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Legal Bases of the Internal Insurance Market in Europe

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A. Introduction

The Treaty establishing the European Economic Community of 25 March 1957 (Treaty of Rome) logically provided also for a common insurance market. The aim was to create a market where insurers having their head office in a member state would be free to operate in all other member states, and at the same time to ensure that competition was not restricted. The prerequisite for reaching this target was the realisation of the fundamental freedoms, in particular the freedom of establishment (Art. 43 *et seq*. EC Treaty[1]), the freedom to provide services (Art. 49 *et seq.* EC Treaty and the free movement of capital (Art. 56 *et seq.* EC Treaty).

The freedom of establishment allows an insurance undertaking whose head office is situated in one member state to open a branch office, a subsidiary or an agency in the territory of another member state under conditions equivalent to those which govern undertakings established in the latter country (principle of national treatment for nationals of other member states).

The freedom to provide services (FOS) allows an insurance undertaking established in the territory of one member state to exercise cross-border activities in another member state without having an establishment therein, and here again under conditions equivalent to those applying to domestic companies. In this relation three cases are possible:

- The insurance company goes into the other member country in order to offer insurance cover therein.

- The policyholder goes into the other member country in order to seek insurance cover therein.

- The insurance undertaking and the policyholder remain in their respective countries, but effect a cross-border insurance contract either in the way of traditional correspondence or through the now customary modern communication means.

In the first case mentioned above, difficulties may arise with regard to the **separation** between FOS and freedom of establishment when the insurer's activity is no longer exercised in individual cases and on a temporary basis, but when the business has grown to a certain importance and continuity, which would in fact call for a branch office which, however, the undertaking does not establish. According to the estab-

[1] **EC Treaty means:** The consolidated version of the Treaty establishing the European Community as amended by the Treaty of Nice.

lished case-law of the European Court of Justice[2] it may be assumed that the insurer no longer operates under the freedom to provide services but makes use of the freedom of establishment, when the insurance business is carried on by a person who, though being independent, is permanently charged to do so and is operating from a location situated in the host country. Freedom to provide services is said to be where e.g. a foreign insurance undertaking operates via a domestic broker who is independent from the insurer – which should obviously be the case- and serves only the interests of the policyholder. However, if the broker is tied to the insurance company through hidden acquisition or commission agreements, he is acting as a branch office of the insurer; he is not operating by way of services.

With a view to abolishing the restrictions on freedom of establishment and on freedom to provide services the Council of the European Economic Community had adopted so-called **General Programmes**[3] on the basis of Articles 54 and 63 of the Treaty of Rome which laid down which restrictions on the two fundamental freedoms were to be abolished in which intervals through Council Directives and under what conditions this would have to be done. For the insurance sector the following was provided:

- Freedom of establishment and freedom of services for reinsurance was to be implemented by end-1963.

- The restrictions on freedom of establishment for non-life insurers were to be abolished not later than by end-1965 and those for life-insurers not later than end-1967. In both cases the prior condition was that beforehand the conditions for the taking-up and pursuit of the activities concerned be coordinated.

- The restrictions on freedom to provide services were to be abolished for non-life insurers not later than by end-1967 and for life insurers not later than by end-1969. The prior conditions were the realisation of freedom of establishment, the coordination of the insurance contract law („to the extent as the disparities between these provisions entail disadvantages for the insured persons and third-parties”) and the simplification of formalities in relation with the recognition and enforcement of judgments.

The **free movement of capital** allows the unrestricted cross-border transfer of assets (e.g. capital for the establishment of a company, re-transfer of profits made). With regard to the removal of restrictions the Council did not establish a General Programme, as it had done with regard to freedom of establishment and freedom to provide services. The Treaty of Rome provided that the restrictions on these fundamental freedoms be abolished step by step over the transitional period, i.e. until end-1969, to the extent necessary for the functioning of the Common Market (Art. 67 Treaty of Rome). In this respect it must be kept in mind that the free movement of capital concerns only unilateral cross-border transfers of assets; the bilateral exchange of service against payment, in the insurance sector premiums and insurance benefits or claim payments, falls under the movement of goods and services and consequently is covered by the General Programme for the abolition of restrictions on freedom to provide services.

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[2] ECJ Judgment of 04 December 1986, Case 205/84 "COM vs. Federal Republic of Germany", ECR 1986 p. 3755.

[3] General Programme for the abolition of restrictions on freedom of establishment of 18 December 1961, OJ No. 2 of 15 January 1962, p. 36.
General Programme for the abolition of restrictions on freedom to provide services of 18 December 1961, OJ No. 2 of 15 January 1962, p. 32.

The establishment of the framework for the internal insurance market, in particular the realisation of the fundamental freedoms, proved itself to be extremely difficult.

It was mainly the **supervisory law** of member states which stood in the way of rapid realisation of the objectives which the Treaty set for this sector. The provisions of this supervisory law differed widely from one country to the other as to the aim, the purpose and the intensity of supervision. This was related to the differences between the individual member states as to the importance of consumer protection. A common market – such was a long-standing belief – could not be realised before the approximation of laws, in particular relating to supervision of insurance, had made so much progress that the risk of distortions of competition and different amounts of consumer protection was largely eliminated. Working hard for years, the parties concerned succeeded in approximating the national legal systems in many fields of the supervisory law, which naturally, as usual when compromises are made, resulted in weakening the intensity of supervision in countries with a strict supervisory law and in strengthening the intensity of supervision in countries with a weak or even non-existing supervisory law. During the last development phase, however, the Community bodies decided to do without coordination, although the new Art. 100a of the Treaty of Rome (now Art. 95 EC Treaty) facilitated the approximation of laws through Directives. Relying on the case-law of the European Court of Justice (ECJ[4]) and in line with the proposals contained in the White Paper of the Commission on the Completion of the Internal Market[5] they rather began to encourage member states to more **mutual recognition** of national provisions.

So member states kept their **regulatory autonomy** in particular fields which were not yet blocked, however on the condition that they acknowledge e.g. foreign safety standards as equivalent to domestic standards. Where distortions of competition were clearly foreseeable as a result of different national safety standards being maintained in a domestic market, a remedy was found in the way of Directives by abolishing, among other things, the safety standards. The Third Directives, for example, banned the **preventive supervision of products and prices** which existed in the majority of member states, because in one and the same market insurers with products liable to approval were not capable of competing with insurers offering products exempt from approval.

In the other fields where different rules between member states may be maintained, the European Commission at least is confident that if discriminations occur – which can only be discriminations against "nationals" on account of the mutual recognition of the national legal systems – the individuals concerned will apply pressure on the competent authorities of their State as long as these have not abolished the discriminatory measures. If this should come true, the approximation of laws would in fact also be realised in the insurance sector, and this at the lowest possible level. This, however, would help neither the insured persons nor the insurance companies.

Even after the completion of the Single Market the harmonisation of national supervisory laws must be pursued to the necessary extent, yet not by removing them without replacement, but by adopting uniform, modern rules protecting the insurance sector against distortions of competition and the insured persons against irregularities and insolvencies.

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[4] ECJ Judgment of 18 January 1979, Cases 110 and 111/78 "van Wesemael", CJR 1979 p. 35/52.; ECJ Judgment of 20 February 02.1979, Case 120/78 "Cassis de Dijon", CJR 1979 p. 649/662.

[5] Completing the Internal Market, White Paper from the Commission to the European Council (COM (85) 310 final of 14 June 1985 (points 61-79)

In June 1998, the European Council of Cardiff for example requested the Commission, in view of the structural changes in Europe (introduction of the Euro and enlargement of the Union) and in the World market (increasing globalisation not least as a result of the removal of restraints on market access through the WTO agreements), to develop a framework for measures to improve the Single Market for financial services. In a Communication of May 1999[6] the Commission presented a Financial Services Action Plan. Therein the attempt is made:

- to confirm the objectives which policymakers should pursue during the following years
- to establish a list of relative priorities and a time-table for the achievement of the objectives
- to lay down a number of measures helping to achieve the objectives.

Apart from the completion of urgent current projects the Action Plan provides for new priority activities in at least three fields: wholesale markets, retail markets and sound supervisory structures.

The projects were to be implemented not later than 2005.

In a number of cases rapid progress was made.

In the insurance sector e.g., the rules applicable to the fields of winding-up of insurance undertakings, amendment of solvency rules (Solvency I), supervision of insurance groups and financial conglomerates and treatment of the institutions for occupational retirement provision have been coordinated.

Progress was made also in the field of general consumer protection, in particular through the adoption of the Directive on the distance marketing of financial services, the Insurance Mediation Directive and the Unfair Commercial Practices Directive.

The work aimed at tightening and accelerating the regulatory activity and supervision in the financial services sector could also be completed. The tasks of the Insurance Committee hitherto were assumed by the “European Insurance and Occupational Pension Committee” (EIOPC). The area of work was extended to include in particular reinsurance issues. In addition, a new “Committee of European Insurance and Occupational Pension Supervisors” (CEIOPS) was established to support the Committee. It was intended to assist the EIOPS and to replace the Conference of European Insurance Supervisory Authorities. The new procedure is based on the so-called Lamfalussy Report of 2001.

Finally, at the end of 2005 the second reinsurance Directive was adopted, which provides the legal framework for the internal market of specialist reinsurers which primary insurers have had for a long time.

It was, however, not possible to complete the work on an entirely new solvency scheme for insurance undertakings (Solvency II) and the necessary adaptation of the European law on annual accounts of insurance undertakings to international standards.

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[6] Financial Services: Implementing the Framework for Financial Markets: Action Plan, Communication from the Commission, COM (1999) 232 of 11 May 1999.

Not only has the internal insurance market become more uniform in regulatory and economic terms, but it has also become larger. In June 1993 the European Council, in its meeting in Copenhague, made the policy decision on the future enlargement of the Union by the associated central and east European countries. Then it established also the criteria to be met by the applicant countries. Beside the political and the economic criteria the criterion of the incorporation of the Community *acquis* has to be met, i.e. the applicant countries have to transpose the Community rules created for the Single Market into their national laws.

That means that these countries had to accomplish in the shortest time what the ancient member countries had decades for, starting in addition from a much better economic and social position.

By means of pre-accession assistance programmes the EU made large efforts to help the applicant countries to transpose the "acquis communautaire" as quickly as possible. Technical assistance was and is given in particular under the PHARE programme[7]. The progress made is measured by Peer Review Procedures. Beside the European Union international organisations such as the International Association of Insurance Supervisors (IAIS) or OECD, UNCTAD, IMF and the World Bank and in particular national governments, organisations and associations have helped for years to create market economy structures in the insurance sector both in Europe and worldwide.

Effective from 1 May 2004 the number of EU member countries rose to 25, an enlargement which is unique in terms of size and diversity in the history of European integration. With the integration of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, Slovenia[8] , the European Union – more or less ranking equal with the United States - has risen to be the largest insurance market in terms of premium income. With roughly half a billion people the EU, after China and India, is third in the list of the most densely populated markets worldwide.

As in the insurance sector no transitional provisions were stipulated, all coordinated provisions relating to the Single Market have become applicable in the new member countries at the time of accession.

Other European countries will probably join the European Union in the near future.

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[7] Cf. Communication from Commissioner Verheugen of 27 October 2000, C (2000) 3103 p. 2: PHARE Review 2000, Strengthening preparations for enlargement.

[8] The Accession Treaties of the new Member States are published in OJ n° L 236/1 of 23 September 2003.

B. The Insurance Directives

I. General Remarks

The essential bases for the pursuit of the insurance activity still are in particular the national supervisory laws of member states. However, the Community bodies have an opportunity to encourage member states, on the basis of the EC Treaty, to change their national laws. This is done **in general through Directives.**

These instruments are directly binding on member states as to their objective, whereas the member state is free to choose the form and method of attaining the objective prescribed (Art. 249 sentence 3 EC Treaty). In accordance with in particular the national constitutional law the State may implement the Directive through an Act, a Regulation or an administrative act. For the purpose of implementation, the national parliaments are bound to the objective of the Directive, if they take part in the procedure at all.

Who adopts the Directive results from the substantive enabling provision of the EC Treaty. In general, this will be the Council; on the other hand, the power of cooperation of the European Parliament has been increasingly extended. In particular the **codecision** procedure (Art. 251 EC Treaty), which is important exactly in the fields of liberalisation and approximation of laws, strengthens the Parliament's position. The procedure provides up to three readings, in which the Parliament has it in his hands to eventually prevent the adoption of the Directive by vetoing against it. This procedure is only used if the enabling provision explicitly refers to Art. 251 EC Treaty.

Apart from Directives the Community bodies may take action in particular through **Regulations, decisions and recommendations or opinions.**

Regulations are legal rules in a material meaning; they are directly applicable in each member state vis-à-vis everybody (Art. 249 sentence 2 EC Treaty). Unlike Directives Regulations do not need to be transposed by the national legislator. The regulator is either the Council or the Commission in accordance with the relevant enabling provision of the EC Treaty.

Decisions (Art. 249 sentence 4 EC Treaty) are binding and applicable to individual cases, in keeping with the administrative act. They are addressed either to member states or to individuals (natural or legal persons).

On the contrary, **recommendations** and **opinions** are non-binding (Art. 249 sentence 5 EC Treaty). However, in particular recommendations may be heralds of binding legal instruments enacted by Community bodies in case member states should ignore the recommendations.

Finally, sources of the Community law are also the legal instruments adopted by the entirety of member states in accordance with Art.293 of the EC Treaty. These **agreements concluded under international law**, which include the **Rome Convention on the law applicable to contractual obligations** which in the past has had so much importance also for the internal insurance market, are directly applicable to and against everybody after their ratification by the national parliaments.

II. The Directives on direct non-life insurance

1. The first Directive

The first non-life insurance Directive[9] is the most important insurance Directive at all because all other Directives which were adopted on the way to the internal insurance market are built on it. As a prior condition for the adoption of the Liberalisation Directive and the implementation of freedom of establishment in non-life insurance, this Directive was intended to coordinate the conditions for the taking-up and pursuit of this business. The insured persons were to benefit from an equal degree of consumer protection in each member country, irrespective of whether they took out insurance through a domestic insurance undertaking or the branch office of a foreign insurer, and insurers were to pursue their business in the respective member country without having to confront different market opportunities resulting from different supervisory requirements.

First of all, the Directive made it clear that it was necessary to extend supervision to **all insurance classes**, which, however, did not mean that all classes be supervised in the same way and with the same intensity. In an Annex to the Directive, following work done by OECD, a classification of non-life risks according to classes of insurance was made, without the classes being defined in detail and separated from each other.

For all classes it was established that prior to taking-up the business, the undertaking had to get an official **authorisation**, and this both for the head office of a domestic undertaking and for the branch office of a foreign insurer.

The **conditions for authorisation** were coordinated to a large extent. It was made clear that the authorisation had to be granted when the conditions were fulfilled (exception: branch office of insurers having their head office in third countries); it was not allowed that an application for authorisation be examined in the light of the economic requirements of the market.

The **on-going supervision** of an insurer having obtained an authorisation also extended to all insurance classes. In this respect, the law of the **country in which the company operated (host country)** was applicable; it could e.g. continue to require that the general insurance conditions and scales of premiums be subject to an official authorisation before they could be applied, how the technical provisions were to be calculated and covered and how the assets representing the technical provisions were to be valued. In contrast, the own funds requirements (so-called **solvency requirements)** were coordinated, that is the funds which the insurer has to have in addition to the assets representing liabilities and provisions.

For the first time, the **responsibility for supervision** was divided between the supervisory authorities of the home country, where the head office of the undertaking was situated, and the host country, where the

[9] First Council Directive 73/239/CEE of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and the pursuit of the business of direct insurance other than life insurance, OJ. n° L 228 of 16 August 1973, p.3.

undertaking carried on its business. Essentially, responsibility was to reside in the supervisory authority of the host country; the home country authority was only responsible for monitoring the state of solvency.

For all member states, the Directive brought a radical change of their respective supervisory laws. Therefore, during the initial discussions of the draft Directive member states suggested to extend the provisions of the Directive only to insurers who intended to take-up cross-border activities (undertakings with **vocation européenne**). This suggestion was rejected by the Commission as being incompatible with the objective of the EC-Treaty which was to create a common market also in the insurance sector. It conceded only the exemption of small mutual insurance associations and certain public and semi-public institutions (including the German *Monopolanstalten* – monopolistic institutions under public law) from the scope of the Directive.

2. The liberalisation Directive

The liberalisation Directive[10], following the prescriptions in the relevant General Programme, obliged member states to abolish all provisions under which nationals of other member states were treated differently from their own nationals in respect of establishment in the field of non-life insurance. The main **discriminatory provisions** of the different member countries to be abolished were explicitly enumerated in the Directive. Apart from the Reinsurance Directive, this Directive was the only one in the insurance sector which explicitly abolished still existing formal restrictions on the fundamental freedoms. Shortly after its adoption, the European Court of Justice decided that both with regard to freedom of establishment and freedom to provide services the principle of national treatment for nationals of other member states had become directly applicable on the expiry of the transitional period provided for in the EC Treaty, without a Directive and its transposition into the national laws being necessary[11]. Therefore, at the end of 1974, the EC Commission withdrew all liberalisation Directives not yet adopted by the Council, among them that relating to the freedom of establishment for life insurance companies.

3. The Coinsurance Directive

For a long time, the efforts to realise the conditions necessary for the implementation of freedom to provide services, which began approximately at the same time as the work aimed at realising freedom of establishment in non-life insurance, remained unsuccessful. At first, the idea was that, similar to the right of establishment, the cross-border movement of services should also be subject to the law and the supervision of the country where the risk was situated (the "**host country principle");** essentially, the same conditions for authorisation and pursuit of activity were to be applicable, with the exception of the requirement to establish a branch office and appoint an authorised agent. In 1970, the EC Commission changed this concept. Now, the **home country principle** was to apply in the place of the host country principle, i.e. the provider of services should be allowed to sell the products customary and admitted in his country of origin also in other countries, without having to comply with the law or the supervisory

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[10] Council Directive 73/240/EEC of 24 July 1973 abolishing restrictions on freedom of establishment in the business of direct insurance other than life insurance, OJ n° L 228 of 16 August 1973, p. 20.

[11] ECJ Judgment of 21 June 1974, Case 2/74 "Reyners", ECR 1974, p. 631; ECJ Judgment of 03 December 1974, case 33/74 "van Binsbergen", ECR 1974, p. 1299.

practice in these countries. The insurance client would get the opportunity to seek for the most favourable insurance cover within the Community. The risk of any distortions of competition was to be prevented by means of far-reaching coordination of the supervisory, contract, fiscal and bankruptcy laws. As on account of the past experience this coordination work was expected to take a long time, the supervisory authorities of member countries suggested to liberalise first **cross-border coinsurance**, because in this field previous coordination measures were not necessary and, on the other hand, a need for international cooperation of insurers had often arisen during the past exactly in respect of the coverage of risks by the way of coinsurance. The Commission took up the suggestion and developed, on the basis of a working document of the Conference of the Insurance Supervisory Authorities, a proposal for a Directive, which was finally adopted by the Council in 1978.[12].

The Directive provides that insurance undertakings which in one member state are authorised to carry on the insurance class concerned, may participate in coinsurance contracts covering risks included in this class in all other member states even if they are not authorised in the country concerned.

The regulation does not apply to risks other than **marine and transport, aircraft, fire and other damage to property and liability risks** except motor, nuclear and pharmaceutical risks. A further restriction consists in that the Directive applies only to risks which by reason of their nature or size call for the participation of several insurers for their coverage. The supervisory authorities were asked to give more detailed information in this respect in mutual agreement.

From the start the focus of the discussions on this Directive was on the position of the "**leading insurer".** For the majority of member states he was to guarantee that the law of the host country, in particular the contract and supervisory laws, was respected in the coinsurance business. These countries assumed that, unlike the other coinsurers, the leader had to be established and authorised in the country where the risk was situated. As – according to customary practice and as explicitly stated in the Directive – the insurance conditions for these contracts were laid down by the leader, they took it for granted that the contract could only be based on insurance conditions approved by the supervisory authority of the leader. The European Commission and a minority of member states did not agree. The compromise which eventually was found[13], was so vague that each State could interpret it according to its own conviction. The Commission instituted proceedings before the European Court of Justice against the countries which provided in their national laws that the leader had to be established and authorised in the host country and they were taught by the Court, that both the establishment and the authorisation requirements were incompatible with Articles 59 and 60 of the Treaty of Rome[14] , because

- the **establishment requirement** was the negation of freedom to provide services. After the expiry of the transitional period, however, this freedom was directly applicable law. The harmonisation of legislative provisions was no longer accepted as a prior condition for the granting of this right.

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[12] Council Directive 78/473/EEC of 30 May 1978 on the coordination of laws, regulations and administrative provisions relating to Community co-insurance , OJ n° L 151/25 of 07 June 1978.

[13] Art. 2 (1) (c): "for the purpose of covering this risk, the leading insurer is authorised in accordance with the conditions laid down in the First Coordination Directive, i.e. he is treated as if he were the insurer covering the whole risk".

[14] ECJ Judgment of 04 December 1986, Case 205/84 "Commission vs. Federal Republic of Germany", ECR 1986, p. 3755.

- the **authorisation requirement** was compatible with the EC Treaty for reasons of consumer protection only. The policyholders of a coinsurance contract did not need such protection because they were large undertakings or groups of undertakings capable of protecting themselves.

It should be also mentioned that the supervisory authorities could not carry out the order of the EU legislator to give a more detailed definition to the nature and the amount of the risks concerned. The majority of member states laid down certain **threshold values** for the respective classes, which had to be exceeded if the insurers wanted to make use of Community coinsurance. This, too, was a reason for the EC Commission to institute legal proceedings against these countries. However, the actions were dismissed as being inadmissible or ill-founded. The necessary delimitation has now been made in Article 26 of the Second Non-Life Insurance Directive.
In practice the Community coinsurance is extremely insignificant.

4. The tourist assistance Directive

The **notion of insurance** was and until today is not coordinated in the Council Directives. This may cause difficulties in fringe areas where an unmistakable assignment to the insurance notion does not exist, in particular in relation with the cross-border pursuit of business.

A typical example are the **activities of automobile clubs and other assistance organisations,** which offer, against prior payment of a compensation, to give assistance in particular situations, in particular during a voyage (e.g. in the form of an "assistance letter"). While in the past the supervisory authorities of some countries considered this to be pursuit of insurance transactions, those of other countries regarded them as insurance-like supplementary business to the main business which was not insurance. The result was that companies from countries where the insurance nature of their business was excluded, did not obtain the insurance authorisation needed for the establishment of a branch office for the sole reason that the mechanism of cooperation and division of powers between the authorities of the home country and the host country laid down in the First Non-Life Insurance Directive could not function.

Following the suggestion of the EC Conference of Supervisory Authorities the EC Commission proposed to the Council to add a new class to the First Non-Life Insurance Directive, the **class no. 18 "Assistance for persons who get into difficulties while travelling, while away from home or while away from their permanent residence".** Regardless of a number of exceptions provided for individual member states, this was to make clear that this type of assistance was to be considered to be insurance operations in all countries of the Community, irrespective of whether their object was cash payments or payments in kind. In addition, the attempt was made to take account of the special nature of the way to check on the ability to perform payments in kind (ensuring that competent staff and sufficient material is available in order to perform the services promised). The Directive was adopted by the Council at the end of 1984.[15].

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[15]Council Directive 84/641/EEC of 10 December 1984 amending, particularly as regards tourist assistance, the First Directive 73/239/EEC on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, OJ n° L 339 of 27 December 1984, p. 21.

5. The Directive on credit and suretyship insurance

Because it was not possible to reach an agreement, the First Non-Life Insurance Directive had postponed until a later time the solution of two problems from the field of credit and suretyship insurance, namely the treatment of export credit insurance operations for the account of or guaranteed by the State, or where the State is the insurer, and the prohibition existing in Germany under the supervisory law on writing credit and suretyship insurance beside other classes (requirement of specialisation of classes). Both issues were to be settled in another coordination Directive within four years of the notification of the First Non-Life Insurance Directive. At the end of lengthy negotiations this Directive was finally adopted by the Council in 1987[16].

For economic and political reasons no agreement could be reached on the inclusion of the **export credit insurance operations for the account of or with the support of the State** into the First Directive. Member states considered this type of credit insurance to be a State measure of export promotion. The freedom to use these measures in a flexible way was not to be restrained by supervisory prescriptions. All compromise proposals failed, including those of the European Parliament, suggesting to submit to the Directive at least credit insurance operations relating to exports within the Community. The Directive maintained the exclusion of this type of insurance from the scope of the First Directive, without setting a new deadline for future coordination.

The second open question was solved by obliging Germany to abolish the **specialisation requirement.** Germany had made an effort to maintain this requirement on the grounds that credit and suretyship insurance covered so extremely large risks that the simultaneous pursuit with other classes put the latter in considerable jeopardy. Relevant negative experience had been made in Germany during the world economic crisis. The other member states were not of the same opinion, although credit insurance was mainly written by specialist insurers in their markets, too. At least, the particular danger of the credit insurance was taken into account in the amount of the **minimum guarantee fund** which for this insurance class was sizeably increased and the establishment of an **equalisation provision** was made mandatory; this is a special technical provision aimed to equalize fluctuations in loss ratios in future years or to provide for special risks. The calculation of this provision was determined in detail in the Directive, whereas member states were free to choose between four methods.

6. The Directive on legal expenses insurance

Similar to credit and suretyship insurance, a **specialisation requirement** was prescribed for legal expenses insurance in Germany, as well, however for a different reason. The German Supervisory Authority held the opinion that **conflicts of interest** which are bound to arise where e.g. the insurer writes legal expenses insurance and liability insurance simultaneously, can only be eliminated if an insurers carries on no other classes beside legal expenses insurance. The other member states did not think that the risk of conflicts of interests was such great; in any case they considered the protective measures taken in Ger-

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[16] Council Directive 87/343/EEC of 22 June 1987 amending, as regards credit insurance and suretyship insurance, the First Directive 73/239/EEC on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance OJ n° 185 of 04 July 1987, p. 72.

many against this risk absolutely excessive. In their opinion the specialisation requirement was an unjustified barrier for foreign multiple line or composite insurers who wanted to carry on legal expenses insurance in Germany by way of freedom of establishment. As during the deliberations on the first non-life insurance Directive an agreement on a common solution was not possible, the problem was postponed like in credit and suretyship insurance. It was left to future coordination measures, which were to intervene within four years of the adoption of the First Directive, to find a solution for precluding the risk of conflicts of interests. In fact, the solution was not found after four, but after fourteen years: The legal expenses Directive of 1987[17] prohibited Germany from maintaining the specialisation requirement.

In order to prevent conflicts of interests, the Directive provides **three model solutions**, of which each member state has to adopt at least one in its legal system; it may, however, adopt all solutions and leave the choice of the model to insurers. The solutions are considered equivalent. They are all based on the assumption that the risk of conflicts of interests can only arise in relation with the management of legal expenses claims.

Therefore, conflicts of interests are to be prevented

- either by means of **separate claims settlement** by ensuring that no member of the staff who is concerned with the management of legal expenses claims is entrusted at the same time with a similar activity in the other classes, or

- by entrusting the management of claims in respect of legal expenses insurance to separate **independent claims settlement bureaux** having separate legal personality or

- by affording the insured person the right to entrust the defence of his interests to a **lawyer of his choice**.

In addition, the Directive provides further rules for the protection of persons having legal expenses cover, e.g. the free choice of the lawyer by the insured person, a kind of arbitration procedure and certain obligations of the insurer to inform the insured person about his rights.

7. The Second Directive

As intended by the European Commission and in accordance with the General Programmes, the Second Directive was to implement **freedom to provide services** in non-life insurance after freedom of establishment in this sector had been realised to a large extent by the First Directive.

The work for this aim turned out to be extremely difficult. Several times the Commission felt compelled to revise its conception completely. After in 1970 it had swung round from the host country principle to the home country principle, it had created the need to carry out extensive coordination work, in particular with a view to banning the risk of distortions of competition.

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[17] Council Directive 87/344/CEE of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance, OJ n° L 185 of 04 July 1987, p. 77.

As it became clear very quickly, that this work could not be done in one decade, the Commission tried to progressively introduce freedom to provide services (FOS). With the exception of coinsurance FOS was to be implemented in the first place in the insurance covering **transport risks** and **industrial and commercial risks**, because it was believed that in this field, unlike the **retail business,** supervision could be reduced to checking on the financial position of undertakings, and that therefore coordination would be possible by abolishing supervisory standards based on other than financial rules.

However, it promptly appeared that member states were not prepared to join the Commission on this road. Part of them rejected the distinction entirely, other countries considered the definition criteria inappropriate or too vague. For a long time, a large number of other problems seemed to be unsolvable. The distinction between the activity pursued by way of establishment and the activity pursued by way of freedom to provide services, the issue of the law applicable to contracts, the question whether or not the prior authorisation of conditions and scales of premiums could be maintained, the treatment of compulsory insurance, the question of the involvement of the host country supervisory authority in the authorisation procedure for the activity pursued by way of services, the respective powers of intervention of the supervisory authorities in the host countries and the home country, the question of whether freedom to provide services should also be granted to branch offices, the question of the provisions and practices to be applied regarding the calculation and representation of technical provisions and much more. At times, the Commission Proposal for a Directive was blocked by ninety (!) reservations from member states.

The breakthrough came following the aforementioned **ruling of the European Court of Justice**, given on an action brought by the Commission against some member states in particular on account of the infringement of Articles 59 and 60 of the Treaty of Rome (today Articles 49 and 50 of the EC Treaty) due to the allegedly faulty transposal of the Coinsurance Directive.[18]. In this ruling the ECJ unmistakably stated that contrary to the opinion of the majority of member states, Articles 59 and 60 of the Treaty of Rome had become **directly applicable** at the end of the transitional period, including in the insurance sector, and this irrespective of whether or not the coordination measures initially required as a prior condition, had been executed.

The request brought forward by some member states to the effect that foreign EC insurers have not only an authorisation but also an establishment in the host country in order for a correct supervision to be ensured, was considered by the Court of Justice as an unjustified negation of freedom to provide services, with the exception of compulsory insurance. In view of the extent of coordination in the supervisory law already reached through the First Directive, it should be possible for supervisory authorities, in particular by the means of cooperation agreed upon, to ensure supervision of the cross-border business done by way of services. Compelling reasons of the **general good** justifying the restrictions on freedom to provide services did therefore not exist.

On the contrary, the ECJ recognised, that the **insurance sector** is a **particularly sensitive sector** with regard to consumer protection. Therefore, it concluded that in view of the absence of coordination in particular in the field of the **insurance contract law** and of the provisions relating to **technical provisions**, member states would be able to maintain the requirement of authorisation by the supervisory authority of

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[18] Cf. FN 14

the host country with respect to activities pursued by way of services and to apply the law of this country in particular to contracts and technical provisions. Finally, it was of great importance that the Court of Justice settled the long-lasting dispute on the **separation between the freedom of establishment and the freedom to provide services**, by stating that it was a case of freedom of establishment where the insurer had a permanent presence in the host country, even if no formal branch office was established. Furthermore, the insurer was subject to the provisions regarding freedom of establishment if he directed his activities entirely or mainly to the territory of another country, that is the host country.

Revised on the basis of this jugdment, the Commission Proposal for a Second Non-Life Coordination Directive was adopted in mid-1988[19]. Therein the business carried on by way of establishment is separated from business by way of services in the same way as is done in the European Court ruling. In line with the Court's suggestions and in view of the **different needs for protection** of the insured persons, the Directive provides **different rules for the insurance of large risks and of mass risks**. **The separation is made on the basis of qualitative and quantitative criteria.**

Transport and credit and suretyship risks are always considered to be **large risks** to the extent they relate to the industrial and commercial activity or the liberal profession exercised by the policyholder.

In property and liability insurance the quantitative separation is based on criteria taken from the Fourth Company Law Directive, the Accounts Directive[20]. A large risk is said to be where the policyholder fulfils two of the following three conditions:

- balance sheet total exceeding 6.2 million Euro,
- net turnover exceeding 12.8 million Euro,
- average number of employees during the financial year more than 250.

For the sector of large risks a major step towards the **home country principle** was made. The host country is no longer allowed to require authorisation for the services business. As to the calculation and the representation of technical provisions for the business written by way of services, the provisions and practices of the home country are applicable. Moreover, no member state is allowed to prescribe a "preventive supervision of conditions and scales of premiums", neither in the form of prior approval nor of systematic notification, for the large risks business in general, that is for business transacted in the home country, on an establishment basis and on a services basis (exceptions are only permitted for compulsory insurance risks). As to the law applicable to the contract, the parties have a certain amount of freedom of choice up to complete freedom in transport insurance.

However, in the **retail and small commercial business** the **host country principle** continues to be largely applicable. Member states may e.g. still require from foreign EC insurers to obtain the authorisation for transacting business on a services basis. The provisions of the host country governing the calcula-

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[19] Second Council Directive 88/357/EEC of 22 June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and modifying directive 73/239/EEC, OJ n° L 172 of 4 July 1988, p. 1.

[20] Art. 11 of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, OJ n° L 222 of 14 August 1978, p. 11.

tion and representation of technical provisions are also applicable to this business. As a rule, the law of the country where the policyholder has his residence is applicable to the contracts, freedom of choice is strongly restricted. In addition, member states may continue to prescribe the preventive supervision of conditions and scales of premiums with respect to this business.

A certain amount of harmonisation of the **means of observation and correction,** which all member states have to provide to the supervisory authorities, is of great importance. These include, apart from observation means such as the general access to information and the right to carry out on-the-spot investigations at the company's premises, in particular the **general clause** modelled on the then-Article 81 (2) sentence 1 of the German Insurance Supervisory Law, under which the supervisory authorities may take vis-à-vis insurers any measure necessary to ensure that in each of the member states the activities of the undertaking remain in conformity with the statutory and administrative provisions with which the company has to comply in each member state, and in particular with the scheme of operations – in so far as it remains mandatory – and to prevent or remove irregularities prejudicial to the interests of policyholders.

In addition, the Directive contains in particular complex rules on the **cooperation of supervisory authorities** with respect to the authorisation and current supervision of undertakings and provisions governing compulsory insurance, the information to be given to policyholders, statistical data provided to the insurance supervisory authorities, rules relating to covering technical provisions by matching assets, the requirement of equal treatment for national and non-national insurance creditors in the case of bankruptcy, and so on.

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As far as freedom to provide services is concerned, the provisions of the Directive are not applicable to insurers who do not fall in the scope of the First Directive nor to, in particular, motor liability insurance, nuclear and pharmaceutical risks insurance and compulsory insurance relating to building activities.

8. The FOS Directive for motor vehicle liability insurance

On account of its special nature and its great social importance **motor vehicle liability insurance** had initially been excluded from the scope of the Second Non-Life Directive in its part relating particularly to the freedom to provide services.

The amending Directive of November 1990[21] filled this gap and included motor vehicle liability insurance into the scheme of the Second Directive. Despite a large amount of criticism from the European Parliament and some member states this directive also provided a different treatment for large and mass risks, though here the focus of interest was less on the policyholder than on the victim of a road accident, who needs to be protected in any case, irrespective of whether or not the policyholder is in need of protection.

The distinction criteria are those used in the Second Directive. The home country principle generally applies to the business by way of services in the large risks sector, whereas with respect to mass risks the

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[21] Council Directive 90/618/EEC of 8 November 1990 amending, particularly as regards motor vehicle liability insurance, the directive 73/239/EEC and the directive 88/357/EEC which concern the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance, OJ n° L 330 of 29 November 1990, p. 44.

host country principle is maintained. The approval of scales of premiums is to be abolished for large risks in general, that is not only for business by way of services. The provisions of the Second Directive relating to compulsory insurance apply with respect to insurance conditions and the applicable law. The following particular features should be mentioned: the obligation of the provider of services to join in the host country the local **national Bureau** under the green card agreement and the **national Guarantee Fund** for the compensation of victims of accidents caused by uninsured or unidentified vehicles. In addition, the provider of services has to appoint a **claims handling representative** in the host country, whom in particular the victim may address in relation with his claims.

Apart from including motor vehicle liability insurance into the Second Directive the amendment Directive lays down the **principle of third country reciprocity** for the entire non-life insurance sector. According to this principle undertakings having their head office in a non-EU State are only capable of establishing or acquire subsidiaries in the European Union if this State is granting the same opportunities to insurers from EU member states.

9. The Third Directive

By adopting the third non-life coordination Directive of June 1992[22] the European Community had established the legal basis for **single market conditions** in the non-life insurance sector. The Directive achieves that a Community undertaking is capable of pursuing its activity in a single area, i.e. the territory of the Community, instead of different member states. Logically, the insurer no longer needs a separate authorisation for and from each member state. The single authorisation granted by the **home country supervisory authority** is to be valid for the entire territory of the Community, irrespective of whether or not the insurer is intending at all to carry out cross-border activities, irrespective of whether or not he wants to establish branch offices in other countries and irrespective of whether or not he wants to make use of the freedom to provide services (“**single-licence principle”**). In the view of the EU legislator, the requirements of the European Court of Justice with regard to achieving genuine single market conditions were met:

- The provisions relating to **technical provisions** are coordinated. The rules governing the calculation of these provisions and the valuation of representative assets are laid down in the Directive on the annual accounts and consolidated accounts of insurance undertakings of December 1991[23]. The question of the assets admitted for covering technical provisions is solved by the Third Directive itself, which not only establishes the principle that with regard to investments the principles of safety, yield and marketability must be respected and at the same time investments must be diversified and adequately spread, but also a maximum list of admissible **investments** which member states are free but not obliged to adopt when they transpose the Directive into their national law; in other words, they may prescribe much stricter provisions than those of the Directive.

[22] Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life insurance and amending directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive), OJ n° L 228 of 11 August 1992, p. 1.
[23] Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings, OJ n° L 374 of 31 December 1991, p. 7.

- On the other hand, the Commission did not even try to coordinate the **insurance contract law** as recommended by the European Court of Justice. In view of the fact that since 1979 no progress had been made in the discussion of the respective proposal for a Directive, the Commission considered any further attempts at coordination hopeless. Then again, in its opinion, coordination was not necessary, because as a rule, as far as policyholders in the retail business were concerned, the private law of the respective country was applicable, including the consumer protection therein provided.

Now, in countries where it still exists, the **preventive supervision of conditions and scales of premiums** has to be abolished also for the retail and small commercial business: In the future, neither a prior approval requirement nor an obligation to systematically notify insurance conditions and scales of premiums must be imposed on insurers. The objective is that an insurer be capable of selling the products which he offers in his home country in the other member states immediately, without being subjected to prior State supervision in the home country nor in the host country. Similarly, a competitor should also be capable of immediately offering the same or a similar product without having to ask the supervisory authority first.

Special provisions apply to **compulsory insurance.** In this field the supervisory authorities of the host countries are free to ask for the notification of the insurance conditions prior to their use in order to check whether the protection prescribed by the legislator is really provided.

Similar provisions apply to **private health insurance** where it replaces, totally or in part, social security sickness insurance (a so-called substitute for social security insurance). With regard to this insurance member states may require that the business concerned be written on a similar basis to life insurance, a funding system, under which premiums are used to finance both current costs and technical provisions for increasing age. The special rule which Germany was granted in the first non-life insurance Directive to the effect that the **specialisation requirement** for health insurers could be maintained in this country and be opposed to foreign EC insurers, was abolished.

The Directive adopted, following the Second Banking Directive of 1989[24], a new provision relating to the **control of shareholders** of insurance companies and the obligation of supervisory authorities to ensure that the managers of insurance companies are honourable and qualified in their field.

Supervision is carried out by the supervisory authority of the head office country and by that of the host country, the main responsibility residing with the head office country authority. This authority is responsible for granting and if necessary, withdrawing the authorisations still required under the law, and it is entrusted with the **prudential supervision** of the entire insurance company, irrespective of where it is operating. Therefore, the authority may carry out on-the-spot investigations at the premises of branch offices of the insurer, in which the supervisory authority of the host country may take part. The task of the supervisory authorities of the host countries consists first of all in **ensuring** that the insurer complies with the **laws and regulations of the host country** which he has to comply with for reasons of the general good. Any infringements are to be prosecuted and punished on the basis of a rather complicated cooperation model.

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[24] Cf. Articles 5 and 11 of the Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of credit institutions and amending directive 77/780 EEC, OJ n° L 386 of 30 December 1989, p. 1.

In addition, the Directive comprises a number of detailed rules mainly relating to the supervisory law, the contract law and the fiscal law. In this respect, the abolition of the **monopolies**, by 1 July 1994, which member states had granted to bodies established within their territories, had a particular political importance. In Germany, mainly the monopolies in respect of the fire insurance for buildings were affected by this measure.

10. The consolidation of Directives („Codification")

The Commission has realised that it is necessary to clarify and simplify the Community law, in order that it is possible for the citizen to understand it and to take advantage of the rights accorded to him. The Commission instructed all its services to consolidate the legal provisions not later than after the tenth amendment. (The Commission speaks of codification). With respect to non-life insurance this codification could not yet be completed. This is regrettable, because exactly this field with its multitude of Directives including references to and amendments of legislation measures already adopted, is scarcely comprehensible any more.

III. The Directives on direct life insurance

1. The First Directive

Nearly six years after the adoption of the first non-life insurance Directive and with a delay of twelve years as compared to the deadline fixed in the General Programme for the implementation of freedom of establishment, the first coordination work in the life insurance sector could be completed in the form of the first life-insurance Directive of March 1979[25]. The Directive is largely consistent with the first non-life insurance Directive.

Differences exist in particular with regard to the **solvency rules.** While premiums and claims incurred are the basis for the own funds requirements in non-life insurance, the essential criteria in life insurance are the mathematical provision and the capital at risk. While in non-life insurance the solvency must be represented mainly by explicit elements, i.e. items which are disclosed in the balance-sheet, in life insurance implicit values, in particular the profitability of an undertaking, may be used as well. Germany in particular had attached great value to the consideration of implicit elements. The German Supervisory Authority e.g. held the opinion that in life insurance an adequate safety level could only be achieved by using extremely prudent bases for the calculation of premiums and technical provisions. The method of taking into account, in the calculation of the solvency requirements, the included safety margin (the "implicit" solvency margin), which in the end is a surplus and therefore a criterion of the profitability of the undertaking, has the advantage of a certain dynamism as compared to the static explicit elements, for the more the volume of business grows the more the own funds of the undertaking increase. The final solution consisting in a balanced consideration both of explicit and of implicit resources was only found after long and

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[25] First Council Directive 79/267/EEC of 05 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance, OJ n° L 63 of 13 March 1979, p.1.

tedious negotiations with the other member states, where the situation is sometimes totally different from Germany (a high amount of explicit equity capital and less prudent technical bases in particular for the calculation of premiums).

Another issue which was an obstacle to the rapid adoption of the Directive, was the **specialisation requirement** existing in some countries with a view to life insurance. This requirement means that life insurance and other classes must not be pursued simultaneously, that is that life insurance has to be transacted through specialised insurers. The reason is the differing exposure to risks. Life insurance is based on secure, reliable technical bases. This is not the case in the other classes. In order to prevent any losses from the more aleatory non-life insurance classes from adversely affecting the result in the life insurance business and possibly jeopardising the insurer's ability to perform his contractual obligations in this important field of social protection and private provision, it is necessary to isolate the life insurance business as far as possible from the other insurance business.

The specialisation requirement is certainly the best means to achieve this objective. At the beginning of the negotiations it was applied more or less strictly in Germany, France, Ireland and the Netherlands. In Denmark and Italy newly formed multiple-line insurers no longer obtained an authorisation. In Belgium, Luxembourg and the United Kingdom the undertakings were free to choose whether or not they wanted to transact life insurance exclusively or together with other classes. A Decision of the EC Council of Ministers of 1961 made it even more difficult to find a solution, because this Decision requested the Commission to ensure that the existing multiple-line insurers be allowed to pursue both life insurance and all other classes in all countries in the Community, that is also in those where the specialisation requirement existed, provided they adopted a so-called separate management for life insurance on the one hand and for the other business on the other hand.

Ignoring this Decision, the negotiators eventually agreed on making the specialisation requirement the **principle in the Community:** Newly formed multiple-line insurers should no longer be authorised, those already existing should be allowed by member states to continue their business provided that separate management was adopted in accordance with coordinated rules. However, in countries where the absolute specialisation requirement was applicable, multiple-line insurers were only allowed to pursue non-life insurance via a branch office; when they wanted to pursue life insurance in that State, they had to set up a subsidiary for that purpose, which could avail itself of certain facilities for a transitional period.

The Directive applies to all types of life insurance without defining them in detail. Its rules are also applicable to certain insurance-like operations provided that these are authorised in the host country. These are **tontines**, **capital redemption operations** and the **management of group pension funds**, operations which are usual in some States, whereas they are considered as extraneous to insurance and therefore prohibited in other States (e.g. in Germany).

In principle, all life insurance companies are subject to the Directive provisions. Exclusions from their scope are provided in particular only for the **social security institutions**, the occupational pension and provident schemes, funeral expenses funds and other small mutual insurance associations.

2. The Second Directive

A few months after the adoption of the second non-life insurance Directive, at the end of 1988, work began on a similar Directive for life insurance, in particular with a view to implementing in practice the **freedom to provide services** which, according to the case law of the European Court of Justice, was already in existence in this sector; this was done to a certain extent on the basis of the home country principle.

The intention was, similar to non-life insurance, to take account of the differing need for protection of policyholders. However, unlike non-life insurance, it was hardly possible to focus on the quality or the quantity of risks. In the Directive finally adopted in November 1990[26] the criterion chosen for the differential treatment of policyholders was the way the contract was concluded. In cases where the policyholder himself takes the initiative in not seeking insurance cover in his home country with an insurer established there, but has recourse to a foreign insurer abroad (which is called **passive movement of services**, because the insurer remains passive at first), the home country principle applies to a large extent. It is assumed that the prospective policyholder deliberately enters a foreign jurisdiction, forsaking the protection through his national law, an idea which is also the reason why the so-called **correspondence insurance** is exempted from supervision under German supervisory law for instance.

However, passive free movement of services goes beyond correspondence insurance. According to the **brokers' clause** in the Directive which was disputed until the end, passive free movement of services is also said to be where the policyholder approaches a domestic broker with a view to seeking through him for insurance cover in a member state other than his country of residence. Similar to the rules relating to large risks in non-life insurance, the competent authorities of the host country has no longer the right to require from the undertaking concerned to obtain an authorisation from the supervisory authority of the host country before carrying out activities under passive Services. The home country law is applicable to the calculation and representation of technical provisions. A preventive supervision of conditions and scales of premiums by the supervisory authority of the host country is no longer admissible.

In contrast, in all other cases (so-called **active Services**) the host country principle continued to apply. Like in respect of the retail business in non-life insurance, the country where the insurer carried on his activities could prescribe a requirement to obtain the authorisation for activities by way of services, maintain the preventive supervision of conditions and scales of premiums, and so on.

With regard to all life insurance contracts concluded by way of services the policyholder has a **right of cancellation** which he can use within a period to be fixed by the national legislator of 14 to 30 days from the information about the conclusion of the contract.

In order to facilitate the adoption of the Directive, **transitional arrangements** bound to specific deadlines were accepted. Member states were allowed to postpone the application of the brokers' clause until 1996;

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[26] Second Council Directive 90/619/EEC of 8 November 1990 on the coordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC, OJ n° L 330 of 29 November 1990, p. 50.

this transitional period was granted in order to allow member states like in particular Germany, where in the absence of a special regulation everybody may take up the profession of an insurance brokers at once and without any proof of qualification, to adopt the appropriate provisions in order to ensure the professional qualification and independence of insurance brokers.

Consistent with the regulation in the FOS Directive for motor vehicle liability insurance with respect to non-life insurance, the Second Life Insurance Directive establishes the **principle of reciprocity with third countries** for the life insurance sector as well.

3. The Third Directive

The third life insurance Directive[27], adopted at the end of 1992 adopts essentially the regulations of the third non-life insurance Directive, with the exception of some elements specific to life insurance. Here again, the insurer needs only the authorisation from the **supervisory authority of the home country** in order to be able to pursue life insurance business in the Community, be it through branch offices or by way of services. The **prudential supervision** is the sole responsibility of the home country supervisory authority whereas the authority of the host country is substantially involved in the **other areas of supervision.** The preventive supervision of conditions must be abolished where it is still existing. Instead, in order to not leave the policyholder without any protection at all, a large number of **disclosure requirements**, taken from British law, are prescribed which the insurer has to comply with prior to and after the conclusion of the contract for the benefit of the policyholder. In addition, the **right of cancellation** granted in the second life insurance Directive only in respect of contracts concluded by way of services, is now accorded for life insurance contracts in general; member states are given the option to provide exceptions in particular with regard to policyholders who do not need special protection. Operations which in some States had not been considered to be insurance operations and therefore were not authorised (**capital redemption, tontines** and **management of pension funds**) have now to be permitted in all countries.

Four issues were heavily disputed until shortly before the end of the negotiations and were finally solved by way of a political compromise:

- Systematic notification of insurance conditions, scales of premiums and technical bases used in calculating technical provisions,

- Maximum interest-rate applied to the calculation of the mathematical provision

- Calculation of scales of premiums,

- Specialisation.

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[27] Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive) OJ n° L 360 of 09 December 1992, p. 1.

The majority of member states held the opinion that a sole *a-posteriori* control of **insurance conditions, scales of premiums and provisions** was not sufficient to guarantee the necessary safety for policyholders in this insurance class of utmost importance in terms of social policy. Finally, it was agreed that member states should be able to at least require the systematic notification of the technical bases used in calculating the scales of premiums and technical provisions, without that requirement constituting an obstacle for an undertaking to take up its business immediately.

With regard to the calculation of **technical provisions,** in particular of the mathematical provision, the proposed Directive laid down a number of **actuarial principles** which were based on work done by the **Groupe Consultatif des Associations des Actuaires** (a consultative body set up by the association of actuaries of member states). This group had found that, while the methods used in calculating the technical provisions were different between member states, they produced equivalent results in comparable cases and were all equally prudent, so that mutual recognition of the existing supervisory schemes could be recommended. Despite this fact, the majority of member states in the Council held the opinion that at least in respect of the determination of the **technical rate of interest** the attempt should be made to establish specific, coordinated and verifiable rules extending beyond general principles. Finally, member states agreed on an option for member states to the effect that the maximum rate of interest was either generally set at 60 per cent of the average rate on State bond issues (**continental principle)** or determined as a mixed rate of interest taking into account the yield on the corresponding assets currently held and, with regard to future commitments, the anticipated yield on future assets (**British system**). The latter shall be fixed by the supervisory authority. These rules do not apply to certain types of contract such as unit-linked contracts or single-premium contracts for a short duration.

With regard to the **calculation of premiums** the Commission proposal initially provided no rule at all. On the basis of the British prudential philosophy which is characteristic for the entire Directive, the Commission held the opinion that the premium was set according to sole commercial considerations; the main concern was that adequate amounts were placed in the mathematical provisions. At the insistence of the majority of member states it was finally laid down that the premium for new business should be sufficient on reasonable actuarial assumptions, to enable insurers to meet all their commitments and, in particular, to establish adequate technical provisions. It was explicitly stated that while the financial situation of an insurance undertaking might be taken into account, a calculation method built on the systematic and permanent input from resources other than premiums (e.g. contributions from shareholders) was prohibited.

The **specialisation solution** found in the First Life Insurance Directive was further mitigated. From then on, existing multiple-line insurers are allowed to simultaneously pursue life and non-life insurance in all Community countries both on an establishment basis and on a services basis without being hindered by deadlines or obstacles. Moreover, member states can allow all insurance undertakings to take up the health and accident insurance business beside life insurance. In addition, the opponents of specialisation have achieved that this rule has to be examined by the end of 1999, expecting that then the specialisation was completely and definitely abolished. However, such examination did not take place, so that it may be assumed that the present solution will be maintained.

4. The consolidation of Directives („Codification“)

Contrary to non-life insurance the Commission was able to establish a consolidated version (the Commission speaks of codification) of the provisions relating to life insurance. The relevant Proposal for a Directive was adopted by the European Parliament and the Council in 2002[28]. The consolidated Directive includes also the new solvency rules applicable to life insurance (Solvency I).

IV. The reinsurance Directives

1. The first reinsurance Directive

In accordance with the time-table in the General Programmes for the abolition of restrictions on freedom of establishment and on freedom to provide services, the reinsurance sector was liberalised through the relevant Directive of 1964[29], the first insurance Directive at all; that means, that insurers having their head office in other member states had to be treated on the same basis as the national insurers of the member state in question (**national treatment**).

The Directive concerns both specialist reinsurers, i.e. insurers who carry on exclusively the reinsurance business, and primary insurers in respect of that part of their activities which is concerned with reinsurance and retrocession (Art. 2 of the Directive).

In view of the necessarily international nature of this business and on account of a lesser amount of protection needed by ceding insurers, very few restrictions existed in member states in the beginning; therefore the Directive was of little importance. The General Programmes already did not make the coordination of national laws and administrative provisions relating to this business a prior condition for liberalisation. Such coordination did not take place for a long period of time. The later coordination work in the field of primary insurance concerned only the inward reinsurance business of primary insurers.

With respect to specialist reinsurance there was no approximation of laws in the supervisory sector (authorisation, solvency, control of shareholders, etc.). Member states progressively implemented a more or less strict reinsurance supervision. The range within the Community went from complete absence of supervision through restricted supervision up to equality with the supervision of primary insurance companies. The result of the absence of coordination was that while reinsurers could use the right of establishment and the freedom to provide services, they were subject to the law of the host country, that is, they had to obtain an authorisation and to comply with existing authorisation requirements in the same way as national reinsurers, in other words, they did not have a European passport.

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[28] Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, OJ n° L 345 of 19 December 2002, p. 1.

[29] Council Directive 64/225/EEC of 25 February 1964 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession, OJ no. P56 of 04 April 1964, p. 878.

2. The second reinsurance Directive

Not last at the insistence of the supervisory authorities in the then-Insurance Committee, the Commission made the decision in 2002 to stimulate the coordination of provisions relating to the supervision of specialist reinsurers. The supervisory authorities refused to postpone coordination until the work on the new solvency scheme ("Solvency II") was completed.

The decisive reasons for the acceleration were not only safety aspects. The parties concerned had realised that a true Single Market without any discrimination by host countries would result in costs savings on the part of reinsurers and hence in strengthening the economic and competitive power of European reinsurers in the world market. Moreover, harmonised supervision of reinsurance was considered a good basis for inter-state negotiations and agreements with third countries on the facilitation of access to the individual markets. Finally, reinsurers too had understood that the dream of worldwide freedom to provide services could only be achieved also for specialist reinsurers if Europe set a good example, by creating, at least in this field, a market serving as an example for the world, without discriminations such as extensive accounting rules or requirements from the host countries for deposits covering technical provisions.

Relatively quickly, in April 2004, the Commission presented a proposal for a Directive, which was primarily based on the provisions applicable to direct insurers unless the specific features of the reinsurance business required different rules. The Directive was adopted in October 2005[30]

The rules for reinsurers provide in particular:

- Reinsurers must also obtain an authorisation to take up business. This authorisation is valid for all countries in the Community. Therefore, reinsurance companies get the European passport like primary insurers.
- The home country principle is applicable.
- The authorisation requirements are generally the same as for primary insurers..
- A reinsurer is only allowed to pursue the reinsurance business and related business.
- The provisions relating to solvency are consistent with those applicable to primary non-life insurers, and this also with regard to the part of their activities related to life reinsurance. The minimum guarantee fund amounts to 3 million Euro.
- Like in primary insurance equalisation provisions must only be established if the credit insurance is pursued. For other classes member states have the option to provide the establishment of this provision. Being a technical provision, it cannot be taken into account in the solvency capital available, because it does not belong to the free uncommitted own funds. Similar to other technical provisions, the equalisation provision must be covered by qualified assets.
- In contrast to primary insurance, it is allowed that assets are invested in accordance with the "prudent man" principle. The authors of the Directive renounced the use of restrictive quantitative criteria in order to allow reinsurers operating at international level the necessary flexibility in making investments.

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[30] Directive 2005/68/EC of the European Parliament and of the Council of 16 November 2005 on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC as well as Directives 98/78/EC and 2002/83/EC, OJ n° L 323 of 9 December 2005, p.1.

- The pledging requirement (suretyships, deposits, collaterals, letter of credits) to cover reinsurance liabilities is abolished, that means that member states must not require reinsurers to provide security under national laws. This is the consequence from the coordination of supervisory provisions. The Directive provides a transitional period of three years for the abolition of the plegding requirement.
- Reinsurance companies from third countries must not be accorded better treatment than companies within the Community.

V. The Solvency Directives

1. The starting point

After the adoption of the Third Directives in 1992 which led to the completion of the Single Market in the insurance sector in 1994, the Conference of Insurance Supervisory Authorities of member states began to thoroughly consider the solvency rules of insurance undertakings. These considerations were presented in a paper called “Müller Report” of 1997. The Report which assesses the European solvency systems as on the whole satisfactory, also contains a number of proposals for improvement.

On this basis the European Commission proposed to revise the current solvency provisions in two steps.

a. Modification of the provisions on the solvency margin in the existing Directives (**Solvency I**);

b. Broad analysis of a profile of requirements for the comprehensive assessment of the elements affecting the financial position of an insurance undertaking (**Solvency II).** This against the background that in future insurance undertakings will continue to be exposed to tougher competition and that free financial resources will be more and more decreasing.

2. Solvency I

In this respect the Commission had presented proposals for Directives amending the First Life and Non-Life insurance Directives as regards the provisions on the solvency of companies[31]. Since then the Directives have been adopted[32].

They contain in particular the following provisions:

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[31] COM (2001) 634 final – 2000/0251 (COD) and COM (2000) 617 final – 2000/0249 (COD) of 25 October 2000

[32] Directive 2002/13/EC of the European Parliament and of the Council of 5 March 2002 amending Council Directive 73/239/EEC as regards the solvency margin requirements for non-life insurance undertakings, OJ EC no L 77 of 20 March 2002, p. 17; Directive 2002/12/EC of the European Parliament and of the Council of 5 March 2002 amending Council Directive 79/267/EEC as regards the provisions on the solvency margin for life insurance undertakings, OJ n° L 77 of 20 March 2002, p. 11.

- It is stated that the solvency provisions do not entail strict harmonisation. Member states are free to adopt stricter rules.

- Increase of the minimum guarantee fund through adaptation to the rate of inflation (indexing).

- In non-life insurance the thresholds for premiums and claims are increased through adaptation to the rate of inflation (indexing).

- The Supervisory Authorities are accorded strengthened powers for early intervention, when the interests of policyholders are jeopardised.

- The Supervisory Authorities will have the power to decrease the reduction of the solvency margin where the nature or quality of reinsurance contracts of the direct insurer has changed significantly or where there is no or an insignificant risk transfer under the reinsurance contracts.

- A higher solvency margin is prescribed for particular non-life insurance classes which are subject to a particularly volatile risk profile (aircraft liability, liability for ships (sea, lake and river and canal vessels) and general liability).

- Reduction of the required solvency margin in proportion to the decrease in premiums and claims incurred for non-life insurance undertakings who cease the writing of new business.

- Different adjustments in order to clarify, simplify, improve and update the existing provisions.

3. Solvency II

In a working document the Commission had presented its ideas as to the way forward. It wanted to spread the work load on this "large project" on as many shoulders as possible and to involve all parties concerned (member states, Supervisory Authorities, businesses, actuarial professions, practitioners of accountancy, rating agencies, etc.) It was planned to treat the following main topics:

- Quality criteria and quality principles with which the future solvency system has to comply;

- Standardisation and comparison of the existing solvency schemes in insurance (including the option to use internal models for risk measurement and risk management);

- Solvency schemes in accordance with the US Risk-Based Capital model (RBC);

- European solvency scheme and supplementary provisions;

- Solvency requirements for individual companies and insurance groups;

- Examination of the banking supervisory scheme (Basle II)

- Developments in the field of financial reporting;

- Examination of the risks to be taken into account;

- Technical provisions in life and non-life insurance;

- Provisions relating to the admission of assets covering technical provisions (asset-liability management);

- Methods to quantify the investment risk;

- Importance and valuation of reinsurance.

In analysing these particular aspects, which are in no way new territory for supervision, it is possible to use the results of a number of examinations which had been performed by the Conference of European Insurance Supervisory Authorities during the past or which are currently discussed.

The main objective of the efforts made is to better adjust the solvency provisions to the true risks of insurance undertakings and to encourage insurance companies to improve the assessment and management of risks assumed.

Another objective will be to provide supervisory authorities with appropriate qualitative and quantitative tools to measure the "overall solvency" of an insurer. This means that the system must not consist only of a number of quantitative ratios and indicators, but should also cover qualitative aspects which influence the risk standing of a company (management, internal risk models, competitive situation, etc.).[33]

Another interesting point is that the solvency system is intended to encourage insurance undertakings and to give them incentives to measure and manage their risks. For this purpose, there is a need to develop common European principles on "risk management and supervisory review".[34]

Finally, it is requested that to the extent necessary "the general layout of a Solvency II system should be compatible with the approach and rules used in the banking sector" "in order to ensure consistency across financial sectors".[35]

The Solvency II project was divided into two phases.

During the **first phase** which is by now completed[36], member states and the Commission examined and discussed a number of bases and issues (e.g. risk-based capital schemes, lessons from Basle II in the banking sector, the use of internal models, links between annual accounts and internal accounts, etc.) and the general layout of the future solvency system.

The objective of the **second phase** is to determine the details of the scheme. The solvency principles, standards and guidelines were to be discussed and determined, taking account of the work going on at the

[33] Cf. the Commission Report Markt/2509/03 of 3 March 2003, p.3

[34] Commission Paper loc. cit.

[35] Commission Paper loc. cit.

[36] Cf. the Commission Reports Markt 2539/03 of 19 September 03 and Markt 2543/03 of 11 February 04.

same time in the International Association of Insurance Supervisors (IAIS) and the International Accounting Standards Board (IASB) and with the cooperation of the International Association of Actuaries (IAA).

The main conclusion of the discussions in Phase I is that a **three-pillar approach,** similar to Basle II, should also be recommended for the supervision of insurance undertakings.

The **first pillar** is to comprise the "quantitative" financial requirements of the scheme, at least rules on technical provisions, assets and own funds requirements. Another issue will be the adjustment of provisions governing the banking and insurance sector, when and to the extent as banks and insurance companies sell comparable or even identical products.[37]

At any rate the prudence principle is to be maintained in respect of technical provisions. However, it is not clear yet, how to realise an amount of coordination which achieves equality of competition. This applies in particular to the issue of whether in future the equalisation provision will be classified among the technical provisions or the own funds.

As regards the rules on capital investment the Anglo-Saxon concept based on the "prudent man principle" will probably be applied. It will be necessary then to establish objective and verifiable criteria.

In respect of capital requirements, a difference is made between target capital level and absolute minimum capital level. The target capital level is to be determined on the basis of a standard model. However, companies will be given the option of also using internal models to determine the target capital. An interesting aspect is that the target level of the capital requirement should also be covered by safe, diversified and adequately spread assets[38] , a request which in 1997 was not yet supported by the majority in the Working Party of European Supervisory Authorities.
The minimum capital level will probably be determined on the basis of the Solvency I requirements, modified or not modified.

The **second pillar** should comprise the "supervisory review process" similar to the banking sector, with adjustments made on account of the specific features of the insurance sector. Contrary to the banking sector where the capital requirement is of particular importance, the review process in the insurance sector should also include the valuation of provisions and the management of investments.[39]
In the opinion of the Commission, the introduction of the "target capital" concept should be backed up by more precise rules on the risk assessment methods and by a definition of the powers of intervention of supervisory authorities. In particular "the use of internal models cannot be contemplated without substantially developing common lines of interpretation; otherwise, the mutual recognition of supervisory checks would be jeopardised."[40]

The **third** pillar will also be developed along the lines of Basle II, with the specific features of the insurance sector being taken into account. The Commission does not ignore that the interdependence of companies is not as significant in the insurance sector as in the banking sector. However, the objective, that is greater transparency, market discipline and risk-based supervision should be the same in both financial

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[37] Cf. Commission paper Markt/2535/02 of 28 November 02, p. 36.

[38] Commission Paper Markt/2509/03 of 3 March 03, p. 7.

[39] Commission Paper Markt/2535/02 of 28 November 02. p. 52.

[40] Commission Paper loc. cit. p. 53.

sectors. This is also true for the “pitfalls to be avoided”, that is the fact that the information available to institutions may be a factor promoting competitiveness, that the requirement to disclose certain information may significantly aggravate the situation of companies already experiencing difficulties, and that it may be necessary to coordinate the disclosure requirements of the different institutions and authorities, in order to avoid unnecessary double work.[41]

For the first time, the so-called “**Lamfalussy procedure”**[42] was applied for the development of the new solvency concept. The Commission planned to present a proposal for a framework Directive by the end of 2006 (now the deadline is said to be 2007). On the basis of this Directive the details of the Lamfalussy procedure (“level 2”) will be established by the committee of European legislators, i.e. the European Insurance and Occupational Pensions Committee (EIOPC). In this respect, in particular the successor institution of the European Conference of European Authorities, namely the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has a significant consultative task (“level 3”)

The work of the CEIOPS Working Parties and the entire legislative procedure at European level should be completed by 2008. It is therefore not to be expected that the ambitious exercise will be closed soon.

VI. The Directives on insurance groups and conglomerates

1. Directive on the supervision of insurance groups

As early as October 1998 the European Directive on the supplementary supervision of insurance undertakings in an **insurance group** was adopted[43]. The Directive provides that beyond the more or less coordinated supervision of individual insurance undertakings (“solo supervision”), supervisory authorities are entrusted with the task to supervise the financial position of undertakings from the point of view of their membership in a group (solo-plus supervision). In this respect it should be ensured in particular that intra-group transactions such as loans, guarantees and others do not jeopardise the own funds position (solvency) of the insurance undertakings and that multiple use of capital (“double gearing”) does not occur within the group. Furthermore, insurance undertakings which are subsidiaries of insurance holdings, reinsurance companies or insurers having their head office in a third country, should be subject to an additional solvency test at the level of the parent company, without, however, these parent companies being subject to a solo supervision. For the purpose of the effective execution of this additional task the Directive requests member states to provide supervisory authorities with a number of new supervisory tools such as access to relevant information and powers of intervention.

The Directive is the result of a long, intensive discussion which began at the beginning of the nineties in the Insurance Committee of the European Commission and at the level of European Insurance Supervisory Authorities. It was intended to be adopted much earlier, in particular with a view to not causing delay to the coordination work on the supervision of financial conglomerates. However, it became clear soon, that opinions differed in particular on the group of undertakings to be included in the scheme and

[41] Commission Paper loc. cit. p. 67 and Commission Paper Markt/2509/03 of 3 March 03, p. 10.
[42] Cf. Commission Paper Markt/2543/03 of 11 February 04, p. 7.
[43] Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group, OJ n° L 330 of 05 December 1998, p. 1.

that mainly the insurance sector but also parts of the scientific community had misgivings about the necessity to take measures to prevent double gearing similar to those taken in the banking sector. In many fields the Directive does not contain exhaustive rules, but only minimum requirements. In addition, a number of options are given to member states.

The Directive entered into force on 5 December 1998 and was to be transposed into national law by 5 June 2000. The national provisions had to apply first to the supervision of accounts for the financial years beginning on 1 January 2001 or during that calendar year.

2. Directive on the supervision of financial conglomerates

Immediately after the adoption of the Insurance Group Directive the Commission began to work on the corresponding rules for financial conglomerates. The resulting Directive has been adopted since[44].

It is to a large extent built on the Insurance Group Directive. Similar to the latter, its main objectives are

- to ensure that financial conglomerates have adequate capital. The proposed Directive was intended to prevent in particular the multiple disclosure of elements of own funds and the simultaneous use of the same elements to protect against risks in different undertakings of the group ("multiple gearing of capital"). Moreover, the Directive had the purpose to prevent that parent undertakings issue debt bonds and transfer this income as own funds to their subsidiaries subject to supervision (inappropriate "creation of own funds on credit");

- to introduce methods for the calculation of solvency at the level of the conglomerate and

- to establish rules for intra-group transactions, risk concentration and the fit and proper character of the management.

VII. The Directive on occupational retirement provision

According to the Treaty member states may organise their national pension schemes as they see fit. The Commission, however, held the opinion that at least supplementary pension schemes should benefit from the fundamental freedoms provided for by the EC Treaty, which was not the case. The strict capital investment rules of member states hindered pension institutions from efficiently using capital markets and the Euro, and the existing organisation of pension schemes was a serious obstacle to the free movement of employees.

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[44] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council, OJ n° L 35 of 11 February 2003, p. 1.

In October 2000 the Commission had presented the proposal for a Directive on the activities of occupational retirement provision.[45] In the meantime the Directive has been adopted[46]. The adoption was preceded by ten years of tough negotiations.

The Directive applies to **institutions for occupational retirement provision.** Such institutions are operating on a funded basis, they are legally independent from a sponsoring undertaking or a sponsoring professional association and have the purpose to provide retirement benefits on the basis of agreements between employees and employers or with self-employed persons, which are linked with the occupational activity. Being aimed at ensuring financial security in retirement, these benefits generally provide for the payment of a lifelong pension.

The Directive excludes from its scope:

- institutions which are already regulated within the scope of European law, e.g. life insurance companies, investment funds, etc.

- social security institutions,

- institutions operating on a pay-as-you-go basis,

- institutions where the employees of the sponsoring undertakings have no legal rights to benefits and where the sponsoring undertaking can redeem the assets at any time and not necessarily meet its obligations for payment of retirement benefits,

- companies using book-reserve schemes with a view to paying out retirement benefits to their employees.

Member states may choose not to apply the Directive to institutions operating pension schemes with less than 100 members and beneficiaries.

With a view to preventing distortions of competition member states are given the option to include occupational retirement benefits of life insurers and pension funds into the scope of the Directive if a separate management is set up for the relevant assets and liabilities.

Member states may provide that the option of covering biometrical risks and limitating the capital market risk through a guaranteed protection of capital be offered to members if employers and employees so agree.

In addition, the Directive contains provisions regarding the authorisation requirements as well as requirements with regard to information given to the supervisory authority and members.

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[45] COM (2000) 507 final – 2000/0260 (COD) of 11 October 2000.

[46] Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, OJ n° L 235 of 23 September 2003, p. 10.

The rules on capital investment were in the centre of discussions. The investment policy should be based on qualitative, but not quantitative criteria, that is, the principle to be applied should be the "prudent-man" principle, and the security, quality, yields and profitability of the investment should be ensured. As a rule, member states must not impose the choice of a specific type of investment. However, in particular cases, investments may be restricted. Member states may e.g. provide that not more than 70 % of the assets covering the technical provisions may be invested in shares and not more than 30 % in assets denominated in non-matching currencies. Investments in sponsoring undertakings are generally limited to 5 %.

Above and beyond, naturally the home country principle is applied, that is the authority of the country where the retirement institution has its head office, is responsible for supervision. The provisions of the supervisory, social and labour law of the head office country are applicable.

C. Other Legal Bases with Relevance for the Insurance Sector

I. General remarks

The Directives described in chapter B are in the first place related to the supervisory law. Besides, there are a large number of other Directives the centre of which is not the supervisory law but other fields of insurance law and which are therefore of great importance with regard to the completion of the single market in insurance. These include in particular the legal provisions governing motor vehicle liability insurance, the accounting regulations, the winding-up and bankruptcy law, the law applicable to insurance intermediaries, to consumer protection in insurance, the open competition law, and last, not least the regulations on jurisdiction and the enforcement of judgments. Other fields, which presently cannot be dealt with, are the company law, the fiscal and social law, the liability law, and others.

II. The insurance contract law

1. The substantive law

The General Programme for the abolition of restrictions on freedom to provide service[47] provided for the coordination of the substantive insurance contracts law. The aim was to ensure that the parties to the contract were free to choose the legal system which complied most with their needs and at the same time to avoid causing distortions of competition and unduly putting the protection of insured persons and third-parties in jeopardy as a result of differing legal systems. In the first place, policyholders in the retail business were to be protected. It was considered that they should be able to be confident that their rights and duties in respect of the essential issues remain the same irrespective of whether a foreign legal system or that of their own country is chosen as the law applicable to the contract.

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[47] Cf. above FN 3.

In July 1979 the Commission presented to the Council a proposal for a Directive which it amended again after consultation of the European Parliament and the Economic and Social Committee[48].

The proposal was limited to the regulation of a number of important issues in non-life insurance; transport and reinsurance and the insurance of "large risks" were excluded from coordination on account of the non-existing need for protection of policyholders.

The coordination measures provided comprised a certain degree of approximation of the rules on insurance documents, contractual disclosure requirements imposed on policyholders, increases and reductions of risks, repayment of unduly paid premiums or compensations, penalties in case of delayed premium payments, obligations of policyholders after the occurrence of a claim (e.g. salvage operations), termination of the contract (including the policyholder's right of cancellation at the end of the third year for contracts with a policy period exceeding three years) and insurance on behalf of third parties.

In spite of long and tough negotiations it was not possible to reach an agreement on this proposed Directive. In August 1993 the Commission finally withdrew the proposal. In the meantime, it had changed its strategy. Now, in contrast to the General Programme, the Single Market was to be achieved through mutual recognition of existing legal systems and through approximation of national rules on conflicts of law.

A few years later the discussion was reopened in a different context. In a Communication of July 2001[49] the Commission asked whether the approximation so far implemented of particular special sectors of the contract law at European level were the appropriate way to create a properly functioning Single Market. The Commission listed possible solutions in case problems had actually arisen due to the absence of far-reaching coordination. The list, however, was not meant to be exhaustive.

At the end of consultations and discussions in which, apart from the European Parliament and the Council, other interested parties – or stakeholders - including representatives of the insurance sector, took part, the Commission submitted in February 2003[50] an Action Plan for a "coherent European contract law", and on this basis, a Communication[51], where it explained in detail the way how it intended to develop the concept proposed in the Action Plan.

The following approaches are proposed:

- A Common Frame of Reference (CFR) for the European contract law is developed. It shall include clear definitions of legal terms, fundamental principles and coherent model rules of contract law, drawing in particular on the best solutions found in member states. It does not provide legal provisions but serves as a tool for the Commission for reviewing the existing "acquis communau-

[48] Amendment of the proposal for a Council Directive on the coordination of laws, regulations and administrative provisions relating to insurance contracts, OJ n° C355 of 31 December 1980, p. 30.
[49] Communication from the Commission to the Council and the European Parliament on European Contract Law of 11 July 2001 COM (2001) 398 final - .
[50] Communication from the Commission to the Council and the European Parliament of 12 February 2003 – A coherent European contract law – Action Plan, COM (2003) 68 final.
[51] Communication from the Commission to the Council and the European Parliament of 11 October 2004 – European Contract Law and revision of the "acquis" – the way forward, COM(2004)651 final.

taire" and preparing new proposals for legal instruments. The Common Frame of Reference may also be useful as a basis for the following solutions.

After completion of the consultation procedure and a so-called practicability test the adoption by the Commission is foreseen for 2009. Work has already begun. Two among the 32 working parties established deal with issues relating to insurance law.

- In order to remove obstacles to free movement within the Single Market it is intended to promote the development of Standard Terms and Conditions (STC) for EU-wide use. This will be done by creating a platform (probably on a website) for information about existing and planned STC used EU-wide, guidelines on the relationship between the competition rules and EU-wide STC and identifying legislative obstacles to the use of EU-wide STC.

- Finally, a European legal instrument could be created which could be chosen by the contracting parties as the applicable law in particular in cases of cross-border transactions ("optional instrument"). Such instrument could e.g. include provisions on the conclusion, the validity and interpretation of contracts and performance, non-performance and basis of the contractual obligations. On the other hand, it is not yet known whether this instrument will be also applied to contracts concluded with consumers. Many details remain to be clarified. In any case, it remains to be seen what results will arise from the creation of the Frame of Reference mentioned above.

2. The international private law

Though the international private law is national law, at European level it is largely based on coordinated rules on conflicts of laws. In this respect three areas must be distinguished.

Reinsurance contracts and primary insurance contracts covering risks situated outside the Community fall into the scope of the European Convention on contractual obligations of 19 June 1980 (**Rome Convention)**[52].

Primary insurance contracts concluded with Community insurers and covering risks which are situated within the Community are subject to the specific provisions of the **Insurance Directives**[53].

The provisions of the Convention **do not apply** to contracts relating to risks which are situated within the Community but covered by insurers having their head office outside the Community. These contracts are subject to the relevant national rules on conflicts of laws.

The **Rome Convention** gives priority to freedom of choice of the contractual parties with respect to the applicable law. Where no express choice is made, the contract shall be governed by the law of the country with which it is most closely connected.

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[52] Rome Convention on the law applicable to contractual obligations, OJ n° L 266 of 9 October 1980, p. 1.
[53] Art. 7, 8 Second non-life insurance Directive, Art. 2 Second life insurance Directive, Art. 27 Third non-life insurance Directive.

With regard to consumer contracts the Convention contains a special rule which restricts freedom of choice for the benefit of the weaker contract party, establishing, in the absence of an express choice of law, the applicability of the law of the country where the consumer has his habitual residence. Furthermore, the status of the contract is subject to the mandatory rules of the country with which the situation is closely connected.

The underlying idea of the **regulation in the Insurance Directives** is that of consumer protection on the basis of conflict rules. Member states have to grant freedom of choice only for insurance contracts covering large risks, because here the contractual partners are experienced, equally strong individuals who are aware of the risk they run when they submit themselves to a foreign law. For other types of insurance the freedom of choice may be restricted. In this respect the rules give priority to the place where the risk is situated. This notion is defined in detail in the directives.

In all cases member states may allow a more far-reaching freedom of choice in their national rules on conflicts of laws.

The choice of law must be made **explicitly** or follow with sufficient clarity from the terms of the contract or the circumstances of the case. If this is not so or if the parties have failed to choose an applicable law, the law applicable to the contract is that among the legal orders eligible which has the closest connection with the contract. It is assumed, on a refutable basis, that the contract is most closely connected with the member state where the risk is situated. In life insurance it is always the law of the country where the policyholder has his habitual residence, which is applied in these cases.

In general, the conflict rules in the Directives apply also to **compulsory insurance.** Here member states may prescribe that contracts have to be governed by the sole law of the country which imposes the compulsory insurance.

In the near future, the rules governing the law applicable to contractual obligations will be converted into a EU Regulation and modernised[54]. A draft proposal for such Regulation (**Rome I Regulation)** is existing, but it is not yet clear, when it will be adopted.

II. The law applicable to consumer protection in insurance

1. Preliminary remark

The provisions relating to the protection of consumers, including policyholders, were different from one country to another, both in respect of the scope and the strength of the protection. As it was clear that differing consumer protection rules were an obstacle not last to the completion of the Single Market, the EU Services began, even before the Third Coordination Directives were adopted, to direct their attention

[54] Cf. Green Paper of the Commission of 14 January 2003 on the conversion of the Rome Convention 1980 on the law applicable to contractual obligations into a Community instrument and its modernisation, COM(2002)654 final.

to implementing a certain amount of harmonisation in the field of consumer protection. As early as 1975 and 1981, in two Programmes for a consumer protection and information policy[55], the Council of Ministers, for example, had provided that appropriate measures should be taken in order to protect consumers from unfair commercial practices in the area of door-to-door sales and from abuse of power by the seller, in particular through unfair terms in consumer contracts.

2. Unfair terms

The Council attempted to fulfil the request in the consumer protection Programmes for **preventing abuse of power through unfair terms** by adopting the relevant Directive of 1993[56].. This Directive is also applicable to insurance contracts. Its scope includes only standard terms, i.e. it does not apply to individual agreements.

A clause is judged unfair on the basis of a **general clause** which is focused on a significant and unjustified imbalance in the parties' rights and obligations arising under the contract contrary to the requirement of good faith. The Annex to the Directive contains a list of clauses which may but are not necessarily bound to be regarded as unfair.

The general clause is supplemented by the **requirement of wide-ranging balancing of interests.** The focus is in particular on the **transparency requirement** and the **interpretation rules** ("In case of doubt the interpretation most favourable to the consumer shall prevail").

The Directive requires from member states to lay down rules on the legal consequences of unfair clauses (no binding power of such clause). A judicial or administrative review procedure is to be established, in relation with a right of initiative for consumer protection institutions, with a view to ensuring that unfair terms are no longer used.

3. Electronic commerce

The **Directive on electronic commerce**[57] is aimed at stimulating the electronic commerce by ensuring free movement of services between member states. This includes also the insurance sector. In general, the home country principle is to be applicable in this area, that is providers of services are subject to supervi-

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[55] Council Resolution of 14 April 1975 on a preliminary programme of the European Economic Community for a consumer protection and information policy, OJ n° C92 of 25 April 1975, p. 1 and Council Resolution on a second programme of the European Economic Community for a consumer protection and information policy, OJ n° C133 of 3 June 1981, p. 1.

[56] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ n° L 95 of 21 April 1993, p. 29.

[57] Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), OJ n° L 178 of 17 July 2000, p. 1.

sion in the member states where they have their head office in accordance with the local law. This applies both to the taking-up and the pursuit of the activity.

In this respect a number of exceptions have to be considered. The above-mentioned provisions of the Insurance Directives on the applicable law are not affected. In addition, member states are given the option to take own measures for the protection of public order (e.g. youth protection), public health, public safety and consumer protection.

The Directive deals also with the conditions to be fulfilled when contracts are concluded by electronic means. Further, a number of information requirements are imposed on the provider of services.

The Directive is supplemented by the **Directive on electronic signatures**[58] which aims at adapting provisions regulating formal requirements to the needs of modern commercial exchange. The Directive establishes a common framework for electronic signatures and certifications in order to ensure the proper functioning of the Single Market.

Two types of electronic signatures are introduced: a simple signature without special requirements and an advanced signature with special safety measures.

4. Distance marketing of financial services

The adoption of the Directive on the distance marketing of financial services[59] in 2001 filled a gap in the rules on consumer protection. The preceding relevant Directives excluded financial services and hence insurance transactions.

The core points of the Directive are ample **information requirements**, the introduction of a **right of withdrawal,** rules relating to the **reverse settlement** of contracts and general **rules of conduct** for the behaviour of the supplier in the market.

The subject of the Directive refers in particular to insurance contracts between insurers and consumers concluded by means of distance communication (letters, e-mails, phone, fax, etc.).

The **information requirements** concern in particular the supplier, the financial service, i.e. the insurance product, the contract negotiated at a distance (e.g. the existence of the right of withdrawal and the conditions for using this right) and redress procedures (e.g. possibilities to make complaints). The information requirements imposed on insurers by the EU Insurance Directives are not affected.

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[58] Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures, OJ n° L 13 of 19 January 2000, p. 12.

[59] Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, OJ n° L 271 of 9 October 2002, p. 16.

The information must be given to the consumer prior to the conclusion of the contract in writing or in another durable medium, which is available to the consumer.

The consumer, here the policyholder, may **withdraw** from the contract within 14 days, within 30 days in the case of contracts relating to life insurance or pension operations.

The **right of withdrawal does not apply** to travel and luggage insurance, similar short-duration contracts and to contracts which, at the policyholder's request, are fulfilled by both parties before the policyholder notifies this withdrawal (e.g. in case of immediate cover).

Where the policyholder withdraws from the contract, the insurer may require immediate payment for service actually provided under the contract, account being taken of special conditions.

Moreover, the Directive contains special provisions for the benefit of the consumer, aimed at protecting him from **unsolicited offers and services.**

5. Unfair commercial practices

The **Unfair Commercial Practices Directive**[60] is intended to approximate the diverging national provisions on unfair publicity and marketing methods and other unfair commercial practices and to thus strengthen overall consumer rights in relation with the purchase of products and services (including insurances) and help to prevent distortions of competition in the Single Market.

The objective of the Directive is to protect the **average consumer**, who "is reasonably well informed and reasonably observant and circumspect". Where a commercial practice is specifically aimed at a particular **group** (such as children, handicapped people, foreigner), the impact of the commercial practice is assessed on the basis of the behaviour and the knowledge of the average member of this group.

Unfair practices are **prohibited** as a matter of principle. The practices concerned relate to **misleading or aggressive behaviour.** A list in the Annex to the Directive enumerates typical commercial practices which are considered unfair and are therefore not allowed. With regard to insurance it expressly cites e.g. the case of a consumer, who wishes to make a claim on an insurance policy and is asked to produce documents which could not reasonably be considered relevant as to the validity of the claim or of an insurer who is failing systematically to respond to correspondence from consumers; in both cases only in order to dissuade a consumer from exercising his contractual rights (no 27 in the list in the Annex).

With regard to financial services the Directive allows member states to adopt stricter and more restrictive provisions.

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[60] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (Unfair Commercial Practices Directive), OJ n° L 149 of 11 June 2005, p. 22.

IV. The Directives on motor vehicle liability insurance

1. Preparatory work

Among all insurance classes, the Community bodies have probably given the most intense attention to motor vehicle liability insurance. For example, the Directives already mentioned aimed at creating and facilitating freedom of establishment and freedom to provide services provided special rules for motor liability insurance. In addition, the Council has adopted five special Directives in order to try to harmonise the substantive legal framework for this insurance class. The aim of this effort was and is to make the free movement of persons and goods in the Single Market as easy as possible without weakening the protection of victims of road accidents in member countries.

The coordination work of the Community had been preceded in particular by the **Strasbourg Convention** of 1959, where European Council member states laid down specific minimum requirements for this insurance class, which were to be implemented in each State joining the Convention. These requirements included:

- to grant the victim a direct claim against the liability insurer of the author of the damage (**action directe**),

- to set up a **compensation fund** which gives the victims a legal right to compensation in cases where the owner of the vehicle has failed to comply with his obligation to take out liability insurance or cannot be identified and

- to include the **owner of the vehicle** into the group of additional persons insured.

The precondition for the coordination work within the Community is the **Green Card System** which at the same time is of prime importance for cross-border movement of vehicles, in general.

This system is based on the following principles:

- In each country which wishes to join the system (meanwhile nearly all European countries are participating), motor liability insurers establish a bureau, of which they are members.

- This bureau has two types of tasks. Acting as a so-called **Paying Bureau** it issues “international insurance cards for motor traffic” (so-called green cards) via its members to policyholders. In its capacity as a **Handling Bureau** it settles the claims made in its country by victims of road accidents against motorists from abroad who entered the country with a valid green card. The claims are settled in accordance with the law applicable in the visited country. Afterwards, the Paying Bureau reimburses the Handling Bureau for all expenses arisen in relation with the claims settlement.

The green card system provides a means to adapt the differing level of insurance protection in the individual countries to the legal requirements of the visited country. Motorists need not take out additional motor liability insurance at each national border they cross (so-called **cross-frontier insurance**) in order to adapt their insurance cover to the requirements of the visited country, and the victim of a road accident in the visited country is not obliged to address his claim to the motor liability insurer abroad, but he can contact a domestic entity, which is the Handling Bureau.

2. The first motor insurance Directive

In the First motor insurance Directive of 1972[61], the Council had the purpose to facilitate the free movement of vehicles between member states by abolishing the **check on the green card** for vehicles normally based in a member state and entering another member state. As a condition for its entry into force, the Directive requested that the Bureaux of member states conclude an agreement guaranteeing the settlement of claims in accordance with the law applicable at the place of the accident, caused by insured or non-insured vehicles normally based in another member state.

In addition, the Directive prescribes that all vehicles in the Community be covered in respect of civil liability and that the cover be valid in the entire territory of the Community. A valid green card or frontier insurance has to be evidenced for vehicles normally based in a third country or in a non-European territory of a member state. The agreement mentioned above was concluded through a so-called Supplementary Agreement between the Green Card Bureaux, which entered into force in 1974 and which was joined by Bureaux of non-EEC countries (e.g. Finland, Norway, Sweden, Austria, Switzerland, Hungary and then-CSSR). Under the terms of this Agreement a **valid registration plate** of a member State of the Agreement is sufficient evidence of insurance.

The **minimum insurance cover** which in spite of all coordination measures was still differing from one country to another, remained extremely unsatisfactory. This was – and to a certain extent still is – true in particular in cases where a motorist who in his own country has adequate insurance cover, suffers in a foreign country, without his own fault, an accident caused by a vehicle which is – as compared to his own standard – completely underinsured, because the minimum amount of cover applicable in the country concerned does not allow full compensation of the damage.

3. The second motor insurance Directive

By adopting the Second motor insurance Directive of 1983 the Council tried to improve this situation[62]. The Directive states at first that motor liability insurance must cover compulsorily both **damage to property** and personal injuries. Like-wise it requires that, without prejudice to the right of member states to lay down or maintain higher compulsory guarantees, member states set up the following **minimum amounts of cover**:

- in the case of personal injury, 350 000 ECU where there is only one victim; where more than one victim is involved in a single claim, this amount will be multiplied by the number of victims,

- in the case of damage to property 100 000 ECU per claim, whatever the number of victims.

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[61] Council Directive 72/166/EEC of 24 April 1972 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles, and to the enforcement of the obligation to insure against such liability, OJ n° L 103 of 02 May 1972, p. 1.

Member states may, in place of the above minimum amounts, provide for a minimum amount of 500 000 ECU for personal injury where more than one victim is involved in a single claim or, in the case of personal injury and damage to property, a minimum overall amount of 600 000. A further object of the Directive is the requirement already contained in the Strasbourg Agreement to set up a compensation fund for damage to property or personal injuries caused by an unidentified or uninsured vehicle. With a view to preventing the **risk of fraud**, member states may limit or exclude the payment of compensation in the event of damage to property by an unidentified vehicle and they may provide, in the case of damage to property caused by an uninsured vehicle, an excess of not more than 500 ECU for which the victim (!) may be responsible.

The Directive excludes that any contractual clause contained in an insurance policy (driving of vehicles by unauthorised persons, by persons who do not hold a licence, etc.) be invoked against the injured third party. Finally, the Directive prescribes that the compulsory insurance of personal injuries be extended to include family members.

4. The third motor insurance Directive

The Third Directive on motor liability insurance of 1990[63] strengthens again the protection of consumers and victims of road accidents. It lays down that every motor liability insurance policy has to guarantee the **minimum amount of cover** prescribed in the country visited; however, when the country where the vehicle is normally based, prescribes a higher amount of cover, the latter determines the extent of compensation. Moreover, the compulsory insurance is extended to include personal injuries to all **passengers** other than the driver.

The **compensation fund** for unidentified and uninsured vehicles is not allowed to make the payment of compensation conditional on the victim's establishing in any way that the person liable is unable or refuses to pay. Any dispute between the fund and the civil liability insurer as to which must compensate the victim must not work to the disadvantage of the victim; member states have to ensure that one of these parties will provisionally compensate the victim without delay. Eventually, member states have to ensure that the parties involved in a road traffic accident are able to ascertain promptly the identity of the insurance undertaking covering the liability of the author of the accident.

5. The fourth motor insurance Directive

The degree of coordination achieved to-date did not prevent that an injured party having to claim in another country against a party resident there and an insurer authorised there had to overcome considerable difficulties to get his right (foreign legal system, foreign language, unfamiliar settlement procedures). Therefore, the European Parliament called on the European Commission to present a proposal for a Directive to solve these problems.

[62]Second Council Directive 84/5/EEC of 30 December 1983 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles, OJ n° L 8 of 11 January 1984, p. 17.
[63] Third Council Directive 90/232/CEE of 14 May 1990 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles, OJ n° L 129 of 19 May 1990, p.33

The Fourth motor insurance Directive[64], which has been adopted since, complies with the request of the Parliament.

The injured party is given a direct right of action against the liability insurer of the author of the accident (ancient request in the Strasbourg Agreement, see above). The injured party will be able to apply to a contact body in his home country for the settlement of the damage suffered abroad. Each insurer who is authorised for motor liability insurance in one member state has to appoint a claims representative in each of the other member states, who will assume this task on behalf of the injured party.

The claims representative is required to make an offer of compensation or at least to provide a "reasoned" reply within three months of the date when the injured party presented his claim for compensation. The aim is to accelerate the procedure.

For the purpose of identifying the insurer an information centre is to be established in each member state from which the injured party, indicating the registration number of the vehicle concerned, may obtain information about the foreign insurer of this vehicle and his domestic claims representative. Where the insurer of the author of the damage has failed to appoint a representative or where the representative has failed to reply in time, a compensation body in the country of residence of the injured party will carry out the settlement. The tasks of this body can be assumed either by the Green Card Bureau or the Guarantee Fund.

The provisions of the Directive apply also when the accident has occurred in a non-EU member country which is member of the Green Card system and when both the injured party and the insurer of the person responsible for the damage come from a member state of the Community.

The Directive affects neither the substantive law applicable at the place where the accident occurred nor the rules of private international law on the conferral of jurisdiction.

6. The fifth motor insurance Directive

The Directive[65] intends to modernise the preceding Directives and to improve the protection of victims. By further strengthening and consolidating the internal market of motor insurance it is intended to achieve one of the main targets of the Community measures in the field of financial services (and hence of the aforementioned Action Plan).

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[64] Directive 2000/26/EC of the European Parliament and of the Council of 16 May 2000 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles and amending Council Directives 73/239/EEC and 88/357/EEC (Fourth motor insurance Directive), OJ n° L 181 of 20 July 2000, p. 65.

[65] Directive 2005/14/EC of the European Parliament and of the Council of 11 May 2005 amending Council Directives 72/166/EEC, 84/5/EEC, 88/357/EEC and 90/232/EEC and Directive 2000/26/EC of the European Parliament and of the Council relating to insurance against civil liability in respect of the use of motor vehicles, OJ n° L 149 of 11 June 2005, p. 14.

The main measures are:

- A significant increase of the minimum amount of cover - in the case of personal injury - to 1 000 000 € per victim and 5 000 000 € per claim whatever the number of victims, and in the case of damage to property of 1.000 000 € per claim, whatever the number of victims. The automatic adaptation linked to the European Index of Consumer Prices (EICP) published by Eurostat is to ensure that the amounts of cover are not eroded over time. The review is to take place every 5 years.
- In the event of accidents caused by unidentified vehicles, the compensation body has to pay also for damage to property, where it is accompanied by major personal injuries.
- Any statutory provision or any contractual clause which exclude a passenger from insurance cover on the basis that he knew or should have known that the driver of the vehicle was under the influence of alcohol or of any other intoxicating agent at the time of an accident, is void.
- Victims of an accident occurred abroad may bring legal proceedings against the civil liability insurer in the member state in which they are domiciled (additional jurisdiction).
- All injured persons enjoy a direct right of action from road accidents against the motor liability insurer.
- Insurers are not permitted to invoke any excess against an injured party as far as motor liability insurance is concerned.
- Personal injuries suffered by pedestrians, cyclists and other non-motorised users of the road, who, as a consequence of a road accident, are entitled to compensation in accordance with national civil law, are covered by motor liability insurance.
- Clarification that the motor liability insurance covers the entire territory of the Community, irrespective of the period in which a vehicle remains in other member states.
- Right of the policyholder to request a statement of the claims experience or of the absence of claims regarding the vehicle.

7. Summary and outlook

As a summary it may be stated that during the past, major progress has been made with regard to the coordination in the field of motor liability insurance. Besides, the single market in motor insurance was not only created through Directives, but also through Recommendations and Decisions of the Commission[66].
On the other hand, it cannot be taken for granted, that the same level of protection for consumers and victims and equality in respect of competition for insurance providers has been achieved. There still are discrepancies in particular in substantive liability and contract law. The European Parliament and the Commission will certainly continue to promote the coordination in this field.

[66] Cf. e.g. Commission Recommendation 81/76/EEC of 8 January 1981 on accelerated settlement of claims under insurance against civil liability in respect of the use of motor vehicles, OJ n° L 57/27 of 4 March 1981 and Commission Decisions 2003/564/EC and 2004/332/EC of 28 July 2003 and 02 April 2004 on the application of Council Directive 72/166/EEC relating to checks on insurance against civil liability in respect of the use of motor vehicles, OJ n° L 192 of 31 July 2003, p. 23 and n° L 105 of 14 April 2004, p. 39.

V. The insurance accounts law

1. First attempts at coordination

The purpose of the Fourth and the Seventh company law Directives was the approximation of national provisions governing the layout and the contents of annual accounts and annual reports and of the rules on valuation and disclosure, with a view to improving, for the protection of shareholders and creditors, the comparability of financial information from undertakings operating within the Market.

Both the insurance sector and the banking sector were only in part covered by the coordination measures. On the one hand the above-mentioned Directives concerned only limited companies and limited liability companies, on the other hand member states were given the option to temporarily exclude insurance companies and banks from the scope of the Directives on account of the specific characteristics of these companies. The **Insurance Accounts Directive** of December 1991[67] was to fill this gap for the insurance sector.

This Directive was not a **coherent body of rules** for insurance companies. It set up rules for specific insurance situations only and, as to the rest, referred to provisions of the Fourth and Seventh Directives. However, the provisions reached beyond the scope of the latter Directives insofar as they included all insurance companies covered by the first insurance Directives, irrespective of their legal forms. Moreover, they were also applicable to **specialist reinsurance companies.**

The Directive tried to make a step further in the direction of the approximation of accounting rules, in accordance with the mandate for harmonisation under the Treaty of Rome. Further coordinating provisions with regard to financial reporting regulations were contained in the third insurance Directives. In view of the fact that more and more insurance companies began to operate across borders, the coordination measures were aimed at achieving in particular **improved comparability** of annual accounts and consolidated accounts of insurers, for the benefit of creditors, debtors, shareholders, policyholders, their consultants and the public in general. This list does not mention supervisory authorities. This is understandable with a view to the legal bases of the Accounts Directives.

Nevertheless coordination was of major significance for the supervisory law as well, not only because e.g. the third non-life insurance Directive referred to provisions of the insurance accounts Directive. The approximation of the provisions on financial statements achieved also a uniform minimum level in a special area of prudential supervision. While the Third Directives requested member states to require insurers to submit the documents and statistical records needed for supervision on a regular basis, member states were free to determine the exact type of documents and records requested.

In view of the fact, that the individual member states had developed a very **different degree** of "**financial reporting culture",** there was the risk that without the coordination of financial statements these important supervisory tools would remain relatively under-developed in some member states and that equivalent supervisory standards which are a prerequisite for the proper functioning of the Single Market, would have been developed.

On the other hand, in the field of financial reporting in insurance as well, the coordination efforts were only partly successful. Too great were the discrepancies between the points of view in particular of the **Continental European countries** on the one hand and the **Anglo-Saxon countries** on the other.

While Continental financial reporting is mainly focussed on the **protection of creditors**, here in particular the protection of policyholders, the Anglo-Saxon reporting practice gives priority to the **interest of company owners**. This is the reason why in countries in the first group insurers tend to value their assets at too low and their liabilities at too high a figure, in order to prevent that as a result of imprudent distribution of profits too many financial resources are drawn from the company and are no longer available as liable capital for emergencies. They present themselves poorer than they are. This is not the case in Anglo-Saxon countries. Here it may happen that the insurer demonstrates financial strength and distributes profits to shareholders or policyholders which he possibly has not even made yet.

Like in the fourth company-law Directive a way was found to overcome the difficulties: instead of genuinely coordinating the differing points of view, member states were given a number of options – there was talk of more than 130 options – some of which were capable of not only making the comparability of annual accounts more difficult, but also of causing distortions of competition between insurance companies. On the other hand, it has to be acknowledged that the coordination measures to date were meant to be **first steps** and that others were intended to follow.

2. The new accounting strategy

The new impetus to further coordination was given at first not by insurers or insurance supervisory authorities. It came from the actors in the securities markets. Globalisation and new developments in information technology gave fresh impetus to securities markets worldwide. The large European companies need internationally accepted annual accounts in order to be able to avail themselves of the word-wide capital markets. However, the accounts which these companies drew up in accordance with national provisions were no longer usable at international level. For reasons of comparability and transparency alone they were forced to draw up additional annual accounts in accordance with international standards, which was extremely burdensome in terms of costs and a competitive disadvantage for European companies.

The Communication of November 1995[68] proposed a new approach to harmonisation with the consent of member states. As was to be expected, the prudence principle, applicable in large parts of Continental Europe, was dropped and replaced by the Anglo-American accounting rules. The only question was whether the coordination should be carried out on the basis of the US GAAP (Generally Accepted Accounting Principles) or the International Accounting Standards or, recently, the International Financial Reporting Standards (IAS/IFRS). Eventually, the IAS developed by the International Accounting Standards Board (IASB), the former International Accounting Standards Committee (IASC), were chosen as the basis for harmonisation.

[67] Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings, OJ n° L 374 of 31 December 1991, p. 7.
[68] Communication COM 95(508) of 14 November 1995 from the Commission – Accounting harmonisation: a new strategy vis-à-vis international harmonisation

The IAS are not laws but a set of accounting principles dealing in detail with individual issues. IASB, a private-law institution, is the supreme body responsible for adopting financial reporting standards. Its members are accountants, analysts and practitioners of accountancy from Australia, Germany, France, Japan, Canada, USA and the United Kingdom.

In a further Communication of June 2000[69] the Commission stated in detail what steps were to be taken in order to reach the objectives.

It stated in particular that the European Union cannot delegate responsibility for setting financial reporting requirements to a non-governmental third party. Therefore, the standards developed by IASB must be integrated into the EU financial reporting legislative framework. EU authorities must have the means to exercise the necessary regulatory oversight and correct any material deficiencies or concerns in relation to IAS. Therefore, an EU endorsement mechanism is needed before the standards are applied. The authorities will intervene only, when the standards contain material deficiencies or fail to comply with features specific to the EU environment.

Moreover, the EU Accounts Directives were to be modernised immediately, in order to reduce potential conflicts with IAS and bring the Directives into line with modern accounting developments. The Commission cited the example of the recognition and measurement of intangible assets.

Finally, the Commission announced to make a contribution by issuing a Recommendation on Quality Assurance for Statutory Audit.

The first measure taken on the basis of this Communication was the Commission Recommendation on quality assurance for the statutory audit[70]. The objective was to establish national review procedures used to ascertain that auditors actually comply with the statutory coordinated requirements.

Following the suggestions in the aforementioned Communication, the Council and the Parliament required in a Regulation of July 2002[71] that, beginning in 2005, publicly traded companies have to prepare their consolidated accounts in accordance with IAS/IFRS. In respect of all other companies (e.g. in the insurance sector the mutual insurance associations) the Regulation accords member states options as to the implementation of the international accounting principles. The same applies to the annual accounts of individual companies.

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[69] Communication COM 2000 (359) final of 13 June 2000 from the Commission to the Council and the European Parliament - EU Financial Reporting Strategy: the way forward

[70] Commission Recommendation 2001/256/EC of 15 November 2000 on quality assurance for the statutory audit in the European Union: minim requirements, OJ n° L 91 of 31 March 2001, p. 91.

[71] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ n° L 243 of 11 September 2002, p. 1.

The modernisation of the Accounts Directives was primarily achieved by the Directive of June 2003.[72] Before that, the "Fair Value Directive"[73] had allowed the valuation at fair value. This Directive, however, did not concern insurance companies, because the Insurance Accounts Directive already permitted the recognition of fair value, though at the time this option was not used in all member states.

The adoption of the aforementioned Directives and of the IAS Regulation of 2002 set the course for the introduction of the International Accounting Standards. What was missing now, was only the recognition ("endorsement") of the IAS/IFRS by the European Union. The bodies involved in the procedure were, besides the European Commission, representatives of member states in an Accounting Regulatory Committee (ARC) and representatives of market participants (users, auditors, national financial reporting bodies) in the European Financial Reporting Group (EFRAG). The endorsement procedure is completed when the IAS/IFRS are published in the form of Regulations in the Official Journal of the European Union.

By Commission Regulations (EC) No 2236/2004[74], No 2237/2004[75], No 2238/2004[76] of 29 December 2004 and the Commission Regulation (EC) No. 211/2005[77] of 4 February 2005 all IAS/IFRS including the relevant interpretations were adopted in European law.

However, a gap in the coordinated international financial reporting system continues to exist. The IFRS 4[78] adopted and published by the Commission Regulation (EC) No 2236/2004 allows insurance companies to maintain, for the time being, a large part of their present accounting practices for insurance contracts; insurance contracts in the meaning of IFRS 4 being agreements comprising a significant transfer of insurance risks.

This means that these companies may continue to show their liabilities from contracts, in particular technical provisions, in accordance with their national law, US-GAAP or similar standards. The reason is that it is hardly possible to valuate these liabilities at fair value, because there is no market for insurance contracts. Modelling of fair values could probably be a possible way. The related problems are not yet solved.

Large risks provisions and equalisation provisions are not covered by this exception. They are not considered to be insurance liabilities.

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[72] Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings, OJ n° L 178 of 17 July 2003, p. 16.
[73] Directive 2001/65/EC of the European Parliament and of the Council of 27 September 2001 amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions, OJ n° L 283 of 27 October 2001, p. 28. A consolidated (unofficial) version of the Insurance Accounts Directive was established through the CONSLEG system of the EC Publication Office (cf. CONSLEG 1991L0674 of 17 July 2003).
[74] OJ n° L 392 of 31 December 2004, p. 1.
[75] OJ n° L 393 of 31 December 2004, p. 1.

[76] OJ n° L 394 of 31 December 2004, p. 1(Rectification OJ EC No 29 of 2 February 2005, p. 58).
[77] OJ n° L.41 of 11 February 2005, p. 1.

[78] OJ n° L 392 of 31 December 2004, p. 1 Annex.

Nearly all capital investments of insurers are to be considered as financial instruments within the meaning of IAS 39 and therefore to be shown at fair value. In this regard no exceptions for insurance companies were made.

The result is that the assets and liabilities side of the balance are treated in an unequal way ("mismatching") which is inconsistent and may cost companies much money.

The exception from the fair-value accounting principle is only acceptable for a transitional period (Phase I) and therefore must not be accepted beyond. In a following phase the final standard for insurance contracts is to be developed. Preparatory work is under way.

In conclusion, it should be stated once more, that the requirement to use IAS/IFRS is only applicable as far as consolidated accounts are concerned. Whether and when such requirement will be extended to include annual accounts of individual companies is not predictable.

VI. The liquidation and solvency law

Though the main objective of insurance supervision is exactly to prevent an insurance undertaking from going bankrupt, insurance supervisory authorities of member states have advocated speedy coordination of the rules on **composition and bankruptcy proceedings involving insurance undertakings** well before the First Coordination Directives were adopted**.** The starting point was at first, that the draft Convention on bankruptcy, composition and similar proceedings, submitted by government experts of member states under Article 220 of the Treaty of Rome, excluded insurance undertakings from its scope irrespective of their legal form, except undertakings carrying on solely reinsurance. Supervisory authorities held the opinion that the system of overall solvency which was already provided for in the draft proposals for the First Insurance Directives, required uniform liquidation rules for all insurance undertakings on the basis of equal treatment of all insurance creditors, irrespective of where the contract had been concluded and where the assets of the undertaking where localised. Furthermore, it was thought that the specific need for protection of policyholders required to involve supervisory authorities, in their capacity as advocates for insurance creditors, more strongly in the compulsory liquidation procedure. Above all they should have the opportunity to overcome the fatal all-or-nothing principle of the traditional insolvency law by using the means of the special administrative law and taking supervisory measures to avoid the bankruptcy of an insurer even when the reasons for initiating bankruptcy proceedings already existed (e.g. by contract-related measures such as premium increases or reductions of benefits or claims payments or by ordering the transfer of portfolios).

In 1971 a working party of the Conference of Insurance Supervisory Authorities had begun to consider the setting of liquidation rules based on the principles of **universality** and **equal treatment** of all insurance creditors. On the basis of its report the Commission prepared a first draft Directive. It dealt with

- **voluntary liquidation**, i.e. closing the entire operation from the own initiative of the company's bodies,

- the so-called **normal compulsory liquidation**, i.e. closing the operation as the automatic consequence of the authorisation being withdrawn, and

- **special compulsory liquidation**, the closing of operation on account of stated or imminent insolvency.

The core provisions of the Directive were to be the rules on the **distribution of assets** in the course of the special compulsory liquidation. An expert appointed by the Commission provided for two approaches:

- **The method A** provided for breaking down assets into national winding-up funds to be distributed to the entirety of the company's creditors and to apply in each country the criterion of the internationalisation of privileges.

- Under **the method B** the assets representing technical provisions were to be transformed into a separate fund at the time the proceedings were opened, with the sole purpose of satisfying the insurance creditors' claims.

The European Commission decided to base its draft proposal on the method B. It required that each undertaking establish and keep up to date a **register** listing all assets representing technical provisions. Thus it should be possible in any case of emergency to separate the funds available to policyholders from the rest of the company's assets.

On account of the objections and suggestions of government experts the draft Directive was amended several times. A proposal could not be presented to the Council, because suddenly the point of view prevailed that it would be better to include the special compulsory winding-up proceedings for insurance companies into the planned general EU Insolvency Convention and to leave only some specific features of the bankruptcy of insurance companies and the normal compulsory winding-up to a specific winding-up Directive.

When the completion of the work on the Agreement got delayed, supervisory authorities requested the Commission to resume discussions on a specific Directive for insurance companies. In 1987 the Commission finally presented to the Council such a proposal for a Directive, which was based to a large extent on the ancient projects. Year-long discussions were to follow, at times interrupted because no success could be achieved. In particular, it was not possible to reach an agreement on the possible precedence of insurance claims over the claims of other creditors when bankruptcy proceedings were opened against an insurer. When finally negotiators agreed on dropping the wish to accomplish harmonisation in this field, the road to success was opened. The problem concerned was also solved on the basis of conflict rules in relation with minimum coordination through an option. In March 2001 the Directive could finally be adopted at the end of thirty years of preparatory work[79]. The Directive regulates the reorganisation and winding-up of insurance companies as defined by the First Insurance Directives for life and non-life insurance companies. Specialist reinsurers or pension funds e.g. are not covered by the Directive; they are covered by the rules of the Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings[80], which has been substituted for the EU Insolvency Convention of 1995 which never entered into force, because it was never signed by all member states.

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[79] Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings, OJ n° L 110 of 20 April 2001, p. 28.
[80] OJ n° L 160 of 30 June 2000, p. 1.

The Directive establishes rules for two fields of law, the rules on conflicts of laws and the substantive law applied to winding-up proceedings.

In respect of conflict rules, in accordance with the other Directives, the Directive takes the home country principle as a basis. According to this principle the authorities of the home country of the insurer are alone responsible for initiating reorganisation and liquidation measures. These measures are fully effective throughout the Community without further formalities; any implementation or recognition by other member states is not necessary.
For the purpose of the Directive, branch offices of insurance undertakings from non-EU member states are considered independent undertakings and are treated in their host State as if they were an undertaking there established. The substantive law of the home State governs all essential issues in relation with the reorganisation and winding-up procedure, in particular the issue of opening and carrying out the procedure and its effects.

The Directive is mainly concerned with the protection of policyholders which is ensured by giving precedence to their claims over the claims of other creditors. The Directive gives member states the option to adopt one of two different methods by

- granting insurance claims absolute precedence over any other claims with respect to assets representing the technical provisions;

- by granting insurance claims a special rank, which may only be preceded by particular other claims (on salaries, taxes, social security and other), over the entire assets of the insurance undertaking.

That means that the two methods which during the seventies were proposed for the distribution of assets are taken up here in the form of an option.

This Directive is virtually the corner stone of the building of European legislation relating to insurance companies, a development which began in 1973 with the First non-life insurance Directive (from authorisation through current supervision to withdrawal from operation). All other Directives which are yet to come, will serve to maintain and modernise this building.

VII. Guarantee Schemes

Not all member states have introduced guarantee schemes for the insurance sector. The lack of coordination in this area may lead to varying degrees of protection for insured persons, and thus to distortions of competition detrimental to the Single Market. Directives for the banking and investment sector have already been adopted, in 1994[81] and 1997[82]. The Commission is now considering issuing a similar Directive for the insurance sector.

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[81] Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes, OJ no. L 135 of 31 May 1994, p. 5.

The initial work has already begun. A preparatory paper[83] describes how such a Directive might look. It may be a framework Directive which leaves the member states a great deal of latitude with respect to details. Essentially, the guarantee scheme is to encompass both the life and non-life sectors, although an exclusion of classes without a consumer character (e.g. transport insurance) is being considered. Membership in the guarantee scheme is to be a prerequisite for operation of an insurance business. Further questions have yet to be resolved, such as which persons are to be covered by the scheme (only consumers or also small businesses?), the scope of coverage (full coverage or with deductibles in order to limit the moral hazard risk?), the exclusion of insurers from the scheme upon non-performance of obligations under the system, the treatment of companies from third countries, etc.

The Commission has not yet decided whether to propose a Directive.

VIII. Insurance intermediary law

1. The 1976 insurance agents and brokers Directive

Certainly since the ECJ's rulings in the cases “Reyners” and “van Binsbergen”[84], it is clear that, after expiration of the transitional period, all citizens of the member states, including **insurance intermediaries,** essentially have **freedom of establishment and the freedom to provide services**, regardless of whether the coordination measures necessary for efficient functioning of the market have been taken or not. In the absence of coordination of the conditions of entry to and exercise of the profession and mutual recognition of evidence of qualifications, the member states would be free to impose national requirements, even upon persons from other member states seeking to exercise their freedom of establishment or freedom to provide services. This would lead to considerable difficulties and discriminatory practices in the insurance mediation sector. In this area in particular, **national regulations** with respect to the requirements for entry into the profession **vary very widely** from country to country, ranging from admission requirements combined with strict requirements with regard to reliability and professional expertise, to simple registration requirements, to the absence of any regulation whatsoever. The latter is the case in Germany, where anyone can be an insurance intermediary, regardless of whether he or she is qualified for that profession or not, based on the argument that freedom of trade must not be restricted. For intermediaries from countries with lenient requirements, or no requirements at all, the freedom to establish or provide services in countries with stricter regulations would exist only on paper, since they would be unable to meet the requirements in the host country. The Council therefore attempted, in the insurance agents and brokers Directive of 13 December 1976[85], by imposing transitional provisions, to enable even intermediaries who have not passed examinations or received authorisation in their country of origin, but who have demonstrated their professional qualifications over a certain period of time through actual practice, to exercise

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[82] Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor compensation schemes, OJ no L 84 of 26 March 1997, p. 22.

[83] Draft of a Commission proposal of 12 December 2005 – Markt/2534/05.

[84] Cf. FN 11.

[85] Council Directive 77/92/EEC of 13 December 1976 on measures to facilitate the effective exercise of freedom of establishment and freedom to provide services in respect of the activities of insurance agents and brokers (ex ISIC Group 630) and, in particular, transitional measures in respect of those activities, OJ no L 26 of 31 January 1977, p. 14.

those fundamental freedoms. In other words, the Directive does not coordinate modes of entry and practice of the profession, and is merely a **provisional regulation** which expires as soon as a detailed Community regulation is enacted.

The scope of the Directive includes:

a) **brokers**, i.e. persons who act as intermediaries between policyholders and insurance and reinsurance companies, among which they are free to choose, preparing insurance contracts and sometimes, e.g. in the event of claims, assisting in administration and performance;

b) **exclusive and multiple agents**, i.e. persons who, based on one or more contracts or powers of attorney, are hired to offer, propose, prepare or conclude insurance contracts on behalf and for the account, or only for the account, of one or more insurers, or to assist in their administration and performance, e.g. in the event of claims;

c) **sub-agents** (occasional agents and collecting agents), i.e. persons not falling under a) and b) who act for the account of the persons named above and are instructed e.g. to perform preparatory work, present insurance contracts or collect premiums without assuming any obligation towards or from the public.

Member states which require specific evidence of qualification for entry into and practice of the insurance intermediary profession must notify the persons seeking to exercise their freedom of establishment and freedom to provide services in a timely manner which of the above categories they fall under and which provisions of the Directive apply to them.

Those states must recognise practical expertise and experience gained in the country of origin through actual professional activity as an equivalent for the general, commercial and professional expertise required by national regulations, provided the professional activity is of a certain duration. This minimum duration is presumed to be met for brokers and exclusive or multiple agents if the applicant

- worked for four years, without interruption, as a self-employed person or in an executive position;

- worked for two years without interruption as a self-employed person or in an executive position, if it is demonstrated that he or she has worked for at least three years for insurance agents, brokers or companies; or

- worked for one year without interruption as a self-employed person or in an executive position, if he or she demonstrates prior training for the activity in question which is confirmed by a state-recognized certificate or recognized as adequate by the competent professional association.

If a member state has stricter requirements for brokers than for insurance agents, it may require intermediaries to obtain the aforementioned professional experience as a broker. An insurance agent may practice as a broker if he or she presents permanent powers of attorney from one or more insurer authorising him to represent the company or companies for all or part of actions consistent with ordinary business operations.

The requirements for sub-agents are more lenient: in that case, only two years of professional experience is required, and in some cases only one.

The Commission has published a list indicating which national authorities or institutions are competent for issuing and receiving the various certifications regarding actual professional experience, reliability and freedom from bankruptcy.

The Directive was to be implemented into national law and applied by mid-1978.

2. The intermediary Recommendation

True single market conditions were supposed to exist in the insurance sector as well beginning in mid-1994: customers were to have the opportunity to choose what was best for them among all products from all Community states.

The EC Commission has recognised that, especially in the mass market business, customers have not been able to take advantage from the widened product range as hoped. Rather, customers need **advice and support** from skilled and reliable insurance intermediaries, something which is apparently not yet recognized in all states, as the various qualification requirements show. The Commission also felt that the free provision of services was being hindered by the **divergent qualitative standards for insurance intermediaries**. In spite of the 1976 insurance agents and brokers Directive, some member states had refused to grant this freedom to intermediaries from states with little or no professional regulations for understandable consumer protection reasons by imposing relatively strict entry requirements. Ultimately, this discrimination, born out of mistrust, could only be avoided, in the Commission's view, if all Community states would allow only qualified persons to work as insurance intermediaries.

To this end, the Commission issued a Recommendation to all member states on 18 December 1991, in order to ensure that all insurance intermediaries meet certain requirements and are entered in a register[86].

The Recommendation essentially applies to **all categories of insurance intermediaries**, regardless of whether they are self-employed or in a dependent employment relation. All distribution channels are to be covered, i.e. including banks, automobile dealers and department stores. The Recommendation also applies to "part-time agents." Member states may only exempt person who act as intermediaries in addition to another commercial activity, such as bicycle dealers who sell bicycle theft insurance and travel agencies who sell travel insurance. More lenient requirements also apply for legal entities acting as insurance intermediaries, in which case it is enough for the management board to include a sufficient number of qualified persons and for the other employees to have basic training in the relevant matter.

In order to protect the interests of insurance customers, the Commission recommends a strict distinction between **insurance brokers,** i.e. intermediaries independent from insurers, and **insurance agents,** who are under contract with one or more insurers. Brokers are to be required to disclose to insurance customers whether and which direct links exist to insurance companies and investments in or by those companies. Brokers are also to be required to disclose the breakdown of their business in the previous year

[86] Commission Recommendation 92/48/EEC of 18 December 1991 on insurance intermediaries, OJ no L 19 of 28 January 1992, p. 32.

among the various insurers to an institution designated by the relevant member state. The purpose of this provision is to confront the problem of pseudo-brokers, and create certainty for insurance customers that those presenting themselves as brokers are actually brokers. The Recommendation leaves it to the member states to define the precise criteria for determining whether intermediaries presenting themselves as brokers are actually to be regarded as independent.

Of particular importance are the **subjective approval requirements** which the Commission recommends for insurance intermediaries. Accordingly, intermediaries are required to have general, commercial and professional knowledge and abilities, as well as a good reputation. They are ineligible if they have filed for bankruptcy in the past, unless they have been rehabilitated under national law. As far as professional expertise is concerned, a distinction may be made between brokers and other intermediaries. Details are to be defined by the individual member states or their recognized professional institutions. With the exception of brokers, insurers are to be allowed to define qualification requirements for their intermediaries, subject to government supervision. The Commission also recommends that insurance intermediaries be required to obtain **professional indemnity insurance**, unless the intermediary is indemnified by his or her insurance company, a requirement which is not met by brokers and would be very difficult to meet for multiple agents. Finally, brokers may be required to document adequate financial capacity. An important requirement is that all intermediaries with the necessary qualifications are to be entered in a register. Only registered persons may act as insurance intermediaries. The **register** may be established and kept either by the national government itself or by a professional association recognized by the government. Insurance companies may keep a register for their own intermediaries, but must allow the government to access the register at any time. If a central register is established, it must distinguish between brokers and other intermediaries. The intermediary must inform customers of their registration e.g. on letterheads, in advertising, etc.

In order to enforce these requirements, the Commission recommends the imposition of sanctions against persons acting as an insurance intermediary without authorisation, whether such persons are registered but fail to meet the necessary requirements, or whether they are not even registered.

The Commission has opted to use a non-binding Recommendation to accomplish its objectives **instead of a Directive**. It did so primarily in order to give the states with more lenient requirements for intermediaries, or no requirements at all, the opportunity to implement the guidelines included in the Recommendation in a more flexible manner, in a fashion consistent with national laws.

The Commission has asked the member states to report within three years, i.e. by the end of 1994, whether they have followed the Recommendation. Representatives of the Commission have left no doubt that they would propose a Directive in this matter should such a measure prove necessary due to the inactivity of individual member states. Until such a Directive is enacted, the transitional provision in the 1976 insurance agents and brokers Directive will continue to apply, since the Recommendation is non-binding.

3. The new mediation Directive

Due to the fact that some member states did not follow the Commission's Recommendation at all (like Germany), and some only in part, the Commission decided to make another attempt to coordinate requirements in this sector. In September 2000, it presented a proposal for a new Directive[87], whose objective was two-fold: to finally make it easier for insurance intermediaries to exercise their freedom of establishment and freedom to provide services in practice, and to improve protection for the interests of insurance customers. The Directive was to expand the supply of insurance products in the EU and thus to enable e.g. private customers to participate in the benefits of the Single Market. This Directive was to replace the 1977 Directive, and was to be the only binding Community text applicable to intermediaries.

The Directive has since been enacted[88].

The proposed Directive is based on the concept laid out by the Commission in its December 1991 Recommendation, reviving the principles set down in that document and making them binding. This means that all insurance and reinsurance intermediaries must now be registered. However, the Directives does allow for a large number of exceptions. For example, employed field service workers do not even fall within the scope of the Directives and therefore need not be registered and "tied intermediaries," who work for only one company, also do not need to be registered.

Registration is open only to intermediaries who meet certain requirements with respect to professional qualification. For example, they must

- possess the knowledge and ability defined in their country of origin;

- be of good repute;

- have professional indemnity insurance or an equivalent guarantee covering professional negligence; and

- have sufficient financial capacity, if the insurance intermediary manages customer funds.

Like other accepted legal texts in the field of insurance, the proposed Directive stipulates minimum requirements, meaning that the member states may enact stricter regulations, albeit only for intermediaries registered in their sovereign territory. Based on their registration in their country of origin, insurance and reinsurance intermediaries may work in other member states by means of the freedom to provide services or by establishing a branch office.

The Directive also contains requirements as to which information insurance intermediaries must disclose to potential customers, and the form which must be observed for such disclosures. In particular, customers must be told whether their intermediary is working on behalf of one or more companies or whether their intermediary is providing them with comprehensive advice about all of the products available on the market.

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[87] COM (2000) 511 final – 2000/0213 (COD) of 25 September 2000.

[88] Directive 2002/92/EC of the European Parliament and the Council of 9 December 2002 on insurance mediation, OJ no L 9 of 15 January 2003, p. 3.

IX. Insurance cartel law

In 2003, the European Commission issued a new Regulation[89] exempting certain practices within the insurance sector from the cartel prohibition in Article 81 of the EC Treaty. On 1 April 2003, the Regulation replaced the old 1992 exemption regulation, which expired on 31 March 2003. The Regulation applies through 31 March 2010.

The Block Exemption Regulation (BER) excludes certain agreements from the general prohibition provided the cooperation among the insurers does not exceed the degree justified in the interests of the consumer. It is meant to give legal certainty to companies while granting an exemption only to the extent associated with efficiency gains and benefits for the consumer.

In particular, the exemption applies primarily to **joint risk calculations and risk studies**, **standard policy conditions**, **insurance undertaking groups** and **security devices**.

Joint **risk calculations and studies** are deemed necessary because insurers rely on precise and reliable information about insured risks, so that the exchange and compilation of statistical data must be as comprehensive as possible. However, joint definition of premiums remains prohibited.

The development of **standard policy conditions** by national insurer associations, especially in the mass market business, creates efficiency advantages for insurers and also serves to protect consumers (market transparency is a prerequisite for competition). The current practice may therefore be retained. As is currently the case, the institution and announcement of standard conditions must be non-binding: the innovativeness of insurers must not be repressed by the standard conditions. Express reference must be made to the possibility that clauses may deviate from the standard conditions. The exemption does not apply if the standard conditions contain one or more of the clauses listed in Article 6(1) of the BER. For example, the standard conditions may contain no reference to the amount of gross premiums, may not provide for comprehensive cover, including risks to which a large number of policyholders are not even exposed, they may not allow the insurer to modify the term of the policy without the express consent of the policyholder, may not bind the policyholder for a term longer than three years, except in life assurance, may not require assumption of the existing contract by the acquirer in the event the insured object is transferred, may not exclude or limit coverage if the policyholder uses security devices which are approved in specifications issued by one or more insurer associations in one or more member states, or on the European level, etc.

The setting up and operation of several insurers in a **group of undertakings** serves to increase subscription capacity. Many large or unknown risks could not be insured without the formation of groups. The Regulation also allows such groups in part in order to avoid slowing or frustrating innovations in risk bearing.

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[89] Commission Regulation (EC) No. 358/2003 of 27 February 2003 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, OJ no L 53 of 28 February 2003, p. 8.

In most member states, insurer associations have issued specifications for **security devices,** as well as guidelines for the recognition and testing of such devices. The current exemption applies to these as well. However, agreements which go beyond harmonised Community security provisions are no longer exempt, since otherwise the object of the harmonisation could be jeopardized.

If they have doubts whether the requirements for an exemption under the BER are met, insurers may request **negative clearance** or an **individual exemption**.

X. Jurisdiction, Recognition and Enforcement of Judgments

Jurisdictional rules which vary from member state to member state and cumbersome exequatur procedures complicate cross-border commercial transactions considerably. Single market conditions do not exist if judgments issued in one member states have to be subjected to a new material review by a court in another member state or if the judgment is not recognized because such jurisdiction does not exist in the other member state.

Therefore, member states were asked early on to simplify formalities for the mutual recognition and enforcement of judgments and arbitral awards.

In the 1968 EEC Jurisdiction and Enforcement Convention (**the Brussels Convention**), the member states not only attempted to ensure mutual recognition and enforcement of judgments in civil and commercial matters, but also defined an international jurisdiction in this area binding for all member states.

The Brussels Convention was largely superseded, effective 1 March 2002, by the Regulation on jurisdiction and recognition and enforcement of judgments in civil and commercial matters[90] (**the Brussels Regulation**).

As far as **jurisdiction** is concerned, the Brussels Regulation features a self-contained system. The "exorbitant" national jurisdiction rules which grant the protection of the courts to their own citizens at the expense of foreign nationals are largely abolished. In general, the courts of the state in which the defendant has his or her residence (or registered office) has jurisdiction in international matters, with local jurisdiction determined, with a few exceptions, by the sovereign law of the state of residence.

In addition to the general jurisdiction, the Regulation provides for a number of **special jurisdictions**, including the jurisdiction of the place of performance and tort jurisdiction.

A special provision applies for lawsuits in **insurance matters**, since lawmakers took the view that insured persons and beneficiaries generally require special protection.

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[90] Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and recognition and enforcement of judgments in civil and commercial matters, OJ no L 12 of 16 January 2001, p. 1.

Thus, an **insurer with registered office in a member state** may be **sued** before a court in the state in which it has its registered office, in another member state, before the court where the policyholder, insured person or beneficiary has his or her place of residence or, if the insurer is a co-insurer, in the member state in which the lead insurer is sued. If the insurer has no registered office in the sovereign territory of a member state, but does maintain a branch office or agency there, it is treated in case of disputes arising from operation of the office or agency, as if its registered office were in the sovereign territory of the member state.

In **liability disputes,** as well as disputes relating to the insurance of **immovable objects**, the plaintiff may choose another place of jurisdiction in a suit against an insurer with registered office or branch office in a member state: he or she may also sue the insurer before the court at the place in which the damaging event occurred. If movable objects are insured under the same contract as well as the immovable objects and are affected by the same damaging event, that place of jurisdiction may be chosen by the plaintiff for those objects as well.

Finally, in liability insurance, all jurisdictions available to the policyholder are also open to the injured party, provided a direct action is admissible under substantive contract law.

The **insurer, for its part,** may only **sue** before the courts of the member state in which the defendant maintains his or her place of residence, regardless of whether the defendant is the policyholder, insured person or beneficiary.

Jurisdictional agreements in insurance matters are only allowed by the Regulation within very narrow limits[91].

Judgments issued in one member state are generally **recognised by operation of law** in all other member states, so that a special recognition procedure is not required. Only in exceptional cases, where a legally relevant need exists to clarify the recognisability of a judgment in binding fashion, may an action for declaratory judgment be requested. As grounds for refusing recognition, the Regulation cites e.g. non-compliance with special provisions regarding jurisdiction in insurance matters, in addition to the typical grounds (e.g. judgments contrary to public policy).

With respect to **enforcement,** the Regulation calls for an essentially unilateral **enforcement order issuance procedure** applicable for all member states (exception: the United Kingdom, where registration takes place). If the order is issued at the request of the beneficiary, the foreign judgment has the full effect of a domestic judgment. The local jurisdiction of the court issuing the order is determined by the debtor's place of residence or the place where execution is to take place. Each party may appeal the enforceability decision. The Regulation does not govern actual execution of the judgment: the relevant national law at the place of execution applies in that regard.

Finally, it should be noted that the Brussels Regulation only applies for member states of the European Union. In relation to EEA states, the 1988 **Lugano Convention** applies, which is consistent with the Brussels Convention and has yet to be adapted to the Brussels Regulation.

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[91] Cf. Art. 13 of the Regulation.

XI. Other Fields of Law

1. Equal opportunity and equal treatment of men and women

The principle "**equal pay for male and female workers for equal work**" has been established since 1957 in Article 119 of the Treaty Establishing the European Economic Community (today, Article 141 of the EC Treaty). "Pay" in terms of this provision includes not only typical wages and salaries, but also all other current and future compensation which the employer pays to the employee, directly or indirectly, based on the employment relation. This includes benefits as part of an **occupational pension scheme** originating in an agreement between the employer and the employee and forming part of the employment contract.

The **ECJ,** based on Articles 119 of the EEC Treaty and 141 of the EC Treaty, as well as general equality principles in the constitutions of the member states which, according to the rulings of the Court, are also components of Community law, has required equal treatment of men and women even in areas which are not covered by the limited material scope of the original norm. In similar fashion, the **Council**, acting alone at first, and then in conjunction with the **European Parliament**, has attempted to enforce a general ban on gender-based discrimination in a wide variety of areas by enacting a large number of **Directives**. The most important Directives for the insurance sector are the general 1975 Directive on application of the "equal pay" principle[92], the vocational access Directive[93], the Directive relating to equal treatment in occupational social security schemes[94] and the Directive on access to goods and services[95].

Actuaries were greatly concerned by proposals made by the Commission and, especially, by some politicians, in preparing the Directive on the implementation of the principle of equality in occupational social security schemes. There was a serious danger that the equivalency principle unique to the insurance sector would be abandoned and only "unisex" premiums would be allowed. It is thanks to the massive protests e.g. by actuaries that life assurance companies are still able to operate based on actuarial principles.

The Commission is now attempting to simplify, modernise and improve Community law relating to equal treatment by combining the applicable provisions of the existing Directives into a single text, i.e. a new

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[92] Council Directive 75/117/EEC of 10 February 1975 on the approximation of the laws of the Member States relating to the application of the principle of equal pay for men and women, OJ no L 45 of 19 February 1975, 19.

[93] Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment of men and women as regards access to employment, vocational training and promotion, and working conditions, OJ no L 39 of 14 February 1976, p. 40, amended by Directive 2002/73/EC of the European Parliament and the Council of 23 September 2002, OJ no L 269 of 5 October 2002, p. 15.

[94] Council Directive 86/378/EEC of 24 July 1986 on the implementation of the principle of equal treatment of men and women in occupational social security schemes, OJ no L 225 of 12 August 1986, p. 40, amended by Council Directive 96/97/EC of 20 December 1996, OJ no L 46 of 17 February 1997, p. 20.

[95] Council Directive 2004/113/EC of 13 December 2004 on the implementation of the principle of equal treatment of men and women in the access to and supply of goods and services, OJ no L 373/37 of 21 December 2004.

Directive. A proposal for a Directive was presented in 2004 and, after an initial hearing by Parliament in 2005, was revised. The Commission does not limit itself to an editorial summary of the existing provisions, but also proposes substantive legal changes which, in many cases, would lead to stricter regulations. However, the rules on actuarial calculation of premiums and benefits set down in the aforementioned Directives relating to pensions are not to be touched: the Commission expressly acknowledges in its proposal, in accordance with the rulings of the ECJ, that gender-specific formulas are objectively justified distinctions, a view which has been confirmed by the Court's rulings relating to the 2004 Directive on equal treatment in the access to goods and services. In spite of those rulings, members of Parliament have once again attempted to institute a ban on gender-specific calculation, although that motion has yet to find majority support.

It is not currently foreseeable when enactment of the proposed consolidation Directive can be expected.

2. Reinforced supervision of financial institutions

Due to a number of cases of fraud in the international financial services market, particularly the bankruptcy of the Bank of Credit and Commerce International ((BCCI), once the seventh-largest private bank in the world, the Commission felt the need to supplement the specific Directives for financial institutions (banks, insurance companies and investment firms) in order to strengthen the powers of the supervisory authorities and thus improve their ability to fight and prevent fraud and other irregularities.

The "**BCCI Directive"**[96], which was adopted in 1995, states that:

- financial services groups must have a **transparent structure**; a situation must be avoided in which a non-transparent structure makes effective supervision more difficult or impossible. If necessary, supervisors may refuse or revoke approval;
- **the head office and registered office** of the supervised company must be in the same member state; the purpose of this provision is to ensure that the competent supervisory authority has direct access to the company's management;
- **auditors** must notify the competent supervisory authority without delay of all facts and decisions of which they gain knowledge in the course of their activities which may constitute violations of the law, jeopardise the continued existence of the company or may result in the refusal to certify the accounts or express reservations;
- the **exchange of information** called for in sector-specific Directives may be extended to institutions which, based on experiences in the BCCI case and in other scandals, may play a major role in discovering problems. These include all authorities and bodies "responsible under the law for the detection and investigation of breaches of company law," as well as central banks and other institutions responsible for supervising payment systems.

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[96] Directive 95/26/EC of the European Parliament and of the Council of 29 June 1995 amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non-life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms and Directive 85/611/EEC in the field of undertakings for collective investment in transferable securities (Ucits) , with a view to reinforcing prudential supervision, OJ no L 168 of 18 July 1995, p. 7.

3. Fighting money laundering and terrorist financing

International standards for the fight against money laundering and terrorist financing are established by the Financial Task Force on Money Laundering (FATF), a working group created by the 1989 World Economic Summit. The 40 recommendations issued by that group were revised in 2003. In addition, the FATF's mandate was extended after the events of 11 September 2001 to include the fight against terrorist financing.

The relevant EU Directives[97] were replaced by a new Directive[98], mostly in order to incorporate the work of the FATF. The new Directive calls e.g. for

- including the fight against terrorist financing;
- ascertaining and checking the identity of the customer and beneficial owner upon the establishment of and during the business relationship, to which end data going beyond mere formal indication is to be obtained (purpose and nature of the business relationship, routine monitoring of transactions);
- defining a risk-based approach, i.e. shifting the focus of prevention efforts to the actual risk situation; and
- extending the scope of the regulations e.g. to intermediaries of life assurance contracts, insofar as the insurer is not responsible for such contracts.

Although the provisions of the Directive go into extensive detail, the member states still have the latitude to enact more precise provisions, e.g. regarding the duty to identify customers and beneficial owners, the obligations of the affected persons to exercise due care, etc. The Directive must be implemented into national law by 15 December 2007.

D. Further Development of the Internal Insurance Market

The legislation enacted by the EU in the past must form the basis for the further development and modernisation of the internal market for insurance. After nearly all of the 42 legislative measures originally called for in the Action Plan were successfully concluded, the European Commission gave in to the desire e.g. of the industry for a legislative break. In a Green Paper presented in May 2005, "Financial Services

[97] Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, OJ no L 166 of 28 June 1991, p. 77, amended by Directive 2001/97/EC of the European Parliament and the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering – Commission Declaration, OJ no L 344 of 28 December 2001, p. 76.
[98] Directive 2005/60/EC of the European Parliament and the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, OJ no L 309 of 25 November 2005, p.15.

Policy 2005 – 2010,"[99] the Commission declared that future efforts would focus on completing the unfinished work and consolidating the existing legal framework. Of particular importance will be ensuring that existing EU regulations are efficiently implemented into national law, rigorously enforced by supervisory agencies and routinely monitored so as to ascertain their adequacy and beneficial effect. After holding a public hearing, the Commission defined its final position in a December 2005 White Paper[100]. Accordingly, the political priorities for the next five years are as follows: dynamic consolidation of past progress and ensuring efficient implementation and application of the existing legal framework; rigorous application of the agenda for "good legislative practice" in future legislation; improving convergence in the field of supervision; strengthening competition among providers, especially in the private client markets; strengthening Europe's influence on the global financial markets; advancing the Lamfalussy process and avoiding costly double reporting and disclosure duties for businesses beginning in 2008. In other words, future legislative activity will essentially be limited to the development of a Directive on Solvency II, reducing bureaucratic expense for international consolidation and regulating guarantee schemes. Legislative activities e.g. with respect to supervising rating organisations and financial analysts will not be pursued.

In so doing, the Commission has chosen a correct, albeit thorny, path to improve the efficiency of the internal market. Of particular importance is that member states are finally beginning to show more discipline in implementing the Directives which have been enacted. Defective implementation of Community law, or the failure to implement it altogether, is not a minor offense, but the most serious violation which a member state can commit, both towards its fellow member states and towards its own population. Member states which deliberately violate their obligations in this manner diminish the economic benefits of market integration, or eliminate them altogether, and thus recklessly put the entire European union in jeopardy.

E. Conclusion

The goal of the parties to the Treaty establishing the European Economic Community, the creation of a common market in the insurance sector as well, has been achieved. It has taken five decades for insurance companies in the Community and the other parts of the European Economic Area to obtain the right to offer their services in all member states, from their registered office or via branch offices. By the same token, insurance customers within this economic area can turn to all insurance companies in that area, comprising several thousand companies, in order to find, and generally to receive, the optimal insurance coverage for them. This is something which the participating European countries can be proud of: it is the only system of its kind in the world. In the over two hundred years of its existence, the United States has not even been able to implement freedom of establishment for insurance companies.

The European Single Market will grow even larger in the future. Bulgaria and Romania are slated to accede to the European Union in 2007, and other European countries will follow. This enlargement process will stimulate commerce and the economy in general and the insurance industry in particular, making the European insurance market even stronger.

[99] Green Paper of 3 May 2005 on Financial Services Policy (2005 – 2010), COM/2005/177/final.
[100] White Paper of 5 December 2005 on Financial Services Policy (2005 – 2010), Com/2005/629.