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## The state of the art on the mandatory obligation for companies to carry insurance coverage against catastrophic events set forth in the Budget Law 2024

On 31<sup>st</sup> March 2025, subject to further extensions<sup>1</sup>, the deadline will expire for certain Italian companies and foreign companies with permanent establishment in Italy to take out insurance policies to cover the adverse effects of natural disasters and catastrophic events, as set forth in Article 1, paragraph 101 of Law No. 213 of 30<sup>th</sup> December 2023 ("**Budget Law**").

This obligation was introduced by the legislator in order to address the social and economic consequences deriving from the frequent calamitous events that damage the Italian territory (and that determine significant impacts on the public budget), transferring - at least in part - these consequences to the insurance companies according to a principle of mutuality among the insured parties subject to the obligation to provide themselves with such insurance coverage.

In this context, the Budget Law identifies a broad group of companies subject to the obligation to enter into these kind of insurance policies (constituted by companies required to register in the companies register pursuant to Article 2188, hereinafter the "**Obligated Persons**"), from which would be excluded only small entrepreneurs, direct cultivators of land<sup>2</sup>, artisans, and those engaged in organized professional activity.

At the same time, the list of assets to which the insurance cover must relate is also detailed, consisting of the assets "*referred to in Article 2424, first paragraph, section Assets, item B-II, numbers 1), 2) and 3), of the Civil Code directly caused by natural disasters and catastrophic events occurring on national territory*". These assets are essentially tangible fixed assets consisting of land, buildings, plant, machinery, industrial and commercial equipment (hereinafter "**Assets**")<sup>3</sup>.

In view of the compulsory nature of this insurance cover, an obligation to undertake these kind of risks is also imposed on insurance companies, with the purpose of ensuring that Obligated Persons have access to such insurance policies, an obligation to contract, sanctioned by an administrative sanction ranging from Euro 100,000 to Euro 500,000.

The obligations and provisions set forth in the Budget Law should have been implemented by the Ministry of Economy and Finance and the Ministry of Enterprise and Made in Italy (hereinafter referred to as the "**Ministries**") by means of a specific decree, concerning "*further implementation and operating modalities of the insurance schemes referred to*" in the Budget Law, as well as "*the methods for identifying the calamitous and catastrophic events eligible for indemnification as well as for the determination and periodic adjustment of the premiums, also taking into account the principle of mutuality and, having consulted IVASS, the methods of coordination with respect to current regulatory and prudential supervisory acts on insurance also with reference to the limits of the capacity to assume the risk*" and for updating the deductibles and the coverage.

As is well known, this decree has not yet been published in its final version (despite the imminent effectiveness of the obligation for the Obligated Persons to enter into these kind of policy), but, on the basis of drafts published in recent months ("**Draft Regulation**"), it is nevertheless possible to have a certain details on how obligations set

<sup>1</sup> As is well known, following an initial postponement of the deadline dictated by the so-called Decreto Milleproroghe to 31st March 2025, a further extension of the entry into force of the obligation in question is currently being discussed.

<sup>2</sup> Farmers in particular are excluded from this obligation, with reference to whom the regulation of the National Mutual Fund for the coverage of catastrophic meteo-climatic damage to agricultural production caused by floods, frost and drought, introduced by the 2022 Budget Law, remains in any case in place.

<sup>3</sup> It is recalled that buildings affected by building abuse or lacking the required authorisations are excluded from the obligation.

forth in the Budget Law could be implemented.

## **1. Insurance companies subject to the obligation to contract**

The Draft Regulation identifies and specifies the companies due to contract.

In particular, such undertakings are insurance companies authorized to issue insurance policies related to insurance branch 8 pursuant to Article 2, paragraph 3 of the Code of Private Insurance ("*fire and natural elements*"), even if they operate under the regime of establishment or freedom to provide services, "*that underwrite insurance contracts, at an individual or group level, to cover damage*" to Assets deriving from catastrophic and calamitous events identified by the decree (which will be discussed in greater detail below). In addition, the Draft Regulation would also envisage the option, within insurance groups, to designate one or more group companies as authorized parties to fulfil the obligation to underwrite insurance contracts referred to in Budget Law.

In this regard, it is worth noting that this obligation also extends to foreign companies and, on the other hand, is "limited" to only those companies (Italian and foreign) authorized for insurance branch 8 that carry out insurance business in this specific segment of the market (it therefore appears to exclude companies authorized for Branch 8 that do not have in place contracts covering catastrophic losses).

While such a limitation would exclude from the obligations referred to in the Budget Law those companies that, by commercial choice, do not offer catastrophic coverage to clients, the language used could imply uncertainties in terms of interpretation, also in light of the sanctions dictated by the Budget Law in the event of non-compliance with the obligation to undertake these type of risks.

In fact, it is not clear whether a company, authorized for insurance branch 8 but which does not carry out - on the effective date of the obligation - any underwriting activity in the catastrophe area, will be subject to the obligation to contract set forth by the Budget Law even in the event of a (future) issuance of a single policy, without, however, wishing to commence an effective commercial activity in this sector.

On the other hand, further uncertainties arise - above all - in the hypothesis in which an insurance company intends to permanently cease its business of underwriting the catastrophe risks of Obligated Persons. From the wording of the Draft Regulation on this, it would seem to be possible to infer that companies may also choose to exit this market sector, given that the obligation would only apply to those companies that "*perform underwriting activities*" of policies covering damage to the Assets of Obligated Persons. Nonetheless, a broad interpretation of this provision could ultimately lead to evasive interpretations by market participants.

In this regard, it is therefore to be hoped that the final version of the decree, or rather IVASS, will clarify in greater detail the actual scope of the obligation to contract under the Budget Law.

## **2. Insurance cover**

On the basis of the provisions of the Budget Law, the Draft Regulation sets forth detailed rules relating to the types of risks to be insured, the methods for defining insurance premiums, and the extent of deductibles and ceilings.

### *The events to be insured*

The Draft Regulation first of all identifies the types of events<sup>4</sup> that must be covered by insurance companies, which are as follows:

- (i) floods, inundations and overflows, by which is meant any spillage of water from embankments, reservoirs and lakes or watercourses resulting from natural weather events;

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<sup>4</sup> Interestingly, continuations of calamitous and catastrophic events within 72 hours of the first event are considered as a single event.

- (ii) earthquakes, provided that the property is located in an area among those affected by the earthquake according to the location made by the National Institute of Geophysics and Volcanology;
- (iii) landslides of various kinds, even if not caused by water infiltration.

Notwithstanding the foregoing, pursuant to Article 1(3), the policies do not cover:

- (i) damage that is a direct consequence of man's active behaviour or damage to third parties caused by insured property as a result of events;
- (ii) damage resulting directly or indirectly from acts of armed conflict, terrorism, sabotage, riotous actions;
- (iii) damage relating to nuclear energy, weapons, radioactive, explosive or chemical substances or resulting from pollution or contamination.

In particular, compared to some previously circulated drafts, the exclusion for damage as a direct consequence of man's active behaviour, previously defined in terms of an exclusion for each "human factor", is reformulated, which seemed to narrow the scope of coverage by excluding it for all damage as a direct and indirect consequence of human action.

In the new wording, on the other hand, exclusion is limited to any damage that is a direct consequence of man's active conduct.

It is understood, however, that damage to third parties caused by insured property as a result of natural events is not covered.

### Premium

The quantification of the insurance premium is one of the most complex and delicate aspects for insurance companies in relation to the types of risks referred to in the Budget Law, given, on the one hand, the difficulty of quantifying the risk assumed using traditional actuarial techniques and, on the other hand, the impact of claims from an economic point of view.

On this point, the Draft Regulation stipulates that insurance premiums must be determined in proportion to the risk, also by assessing the location of the risk on the territory and the vulnerability of the Assets<sup>5</sup>.

To this end, the insurance company will have to consider the historical series concerning the occurrence of natural and catastrophic disasters, available hazard or risk maps of the territory and, where possible, apply predictive models of the probability of occurrence of events and of the vulnerability of Assets.

Such a provision would seem to entail particular operational complexities for insurance companies. For example, historical series (also due to *climate change*) are increasingly questioned by market players, given the exceptional (in terms of magnitude and frequency) occurrence of calamitous and catastrophic events in recent years. Moreover, given the unpredictability of such events, the use of reliable predictive models would also be particularly complex.

As consequence, these aspects could entail two possible risks for insurance companies:

- (i) on the one hand, an incorrect pricing of insurance risks, which could impact on the solvency of insurance companies; and
- (ii) on the other hand, a wrong calculation (in excess) of the insurance premium could discourage Obligated Persons from entering into these policies, with the possible risk of being challenged by IVASS for failing the obligation to contract.

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<sup>5</sup> In addition, these premiums will have to be periodically updated, also based on the principle of mutuality, to reflect changes in economic values and risk knowledge and modelling.

To this end, it would therefore be hoped that IVASS, or rather the Ministries when implementing the decree, would provide certain guidance on the correct methods for quantifying the premium, with a view to supporting market operators in fulfilling their obligations.

#### Deductible and ceilings

With regard to the deductible, a scaled mechanism is envisaged, whereby:

- (i) for policies with a sum insured up to Euro 30 million, the overdraft may not exceed 15% of the indemnifiable loss;
- (ii) for policies not included in (i) above, and policies underwritten by "large companies"<sup>6</sup>, the determination of the overdraft is left to the free negotiation between the parties.

The Draft Regulation also sets out provisions on ceilings, which, where agreed between the parties, must be in line with the following requirements:

- (i) for policies up to Euro 1 million in amount insured, the ceiling is equal to the sum insured;
- (ii) for policies from Euro 1 million to Euro 30 million, the ceiling may not be less than 70% of the amount insured;
- (iii) for policies whose sum insured exceeds Euro 30 million or for policies underwritten by "large companies", the determination of the ceiling is negotiated between the parties.

#### Transparency of the insurance offer and adjustment of the conditions of policies currently on the market

The Draft Regulation also emphasizes the ways in which the transparency and competition of the companies' offerings to the Obligated Persons is to be promoted, providing the mandatory publication of the information set and insurance conditions on the insurance companies' websites.

Moreover, it should also be noted that Law No. 193 of 16<sup>th</sup> December 2024 innovated the Budget Law by introducing paragraph 105-bis to Article 1 of the Budget Law, which provides for a product comparison portal, managed by IVASS, similar to the one currently in force in the area of third-party motor liability, which will allow for a transparent comparison of the insurance contracts offered.

For this purpose, each insurance company will be required to enter the insurance contract into the portal, indicating the general conditions, the scope of cover and any exclusions and limitations<sup>7</sup>.

Finally, it should be noted that Article 11 of the Draft Regulation states that:

- (i) policies already existing on the market must be adapted within 90 days of the publication of the decree;
- (ii) policies already in place must be adjusted from the first renewal and/or settlement following the entry into force of the decree.

### **3. Limits to risk-taking activities and *governance* profiles of insurance companies**

Unlike the obligation to contract in the area of third-party motor liability, for which there is essentially an "absolute" obligation to accept insurance proposals from clients, the obligation to contract set forth in the Budget Law (as implemented by the Draft Regulations) identifies an obligation to contract that is limited to the risk appetite and solvency requirements of the insurance companies.

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<sup>6</sup> This refers to companies with a turnover of more than EUR 150 million and 500 or more employees at the balance sheet date.

<sup>7</sup> The operation of this portal will be governed by a special decree issued by the Ministry of Enterprise and the Made in Italy on the proposal of IVASS.

So, companies are required to predetermine, as part of the overall definition of the company's risk appetite pursuant to Article 5(2)(e) of IVASS Regulation no. 38/2018, their risk appetite with respect to the catastrophic risks to be assumed, consistent with their solvency requirements and setting risk tolerance limits.

These assessments must be updated annually, also taking into account the risk mitigation mechanism put in place by the companies, including the cession of reinsurance risks to SACE.

If the risk thresholds are exceeded, companies will be required to cease undertaking new risks and promptly inform IVASS. Third parties and clients shall also be informed immediately by means of publication on the website.

For the purposes of setting risk limits and thresholds, a key contribution is made by the actuarial and *risk management* functions of insurance companies, which are required to, respectively:

- (i) to provide its assessments of the underwriting of catastrophe risks as part of its opinion on overall underwriting policy and the adequacy of reinsurance arrangements; and
- (ii) report on the methodologies and models used in setting risk tolerance limits.

In this sense, it can be argued that the Draft Regulation does not identify an unconditional obligation, but one that is tailored to the actual underwriting capacity and solvency requirements of each insurance company/group.

It is worth noting that, pursuant to Article 5(6) of the Draft Regulation, the aforementioned provisions also apply with reference to EU companies operating in Italy under the freedom to provide services and the freedom of establishment regime, which is difficult to reconcile with the principles and provisions of the Solvency II framework, according to which the supervision of governance aspects is the responsibility of the supervisory authorities of the home Member State.

#### **4. Reinsurance Operations by SACE S.p.A.**

The Draft Regulation also intervenes on the reinsurance transactions to which SACE is due by virtue of the Budget Law, which, on this point, authorizes the aforementioned company to grant reinsurance cover up to 50% of the indemnities due, using a fund guaranteed by the State with a maximum annual limit of 5 billion Euro for 2024 and, for the two-year period 2025-2026, with a ceiling not exceeding the greater of 5 billion Euro and the free resources, as at 31<sup>st</sup> December of the previous year, not used, present in the relative Guarantee Fund.

Based on the above, the Draft Regulation would provide that, in the event that insurance companies avail themselves of SACE cover, these companies would transfer to SACE:

- (i) the risks arising from the entire portfolio of insurance policies covering claims under the Budget Law, namely
- (ii) the risks arising from the entire portfolio of insurance policies covering claims under the Budget Law, net of the risks inherent in the policies taken out with "large enterprises".

This provision, which is indeed unclear, would seem to indicate that insurance companies may not, in their relationship with SACE, independently select the risks to be transferred (*pro rata*) to SACE, but may only choose whether (i) to transfer the entire portfolio of policies, or (ii) to deduct from this portfolio only the policies underwritten with large companies.

However, policies that comply with the requirements of the decree remain excluded from the reinsurance offered by SACE.

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