, we are capable of monitoring, on the one hand, any business and environmental risks associated with greenhouse gas emissions and, on the other hand, we can design and develop new solutions that simultaneously offer a competitive advantage to our Group as well as an incentive for policyholders for the transition to a business model with reduced emissions.

Identified risk

Our response to risk

Underwriting risk

Emerging risks

We actively engage in creating more stable communities while monitoring and tackling the effects of a changing society. We develop and offer **flexible and modular solutions with elevated social security and welfare content** for the coverage of healthcare costs and other potential current and future needs for individuals, families and communities. We undertake to strengthen dialogue with individuals during their entire period of interaction with our companies. We provide customers with complete and easily accessible information on products and services while helping them to understand the primary risks that may affect their income capacity and aiding them in accurately assessing their capacity to save as well as identifying their current and future needs. We believe that insurance coverage is the most appropriate tool to forecast and meet potential needs of both younger and older individuals with the required advance notice; we therefore formulate and present offers even in the case of market contexts with little knowledge and low individual propensity for insurance solutions.