

Avenue Louise 240, Box 5  
1050 Brussels  
Telephone: 32 (0)2 626 05 00  
Fax: 32 (0)2 626 05 10  
www.steptoel.com  
E-Mail: pwoolfson@steptoel.com

**BRIEFING**

3 November 2006

Re: **Delay in harmonising policyholder protection/insurance guarantee schemes at the EU level has “knock-on” effects in Member States; the example of the German *Sicherungsfonds* scheme**

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1. **Introduction**

Following the collapse in the early 1990s of Bank of Credit and Commerce International (“BCCI”), the European Union moved swiftly to introduce harmonised rules to guarantee payment of bank deposits to depositors in the event of insolvency of an EU-supervised credit institution<sup>1</sup>. Similar provisions entered into force to protect sums deposited with investment firms<sup>2</sup>.

Insurance guarantee schemes for the insurance sector have not, however, been subject to any harmonisation measures at the EU level. Some perceive this as a lacuna in the EU regulatory framework for financial services which ought to be addressed by the European Commission (see 2 below). Meantime, the absence of a harmonised regime means that certain Member States, such as Germany, continue to legislate without due regard to the interests of insurers authorised in other Member States and operating on the German market on a freedom of services or branch basis (see 3 below)<sup>3</sup>. This sort of initiative can have unfortunate consequences (see 4 and 5 below).

2. **EU-level initiatives**

The European Commission has been considering the question of harmonisation of national provisions (if any) on insurance guarantee schemes for over five years. Recent initiatives include:

- In the course of 2005, Directorate General Internal Market of the Commission published various “working papers”, culminating at the end of the year in a preliminary and unofficial draft of a proposal for a Directive. That draft reflected input and comments from

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<sup>1</sup> Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994, known as the Deposit Guarantee Schemes Directive.

<sup>2</sup> Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes, known as the Investor Compensation Directive.

<sup>3</sup> This briefing addresses coverage for voluntary, life and non-life insurance. It does not cover compulsory cover e.g. motor.

a number of sources, including insurers active on a pan-European scale<sup>4</sup>.

- Since then, there has, however, been little progress, the reason being that the Commission remains unconvinced that there is sufficient political will to proceed with a formal proposal. Any proposal would have to be tested against the Commission's current credo of "less, but better, regulation". The Commission's White Paper on Financial Services Policy, 2005-2010, cryptically remarks that, in relation to such schemes, "...The Commission will decide in 2006 whether to propose legislation in this area."
- Given this uncertainty and notwithstanding all the preliminary work in recent years, on 23 August the Commission announced a call for tenders on: "*insurance guarantee schemes in the EU: comparative analysis of existing schemes, analysis of problems and evaluation of options and their feasibility*". Details of the call for tender (whose deadline has now expired) are at [MARKT/2006/20/H](#).

The study sought by the Commission will have a strong statistical and methodological bias. For the purposes of this briefing, pages 5 to 24 of the call are the parts of real interest, since they set out the Commission's views and objectives for guarantee schemes. Page 17 illustrates the current difficulties and specifically refers to the example of sales of policies sold by a UK company on the German market through a branch: such policies are not protected by either the UK or German schemes.

In sum, progress at the EU level is painfully slow. Even assuming that the above feasibility study concludes that EU-wide harmonisation should proceed, it is unlikely that Member States would be required to implement a new regime until 2010. Meantime, Member States continue to legislate for their own purposes and markets. A recent example is the German *Sicherungsfonds* scheme, which this briefing now examines.

### 3. **Insurance guarantee schemes under German law**

For present purposes, the relevant provisions are in Article 124 (on the guarantee scheme, *Sicherungsfonds*) and Annex D (on consumer information) of the *Versicherungsaufsichtsgesetz* (the Insurance Supervision Law, "*VAG*").

#### 3.1 Article 124, VAG

The Law of 15 December 2004 (*BGBl. I S. 3416*) amending the *VAG* introduced new provisions on the *Sicherungsfonds*<sup>5</sup>.

Article 124 provides that German and third country insurers which are subject to German authorisation and which are authorised to carry on life and substitute sickness insurance business (as defined in the *VAG*) must join the *Sicherungsfonds*.

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<sup>4</sup> Our firm set up a forum in 2005 to comment on a previous draft of the working paper. The next draft reflected various comments provided by the forum.

<sup>5</sup> In May of this year, the duties of the *Sicherungsfonds* were transferred to a new entity, the *Protector*. See [www.protector-ag.de](http://www.protector-ag.de).

### 3.2 Annex D of the VAG

The Law of 15 December 2004 also amended Annex D of the *VAG* concerning consumer/pre-contractual information. The relevant provision amended Chapter I, Number i) of Annex D: it requires the insurer - whether a life or non-life insurer - to inform the policyholder prior to conclusion of the contract whether or not the insurer is a member of the *Sicherungsfonds*<sup>6</sup>.

## 4. BaFin's assessment of the new provisions

### 4.1 BaFin website

*BaFin*, the competent authority in Germany, for insurance supervision has published "frequently asked questions" ("fact sheet") on its website. The factsheet specifies the form and context of the information which an insurer must provide to consumers. Information must:

- be in written form;
- be in German or the native language of the policyholder;
- be formulated in a manner that an average consumer can understand without a lawyer's assistance, i.e. in a manner that an average consumer could not misunderstand;
- set out distinctly: (i) information which derives from public law requirements; and (ii) information related to the specific insurance policy (civil/private law). The factsheet recommends a separate sheet for public law, rather than inclusion in the insurance policy itself. If the insurer chooses to include public law information in the policy, it must comply with a higher standard of clarity and detail for the public law information. (The *Sicherungsfonds* and related membership is a public law requirement.)

Furthermore, the factsheet states that EU/EEA countries have their own insolvency protection provisions. *BaFin* simply advises interested consumers to contact EU/EEA insurers, whether operating on the German market on a freedom of services ("FOS") or establishment basis, or the national supervisory authorities for further information.

### 4.2 Comment

The above amendments to the *VAG* have several immediately identifiable consequences:

- Independent distribution channels – principally, insurance brokers – apply their own criteria for assessing whether or not to recommend an EU/EEA insurer to their clients. The Insurance Mediation Directive<sup>7</sup> requires them to do so, in particular through duties to carry

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<sup>6</sup> The Annex D amendment does not distinguish between life and non-life insurers, yet there is no *Sicherungsfonds* for the non-life sector. Therefore, EEA (and German) non-life insurers are, theoretically, bound to state that they are not members of a German scheme – this is not surprising, since there is no such scheme.

<sup>7</sup> Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, known as the Insurance Mediation Directive. Germany has not yet implemented this Directive into

out a “fair analysis” of the market and to provide a “reasons why” letter to the client. Brokers also use the *VAG* pre-contractual disclosure requirements in their assessment; membership of the *Sicherungsfonds* is, therefore, a factor in recommending a product.

- Similarly, insurance agents appointed by EU/EEA insurers face a difficulty in having to explain to clients that their principals are not members of the *Sicherungsfonds*.
- Consequently, EU/EEA insurers are faced with a difficult commercial choice: (i) state clearly that they are not members of the *Sicherungsfonds* and then explain the merits of their home State solvency regime (e.g. the “tripartite” system in Luxembourg); or (ii) if they do have a home State scheme (e.g. France), describe its scope (especially if coverage is more extensive than the coverage available under the *Sicherungsfonds*); or (iii) in the peculiar case of the UK, explain, if a FOS insurer, that the UK scheme should apply and, if operating through a branch in Germany, that the UK scheme will not apply<sup>8</sup>.
- Stating in pre-contractual information whether an insurer is a member of the *Sicherungsfonds* can create a false sense of security in that, for example, a foreign insolvency might, in fact, result in a higher pay-out which is more promptly settled.
- Neither the *VAG*, as amended, nor the factsheet provides guidance on how an EU/EEA insurer should fulfil any requirement to provide information on insolvency protection in its home country.

We accordingly contacted *BaFin* in order to find out more about how EU/EEA insurers operating on the German market can address questions on insolvency.

*BaFin* replied to us in writing stating that, prior to conclusion of the contract, an EU/EEA insurer operating on the German market must inform the policyholder whether or not it is a member of a German scheme, i.e. the *Sicherungsfonds*. *BaFin* added that, if the German legislator had wanted the EU/EEA insurer to inform the policyholder about a scheme in its country of origin, an appropriate provision would have been included in the 2004 amendment<sup>9</sup>.

We then contacted *BaFin* again (by telephone) to discuss draft wording for EU/EEA insurers to use in order to inform policyholders about insolvency protection. We based our drafting on the factsheet published on the *BaFin* website and suggested that the insurer could state that it is a member of its national, home State scheme. The *BaFin* official gave a baffling reply: our drafting could mislead the consumer under the German provisions. This is patently wrong: it denies the consumer important, pre-contractual information regarding benefits of the policy contemplated. If this is truly *BaFin*'s position, it denies the right to refer to a foreign scheme and is, therefore, potentially in breach of the pre-contractual disclosure requirements of the

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national law. Trade press sources refer to entry into force of the implementing legislation in January 2007 (though there may also be transitional provisions).

<sup>8</sup> *BaFin* chooses to draw the consumer's attention to this anomaly on its website at: [http://www.bafin.de/versicherungsaufsicht/va\\_sicherungen.htm](http://www.bafin.de/versicherungsaufsicht/va_sicherungen.htm). Strangely, the warning is in German only and so does not appear in the English language version of the factsheet.

<sup>9</sup> *BaFin* compounds this by failing to refer to “...*Sicherungsfonds* or equivalent in another Member State...”

insurance Directives, of European Commission pronouncements on the scope of host State “general good” and might also be in breach of a home State rule requiring the insurer to inform the policyholder that the insurer is a member of a scheme.

## 5. Conclusion

This briefing does not plead for the introduction of an EU-wide insolvency protection regime. Rather, it seeks to illustrate the effects of the absence of such a regime and the perhaps unforeseen consequences of unfortunate, national drafting of legislation. The German rules are an excellent example of the effects on EU/EEA insurers: such insurers cannot be members of the *Sicherungsfonds* and so, in practice, are automatically put at a competitive disadvantage; nor – according to *BaFin* (at least unofficially) – can they easily put forward arguments to overcome this competitive disadvantage, since these might mislead the German consumer as to the applicability of the German scheme<sup>10</sup>.

Needless to say, the UK regime, which denies extension of its protection scheme to the foreign branches of UK insurers, creates an additional legislative lacuna in this unhappy patchwork.

EU/EEA insurers therefore need to reflect on how best to apply the legal analysis set out above to the commercial reality of sales on the German market. This might well mean:

- “facing down” *BaFin* on its interpretation of the 2004 amendments and how these are reflected in public documents such as the website factsheet;
- engaging distributors in dialogue to pre-empt their and their clients’ questions;
- examining marketing and contractual materials so as to ensure, within reason, conformity with the *VAG* provisions on the *Sicherungsfonds* and including references to equivalent schemes in the home Member State; and
- analysing the *VAG* provisions – which, no doubt, are considered German general good – for conformity with Community law principles of non-discrimination, necessity and proportionality.

Lastly, although the *VAG* provisions are limited to specific life and health classes, there must be a risk that, having adopted restrictive provisions and practice for these classes, the legislator will be further emboldened to show the same disregard for EEA insurers in any future insolvency regime for the non-life sector.

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<sup>10</sup> Incidentally, the same situation arises in France, where only insurers which are supervised by the French authorities are covered by the equivalent insolvency protection scheme; however, French law and practice would not prevent a foreign insurer from setting out details of its national scheme.

If you have any questions concerning this Briefing, please contact Philip Woolfson on +32 2 626 05 19 ([pwoolfson@step toe.com](mailto:pwoolfson@step toe.com)), Simon Arnot on +32 2 626 05 43 ([sarnot@step toe.com](mailto:sarnot@step toe.com)) or Ilinca Filipescu Chalançon ([ifilipescu-chalancon@step toe.com](mailto:ifilipescu-chalancon@step toe.com)) on +32 2 626 05 26.

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