

Meinrad Dreher

Treatises on Solvency II



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Preface

“Treatises on Solvency II” collects 13 articles on the new European insurance supervisory regime under the Solvency II Directive and the EIOPA Regulation, viewed predominantly from a legal standpoint. The articles treat the basis of the European insurance supervisory regime and its three pillars of solvency, governance, and disclosure. As background and by way of example, the treatise describes the German insurance supervisory regime and the efforts of the German legislator to implement the Solvency II system into this German insurance supervisory regime.

These articles were written in the period from 2009 to 2014, the time frame within which the Solvency II system was being created. They were first published in German and reflect the states and stages of the European and German insurance supervision at the time of their particular publication.

Although the insurance supervisory system is now definitively marked by European standards, there has been no thoroughgoing debate and consideration of this system with respect to theory and practice. In only a few Member States has there been public discussion of the issues implicated by the new European insurance supervisory regime. This book is intended to contribute to such a European debate by making the collected articles accessible in English. The intended addressees consist of, i.a., European and national insurance supervisory authorities, insurance undertakings, legislators dealing with insurance supervision, interested associations, financial auditors, courts, and above all insurance academics.

This book would not have been possible without contributions from various persons. First of all, the articles rendered from German into English by specialized translators had to be refined and harmonized. In this regard, my thanks go to attorney-at-law Ms. Julia Körner, research assistant to my academic chair at Mainz University, for her commitment, dedication, and input. For their dedicated support in producing, editing, and finalizing the indexes, I gratefully acknowledge my assistants: Ms. Judith Kreher, law clerk; Mr. Benjamin Franz, law clerk; Mr. Tobias Gerigk, cand. jur.; and Ms. Sarah Gillenberg, stud. jur. Significant contribution in the form of generous financial support for translating and printing was provided by the Dr. Paul-Otto Faßbender Stiftung für Bildung und

Wissenschaft [Foundation for Education and Science] of Düsseldorf, and I take this opportunity to express my particular thanks to the Foundation. Finally, I thank the publishers, editors, and co-authors involved with the initial appearance in print of these articles for their permission to publish these writings in English in the form of this book.

Mainz, Germany
1 October 2014

Meinrad Dreher

List of Abbreviations

AG	Die Aktiengesellschaft (Zeitschrift), The Journal of Corporation Law
AktG	Aktiengesetz, German Stock Corporation Act
ALM	Asset-Liability Management
art.	Article
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht, Federal Financial Supervisory Authority
BaFin-Journal	Bundesanstalt für Finanzdienstleistungsaufsicht-Journal, Federal Financial Supervisory Authority-Journal
BB	Betriebs-Berater (Zeitschrift), The Journal of Management Consultant, Law, Tax & Economics
BDSG	Bundesdatenschutzgesetz, German Federal Data Protection Act
BGB	Bürgerliches Gesetzbuch, German Civil Code
BGHZ	Entscheidungen des Bundesgerichtshofes in Zivilsachen, Decisions of the Federal Court of Justice in Civil Matters
BGBI.	Bundesgesetzblatt, German Federal Law Gazette
BJR	Business Judgement Rule
BR-Drucks.	Bundesrat-Drucksache, Document of the German Bundesrat
BT-Drucks.	Bundestag-Drucksache, Document of the German Bundestag
BVerwG	Bundesverwaltungsgericht, Federal Administrative Court
BVerwGE	Bundesverwaltungsgerichts-entscheidungen, Federal Administrative Court Decisions
CCZ	Corporate Compliance (Zeitschrift), Journal of Corporate Compliance
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CFL	Corporate Finance Fachportal (Zeitschrift), Journal of Corporate Finance
CMLRev	Common Market Law Review
COF	Classification of Own Funds

COM	European Commission Documents
DB	Der Betrieb (Zeitschrift), Journal of Business, Tax and Economic Law
DÖV	Die Öffentliche Verwaltung (Zeitschrift), Journal of Public Administration
DCGK	Deutscher Corporate Governance Kodex, German Corporate Governance Code
DRS	Deutsche Rechnungslegungsstandards, German Accounting Standards
DVO	Durchführungsverordnung, Draft Implementing Measures Solvency II
ECB	European Central Bank
ECJ	European Court of Justice
ed	Edition
ed., eds.	Editor, editors
e.g.	Exempli gratia
EIOPA	European Insurance and Occupational Pensions Authority
EOF	Eligibility of Own Funds
EU	European Union
EuR	Europarecht (Zeitschrift), European Law Journal
EuZW	Zeitschrift für Europäisches Wirtschaftsrecht (Zeitschrift), Journal of European Business Law
EWiR	Entscheidungen zum Wirtschaftsrecht – Kurzkomentare (Zeitschrift), Decisions in the Field of Economic Law – short commentaries
FAZ	Frankfurter Allgemeine Zeitung, Frankfurt General Newspaper
f., ff.	Following page, following pages
FMA	Financial Market Authority (Austria)
FinDAG	Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht, Financial Services Supervisory Act
FinStabGEG	Gesetz zur Stabilisierung der deutschen Finanzaufsicht, Act to Strengthen German Financial Supervision
FIW	Forschungsinstitut für Wirtschaftsverfassung und Wettbewerb, Research Institute for Economic Constitution and Competition
FS	Festschrift, Publication in Honor
GDV	Gesamtverband der Deutschen Versicherungswirtschaft, German Insurance Association
GenTG	Gentechnikgesetz, Genetic Engineering Act
GG	Grundgesetz, German Constitution
GmbHR	Gesellschaft mit beschränkter Haftung Rundschau (Zeitschrift), Journal of Limited Liability Companies
GWG	Geldwäschegesetz, German Money-Laundering Act
HGB	Handelsgesetzbuch, German Commercial Code

i.a.	Inter alia
IAS	International Accounting Standard
IASB	International Accounting Standards Board
i.e.	Id est
ICS	Internal Control System
id.	Idem
IFRS	International Financial Reporting Standard
Inc.	Incorporation
IR	Implementing Regulation
JECLAP	Journal of European Competition Law and Practice
Jite	Journal of Institutional and Theoretical Economics
JZ	Juristenzeitung (Zeitschrift), Jurists' Journal
KSzW	Kölner Schrift zum Wirtschaftsrecht (Zeitschrift), Cologne Journal of Economic Law
KWG	Kreditwesengesetz, German Credit Service Act
MaComp VA	Mindestanforderungen an die Compliance Funktion (Versicherungsaufsicht), Minimum Requirements for the Compliance Function (Insurance Supervision)
MaComp WA	Mindestanforderungen an die Compliance Funktion (Wertpapieraufsicht), Minimum Requirements for the Compliance Function (Securities Supervision)
MaRisk BA	Mindestanforderungen an das Risikomanagement (Bankenaufsicht), Minimum Requirements for Risk Management (Banking Supervision)
MaRisk VA	Mindestanforderungen an das Risikomanagement (Versicherungsaufsicht), Minimum Requirements for Risk Management (Insurance Supervision)
MCR	Minimum Capital Requirement
n.	Number
no.	Numero
NJW	Neue Juristische Wochenschrift (Zeitschrift), New Weekly Journal of Law
NZBau	Neue Zeitschrift für Baurecht (Zeitschrift), New Journal of Building Law
NZG	Neue Zeitschrift für Gesellschaftsrecht (Zeitschrift), New Journal of Company Law
OECD	Organisation for Economic Cooperation and Development
OFT	Office of Fair Trading
OJEU	Official Journal of the European Union
ORSA	Own Risk and Solvency Assessment
öOGH	Österreichischer Oberster Gerichtshof, Austrian Supreme Court
para.	Paragraph
pp.	Paginae
QIS	Quantitative Impact Study
ref.	Reference

RegE	Regierungsentwurf, Government's Draft
RSR	Regular Supervisory Report
RTS	Report to Supervisors
SCR	Solvency Capital Requirement
sec., secs.	Section, sections
sent.	Sentence
SFCR	Solvency and Financial Condition Report
SGG	Sozialgerichtsgesetz, Social Court Act
SRP	Supervisory Review Process
StGB	Strafgesetzbuch, German Criminal Code
StrlSchV	Strahlenschutzverordnung, German Regulation on Protection against Harm from Ionizing Radiation
subpara.	Subparagraph
TFEU	Treaty on the Function of the European Union
TKG	Telekommunikationsgesetz, Telecommunication Act
TP	Technical Provision
TSIM	Tests and Standards for the Use of an Internal Model
UFR	Ultimate Forward Rate
VAG	Versicherungsaufsichtsgesetz, German Insurance Supervision Act
VersR	Versicherungsrecht (Zeitschrift), Journal of Insurance Law
VersVergV	Versicherungsvergütungsverordnung, German Remuneration Regulation for the Insurance Industry
VGH	Verwaltungsgerichtshof München, Munich High Administrative Court
viz.	Videlicet
VuR	Verbraucher und Recht (Zeitschrift), Journal of Consumer and Law
VVG	Versicherungsvertragsgesetz, Insurance Contracts Act
VW	Versicherungswirtschaft (Zeitschrift), Journal of Insurance and Economy
VwGO	Verwaltungsgerichtsordnung, Code of Administrative Court Procedure
WiSt	Wirtschaftswissenschaftliches Studium (Zeitschrift), Journal of Economic Studies
WM	Wertpapiermitteilungen – Zeitschrift für Wirtschafts- und Bankenrecht (Zeitschrift), Securities Review – Journal of Commercial and Banking Law
WpDVerOV	Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsanforderungen für Wertpapierdienstleistungsunternehmen, German Investment Services Conduct of Business and Organization Regulation
WPg	Die Wirtschaftsprüfung (Zeitschrift), Journal of Accounting
WpHG	Wertpapierhandelsgesetz, German Securities Trading Act

WuW	Wirtschaft und Wettbewerb (Zeitschrift), Journal of German and European Competition Law
WuW/E	Wirtschaft und Wettbewerb – Entscheidungssammlung, Decisions collected in the Journal of German and European Competition Law
ZBB	Zeitschrift für Bankrecht und Bankwirtschaft (Zeitschrift), Journal of Banking Law and Finance
ZfV	Zeitschrift für Verwaltung (Zeitschrift), Journal of Administrative Law
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht (Zeitschrift), Journal of Business and Company Law
ZHR	Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (Zeitschrift), Comprehensive Journal of Commercial and Economic Law
ZIP	Zeitschrift für Wirtschaftsrecht (Zeitschrift), Journal of Economic Law
ZIR	Zeitschrift Interne Revision (Zeitschrift), Journal of Internal Revision
ZVersWiss	Zeitschrift für die gesamte Versicherungswissenschaft (Zeitschrift), German Journal of Risk and Insurance
ZWeR	Zeitschrift für Wettbewerbsrecht (Zeitschrift), Journal of Competition Law

Contents

Part I Basics

1	Harmonization of Insurance Supervisory Law	3
1.1	Introduction	4
1.2	The Typology of Harmonization Methods	5
1.3	The European Law Sources for Harmonization of the Insurance Supervisory Regime	8
1.3.1	The Solvency II Framework Directive	8
1.3.2	The Implementing Regulations for the Solvency II Framework Directive	12
1.3.3	The EIOPA Regulation	14
1.3.4	Interim Result	15
1.4	Consequences for the Future Insurance Supervisory System in Germany	16
1.4.1	The Impact of Full Harmonization on the Insurance Supervision Act	16
1.4.2	Supervision According to the Principle of Abusiveness with Regard to Primary Insurance Undertakings	17
1.4.3	The Effect of Full Harmonization in Certain Areas	21
1.5	Conclusions	23
2	Supervisory Review Process	27
2.1	Introduction	28
2.2	Principles of Insurance Supervision Under Solvency II	29
2.3	Objective and Concept of the Supervisory Review Process	30
2.3.1	Objective	30
2.3.2	Art. 36 of the Solvency II Directive and Its Implementation in Sec. 289, Paras. 2–4 of the VAG Reg-E [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]	31
2.3.3	The CEIOPS Advice on Procedures for Supervisory Authorities	36

2.4	The Subjects of the Supervisory Review Process	37
2.4.1	Subject of the Investigation and Investigatory Standard	37
2.4.2	The Governance System as Examination Subject . . .	41
2.4.3	Capital Requirements as Examination Subject	44
2.5	Powers of Supervisory Authorities to Remedy Weaknesses and Deficiencies	53
2.5.1	“Weaknesses or Deficiencies” as Legal Terms	53
2.5.2	The Role of Art. 36, Para. 5 of the Solvency II Directive in the Classification of Intervention Powers	58
2.5.3	Non-compliance with Capital Requirements	60
2.5.4	Non-compliance with Requirements on Governance	61
2.6	Summary	63
3	Insurance Supervisory Law and Consumer Protection	67
3.1	Introduction	68
3.2	Consumer Protection Provisions of the New Insurance Supervisory Regime	69
3.2.1	The EIOPA Regulation	69
3.2.2	The Solvency II Directive	71
3.2.3	The Draft Regulation on Key Information Documents and the Draft Directive on Insurance Mediation	72
3.2.4	The Second and Third Regulatory Levels of the Solvency II System	72
3.2.5	The VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]	73
3.2.6	The BaFin [Federal Financial Supervisory Authority]	74
3.3	The Role of Consumer Protection in the Supervision of Insurance Undertakings	75
3.3.1	The Objective of Supervision	75
3.3.2	Further Implications	77
3.4	Summary	94

Part II Solvency

4	Solvency Requirements	99
4.1	Introduction	100
4.2	The Solvency System Under Supervisory Law	101
4.2.1	The Economic Balance Sheet (Solvency Statement) . . .	101
4.2.2	Own Funds Under Supervisory Law	102
4.2.3	Capital Requirements Under Supervisory Law	103
4.2.4	The Supervisory Review Process	107

4.3	Complexity, Volatility and Procyclicality of the Solvency Requirements: Implications for Solvency Supervision	109
4.3.1	The Problems	109
4.3.2	Complexity	111
4.3.3	Volatility	115
4.3.4	Procyclicality	121
4.4	The New Roles of the Managing and Supervisory Boards, Supervisory Authorities, Courts and Insurance Academics in the Solvency Supervision of Insurance Undertakings	124
4.4.1	The Managing and Supervisory Boards of Insurance Undertakings	124
4.4.2	The Supervisory Authorities	133
4.4.3	Competent Courts in the Insurance Supervisory Regime	146
4.4.4	Insurance Academics	148
4.5	Summary	149

Part III Governance

5	Own Risk and Solvency Assessment	157
5.1	Introduction	158
5.2	Subject-Matter and Objective of the ORSA	160
5.3	The Solvency II Legal Principles Applicable to the ORSA . . .	161
5.4	The ORSA and the Risk Management System	162
5.4.1	The European Law Framework	162
5.4.2	Present Law: The Relationship of the ORSA to Sec. 64 a, Para. 1, 2 of the VAG [German Insurance Supervision Act] and the MaRisk VA [Minimum Requirements for Risk Management (Insurance Supervision)]	164
5.4.3	Future Law: Sec. 28 of the VAG [German Insurance Supervision Act] in the Version of the Ministerial Draft	167
5.5	ORSA, Actuarial Function, Standard Formula and Internal Model	170
5.6	The ORSA, the Compliance Function, and the Internal Audit Function	172
5.7	Individual Issues Concerning the ORSA	173
5.7.1	The ORSA and Free Enterprise	173
5.7.2	The Relationship of the ORSA to Capital Add-Ons	179
5.7.3	The Own Assessment of Interest Rate Risk	180
5.7.4	Significant Deviation from the Assumptions Underlying the Calculation of the Standard Formula and the Internal Model	181

5.8	Documentation and Publication of the ORSA	186
5.8.1	Addressees and General Principles of the ORSA Information	186
5.8.2	The Internal Report	187
5.8.3	Requirements for Reporting to the Supervisory Authorities	187
5.8.4	Requirements for Reporting to the Public	190
5.9	Supervisory Powers with Respect to the ORSA	191
5.10	Summary	192
6	Fitness of Members of Supervisory Board	195
6.1	Introduction	196
6.2	General Requirements of Company Law Applicable to the Qualification of Supervisory Board Members	197
6.2.1	The Federal Court of Justice-Ruling in <i>Hertie</i>	197
6.2.2	The German Corporate Governance Code	199
6.3	The Insurance Supervisory Regime Requirements for the Qualification of Supervisory Board Members	200
6.3.1	The Statutory Rules on the Expertise Requirement	200
6.3.2	The BaFin [Federal Financial Supervisory Authority] Bulletin of 22 February 2010	204
6.3.3	Amendments in the Process of Implementing Solvency II	206
6.4	Individual Expertise of the Supervisory Board Members and the Overall Qualification of the Supervisory Board	211
6.4.1	Requirements for the Individual Supervisory Board Member	211
6.4.2	Overall Qualification of the Supervisory Board	212
6.5	Summary	214
7	Definition and Holders of Key Functions	217
7.1	Introduction	218
7.2	The Term “Key Function”	219
7.2.1	The Key Functions	219
7.2.2	Terminological Dual-Tracking and the Irrelevance of the Difference Between “Key Function” and “Key Task”	220
7.2.3	The Term “Key Functions”: Exhaustive or Open?	223
7.3	The Key Function Holders and Their Subordinate Staff Members in Key Functions	227
7.3.1	The Solvency II System	227
7.3.2	The Equalization of Key Function Holders and Persons Who Effectively Run the Undertaking	228
7.3.3	Factual Distinctions in the Duty of Notice	231
7.3.4	Factual Distinctions in Qualification Requirements	231

7.3.5	Determination of Each Key Function Holder and the Staff Members Subordinate to Them	232
7.4	Summary	241
8	Supervisory Review of Key Functions	243
8.1	Introduction	244
8.2	The “Fit” Requirement for Key Function Holders and Their Subordinate Staff Members in Key Functions	245
8.2.1	The Two-Tier Qualification Structure in General	245
8.2.2	The Special Rules	247
8.2.3	The Fitness of Key Function Holders	249
8.2.4	The Fitness of Subordinate Staff to Key Function Holders	257
8.3	The “Proper” Requirement for Key Function Holders and Their Subordinate Staff Members in Key Functions	258
8.3.1	The Two-Tier Structure of the Proper Requirement and the Proceduralization of the Proper Requirement as Starting Point	258
8.3.2	The Proper Requirement of Key Function Holders	259
8.3.3	The “Proper” Requirement for Staff Members Subordinate to Key Function Holders	264
8.4	The Remuneration of Key Function Holders	264
8.5	The Duties of Notice and Public Disclosure for Key Function Holders	265
8.5.1	The Duties of Notice to Supervisory Authorities	265
8.5.2	The Duties of Public Disclosure	268
8.6	Supervisory Recall and Prohibition of Exercise of Function for Key Function Holders in Cases of Fit-and-Proper Deficiencies and Supervisory Right to Direct Information from Key Function Holders	268
8.6.1	Solvency II	268
8.6.2	VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]	269
8.7	Summary	271
9	‘Senior Management’ of Insurance Undertakings	275
9.1	Introduction	275
9.1.1	The Normative Rules	276
9.2	‘Senior Management’ in the Solvency II System	277
9.3	Summary	281
10	Definition, Tasks and Legal Nature of the Compliance Function	283
10.1	Introduction	284
10.2	The Legal Bases of Compliance Under the Insurance Supervisory Regime	286

10.2.1	The Relationship of Compliance Under the Insurance Supervisory Regime to Compliance Under General Company Law	286
10.2.2	The Solvency II Directive	287
10.2.3	The Draft of the Solvency II Implementing Regulation	288
10.2.4	The CEIOPS Guidelines on the System of Governance	290
10.2.5	The EIOPA Guidelines on the System of Governance	291
10.2.6	The VAG-RegE [Government's Draft of a Tenth Act Amending the Insurance Supervision Act]	292
10.2.7	The Government's Draft of the German Banking Ringfencing Act	293
10.2.8	MaRisk BA [Minimum Requirements for Risk Management (Banking Supervision)]	294
10.2.9	MaComp VA [Minimum Requirements for the Compliance Function (Insurance Supervision)]?	294
10.3	The Definition of "Compliance Under the Insurance Supervisory Regime"	296
10.4	The Task of Compliance Under the Insurance Supervisory Regime and the Compliance-Related Requirements	299
10.4.1	Underlying Principles	299
10.4.2	General Legal Monitoring	306
10.4.3	Advising the Managing Board	313
10.4.4	Evaluation of Risks from Changes in the Legal Environment	316
10.4.5	Evaluation of the Compliance Risk	317
10.5	The Legal Nature of Compliance Under the Insurance Supervisory Regime	318
10.5.1	The Long Arm of the Insurance Supervisory Authority?	318
10.5.2	Company Officials?	319
10.5.3	Statutorily Prescribed and Designed Functions of Undertakings	321
10.6	Summary	322
11	Integrating the Compliance Function into the Legal Department	325
11.1	Introduction	326
11.2	Combining the Legal Department and the Compliance Function as a Legal Problem	327
11.3	Combining the Legal Department and the Compliance Function in Light of Their Respective Responsibilities	328
11.3.1	Crossover in Tasks	328

11.3.2	Advisement of Insurance Undertakings' Staff Members as an Area of Potential Conflict	330
11.3.3	Advisement of an Insurance Undertaking's Managing Board as an Area of Potential Conflict	331
11.3.4	Formation of Law by the Legal Department as an Area of Potential Conflict	333
11.4	Combining the Legal Department and the Compliance Function in Light of the Special Rules Aimed at the Compliance Function as a Key Function	334
11.4.1	Particular Competencies	334
11.4.2	Special Qualifications	335
11.5	Combining the Legal Department and the Compliance Function in Light of the Principle of Functional Segregation	336
11.6	Combining the Legal Department and the Compliance Function in Light of the Principle of Functional Independence	337
11.7	Combining the Legal Department and the Compliance Function in Light of the Principles of Freedom of Internal Organization and of Proportionality	338
11.8	Summary	340

Part IV Disclosure

12	Supervisory Reporting	345
12.1	Introduction	346
12.2	The Obligations to Notify Based on Formal Grounds	347
12.2.1	The Term "Obligations to Notify Based on Formal Grounds"	347
12.2.2	Obligations to Notify Based on Formal Organizational Grounds	348
12.2.3	Reporting Duties Related to Tariffs and General Policy Conditions	351
12.3	The Disclosure Obligations of Financial Reporting	352
12.3.1	The Disclosure Obligations for Financial Reporting Based on Formal Organizational Grounds	352
12.3.2	The Disclosure Obligations for Substantive Financial Reporting	357
12.4	The Disclosure Obligations for Risk Reporting	364
12.5	Disclosure Obligations at the Group Level	366
12.5.1	The Obligations to Notify Based on Formal Grounds at the Group Level	366
12.5.2	The Disclosure Obligations of Financial Reporting at the Group Level	368
12.5.3	The Disclosure Obligations of Risk Reporting at the Group Level	371
12.6	The Disclosure Obligations for Financial Conglomerates	372

12.7	Further Implications	373
12.7.1	The Function of the Reporting and Disclosure Obligations	373
12.7.2	The Scope of the Reporting and Disclosure Obligations	375
12.7.3	The Relationship Between the VAG [German Insurance Supervision Act] and Solvency II Directive Regarding Reporting and Disclosure Obligations . . .	377
12.7.4	The Concretization and Practical Management of Reporting and Disclosure Obligations	380
12.8	Summary	382
13	Public Disclosure	385
13.1	Introduction	386
13.2	The Objectives and Addressees of the Duties of Public Disclosure	388
13.3	Minimum Content of the Report on Solvency and Financial Condition	391
13.3.1	Overview	391
13.3.2	Financial Reporting	392
13.3.3	Information Related to Formal Organizational Aspects	397
13.3.4	The Information on Risk Reporting	398
13.4	The Duty to Update in the Event of Significant Changes to Published Information	400
13.5	The Duty of Disclosure for Direct Insurance and Reinsurance Undertakings in the National Context	401
13.5.1	Disclosure Duties Under Capital Market Law	401
13.5.2	Disclosure Duties Under Commercial Law	404
13.6	Comparison of the Report on Solvency and Financial Condition Under Solvency II and Publication Required Under National Commercial and Capital Market Law	407
13.6.1	The Equal Rank of the Disclosure Duties of Solvency II and Disclosure Duties Under Capital Market and Commercial Law	407
13.6.2	Content Overlap Between the Report on Solvency and Financial Condition Under Solvency II and the Annual Financial Statement and Management Report	408
13.6.3	Content Overlap Between the Report on Solvency and Financial Condition Under Solvency II and Publications Under Capital Market Law	410
13.7	Disclosure Duties at Group Level	410
13.7.1	Disclosure Duties at Group Level Under Solvency II	410
13.7.2	Disclosure Duties at Group Level in National Context	412

13.7.3	Content Overlap Between the Report on Solvency and Financial Condition at Group Level Under Solvency II and the Annual Financial Statement, Management Report, and Financial Reports Under Capital Market Law	413
13.8	Form of Disclosure in the Report on Solvency and Financial Condition	414
13.9	Protection of Business and Trade Secrets in Public Disclosure Duties	415
13.10	Further Conclusions	416
13.10.1	Regulatory Approach in Public Disclosure Duties	416
13.10.2	Potential Synergies in Fulfillment of Public Disclosure Duties	418
13.10.3	Selection of Publication Date for the Report on Solvency and Financial Condition	419
13.10.4	Relief at Group Level and the Principle of Proportionality	420
13.10.5	Less Favorable Protection of Confidentiality Interests for Direct Insurance and Reinsurance Undertakings Compared to Basel II	421
13.11	Summary	423
	List of Rules	425
	Index	473

Part I

Basics

Chapter 1

Harmonization of Insurance Supervisory Law

Contents

1.1	Introduction	4
1.2	The Typology of Harmonization Methods	5
1.3	The European Law Sources for Harmonization of the Insurance Supervisory Regime	8
1.3.1	The Solvency II Framework Directive	8
1.3.2	The Implementing Regulations for the Solvency II Framework Directive	12
1.3.3	The EIOPA Regulation	14
1.3.4	Interim Result	15
1.4	Consequences for the Future Insurance Supervisory System in Germany	16
1.4.1	The Impact of Full Harmonization on the Insurance Supervision Act	16
1.4.2	Supervision According to the Principle of Abusiveness with Regard to Primary Insurance Undertakings	17
1.4.3	The Effect of Full Harmonization in Certain Areas	21
1.5	Conclusions	23

Abstract This chapter addresses the fundamental issue of what degree of harmonization applies in the Solvency II system. Distinguishing among the several degrees of harmonization—minimum harmonization, maximum harmonization, and full harmonization—leads to the conclusion that the Solvency II Directive has full harmonization as its objective. This has two important ramifications: First, the Solvency II Directive requires that any insurance supervisory regime implementation by the respective national legislators must completely align with the European insurance supervisory regime. Second, a system of full harmonization prohibits national legislators from unilaterally enacting additional measures not provided for in European law. A pertinent example in the German insurance

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supervisory regime is the previously extant general supervision according to the principle of abusiveness, where now the Solvency II system allows only supervision of legality.

1.1 Introduction

The adoption of the Solvency II Framework Directive,¹ the impending passage of the implementing regulations, and the implementation of these European law provisions in the national supervisory systems of EU Member States together constitute decided progress toward fully establishing the internal insurance markets of the European Union. Decades have gone into integrating the internal insurance market; and these efforts have reached their highest point yet, placing the insurance supervisory regime on radically changed footing. Solvency II will consolidate and expand the previously existing EU directives in the area of insurance² and align that policy more clearly with the goal of creating a regulatory framework for primary insurance and reinsurance that achieves the greatest possible uniformity throughout Europe. Consequently, the Solvency II Framework Directive demands the creation of uniform conditions in the conduct of the insurance business throughout the internal market. This uniformity is to be achieved by eliminating the most extreme differences among the supervisory systems of EU Member States. In setting this demand, the Directive enunciates the fundamental legislative objective of Solvency II for Europe.³

Against the background of this goal, however, there still remain to be settled the issues of the degree of the intended pan-European harmonization of the insurance supervisory regime and of the practical implications flowing from changes to the existing supervisory system.⁴ This article addresses these issues. At the outset, this

¹ Directive 2009/138/C of the European Parliament and of the Council of 25 Nov. 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJEU L 335, 17 Dec. 2009, 1 ff.

² For an overview of the European directive policy to this point, see *Rittner/Dreher*, *Europäisches und deutsches Wirtschaftsrecht* [in English: *European and German Economic Law*] (3rd ed. 2008), sec. 31, ref. 4 ff.

³ On this point, see Recital 2 of Directive 2009/138/EU, n. 1 above and also in further detail below, at [1.3.1.2](#).

⁴ The only examination and discussion found on the subject are in *Bürkle*, “Die aufsichtsbehördlichen Eingriffsbefugnisse nach Solvency II” [in English: *Supervisory Intervention Powers under Solvency II*] in: *Dreher/Wandt*, eds., *Solvency II in der Rechtsanwendung* [in English: *Solvency II in Legal Application*] (2009), 191 (208 ff.) on the issue of continuing the prevailing practice in supervision according to the principle of abusiveness; see on this point in further detail [1.4.2.2](#) below; further, there are merely apodictic references that the Solvency II legislation presupposes full harmonization – see, e. g., *Wandt/Sehrbrock*, “Solvency II – Rechtsrahmen und Rechtsetzung” [in English: *Solvency II – Legal Framework and Legislation*] in: *Dreher/Wandt*,

article looks at the classification of harmonization methods under European law (1.2, below). Next, the European provisions of Solvency II legislation are examined with regard to the intensity of the intended harmonization within the insurance supervisory regime (1.3, below). Finally, this article discusses basic issues of European law in consideration of the preexisting design of insurance supervision in Germany, draws conclusions about how the supervisory system will be configured in the wake of Solvency II, and illustrates outcomes using particular real-world areas of supervision (1.4, below).

1.2 The Typology of Harmonization Methods

The methods of legal harmonization across Europe via secondary law directives can be divided into three variants, identified under the criterion of how much discretionary power is left to the national legislator in the field of implementation. The three variants are generally distinguished as minimum harmonization, maximum harmonization, and full harmonization.

In the case of minimum harmonization, the Directive by law sets a minimum level of regulatory intensity, which the national legislator must at least meet but is allowed to exceed. Thus, the minimum harmonization scheme allows a higher degree of regulatory intensity and stricter legal requirements than designated in the Directive. On the other hand, implementation as national law must at least meet the minimum level of harmonization. Accordingly, an implementation that exceeds the stated minimum level under European law does not violate the secondary law provisions of the given directive, even if the implementation should contribute to a fragmentation of the law. A supererogatory implementation, however, must be evaluated against the criterion of possible restrictions on fundamental European economic freedoms in cross-border commerce and the concomitant distortions of competition.⁵ In addition, the provisions of national constitutional law, particularly those provisions relating to basic rights of the persons affected, can set limits on reverse discrimination implicit in stricter treatment of nationals. Over the course of a long period, minimum harmonization by means of directives has been the established method in the European legal harmonization process.⁶

eds., *id.*, n. above, at 1, 23; likewise in the publications of practitioners, as, e.g., *Reorganisation and Sitzverlagerung in der europäischen Versicherungswirtschaft* [in English: *Reorganization and Relocation in the European Insurance Industry*] (KPMG: 2008), 17, downloadable at www.kpmg.de/docs/Reorganisation.pdf.

⁵ Of many relevant voices on the point of the regularly attendant blocking effect of European directives when applied to basic rights, see *Riesenhuber*, “System und Prinzipien des Europäischen Vertragsrechts” [in English: *System and Principles of European Contract Law*] (2003), 222 ff.

⁶ Thus, especially in the first consumer protection directives; see Directive 85/577/EEC of the Council of 20 Dec. 1985 to protect the consumer in respect of contracts negotiated away from business premises, OJEEC L 372 of 31 Dec. 1985, 31 ff.; Directive 93/13/EC of 5 Apr. 1993, on abusive terms in consumer contracts, OJEEC L 95 1993, 29 ff.; Directive 97/7/EEC of the

In contrast to minimum harmonization, the standard of maximum harmonization sets the specified harmonization level according to European law at the upper rather than at the lower limit. Consequently, where a directive prescribes a system aimed at maximum harmonization, implementation by the national legislator is not allowed to exceed the degree of harmonization set under European law. The legislator may, however, prescribe a lower standard. Maximum harmonization is rare and primarily occurs when required to prevent distortions of competition in a certain area, where the distortions result from overly broad national regulatory provisions, in the nature, perhaps, of national legislation seeking to outbid with respect to a given level of legal protection and regulation.⁷

We come then to full harmonization, which combines the devices of both minimal and maximum harmonization⁸ and, by virtue of the legal rules contained in the Directive, represents the broadest form of harmonization. Full harmonization has as its object complete legal harmonization. Thus, in implementing a Directive, the national legislator cannot deviate from the Directive, whether up or down, when the Directive is aimed at full harmonization. This is so because full harmonization by legal rules contained in a Directive has as its end absolute sectoral harmonization of national rights among the Member States.⁹ The difference between a directive aimed at full harmonization and a regulation—besides being acts of law in different

European Parliament and of the Council of 20 Apr. 1997, on the protection of consumers in respect of distance contracts, OJEC L 144, 4 Jun. 1997, 19 ff.; 1997 Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999, on certain aspects of the sale of consumer goods and associated guarantees, OJEC L 171, 7 Jul. 1999, 12 ff.

⁷ Thus, for example, in the area of deposit insurance in the lending sector, where the level of protection was established by law at a maximum of 100,000 euros in art. 1, no. 3 a of Directive 2009/14/EC of the European Parliament and of the Council of 11 Mar. 2009, amending Directive 94/19/EC on deposit-guarantee schemes as regards the amount insured and payout delay, OJEU L 68, 13 Mar. 2009 at 3 ff. by inserting new paragraph 1 a of art. 7 of the original Directive; see most notably on the point of the otherwise threatened distortions of competition also Recital 3 of Directive 2009/14/EC *ibid*.

⁸ The concept of full harmonization as used here is sometimes designated as maximum harmonization, making it difficult to construct legally rigorous demarcations among the several harmonization tools; see, e.g., *Knops*, “Der Verbraucherkredit zwischen Privatautonomie und Maximalharmonisierung” [in English: Consumer Credit between Private Autonomy and Maximum Harmonization] in: Habersack/Mülbert/Nobbe/Wittig, eds., *Die zivilrechtliche Umsetzung der Zahlungsdiensterichtlinie/Finanzmarktkrise und Umsetzung der Verbraucherkreditrichtlinie – Bankrechtstag 2009 – 2010* [in English: Civil Law Implementation of the Payment Services Directive/Financial Market Crisis and Implementation of the Consumer Credit Directive – Banking Conference 2009 – 2010], 195 ff.; on this point see also *Schürnbrand*, “Vollharmonisierung im Gesellschaftsrecht” [in English: Full Harmonization in the Law of Associations] in: Gsell/Herresthal, eds., *Vollharmonisierung im Privatrecht* [in English: Full Harmonization in Private Law] (2009), 273 (74); *Mülbert*, ZHR 172 (2008), 170 (179 ff.).

⁹ On the issue of any discretionary power remaining to the national legislator in implementation, see, e.g., *Riehm*, “Umsetzungsspielräume der Mitgliedstaaten bei vollharmonisierenden Richtlinien” [in English: Member States’ Discretion in Implementation under Directives of Full Harmonization] in: Gsell/Herresthal, eds., *Vollharmonisierung im Privatrecht* [in English: Full Harmonization in Private Law] (2009), 83 ff.

form—is simply that the regulation requires no implementing legislation at the Member State level but is immediately effective. In their legal effect, the methods are interchangeable, distinguished only on the basis of their designations.¹⁰ By different paths, both methods lead to the same result: complete unification of the given areas of law throughout the European Union. Directives intended to bring about full harmonization in given areas thus limit disparate regulatory intensity and by the same token limit distortions of competition among EU Member States. Accordingly, by guaranteeing a level playing field in the legal environment throughout Europe, directives represent the most effective tool for market integration. Directives are thus the most appropriate device—with respect to their given subject-matter—for achieving the completion of the internal markets. It is primarily this characteristic that is occasioning increased application of the Directive as a tool aimed at full harmonization.¹¹

¹⁰ See already *Köndgen*, in: Riesenhuber, ed., *Europäische Methodenlehre* [in English: *European Methodology*] (2nd ed. 2010), sec. 7, ref. 34; *Bast*, in: v. Bogdandy/Bast, eds., *Europäisches Verfassungsrecht* [in English: *European Constitutional Law*] (2nd ed. 2009) 526; thus the problem of a possible abuse of form arises when a directive rather than a regulation is used to establish full harmonization.

¹¹ Above all in the area of consumer protection law; see, e.g., the notice of the Commission on consumer policy strategy of 7 May 2002 (COM (2002) 208 final), OJEU C 137, 8 Jun. 2002, at 2; subsequently, consumer protection provisions were largely reoriented towards full harmonization; for example, the notion of full harmonization is explicit in Recital 10 f. and art. 22 of Directive 2008/48/EC of the European Parliament and of the Council of 23 Apr. 2008, on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJEU L 133 of 22 May 2008, at 66 ff.; see further Recital (EG) 13, Directive 2002/65/EC of the European Parliament and of the Council of 23 Sep. 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, OJEU L 271, 9 Oct. 2002, at 16 ff. and also RegE [government's draft] of the implementation act, BR-Drucks. [Document of the German Bundesrat] 84/04 at 23 ff.; Directive 2007/64/EC of the European Parliament and of the Council of 13 Nov. 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC, and 2006/48/EC and repealing Directive 97/5/EC, OJEU L 319 of 5 Dec. 2007, at 1 ff.; see also the recommendation of the Commission for a comprehensive directive on consumer rights of 8 Oct. 2008 KOM [Commission] (2008), 614 (final); for a detailed treatment of the entire development, see *Welter*, "Vom Anerkennungsprinzip zur Vollharmonisierung" [in English: From the Principle of Recognition to Full Harmonization] in publication in honor of Uwe H. Schneider (2011), 1412 ff.; *Gsell/Herresthal*, in: Gsell/Herresthal, eds., *Vollharmonisierung im Privatrecht* [in English: Full Harmonization in Private Law] (2009), introduction at 1 ff., *Dickert*, "Politische Implikationen der Vollharmonisierung" [in English: Political Implications of Full Harmonization] in: Gsell/Herresthal, eds., *Vollharmonisierung im Privatrecht* [in English: Full Harmonization in Private Law] (2009), 177 (178 f.).

1.3 The European Law Sources for Harmonization of the Insurance Supervisory Regime

1.3.1 *The Solvency II Framework Directive*

1.3.1.1 The Legislative Process

The overriding determinants in establishing the intensity of the desired pan-European harmonization of the supervisory system are the Framework Directive provisions themselves. Indeed, the entire Solvency II legislation makes use of the legislative process¹² such that the Framework Directive is but the first of altogether four regulatory levels. Further steps will see implementing regulations (Level 2 and Level 3) adopted based on the Framework Directive and greater harmonization undertaken. The Level 2 implementing regulations as well as further measures in the regulation levels will be adopted by the European Commission, which is empowered with their implementation, but without the participation of the primary lawmaking bodies of the EU. Pursuant to the reservation of materiality, initially developed by the European Court of Justice¹³ and codified in art. 290, para. 1, AEUV [Treaty on the functioning of the European Union] since the effective date of the Treaty of Lisbon, fundamental provisions must be already addressed in the Framework Directive. But an express and generally applicable provision for the harmonization level sought is not to be found in the Solvency II Framework Directive legislative text. Thus, to determine what measure of harmonization is intended by the Framework Directive one must look primarily to the provisions of the Directive—not those generally directed to the degree of harmonization—and to their telos and classification.

1.3.1.2 The Recitals

First resort for enlightenment as to the harmonization level sought may be the Solvency II Framework Directive Recitals. Recital 2 of the Directive sets forth as the basic objective: “In order to facilitate the taking-up and pursuit of the activities of insurance and reinsurance, it is necessary to eliminate the most serious differences between the laws of the Member States as regards the rules to which insurance and reinsurance undertakings are subject.”¹⁴ At the same time, the Recital refers to the provision of a “legal framework for insurance and reinsurance

¹² See also *Rittner/Dreher, id.*, n. 2 above, sec. 32 ref. 7, following with further references.

¹³ See already ECJ [European Court of Justice], 17 Dec. 1970, E.C.R. case no. 25/70 Köster (1970), 1161, pnt. 6; 27 Oct. 1992, case no. C-240/90 (Germany/Commission), E.C.R 1992 I-5383, pnt. 35 ff.; 13 Jul. 1995, case no. 156/93 (Parliament/Commission).

¹⁴ See Recital 2 of Directive 2009/138/EU, n. 1 above, at 3.

undertakings to conduct insurance business throughout the internal market.” Upon first reading, the terminology of Recital 2—especially the use of “most serious differences” and “legal framework”—seems to belie the objective of full legal harmonization and merely to indicate an amelioration of cross-border business activities and removal of serious differences among supervisory systems. The word “eliminate” in reference to “differences between the . . . laws of the Member States” does, however, demonstrate that the Solvency II Directive, even in its first substantive Recital, is asserting the objective of an essentially unitary system of supervisory systems of EU Member States. In like manner, Recital 11, which also refers to the Directive as “an essential instrument for the achievement of the internal market,” expresses the objective “to bring about such harmonization as is required” to realize a consistent country of origin supervision of insurance undertakings.

Relating to certain regulatory sectors, there are further indications for a harmonization as comprehensive and extensive as possible. For example, Recital 16 provides for enhanced harmonization of regulation for evaluation of claims and liabilities with reference to risk management. Also, Recitals 46 and 54 state that insofar as possible valuation standards for supervisory purposes should be compatible with international provisions. Similarly, Recital 75 regards “community-wide harmonization to the extent possible” as “critical” for supervisory assessment of a proposed purchase of shares.

Recital 40 of the Solvency II Framework Directive sets forth a clear indication for the objective of unifying supervisory systems of EU Member States in expressly stating that “supervisory convergence” is an objective of the Directive. Pursuant to the wording of the Recital, convergence is to apply not only to the supervisory rules and tools, but also in like manner to the diverse “supervisory practices” among the Member States. The Committee of European Insurance and Occupational Pensions Supervisors,¹⁵ created in 2009 and since replaced by the European Insurance and Occupational Pensions Authority (EIOPA),¹⁶ is to make key contributions in this area to harmonization and convergence of, above all, the diverse supervisory practices in the Member States. And further, Recitals 113, 114, and 115 provide for the creation of an additional College of Supervisors in the area of group supervision.

¹⁵ Decision 2009/79/EU of the Commission of 23 Jan. 2009 establishing the Committee of European Insurance and Occupational Pensions Supervisors, OJEU L 25 (29 Jan. 2009) 28 ff., abbreviated as AEAVBA in the German version, but uniformly known by the English-language designation CEIOPS.

¹⁶ Therefore in the following only EIOPA will be used; on the establishment of previous committees by EIOPA, see Regulation 1094/2010/EG of 24 Nov. 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJEU L 331 (15 Dec. 2010), 48 ff. The necessary amendments to the Solvency II Framework Directive and insertion of the EIOPA concept will proceed under a provision known as the Omnibus II Directive; see the proposal of the Commission for a Directive amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (19 Jan. 2001, COM (2011) 8 (final)).

Both the supervisory authorities in the Member States where undertakings belonging to a group are located and also the EIOPA are to be represented in the College of Supervisors to ensure an adequate exchange of information in order to secure effective group supervision.

Convergence of this nature in supervisory rules and tools and in the diverse supervisory practices of the Member States of the EU is not possible without an extensive pan-European, legally harmonized insurance supervisory regime. In the Recitals, the Directive sets out as its objective the convergence of the supervisory systems all the way to the actual supervisory practices, whereby prerequisites of this objective are unified legal principles, harmonized bases for intervention, and congruent legal design of the supervisory tools. The objective of supervisory convergence, however, conflicts in principle at the level of the Directive with the changeover from a rule-based to a principles-based approach to supervision, this latter approach being the one pursued by the Directive.¹⁷ If in following the principles-based approach, one grants to supervisory authorities under application of undefined legal terms¹⁸ a broadened discretionary power for flexible, individually tailored evaluations of supervisory circumstances, this will tend to lead to fragmentation and increasing unpredictability in supervisory practices for undertakings subject to these rules. This result would precisely run counter to the objective of supervisory convergence. Rather, this objective can be attained only by application of a principles-based regulatory structure such as the Solvency II Framework Directive if in turn at the level of the implementing regulations rule-based law is created, such as will lead to uniformity of legal principles and consequently to convergence of supervisory practice.

Indeed, the Recitals to the Solvency II Directive introduce the relationship of rule to exception for complete harmonization and the powers of deviation and self-regulation belonging to the Member States. This relationship is treated in fuller detail in the legislative part of the Directive. Numerous Recitals have as their objective the most complete harmonization possible. Among these are Recitals 2, 11, 75, 87, and 93. Besides these, a total of eleven Recitals—numbers 6, 9, 53, 75, 81, 83, 85, 86, 96, 99, and 127—cede to the Member States a choice among several supervisory schemes or the determination of the regulatory intensity.

1.3.1.3 The Legislative Text

While no general full harmonization of the supervisory system is expressly mandated in the legislative text or in the Recitals of the Directive, one finds the idea of supervisory convergence via legal harmonization set forth in different places

¹⁷ *Wandt/Sehrbrock*, ZVersWiss (2011), 193 (205 f.) correctly point out that the objective of supervisory convergence is to a great extent incompatible with the “principles-based” approach to supervision under the Solvency II system at the level of the Directive.

¹⁸ On this aspect of the principles-based approach, see *Dreher*, VersR (2008), 998 (1000).

among the rules of the Solvency II Framework Directive. Above all, this idea of supervisory convergence via legal harmonization is present in legal bases that grant the Commission the right to adopt more extensive implementing regulations at the second regulatory level (Level 2). Examples are art. 35, para. 4 of the Directive on reporting by supervisory authorities and art. 50, para. 2 of the Directive on establishing a governance system specifically pertaining to risk and stability assessment. These contain the directive to ensure extensive convergence within the designated areas by the adoption of implementing regulations.¹⁹ In addition, in order to ensure the reorganization and financing of insurance undertakings, art. 143 of the Directive allows for enabling powers for implementing regulations with the objective of guaranteeing supervisory convergence. Further still, art. 71 in chapter 5 of the Directive includes a stand-alone provision placing the Member States under an explicit duty to hold their supervisory authorities in line with the convergence principle.

This duty further extends to close cooperation with European institutions, especially with the EIOPA, which has the additional authority to issue non-binding guidelines and recommendations.

The objective of full harmonization in the supervisory scheme is also seen in that the Solvency II Framework Directive expressly grants to the Member States and further down the line to the national supervisory authorities scope for deviation in but a few areas. These areas are group supervision under art. 213 ff., Recital 99, and duration under art. 304.²⁰ Accordingly, in negotiations over the Solvency II Framework Directive, it was not possible to achieve uniform mandatory group supervision by the supervisory authority of the Member State in which the parent company is headquartered. Consequently it is difficult under supervision law to shape pan-European group support for subsidiaries when own funds are concentrated at the top management level.²¹ In principle, under art. 213, para. 1, subchapter 2, the rules relating to supervision of independent insurance undertakings also will be applied to insurance undertakings that belong to a group, to the extent that Title III of the Directive on group supervision does not expressly provide otherwise. Furthermore, in a range of situations, the Member States and the supervisory authorities are empowered objectively to determine on their own the areas where group

¹⁹ The proposal of the Commission for an Omnibus II Directive on Solvency II, *id.*, at n. 16, above, envisions, for example, new art. 35, para. 6 and a new version of art. 50, which are intended to provide additional assurance of convergence.

²⁰ See on this point the comments of Karel van Hulle, Head of the Insurance and Pensions Unit, to the Commission (reproduced in *Lansch/Friedrich*, VW (2011), 266), where he states that Solvency II aims at a more far-reaching harmonization than Basel III, even in fact at full harmonization, and that differences among the Member States are acceptable only in areas of group supervision and in the duration approach: to quote van Hulle in this connection: “With Solvency II we will be creating for the first time a unified supervisory system.” Similarly, *id.*, 3 VersRdsch. (2007), 28 (31).

²¹ The original draft of the Solvency II Framework Directive proposed correspondingly extensive regulation aimed at uniform European standards for group supervision; on this point, see *Krämer*, ZVersWiss (2008), 319 (329 ff.); *Sehrbrock*, ZVersWiss (2008), 27 (30 ff.).

supervision will be applied.²² The supervision of insurance undertakings that belong to groups based on the criteria applied to independent insurance undertakings, resides as before and by virtue of express decision with the individual national supervisory authorities, despite its harmonization under the Directive.

There are a total of 46 rules touching Member State options in the Directive. The fact that deviations from the provisions of the Directive in the nature of a relationship of rule to exception have been allowed in individual expressly designated areas, whereas the Directive overall seeks to craft uniform regulation, shows that in the remaining areas the Directive assumes complete legal harmonization, and thus full harmonization of the supervisory system. So explicit a grant to the national legislator of power to deviate in implementing the Directive, a power restricted to certain regulatory sectors, in itself allows the contrary inference for the objective of full harmonization in all areas comprised by the Directive and requiring implementation under art. 310, para. 1, sent. 1 of the Directive. Through the use of the phrase “at least” in a significant number of its provisions, the Directive indicates that a great number of discretionary legislative areas are granted to the Member States within the prescribed harmonization approach, and this without expressly denoting the Member States as subjects of the rules.²³ This is further supported by the closed system of rule and exception because these differentiations and distinctions would be superfluous in a system of minimum harmonization.

1.3.2 The Implementing Regulations for the Solvency II Framework Directive

The adoption of implementing regulations for Solvency II is imminent. Up to this point there have been only internal drafts of the implementing regulations for the second regulatory level (Level 2) as well as official preparatory announcements and documents emerging from ongoing consultation proceedings.²⁴ It is conceivable that as binding acts the second level implementing regulations will entail a departure from principles-based rules and fill the undefined legal terms of the Solvency II Framework Directive with rules-based content. To this extent, one can no longer on

²² See art. 214, para. 2 of the Solvency II Framework Directive establishing criteria for including undertakings belonging to groups within group supervision by the appropriate national supervisory authority.

²³ See, e.g., art. 35, para. 1, sent. 1 of the Solvency II Directive and also *Dreher*, ZVersWiss (2009), 187 (215) (Chap. 12, below, at 12.7.3).

²⁴ See, e.g., the “List of Policy Issues and Options for the Level 2 Impact Assessment of Solvency II” in the paper “CEIOPS’ Advice for Level 2 Implementing Measures on Solvency II: System of Governance” (CEIOPS-doc. 29/09 (Oct. 2009)) and the “Consultation Document on the Level 2 implementing measures for Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)”, http://ec.europa.eu/internal_market/consultations/2010/solvency-2_en.htm.

the whole speak of legislation in the Solvency II area as a principles-based approach. This is so because a solid conceptual understanding of principles-based law presupposes an equivocal departure, both *de jure* and *de facto* and likewise consistent, from rules-based standards on all regulatory levels.²⁵ Only by attention to form and separately examining the regulatory principles of the individual levels can one arrive at the supposition of a partially principles-based regulatory approach at the highest regulatory level in the Solvency II Framework Directive.²⁶

The preparatory documents and working papers for the impending adoption of the implementing regulations already suggest a regulatory intensity and a high degree of detail, leading to the conclusion that the anticipated standards will be rules-based.²⁷ By the same token, a rules-based design of the implementing regulations points to the objective of complete harmonization of supervisory provisions and anticipates convergence of supervisory practice, since uniform regulatory provisions throughout the EU will be achieved by employing a consistent rules-based approach. Precisely on account of the anticipated legal nature of the implementing regulations at the second level as directly and equally applicable regulations in all Member States, a design of that nature will lead to a level playing field for regulatory standards and will significantly reduce the discretionary scope of the national supervisory authorities in applying the law below the level of discretion that these authorities would have under a consistently applied principles-based approach. To the extent that the implementing regulations are enacted as regulations as anticipated, the European legislator will prefer the objectives of complete harmonization of the regulatory provisions and extensive convergence of supervisory practice to principles-based design of the implementing regulations, such as might tend to lead to fragmentation of the law and its application.

According to a ruling of the ECJ, the fact that the implementing regulations—as might be expected—will exceed the provisions of the basic legal act of Level 1 as to their regulatory intensity and with respect to degree of legal harmonization sought does not contravene the reservation of materiality and the fundamentally principles-based approach of the Solvency II Framework Directive. Thus, the ECJ early on ruled that the implementing regulations are permitted to exceed a purely technical implementation of the basic legal act and to allow for a higher degree of detailed and novel rules.²⁸

²⁵ Along these lines see, *Dreher*, VersR (2008), 998 (1000).

²⁶ For the difference, see *Wandt/Sehrbrock*, ZVersWiss (2011), 193 (203) and *id.*, n. 4 above, at 1, 16.

²⁷ As to the result, also *Wandt/Sehrbrock*, ZVersWiss (2011), 193 (204); *Bürkle*, VersR (2009), 866 (873), and *Weber-Rey*, AG-Report (2007), para. 396.

²⁸ See e.g. – though not with reference to the Lamfalussy process introduced later – as to sanctions foreseen by the Commission only at the level of the implementing regulations, ECJ, 27 Oct. 1992, case no. C-240/90 (Commission/Germany), E.C.R. 1992 I-5383, pnt. 30 ff.; on the Markets in Financial Instruments Directive (MiFID) and the pertinent implementing regulations likewise *Müllbert*, ZHR 172 (2008), 170 (182f.).

1.3.3 *The EIOPA Regulation*

The regulation establishing a European insurance supervisory authority will strengthen the effort toward extensive harmonization that already exists in substantive law sources.²⁹ The stated objective of the regulation in establishing the EIOPA is “to contribute . . . ensuring a high, effective and consistent level of regulation and supervision” in order to establish a European system of financial supervision and thereby to improve the functioning of the internal market.³⁰ It is further the task of the EIOPA in applying European law³¹ to prevent regulatory arbitrage within the EU, which could occur as a result of disparate supervisory levels within the individual Member States. In so doing, the EIOPA by promoting “supervisory convergence” would be ensuring a level playing field for all supervised insurance undertakings.³² The idea of a level playing field is made explicit in relation to the alignment of the technical regulatory standards.³³ In essence, “greater harmonisation and the coherent application of rules for financial institutions and markets across the Union should also be achieved.”³⁴ Accordingly, the objective is a coherent and effective application of basic principles of European law and thus the creation of a “common Union supervisory culture.”³⁵

The special emphasis on the need for extensive harmonization of the supervisory systems of EU Member States is above all attributable to the fact that the establishment of the uniform European supervisory authority, EIOPA, came about in the course of overcoming the recent financial crisis. This crisis, in the view of the European legislator, exposed “shortcomings in the areas of cooperation, coordination, consistent application of Union law and trust between national supervisors.”³⁶ As a consequence, to ensure “correct and consistent application of Union law,” EIOPA was equipped in particular with the power to adopt enforcement measures in the form of decisions with respect to individual supervised insurance undertakings, to the extent a national supervisory authority has not complied with a previous—equally binding—settlement decision of EIOPA.³⁷

²⁹ Regulation 1094/2010/EU of 24 Nov. 2010, establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJEU L 331 (15 Dec. 2010), 48 ff.

³⁰ See Recitals 7, 8, 10, and 66 of Regulation 1094/2010/EU, *id.*, n. 29 above.

³¹ The legal scope of the EIOPA is set forth in art. 1 of Regulation 1094/2010/EU, *id.*, n. 29 above; see especially para. 2 and the expansion in para. 3, under which EIOPA also acts in regard to issues that stand “in relation to” legal acts under para. 1.

³² See Recitals 10 and 21 of Regulation 1094/2010/EU, *id.*, n. 29 above.

³³ Recital 21 of Regulation 1094/2010/EU, *id.*, n. 29 above.

³⁴ Recital 8 of Regulation 1094/2010/EU, *id.*, n. 29 above.

³⁵ Art. 8, para. 1b, art. 29 of Regulation 1094/2010/EU, *id.*, n. 29 above.

³⁶ As specifically set forth at the end of Recital 1 of Regulation 1094/2010/EU, *id.*, n. 29 above.

³⁷ On the legal powers of the EIOPA, see art. 8 ff. of Regulation 1094/2010/EU, *id.*, n. 29 above; on the enforcement measures in particular, see art. 17, para. 6 and Recital 31 of the same Regulation.

In establishing the EIOPA, the European legislator's top priorities were thereby to ensure a uniform supervisory level in the EU, to guarantee uniform application of the substantive provisions, to create a level competitive playing field, and thus to bring about complete harmonization of the EU supervisory systems. If this concept of full harmonization of the supervisory systems had not already been inherent in the basic substantive legal provisions, most especially in the Solvency II Framework Directive, it would not have been legally possible to create such an objective in the establishment of the EIOPA. To this extent, the fact that the objective of the EIOPA is the complete alignment of supervisory systems leads to inferences about the intended and achieved codification of the full harmonization principle in the Solvency II Framework Directive. Thus, the EIOPA is designed only to consistently carry out the substantive provisions of the Solvency II Framework Directive, provisions that must be understood as overwhelmingly directed at full harmonization.

1.3.4 Interim Result

Solvency II legislation has as its goal the full harmonization of supervisory systems in the EU Member States. On the basis of the reservation of materiality under art. 290, para. 1, of the AEUV, the primary reference for the objective of harmonization is the Solvency II Framework Directive. The teleological and systematic interpretation of the Recitals and the legislative text of the Solvency II Framework Directive lead one to the conclusion that the intended result is a complete alignment of the insurance supervisory provisions and a maximally extensive convergence of supervisory practices in the EU Member States. At the least, the specific exceptions in the Directive, namely group supervision and duration approach, where scope has been left to the Member States in implementation, compel by implication the inference of a harmonization design in all other areas.

This conclusion comports with the principle of complete supervisory convergence via legal harmonization.

In addition, the preparatory working papers and drafts on implementing regulations for the second regulatory level (Level 2) show the objective of complete harmonization of the supervisory systems. In their detailed specificity, the planned rules of the implementing regulations are appropriately designed to fill out the principles-based and undefined legal terms, of the Solvency II Framework Directive with well-defined, rules-based content. By virtue of the anticipated legal nature of the implementing measures as regulations, these rules should immediately be applicable throughout the EU.

With respect to full harmonization, the efforts of the European legislator ultimately will be supported and reinforced by the establishment of a European insurance supervisory authority. The work of the EIOPA will lead to establishment of a European system of financial oversight and will ensure coherent, efficient, and effective application of the basic European legal principles in the field of insurance supervision. In this, the goal of complete harmonization of the supervisory systems

within the EU should primarily serve the objective of ensuring a uniform level of supervision and thus a level playing field for insurance undertakings throughout the European internal insurance market.

1.4 Consequences for the Future Insurance Supervisory System in Germany

1.4.1 The Impact of Full Harmonization on the Insurance Supervision Act

The full harmonization flowing from the Solvency II Framework Directive will require a complete alignment of the German Insurance Supervision Act with the requirements of European law. The objective of a level regulatory playing field throughout Europe should be pursued with consistency in implementing the Framework Directive in national law. This means that in implementing the Directive, the German legislator shall not create any supervisory provisions or requirements that deviate from the Framework Directive, except as noted earlier in the particular areas of group supervision and duration approach. The Solvency II Framework Directive rules must be entirely incorporated in the German Insurance Supervision Act.³⁸ Extant provisions of national law that are stricter and exceed the supervisory standard of the Framework Directive cannot persist, or at least must be adjusted to the Directive. In like manner, rules not yet in existence but henceforward required by Solvency II will have to be integrated into the Insurance Supervision Act. Additionally, any supervisory regulation, tools, and practices not represented in the provisions of the Directive must be eliminated and not replaced.³⁹ Along the same lines, legal mechanisms must be provided to ensure convergence of German supervisory practice with the application of the law in the other EU Member States. At the same time, it must not be overlooked that the directly applicable implementing regulations and other related measures adopted in the future by the European Commission will have a substantial effect on application of the law and supervisory practice. This is so because, although the German legislator is entrusted solely with technical implementation and clarification in national law of the principles-based rules of the Solvency II Framework Directive, the rules-based and therefore ultimately determinative provisions will be in the implementing regulations of Level 2. As a result, for this reason and despite the reservation of

³⁸ In this context, the pending Insurance Supervision Act amendment must address the question of whether to enact laws duplicating the directly applicable rules of the implementing regulations. In view of the merely declaratory effect of such an adoption into the Insurance Supervision Act, which additionally might require substantial future amendment, it would be advisable to avoid altogether such duplicative superimposition.

³⁹ See on this point 1.4.2.2, below.

materiality applicable to the Framework Directive,⁴⁰ transfer of responsibility and authority to the European Commission is seen to have been made. In connection with the principles-based and thus flexible requirements of the Solvency II Framework Directive, the Commission will be entrusted in the future with creating essential regulatory provisions directly binding on the national supervisory authorities and, because of directly applicable European law, requiring compliance by insurance undertakings.

1.4.2 Supervision According to the Principle of Abusiveness with Regard to Primary Insurance Undertakings

1.4.2.1 The Existing System of Supervision According to the Principle of Abusiveness Under the General Clause

The third generation of insurance contract law Directive, implemented in national law in 1994,⁴¹ provided for only minimum harmonization and thus granted to the national legislators the authority to enact stricter requirements for supervision under national law of primary insurance undertakings headquartered domestically than for primary insurance undertakings headquartered in another EU Member State. This situation allowed the German legislator to maintain the outdated system of supervision according to the principle of abusiveness with regard to domestic primary insurance undertakings, based on the general clause of sec. 81, para. 1, sent. 2, of the Insurance Supervision Act. Indeed as a result of the third Directive, the German supervisory authorities had to abandon the concept of comprehensive, substantive national supervision. Despite nearly universal rejection in the literature,⁴² based above all on European and constitutional law, supervisory authorities

⁴⁰ See on this point 1.3.1, above.

⁴¹ Council Directive 92/49/EEC of 18 Jun. 1992 (third non-life insurance Directive); Council Directive 92/96/EEC, 10 Nov. 1992 (third life assurance Directive); implementation in German law was accomplished by the Drittes Gesetz zur Durchführung versicherungsrechtlicher Richtlinien des Rates der Europäischen Gemeinschaften, 21 Jul. 1994 BGBl I 1630.

⁴² See *Dreher*, VersR (1993), 1443; WM (1995), 509; *id.*, Die Konkretisierung der Mißstandsaufsicht nach § 81 VAG [In English: Practical Application of Supervision According to the Principle of Abusiveness under sec. 81 of the Insurance Supervision Act] (1997), 9 ff.; *Miersch*, Versicherungsaufsicht nach den dritten Richtlinien [in English: Insurance Supervision under the Third Directives] (1996), 107 ff.; *Zischka*, Bundesversicherungsaufsichtsamt (BAV) – Aufgaben und Kompetenzen – [in English: Federal Insurance Supervisory Office – Tasks and Competencies –] (1997), ref. 451; *Braumüller*, Versicherungsaufsichtsrecht [in English: Insurance Supervisory Law] (1999), 553; *Korinek*, Rechtsaufsicht über Versicherungsunternehmen [in English: Legal Supervision over Insurance Undertakings] (2000), 197 f.; *Bähr*, Das Generalklausel- und Aufsichtssystem des VAG im Strukturwandel [In English: The General Clause and Supervisory System of the Insurance Supervision Act: Structural Transformation] (2000), 230 ff.; generally, *Rittner/Dreher*, *id.*, n. 2. above, sec. 31, ref. 25 ff. with further references.

nevertheless succeeded in pursuing the concept of supervision according to the principle of abusiveness not restricted to infringements of the law. This activity was based on an extremely broad interpretation of the general clause and on self-generated administrative practices developed in circulars.

In the past this system of supervision according to the principle of abusiveness under the broad interpretation given by the supervisory authorities has met with insuperable legal objections as to its foundation. Today it represents to that extent a disadvantage for German primary insurance undertakings in the European market. The system can be explained only from a historical perspective and it stands as a comparatively rigid and intensely regulatory structure⁴³ of a kind not to be found in any other EU Member State. This presents a classic case of reverse discrimination, since it is thus in many areas only the German insurance undertakings that are subject to regulatory restrictions that greatly hamper their business development.⁴⁴ This discrimination toward German insurance undertakings in the European market arises also from the fact that the intended broadening of supervision according to the principle of abusiveness into the area of supervision by the country of operations overinsurance undertakings of other EU countries contravenes European law. Insurance undertakings conducting business in Germany pursuant to the European freedoms to establish enterprises and for movement of services should be treated under sec. 81, para. 1, sent. 2–4, and para. 2 Insurance Supervision Act through sec. 110 a, para. 4, no. 3a Insurance Supervision Act according to the standards of German supervision according to the principle of abusiveness. By this reference, the German legislator in implementing the third Directive has disregarded the European law threefold prescription restricting supervision by the county of operations to (1) monitoring the legal field, (2) monitoring “applicable law” and, on this point, (3) only such as are in the public interest.^{45,46} Consequently, supervision according to the principle of abusiveness, in an intensity comparable to that previously applicable to domestic primary insurance undertakings, cannot in principle be valid for primary insurance undertakings in other EU countries. This in turn gives such undertakings a competitive advantage for business activities in Germany.

⁴³ The general clause of sec. 81, para. 2, sent. 1 Insurance Supervision Act tracks almost word for word the provision of sec. 64, para. 2 Insurance Supervision Act of 1901, which allowed the Imperial Supervisory Office for Private Insurance a legal basis for intervention.

⁴⁴ The following observers also detect reverse discrimination here: *Bürkle, id.*, n. 4 above, at 191, 200 f.; *Winter, VersR* (2005), 145 (158 ff.); *Bähr, VersR* (2001), 1185 (1192 ff.); for actual effect in, for example, product design, see *Dreher/Lange, VersR* (2010), 1109 (1113) on the regulatory impermissibility of variable annuities in Germany.

⁴⁵ On the restrictive concept of the public interest, see Commission Interpretive Communication 2000 C 43/03, of 16 Feb. 2000, “Use of free movement of services and the general good in the insurance sector”.

⁴⁶ See in detail *Rittner/Dreher, id.*, n. 2 above, sec. 31 ref. 28, 95, with further references; in the context of offering variable annuities through insurance undertakings with headquarters in another EU Member State, see also *Dreher/Lange, VersR* (2010), 1109 (1114).

1.4.2.2 The End of Supervision According to the Principle of Abusiveness and Reverse Discrimination

The implementation of the Solvency II Framework Directive in German law will spell the end for a situation that in multiple points of view contravenes European law and raises concerns under constitutional law. This situation includes reverse discrimination, the substantial expansion of supervision by the country of operations and supervision according to the principle of abusiveness in general, which in part is based on a definition of the concept “abusiveness” defined by the supervisory authorities themselves and thus goes beyond mere legal control.

Thus, the very far-reaching, pan-European full harmonization of supervisory systems of EU Member States will lead to both elimination of reverse discrimination through stricter regulatory provisions for German insurance undertakings and by the same token elimination of any expansion of these stricter national law regulations to insurance undertakings in other EU countries. This is most especially true for regulatory requirements that go further with respect to insurance undertakings of other EU countries than they do for domestic companies, when these requirements up to this point have already been prohibited in the insurance industry by specific provisions of secondary law and generally by the criterion of basic economic freedom. Full harmonization will bring about for the first time uniform regulatory standards throughout the EU, thus ensuring uniform market conditions in the sense of a fully harmonized level playing field in the internal market for insurance with respect to the regulatory environment. Thus, supervisory standards, tools, criteria, and powers relating to the country of origin and country of operations supervision for the first time will be fully uniform throughout Europe in the area where full harmonization is applied. In implementing the Directive, national legislators will not be permitted to deviate and thus will not be allowed to retain the attendant diverse levels of regulatory intensity with the resultant prospect of regulatory arbitrage and ultimately to perpetuate the existing distinctive national features of supervisory systems of EU Member States. Further, full harmonization of the supervisory systems will be ensured by the increased convergence of regulatory practice in the EU Member States.⁴⁷ This increased convergence is intended to prevent disparate application of the uniform basic principles under Solvency II and thereby additionally prevent actions of national supervisory authorities amounting to an application of the law contrary to the objective of full harmonization of the European regulatory system.

With the application of Solvency II, the previous supervision according to the principle of abusiveness practice will not be allowed to continue, a practice based on a broad construction of the general clause and self-created by means of circulars and announcements. On the basis of European law alone, implementation of the Solvency II Framework Directive in German law at the national level requires without exception the creation of provisions having the nature of a legal norm; That

⁴⁷ On this point see [1.3.1.2](#) and [1.3.1.3](#), above.

means at least the adoption of regulations ranking below the level of formal legislative laws but constituting laws in a substantive sense.⁴⁸ From the outset, the use of supervisory circulars, announcements, and other such “opinions” from supervisory authorities—such as the MaRisk VA [Minimum Requirements for Risk Management (Administrative Order)]—will be excluded with regard to the application of future legal basics and powers for intervention. The implementation of European law through measures of administrative practice will also be foreclosed.

As a result of all these factors, the supervisory authority cannot continue to usurp the legislative function by the existing practice of expanding its discretionary power on its own by substantively defining, expanding, or contracting the undefined legal requirement of “abusiveness” in general announcements.⁴⁹ The establishment of regulatory powers of intervention only in the case of legal infringements arises not only from the previously noted necessity to implement the provisions of European law by means of legal norms, but even more so in the fact that the Solvency II Framework Directive itself demands the narrowing of scope for regulatory interventions to cases involving actual legal infringement. With regard to the future design of supervisory powers, art. 34, para. 1, sent. 1 of the Solvency II Framework Directive obliges the Member States to provide “that the supervisory authorities have the power to take preventive and corrective measures to ensure that insurance and reinsurance undertakings comply with the laws, regulations and administrative provisions with which they have to comply in each Member State.” In this regard, the Solvency II Framework Directive differs from the rules on supervisory powers in the third Directive. Along with monitoring compliance with provisions of the law, under the third Directive supervisory authorities were expressly permitted to counter other “improprieties” beyond actual legal infringements.⁵⁰ The Solvency II Framework Directive deliberately restricts the supervisory standard to pure control of legality.⁵¹ An indication of this scheme is shown in the fact that the concept of “abusiveness”—as distinguished from the text of the draft Directive⁵²—is nowhere to be found in the final version of the Solvency II Framework Directive.

⁴⁸ General European principle; see, ECJ, 24 Jun. 2004, case no. C-212/02, and *Dreher*, JZ (2002), 1101 (1102); EuZW (1997), 522 (523 f.).

⁴⁹ See, e.g., in reference to MaRisk VA, *Dreher*, “Die BaFin geriert sich als Ersatzgesetzgeber”, [in English: The Federal Financial Supervisory Authority is usurping the legislative function], FAZ, no. 216, 17 Sept. 2009, at 22; in reference to the self-generated supervisory principle banning cross-subsidization, see *Dreher*, ZVersWiss (1996), 499; in reference to the likewise self-generated supervisory principle banning managing board and supervisory board membership for relatives, see *Dreher*, WM (1995), 509 (511 f.).

⁵⁰ See, e.g., art. 13, para. 3b of Directive 2002/83/EC of the European Parliament and of the Council of 5 Nov. 2002 on life insurance (comprehensive Directive on life insurance), OJEU L 345, p. 1; and see also *Bürkle*, *id.*, n. 4 above, at 191, 203 f.

⁵¹ Likewise, *Bürkle*, *id.*, at n. 4 above, at 191, 204; to the same effect also, *Korinek*, VersRdsch (2010), 27 (29), noting “substantive state supervision” in Austria already is confined to matters of law.

⁵² See *Bürkle*, VersR (2007), 1595 (1598); *Präve*, VW (2007), 1380 (1383).

1.4.2.3 Summary

In the event, two conditions are telling: on the one hand, the Directive's full harmonization concept, combined with the adjustment of the Solvency II Framework Directive to the supervisory standard of pure control of legality; and on the other hand, the general requirement of European law that the provisions of the Solvency II Framework Directive are to be implemented in national law through provisions having the nature of a legal norm. The effect of these two factors is such that the previously existing supervision according to the principle of abusiveness for primary insurance undertakings cannot be maintained. The future supervisory system of the Insurance Supervision Act will rather be characterized by the supervisory standard of pure legal control, a necessity for consistent transfer into legal form of existing regulatory areas thus far solely based on supervisory practice, to the extent they comply with the requirements of the Directive. Further, this future supervisory system will be marked by a completely level legal and practical playing field with respect to equivalent regulatory rules applicable to both German insurance undertakings and those of other EU countries. This, however, does not conflict with publication by BaFin [Federal Financial Supervisory Authority] of administrative principles binding only on itself.

In such publications, the supervisory authority does not impose new requirements on the supervised undertakings, but rather renders its anticipated actions discernible, foreseeable, and transparent. This process, too, serves the interests of the insurance undertakings subject to supervision.⁵³

1.4.3 *The Effect of Full Harmonization in Certain Areas*

1.4.3.1 The Requirements for Members of Supervisory Boards

The Solvency II Framework Directive exceeds the present qualification requirements of sec. 7a, para. 4 of the Insurance Supervision Act, with respect to the requirements for members of supervisory councils for insurance undertakings belonging to groups and for insurance holding companies. Specifically, while the provisions of art. 42, para. 1 of the Solvency II Framework Directive, by virtue of express reference in the provisions on group supervision, apply fully and directly to the supervisory and monitoring boards for these undertakings, the Directive does not prescribe any direct qualification requirements for supervisory council members of insurance undertakings not belonging to a group because they do not fulfill the

⁵³ This is the case above all where only explanation of formal supervisory standards is concerned, such as in clarification of the requirements on the CV to be submitted in BAV R [Federal Insurance Supervisory Office Circular] 6/97.

criteria of “persons with key functions” within the meaning of art. 42, para. 1 of the Solvency II Framework Directive.⁵⁴ Thus, the qualification requirements of the Directive will have only indirect and mediated effect on members of the supervisory and monitoring boards of insurance undertakings not belonging to a group.

Thus, in the course of implementing the Solvency II Framework Directive, the provisions relating to the qualification requirements of the supervisory council members will have to be newly drafted and further differentiated. This is so because the Solvency II objective of full harmonization means that the national provisions on monitoring by supervisory council members must duplicate and not deviate from the provisions of the Directive. In future, it will be necessary that specific provisions be designed for the qualifications of supervisory council members of insurance undertakings belonging to groups; and these provisions will have to implement the rules of art. 42, para. 1 of the Solvency II Framework Directive fully in national law. And in contrast to existing sec. 7a, para. 4 of the Insurance Supervision Act, these new provisions must set higher requirements for supervisory council members, in compliance with the Directive. Existing sec. 7a, para. 4 of the Insurance Supervision Act, which gives equal treatment to all supervisory council members, at best will be able to stay in its current form for members of the supervisory and monitoring boards of insurance undertakings not belonging to a group, and then only to the extent this section fully takes into account the indirect effects of the qualification requirements of art. 42, para. 1 of the Solvency II Framework Directive as well as of the governance requirements of chapter 2 of the Solvency II Framework Directive. At the least then, sec. 7a, para. 4 of the Insurance Supervision Act must be construed and applied with consideration for European law provisions for supervisory council members of insurance undertakings not belonging to a group, and perhaps also its contents should be rendered more precisely in terms of increased European influence.⁵⁵

1.4.3.2 The Prohibition on Borrowing

The prior prohibition on borrowing for primary insurers was deduced by the supervisory authorities from the prohibition on conducting non-insurance business. In 2009, however, in the Act to Strengthen the Financial Market and Insurance Supervision⁵⁶ the prohibition was codified in sec. 7, para. 2, sent. 3, clause 1 of the Insurance Supervision Act as an independent provision.⁵⁷ Indeed, the prohibition on conducting non-insurance business, as provided in sec. 7, para. 2, sent. 1 of the

⁵⁴ For a detailed treatment, see *Dreher/Lange*, ZVersWiss (2011), 211 (220 ff.) (Chap. 6, below, at 6.3.3).

⁵⁵ On the subject as a whole, see *Dreher/Lange*, ZVersWiss (2011) 211 (223 f.) (Chap. 6, below, at 6.3.3.2).

⁵⁶ Act to Strengthen the Financial Market and Insurance Supervision, 29. Jul. 2009, BGBl [Federal Law Gazette] I, 2305.

⁵⁷ For background, see, e.g., *Eilert*, in: Bähr, ed., *Handbuch des Versicherungsaufsichtsrechts* [in English: *Manual of Insurance Supervision Law*] (2011), sec. 5, ref. 59 ff.

Insurance Supervision Act in Germany, is represented as well in art. 18, para. 1a and b of the Solvency II Framework Directive. Thus even under Solvency II, insurance undertakings are restricted to conducting insurance business and other business directly connected with the insurance business. The Solvency II Framework Directive does not, however, expressly impose a blanket prohibition on receipt of outside funds by insurance undertakings.

Full harmonization of the European supervisory system entails the future codification in Germany of only the Solvency II Framework Directive provisions and thus also the prohibition on conducting non-insurance business. As to the application of such European-based prohibition, both the autonomous interpretation of the European requirements and the handling of a corresponding prohibition by the supervisory authorities of the other EU Member States in light of the objective of supervisory practice convergence will be crucial. German insurance supervision for decades has tended toward interpreting the provision as a complete prohibition on borrowing. This interpretation cannot be the criterion for future interpretation and application of the prohibition on non-insurance business. The German legislator's recent codification of the prohibition on borrowing will not alter anything in this area.

In view of the fact that a blanket prohibition on receiving outside funds—so far as can be seen—has not existed up to this point in any other EU Member State and that borrowing comports with the business objective and business type⁵⁸ of insurance undertakings, it may be presumed that supervisory practice throughout Europe will develop in the direction of a less restrictive interpretation of the prohibition. With regard to the objective of creating a level playing field in the entire internal market for insurance, one may assume that the prohibition on borrowing—which in its dogmatic approach alone, but also not least in view of its unrealistic management practice has essentially missed the mark—will not be perpetuated in the upcoming new version of the Insurance Supervision Act and at the least will not be retained in the course of the pan-European convergent application of the Directive provisions by supervisory authorities in Germany.

1.5 Conclusions

I. In the Solvency II Framework Directive, the European legislator is pursuing the objective of full harmonization for insurance supervision in Europe. One may read directly in both the legislative text and the Recitals of the Directive the intent to bring about a complete alignment of regulatory provisions and the desire for the greatest possible convergence of supervisory practice in the EU Member States.

This intent is reinforced in the full harmonization set forth in the Framework Directive by the expected implementing measures at Level 2, which in part will fill

⁵⁸ See for the difference, e.g., *Rittner/Dreher, id.*, n. 2 above, sec 9 ref. 56 ff.

the principles-based standards of the Directive with exhaustive rules-based content and—in the form of a European regulation—will apply directly throughout the entire EU. In addition, the newly created European insurance supervisory authority EIOPA, equipped with effective enforcement powers, is responsible for a coherent and maximally effective application of the European provisions.

II. In the course of implementing the Directive, the German legislator must effect a complete alignment of the German Insurance Supervision Act with the provisions of the Solvency II legislation. The Framework Directive itself allows the national legislator to deviate only where express Member State reservations exist and in the areas of group supervision and duration approach. Consequently, in all other areas national legislators must ensure that they are in alignment with the European regulations. In creating the new version of the Insurance Supervision Act, all current provisions therefore must be examined as to whether they exceed or fall short of the rules of the Solvency II Framework Directive, whether a corresponding section in the Directive exists, or whether they are in fact directly prescribed. These are the criteria to be applied in determining which new provisions to insert into the Insurance Supervision Act, which provisions to strike, and which to adapt so that they comport with the level of the Directive provisions as to type and intensity.

III. The extant system of supervision according to the principle of abusiveness for primary insurance undertakings, for which the supervisory authorities essentially relied on the general clause of sec. 81, para. 2, sent. 1 of the Insurance Supervision Act, will not survive the implementation of the Solvency II Framework Directive in German law. In the area of supervision by the country of operations, such supervision according to the principle of abusiveness exceeding pure legal control has already proven contrary to European law. Further, full harmonization of supervision will lead to the abolition of the current reverse discrimination, which has resulted from a stricter treatment of primary insurance undertakings headquartered in Germany vis-à-vis their competitors in other European countries. This is so because on the one hand, the implementation of European Directive provisions in German law by the creation of legal norms will be incompatible with a self-generated administrative practice arising out of circulars and announcements, as has been done in the past with the broadening of supervision according to the principle of abusiveness. On the other hand, the concept of supervision in the Solvency II Framework Directive is aligned solely with the criterion of actual legal infringement. This orientation prohibits any and every form of supervision according to the principle of abusiveness exceeding this standard.

IV. Moreover, full harmonization in the new version of the Insurance Supervision Act will have an impact on regulatory provisions in all those areas where the regulatory level of the previous rules does not reflect exactly the Directive provisions. For example, this is the case with the statutory requirements for qualifications of supervisory council members under sec. 7a, para. 4 of the Insurance Supervision Act and under the recent codification of the prohibition on borrowing in sec. 7, para. 2, sent. 3, clause 1 of the Insurance Supervision Act. Pursuant to the Directive provisions, the Insurance Supervision Act qualification requirements for members of the supervisory and monitoring boards will be further differentiated; in

particular, the level of requirements for members of supervisory councils for insurance companies belonging to groups will be different from the requirements for such members in the case of companies not belonging to groups. On the other hand, the express codification of the prohibition on borrowing concerning insurance undertakings in the Insurance Supervision Act does not comport with the Solvency II Framework Directive provisions, which provide only the European law prohibition on conducting non-insurance business, a law subject to purely autonomous interpretation. Not least because of the desired objective to converge supervisory practice within the EU, the German specific prohibition on borrowing concerning insurance undertakings will not survive.

Chapter 2

Supervisory Review Process

Contents

2.1	Introduction	28
2.2	Principles of Insurance Supervision Under Solvency II	29
2.3	Objective and Concept of the Supervisory Review Process	30
2.3.1	Objective	30
2.3.2	Art. 36 of the Solvency II Directive and Its Implementation in Sec. 289, Paras. 2–4 of the VAG Reg-E [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]	31
2.3.3	The CEIOPS Advice on Procedures for Supervisory Authorities	36
2.4	The Subjects of the Supervisory Review Process	37
2.4.1	Subject of the Investigation and Investigatory Standard	37
2.4.2	The Governance System as Examination Subject	41
2.4.3	Capital Requirements as Examination Subject	44
2.5	Powers of Supervisory Authorities to Remedy Weaknesses and Deficiencies	53
2.5.1	“Weaknesses or Deficiencies” as Legal Terms	53
2.5.2	The Role of Art. 36, Para. 5 of the Solvency II Directive in the Classification of Intervention Powers	58
2.5.3	Non-compliance with Capital Requirements	60
2.5.4	Non-compliance with Requirements on Governance	61
2.6	Summary	63

Abstract This chapter addresses the legal outlining of the supervisory review process. There is an apparent contradiction between principles-based insurance supervision on the one hand and, on the other hand, legal certainty along with foreseeability of supervisory action under art. 36 of the Solvency II Directive.

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With this in view, the chapter next examines the objectives and subject matter of the supervisory review process, with particular scrutiny given to requirements relating to solvency and governance. The powers of supervisory authorities to remedy weaknesses and deficiencies are then taken up.

2.1 Introduction

The principles-based approach of the Solvency II regulatory scheme presents new challenges for insurance supervision. The new supervisory scheme for insurance undertakings has been made dynamic and flexible. These changes put supervision into conflict with legal certainty and foreseeability of official actions.¹ Paradoxically, these changes also increase the intensity of scrutiny by supervisory authorities. These authorities are primarily charged with concern for the actual risk status of the supervised undertakings.² Consequently, they must collect and evaluate large amounts of information from the insurance undertakings.³ Occasionally they must even evaluate the adequacy of measures taken by insurance undertakings' management. This places the supervisory authorities in a position where they must make extensive evaluations and give substance to undefined legal terms. It is, therefore, all the more important to have a clear legal structuring of the Supervisory Review Process, now widely known as SRP.

The preceding is the background to the points addressed in this chapter: First, this article provides an explanation of the general principles of insurance supervision under Solvency II (2.2, below). Then, a detailed account is given of the objective and concept behind the review process under art. 36 of the Solvency II Directive and the VAG RegE [Government's Draft of a Tenth Act Amending the German Insurance Supervision Act]⁴ (2.3, below).⁵ Next, the subject areas involved are set forth (2.4, below). Finally, this article addresses in detail the regulatory intervention powers in the context of the Supervisory Review Process (2.5, below).

¹ See already *Wandt*, "Solvency II – Wird die Aufsicht zum 'Mitunternehmer'?" [in English: Solvency II – Will the Supervisory Authority Become a 'Partner?'], *VW* (2007), 473 (475).

² See art. 29, para. 1 of Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II), *OJEU*, 17 Dec. 2009, no. L 335, 1–155 (hereafter, Solvency II Directive).

³ Any mention of insurance undertakings in this chapter includes reinsurance undertakings.

⁴ See the Government's Draft of a Tenth Act Amending the VAG [German Insurance Supervision Act], 15 Feb. 2012, *BT-Drucks.* [Document of the German Bundestag] 17/9342, also found at *BR-Drucks.* [Document of the German Bundesrat] 90/12, cited as *VAG-RegE* [Government's Draft of a Tenth Act Amending the German Insurance Supervision Act] in this chapter.

⁵ The particulars of the group supervisory review process under arts. 218, para. 4 and 247 ff. of the Solvency II Directive are outside the scope of the matters addressed in this chapter.

2.2 Principles of Insurance Supervision Under Solvency II

As prescribed by the Solvency II Directive, the Supervisory Review Process, in its function as a part of insurance supervision, tracks the general principles of the new insurance supervisory scheme.⁶ One such principle is first of all the risk-oriented character of supervision, a quality that requires supervision to align with the actual risk status of insurance undertakings. This principle is designed to guard against orthodoxy of statistical models. A further principle requires that the individual circumstances of an insurance undertaking be taken into account in evaluating whether it meets supervisory requirements (the principle of proportionality).⁷ Similarly, the principle of materiality ensures that supervisory activities and regulatory requirements are dictated only by material circumstances. For example, immaterial information does not fall under the regulatory duties to report.⁸ Immaterial risks do not figure into the evaluation of the individual risk status of an insurance undertaking.

When put into the regulatory mix along with undefined legal terms as to matters of fact and with discretionary schemes as to legal consequences, these principles allow discretionary scope in assessment (assessment orientation) to the supervisory authorities.⁹ The new insurance supervisory scheme also displays an increased orientation to the modalities and processes of insurance undertaking activities and does not focus on results alone (process orientation). Further, the supervisory scheme increasingly incorporates models and methods from the field of economics into its tool kit (economization). This applies to assessment of compliance with the qualitative as well as the quantitative requirements.¹⁰

⁶ See in detail *Dreher*, “Solvenzanforderungen in der Versicherungsaufsicht nach Solvency II und künftigem VAG” [in English: Solvency Requirements in Insurance Supervision under Solvency II and the Future German Insurance Supervision Act], *ZVersWiss* (2012), 381 (388 f.; 410 ff.) (Chap. 4, below, at 4.2.4 and 4.4.2).

⁷ The European law principle of proportionality applies automatically to the VAG RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] pursuant to interpretation in conformity with the Directive, even if the VAG RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] is not expected to expressly adopt the Directive.

⁸ *CEIOPS*, *CEIOPS’ Advice for Level 2 Implementing Measures on Solvency II: Supervisory Reporting and Public Disclosure Requirements* (2009), no. 3.2.5.

⁹ On whether this manner of assessment is accompanied by restrictions on judicial review, see 2.5.1.3, below and *Dreher*, n. 6 above, at 422.

¹⁰ See in detail as to the principles noted, *Dreher*, n. 6 above, at 410 ff.