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Legislative and regulatory landscape for run-off- strategies in Germany

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Agenda

1. Cross-border portfolio transfers – an overview
2. Enforceability of Solvent Schemes in Germany
3. Implications of Solvency II for insurers
4. European legislation – a perspective

1. Cross-border portfolio transfers – an overview

1.1 Cross-border portfolio transfers – Legal Framework

■ European Legal Framework

- Art. 12 Third Non-Life Insurance Directive (92/49/EEC)
- Art. 14 EU Life Assurance Directive – recast version (2002/83/EC)
- Art. 18 EU-Reinsurance Directive (2005/68/EC)
- CEIOPS: General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the European Union (soft law)

■ German Legal Framework

- Section 14 VAG
- Section 111d VAG
- Section 121f VAG

1.2 Cross-border Portfolio Transfer of Primary Insurance Business

- Sec. 14 VAG changed by 1.1.2008 due to a decision of the Supreme Constitutional Court of Germany (BVerfG)
- Procedure of portfolio transfer remained unchanged
 - Agreement in writing, no consent of policyholders required, announcement in public register, consent by Home Regulator of transferring insurer (BaFin) after:
 - Certificate of necessary solvency margin of the accepting insurer
 - Consent/Consultation of regulator where insured risks/respective establishment is located
- Material prerequisites for Home Regulator's consent more demanding
 - Interests of policyholders are safeguarded and obligations under insurance contracts are met at all times (para 2 sent 2, para 1 sent 2)
 - According to the BVerfG, the interests of policyholders shall not mean the community of policyholders as such but the interests of the very affected policyholders
 - Due compensation provided for the loss of membership in a mutual insurance society and the loss of surplus sharing (para 3,4)

1.3 Cross-border Portfolio Transfer of Primary Insurance Business – Guidelines provided by BaFin

- BaFin established examination criteria in 2005 in reaction to the decision of the Supreme Constitutional Court, prior to the changes of Sec. 14 – criteria in 2008:
 - BaFin anticipated requirement of due compensation and committed to strict examination standards with regard to the interests of the policyholders as required by the BVerfG
 - Strict examination standards apply to all insurance classes and pension funds, it's however possible to consider specifics of the various insurance classes in particular cases
 - Rule of strict examination applies to the merger of insurers as well due to its similar impact on the rights of the insured

- The new individualised interpretation of policyholders' interests strengthens and expands policyholders' right to action according to the guidelines of the BaFin (then: BAV) and the Federal Administrative Court

1.4 Cross-border Portfolio Transfer of Re-Insurance Business

- New Sec. 121f VAG due to the Reinsurance Directive. Entered into force in June 2007, prior to the changes of Sec. 14 – criteria.
- Former situation: no regulatory framework but consent of re-insured required according to Sec. 415 BGB
- New Situation
 - Procedural prerequisites in general identical with portfolio transfer of direct insurance business (comp. Section 14 VAG)
 - Different criteria for examination/consent by Home Regulator of the transferring insurer:
 - Only proof of solvency of purchasing insurer required.
 - Neither consent of the policyholder required nor examination by Home Regulator with respect to the policyholders' interests
 - (P) Lacking protection of the interest of the re-insured could constitute an infringement of constitutional rights

1.4 Cross-border Portfolio Transfer of Re-Insurance Business

- Risks for re-insured due to the new regulation
 - Required level of solvability might fall short of the solvability of the transferring re-insurer
 - Selection of the re-insurer has been part of the risk-management of the re-insured
 - No Compensation for potential loss of membership in a mutual insurance society provided
- Suggested Solutions
 - Agreement on right to exceptional dismissal
 - Lobbying of re-insured
 - (-), no necessary information previous to portfolio transfer
 - Interpretation of Sec. 121f VAG in light of BVerfG-decision
 - (-), Sec. 121f VAG is a bound decision with a limited set of prerequisites
 - Strict criteria with respect to the solvency margin required.
Example: Deutsche Rück UK

1.5 Cross-border portfolio transfers – Non-EU-transfer

- Non-EU portfolio generally accepted by German law, provided that
 - Law of Non-EU state knows and accepts portfolio transfers
 - Rules of procedure depend on non-harmonized law
 - German law requires consent by BaFin

2. Enforceability of Solvent Schemes in Germany

2.1 Enforceability of Solvent Schemes in Germany- Legal framework

- Sec. 88 VAG
 - (P) only applicable for insolvency proceedings

- Directive 2001/17/EC on the reorganisation and winding-up of insurance undertakings,
 - Only applicable on primary business run-off
 - Doubtful whether Solvent Schemes can be considered a winding-up. Schemes do not aim at the financial stability of the insurer but at the dissolution of contractual obligations.

- Sec. 32-35 EuGVVO
 - (P) Solvent Scheme as a judicial decision?
 - (P) In accordance with public order?
 - (P) Competence of jurisdiction?

2.2 Decision of the Higher Regional Court of Celle on the enforceability of Solvent Schemes

- The court ruled that a British Solvent Scheme installed in 2002 were not enforceable with respect to a German policyholder
- Arguments:
 - No applicability of Directive 2001/17/EG as Solvent Scheme had been installed no later than 2002
 - No judicial decision in accordance to Sec. 32 EuGVVO
 - Scheme were no contradictory proceedings
 - The Court were unable to take influence on provisions of the Scheme
 - Effectiveness of court's approval depended on its registration
 - Scheme would however be no breach of public order.
 - British courts would have no competence of jurisdiction over Schemes of Direct Insurers affecting German policyholders due to the rules laid out in Art. 8ff EuGVVO
- Perspective: pending appeal on points of law at the Federal High Court. Date of hearing or decision not yet foreseeable.

2.3 Comments on the Celle-Decision

- Celle-Decision of no general importance as directive 2001/17/EG had not been applicable due to scope of time

- Celle-Decision gives no answer to some basic questions:
 - Do Solvent Schemes fall within the scope of the Directive 2001/17/EG?
 - If so, does the term „decision“ as used in Sec. 32 EuGVVO has to be interpreted in line with the Directive?

- Celle-decision with regard to the restrictive interpretation of the term „decision“ as used in Sec. 32 EuGVVO is appealable:
 - Scheme Court decides on the adequacy of the proposed Scheme
 - Sec. 32 EuGVVO does not refer to any formal aspects of a decision
 - German Procedural Law knows proceedings of compromise as well.

3. Implications of Solvency II for insurers in run-off

3.1 Capital requirements under Solvency II

- The Capital requirements under Solvency II will consist of two levels, the Minimum Capital Requirement (MCR) and the Solvency Capital Requirement (SCR).
- Insurers will have to provide SCR and at least MCR for each portfolio.
- The height of MCR and SCR depends on a number of potential risks, i.e. risk of default, operative risks, risks of the capital market and risks of provision

3.2 Implication of the new Capital Requirements for run-off portfolios

- While run-off portfolio needed only few capital requirements under Solvency I, their risk of default and risks of provisions will trigger considerably higher capital requirements.
- The capital requirement is the higher
 - the less insurance classes the portfolio contains
 - the less diversified the portfolio is
 - the lower the retrocessionaires are rated
- The increased capital requirement will lead to a decline of prices for run-off portfolios.

3.3 Possible Solutions

- Reduction of run-off portfolios sets tied-up capital free.
 - Pro-active run-off management, i.e.
 - Commutation
 - Solvent Scheme
 - Disposal of the run-off portfolio
 - Retro-active re-insurance of the run-off portfolio

- Improvement of run-off portfolio reduces the risks linked to it
 - Diversification of the portfolio
 - Dissolution of the worst-rated retrocessionnaires.
 - Development of an appropriate internal risk model in case the standard calculation model provided by Solvency II does not fit.

4. European legislation – a perspective

4.1 European legislation – a perspective on Solvency II

- QIS 5
 - will run from August 2010 to November 2010.
 - CEIOPS-report expected in April 2011

- Enforcement of Solvency II until October 2012
 - Final Impact Assessment package until October 2010
 - Adoption of Level 2 Implementing measures by COM no later than October 2011
 - CEIOPS final Level 3 supervisory guidelines, including impact analysis
 - Adoption of COM individual decisions regarding 3rd country equivalence by June 2012

4.2 European legislation – a new European System of Financial Supervisors

- September 2009: Commission proposes for a European System of Financial Supervisors (ESFS), consisting of a network of national financial supervisors working in tandem with new European Supervisory Authorities (ESAs)

- ESFS shall be founded on two pillars
 - ESAs supervising micro-economic risks, obtaining full legal personality
 - European Systemic Risk Board (ESRB) supervising macro-economic risks

- Estimated first year of operation: 2011

4.3 European legislation – EIOPA

- Proposed regulator for the Insurance market ➡ European Insurance and Occupational Pensions Authority (EIOPA)
- Structure of EIOPA:
 - Board of Supervisors as main decision-making body, consisting of the heads of the relevant national supervisors and the Chairperson of EIOPA
 - Executive Director responsible for day-to-day management
- Key Tasks and powers of EIOPA:
 - Action in emergency situations, when national supervisors alone lack the tools to respond rapidly to an emerging cross-border crisis
 - Settlement of disagreements between national supervisory authorities
 - Development of technical standards
 - Building a common European supervisory culture and ensuring uniform procedures and consistent supervisory practices throughout the EU

Questions?

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