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Regulation

1 Regulatory agencies

Identify the regulatory agencies responsible for regulating insurance and reinsurance companies.

The Federal Financial Supervisory Authority (BaFin) supervises private and public insurance undertakings with a registered office in Germany. BaFin acts on behalf of the federal government. Insurance undertakings with offices in EU (or EEA) member states that operate in Germany are primarily supervised by the competent authorities of the respective country of incorporation; however, BaFin may consult with foreign supervisory authorities in case of a violation of German law.

2 Formation and licensing

What are the requirements for formation and licensing of new insurance and reinsurance companies?

Insurance companies require an authorisation from BaFin before they carry out insurance business in Germany. Some of the requirements are as follows:

The insurance company has to provide a business plan, which describes the risks that are intended to be covered. Furthermore, there are requirements for the legal form of the insurance company, such as the incorporated company, a public law institution or mutual (insurance) society. There needs to be proof of the existence of sufficient own funds of the insurance undertaking and that the requirements for a sufficient management of the insurance undertaking are met. An insurer is only allowed to conduct insurance business and directly related business. Life, non life and health insurance can not be carried out simultaneously. The simultaneous transaction of life, non-life and health insurance is not permitted. For each of these areas different legal entities are required.

3 Other licences, authorisations and qualifications

What licences, authorisations or qualifications are required for insurance and reinsurance companies to conduct business?

Insurance and reinsurance companies require an authorisation to conduct business in Germany. The term company includes every economic entity that conducts insurance business. The economic entity is, if the need arises, required to reorganise into the admissible legal form of a company.

An insurance or reinsurance company domiciled in an EU or EEA country may set up a branch in Germany or engage in the insurance business without an establishment and does not require an authorisation from BaFin but from the respective supervisory authority in the insurance company's native country where the central office is domiciled.

Insurance companies that are neither domiciled in the EU nor EEA require an authorisation from BaFin.

4 Officers and directors

What are the minimum qualification requirements for officers and directors of insurance and reinsurance companies?

Under the Insurance Supervision Act (VAG) board members of an insurance company need to be reliable and professionally capable. The capability on a professional level is reflected in theoretical knowledge and practical skills in the insurance business as well as management experience.

5 Capital and surplus requirement

What are the capital and surplus requirements for insurance and reinsurance companies?

Insurance companies' own funds have to be adequate to fulfil their obligations. If this is not the case, a funding or solvency plan needs to be submitted to BaFin.

The amount of the so-called guarantee fund that is required differs from the class of insurance. As a general rule, except for a few exceptions the guarantee fund of insurances, except for life insurance, amounts to €2.2 million. The guarantee fund amounts to €3.2 million if liability risk and risk out of credit and guarantee insurance as well as life insurance is concerned.

However, in practice BaFin will not accept undertakings in the market with minimum capitalisation. Additionally the insurance companies are obligated to observe the solvency requirements.

Reinsurance companies require a guarantee fund of at least €3 million.

6 Reserves

What are the requirements with respect to reserves maintained by insurance and reinsurance companies?

There is an obligation for insurance companies to set aside adequate reserves. This obligation is regulated in multiple provisions in the VAG and by BaFin. Actuarial procedures are required to ascertain whether the reserves are sufficient. The required standard differs from the type of insurance.

7 Insurance products

What are the regulatory requirements with respect to insurance products offered for sale? Are some products regulated by multiple agencies?

There are no explicit regulatory requirements for insurance products offered for sale. However, the standard statutory requirements in the VAG and the Insurance Contract Act (VVG) need to be observed.

8 Change of control

What are the regulatory requirements on a change of control of insurance and reinsurance companies? Are officers and directors of the acquirer subject to background investigations?

Under the VAG, a person, who plans to purchase a significant interest (or participation) in an insurance company, is obliged to notify BaFin immediately. A significant interest means 10 per cent of the capital of the company or a relevant influence on the management of an insurance company.

The intention to purchase 20, 33 or 50 per cent of the company's share capital or voting rights requires the immediate notification of BaFin as well. The same applies if the insurance company is to become a controlled company.

The notification has to include facts about the reliability of the person, who intends to acquire a significant interest in the insurance company and facts about the identity of the seller of the shares (person or company).

If the acquirer of the significant interest in the insurance company is organised as a corporate body or commercial partnership, the newly appointed officers and general partners are to be reported to BaFin.

9 Financing of an acquisition

What are the requirements and restrictions regarding financing of the acquisition of an insurance or reinsurance company?

The VAG prohibits insurance companies to engage in business that is not insurance business. BaFin therefore, in principle, places a ban on outside financing of insurance companies. Thus financing of an acquisition by means of borrowed capital is not permitted in Germany for insurance companies.

The ban for outside financing however does not apply to reinsurance companies.

10 Foreign private investment

What are the requirements and restrictions concerning the investment in an insurance or reinsurance company by foreign citizens or companies?

In principle, there are no restrictions and requirements for foreign investments in insurance or reinsurance companies. However, BaFin may prohibit the acquisition of a significant interest in an insurance company if the requirements are not met. If the acquirer of the significant interest is an insurance company, registered in another country, the mother company of an insurance company that is registered in a country state or person who controls an insurance company registered in another country and the requirements for the permissibility of the significant interest is not met, BaFin shall hear the respective foreign supervisory authority.

11 Foreign state investment

What are the requirements and restrictions concerning the investment in an insurance or reinsurance company by foreign governments?

There are no restrictions or requirements for investments by foreign governments.

12 Reinsurance agreements

What are the regulatory requirements with respect to agreements for reinsurance ceded and assumed by insurance and reinsurance companies domiciled in your jurisdiction?

There is no express law for reinsurance agreements under the Insurance Contract Act and its rules are not applicable. If German law applies, the agreement is governed by the German Civil Code (BGB) and German Commercial Code (HGB).

However, for finite reinsurances the Insurance Supervision Act requires a sufficient transfer of risk.

13 Ceded reinsurance and retention of risk

What requirements and restrictions govern the amount of ceded reinsurance and retention of risk by insurers?

There is no legal requirement restricting insurance companies from ceding 100 per cent of the liabilities to one or several reinsurance companies or requirements to retain risks. However, the cession of 100 per cent of the liabilities could lead to the assumption that the insurer does not conduct insurance business but acts merely as an insurance agent. Concerning solvency requirements the cession is only approved up to 50 per cent.

14 Collateral

What are the collateral requirements for reinsurers in a reinsurance transaction?

There are no legal regulations concerning collateral requirements for assuming reinsurance companies.

However, reinsurance companies are also legally required to have sufficient assets in a guarantee fund.

15 Insolvent and financially troubled companies

What laws govern insolvent or financially troubled insurance and reinsurance companies?

The VAG allows BaFin to take measures in order to overcome financial problems of insurance companies. If an insurance company goes insolvent it is BaFin's prerogative to file for insolvency. Most of these regulations also apply to reinsurance companies.

The insolvency proceeding is governed by the German Insolvency Code.

In the wake of the financial crisis the Act on the Implementation of a Package of Measures to Stabilise the Financial Market offers help for troubled financial institutions.

16 Intermediaries

What are the licensing requirements for intermediaries representing insurance and reinsurance companies?

Insurance brokering in general requires a licence. However, not every person who brokers insurance is obliged to obtain a licence. The licence is issued by the Chamber of Commerce and Industry. The licence is not granted, if the intermediary is not reliable, lives in unstable financial circumstances, does not have the required liability

insurance and does not possess the required expertise.

Intermediaries acting commercially need to be entered in a register, which is kept by the local Chamber of Commerce and Industry.

Insurance claims and coverage

17 Third-party actions

Can a third party bring a direct action against an insurer for coverage?

The VVG provides for direct actions against the insurer if

- the case concerns a liability insurance according to obligatory insurance law;
- insolvency proceedings were instituted against the assets of the policyholder; the suspension of insolvency proceedings due to lack of sufficient assets, or a preliminary insolvency administrator was appointed; or
- the residence of the policy holder is unknown.

18 Late notice of claim

Can an insurer deny coverage based on late notice of claim without demonstrating prejudice?

Under the VVG the policyholder and third parties who assert a claim against the insurer are obligated to notify the insurer immediately upon cognition of the insured event.

Usually it is stipulated in the insurance contract that the insurer can deny coverage if the notice is not given in due time and form. The release from obligation to perform does not apply if the policyholder can claim that he did not act with intent or gross negligence. Furthermore, the insurer cannot claim the release from obligation to perform if he learned about the insured event in time by other means.

19 Wrongful denial of claim

Is an insurer subject to extra-contractual exposure for wrongful denial of a claim?

The wrongful denial of a claim can lead to a damage claim. When it comes to the compensation for pain and suffering courts may award a penalty loading in cases of wrongful denial of a claim.

20 Defence of claim

What triggers a liability insurer's duty to defend a claim?

According to the general liability insurance conditions there is no insurer's duty to defend a claim in court. However, the liability insurance conditions determine the authority and obligation to defend the claim in court.

21 Indemnity policies

For indemnity policies, what triggers the insurer's indemnity obligations?

Indemnification payments are payable when everything is done to determine the insured event and the amount of the indemnification payment. In some cases the policyholder is eligible for advance payments if the process of determination is not completed after one month since the notice of the insured event.

22 Incontestability period

Is there an incontestability period beyond which a life insurer cannot contest coverage based on misrepresentation in the application?

The VVG does not provide for an incontestability period. However, the policyholder is required to state all import circumstances in the

application for a life insurance that are known to him. An insurance company may otherwise withdraw from a treaty.

23 Punitive damages

Are punitive damages insurable?

There is no restriction concerning the insurability of punitive damages. The insurance of punitive damages in foreign countries is often excluded.

However, it is to be noted that in Germany punitive damages are not awarded and punitive damage awards from other jurisdictions are in general unenforceable.

24 Excess insurer obligations

What is the obligation of an excess insurer to 'drop down and defend', and pay a claim, if the primary insurer is insolvent or its coverage is otherwise unavailable without full exhaustion of primary limits?

In the German insurance system there is no differentiation between primary insurer and excess insurer. Therefore, there are no legal regulations that govern a duty of an excess insurer to 'drop down and defend'.

25 Order of payment

What is the order of priority for payment when there are multiple claims under the same policy?

For liability insurances, the VVG determines that if the policyholder is liable to multiple claimants and the claims exceed the amount insured, the insurer is obligated to pay the claimants in due proportion of the amounts.

26 Allocation of payment

How are payments allocated among multiple policies triggered by the same claim?

The VVG requires the policyholder to notify every insurer, if he has entered into separate insurance contracts concerning the same risk. If the risk is insured by multiple insurers and the insurance sum together exceed the actual total loss, the insurers are liable for the amount of the respective contract as jointly and severally liable debtors, but the policy holder is only entitled to obtain the actual total loss.

Reinsurance

27 Reinsurance disputes

Are formal reinsurance disputes common, or do insurers almost always reach business solutions for their disputes without formal proceedings?

Arbitration proceedings in connection with reinsurance disputes are more and more common. In the past, reinsurance disputes used to be resolved by reaching a business solution.

28 Common dispute issues

What are the most common issues that arise in reinsurance disputes?

There is only a relatively small number of reinsurance disputes that were made public. The most common topics in reinsurance disputes include the scope of a reinsurance agreement, the failure to notify the reinsurer about claims in due time, the duty of utmost good faith and the follow the fortunes doctrine.

Update and trends

Financial market crisis

As a regulatory response to the financial market crisis the Act on the Implementation of a Package of Measures to Stabilise the Financial Market was introduced. The Act intends to secure the financial solvency of financial institutions, including insurance companies, by overcoming liquidity shortages and strengthening the capital base of financial institutions. A special fund, set up by the Act, may participate in the recapitalisation of financial sector enterprises or may acquire or cover risk positions. However no German insurance company has applied for stabilisation measures. This is because of the relatively low investments in equities and warrants. This is also why an application for stabilisation measures by an insurance company is not to be expected.

Recent developments concerning distribution of surplus

Following a decision of the Federal Constitutional Court in 2005 concerning the distribution of surplus to policy holders of life insurance several changes in the Insurance Contract Act (VVG) and Insurance Supervision Act (VAG) were introduced.

Insurance Contract Act (VVG)

Since 1 January 2008 the VVG has governed the life insurance policy

holder's entitlement to surplus participation, which has become an increasingly important issue.

Insurance Supervision Act (VAG); the transfer of portfolio

The redrafted section 14 of the Insurance Supervision Act (VAG) offers protection for the entitlement to surplus participation also in cases where a transfer of a portfolio takes place. The protection applies to policy holders whose contracts are transferred and to policy holders of the receiving insurance company.

Supervisory minimum requirements for risk management

The German supervisory authority (BaFin) issued a circular in January 2009 concerning the risk management in insurance companies and reinsurance companies with a registered office in Germany as well as pension funds. The circular addresses the handling of several material risks, such as the underwriting risk, market risk, liquidity risk etc. Responsibility for the risk management lies with all managers, irrespective of internal competencies. The company is required to have a business strategy and an adequate risk strategy. An internal monitoring and control system needs to be set up in accordance with the supervisory authority's guidelines.

29 Arbitration awards

Do reinsurance arbitration awards typically include the reasoning for the decision?

Normally arbitration awards state the operative provisions of the judgment, the facts of the case and the reasons for the decision.

30 Power of arbitrators

What powers do reinsurance arbitrators have over non-parties to the arbitration agreement?

The court of arbitration only has power over parties to the arbitration agreement.

31 Appeal of arbitration awards

Can parties to reinsurance arbitrations seek to vacate or confirm arbitration awards through the judicial system? What level of deference does the judiciary give to arbitral awards?

The annulment of an arbitral award is possible under the Code of Civil Procedure (ZPO). The grounds for an annulment are:

- the arbitration agreement was invalid under the applicable or under German law or the party that entered into the arbitration agreement was not capable of doing so;
- one party was not properly notified about the appointment of an arbitrator or the arbitral procedure;
- the right to be heard was not properly granted to one party,
- the arbitral award did not cover the dispute that was addressed in the arbitration agreement;
- the formation of the arbitration board or the arbitral proceeding violated the ZPO or the arbitration agreement and an impact of this on the arbitral award is to be assumed;
- the matter of the arbitral proceeding was not arbitrable under German law; and
- the enforcement or confirmation of the arbitral award is against public order.

Otherwise an arbitral award is enforceable.

Reinsurance principles and practices

32 Obligation to follow cedent

Does a reinsurer have an obligation to follow its cedent's underwriting fortunes and claims payments or settlements in the absence of an express contractual provision? Where such an obligation exists, what is the scope of the obligation, and what defences are available to a reinsurer?

The VVG does not apply to reinsurance contracts. The reinsurance contract is therefore the basis for the obligations of the parties of the contract as well as the reinsurance practice.

The obligation to follow the cedent's underwriting fortunes and claims payments or settlements is an established practice in the reinsurance industry. The follow-the-fortunes duty corresponds with the insurance company's obligation to manage the insurance business.

The follow-the-fortunes duty implies the duty of the reinsurer to accept the decisions and actions of the management of the insurance company as binding.

The follow-the-fortunes duty is only binding as far as risks and claims are covered by the reinsurance contract, the duty furthermore ceases to bind the reinsurance company, if the management of the insurance company violates the rules of professional management deliberately or grossly negligently. Furthermore not included are extraordinary risks and normally ex-gratia payments by the insurance company.

Furthermore, the follow-the-fortunes duty is more pronounced in proportional reinsurance compared to non-proportional reinsurance.

33 Good faith

Is a duty of utmost good faith implied in reinsurance agreements? If so, please describe that duty in comparison to the duty of good faith applicable to other commercial agreements.

The principle of utmost good faith is implied in reinsurance agreements. The standard of good faith in reinsurance contracts compared to other commercial agreements differs because the adjustment of

claims and numerous business processes take place in the insurance company's sector. The reinsurer needs to rely on the diligence of the insurer in areas such as cost sharing, selection of risk, rating, adjustment of claims.

34 Facultative reinsurance and treaty reinsurance

Is there a different set of laws for facultative reinsurance and treaty reinsurance?

The VAG does not differentiate between facultative and treaty reinsurance. The VVG does not apply to any reinsurance agreement.

35 Coverage action

Can a policyholder or non-signatory to a reinsurance agreement bring a direct action against a reinsurer for coverage?

In principle, there are no direct actions of a policyholder against a reinsurer. The Federal Court of Justice (BGH) has held that a reinsurance contract does not have a third-party effect. The grounds for a direct action can only be a cut-through clause in the reinsurance contract.

36 Insolvent insurer

What is the obligation of a reinsurer to pay a policyholder's claim where the insurer is insolvent and cannot pay?

In principle, there is no obligation of the reinsurer towards the policyholder (see question 35), this applies in the case of insolvency of the insurer as long as there are no other grounds for a direct action against the reinsurer (see question 35).

37 Notice and information

What type of notice and information must a cedent typically provide its reinsurer with respect to an underlying claim? If the cedent fails to provide timely or sufficient notice, what remedies are available to a reinsurer?

The reinsurer has a comprehensive right to information. The right to information entitles the reinsurer to inspect and check all documentation in connection with the concrete reinsurance. Concerning the claims settlement the reinsurer is entitled to inspect the claims file.

38 Allocation of underlying claim payments or settlements

In the case of multi-year occurrences, such as pollution, how are underlying claim payments or settlements allocated among policy years covered by multiple reinsurance agreements?

There is no specific German approach to this issue but the allocation of claims to the respective underwriting years is effected by the usual definitions used within international reinsurance contracts.

39 Review

What type of review does the governing law afford reinsurers with respect to a cedent's claims handling, and settlement and allocation decisions?

The law does not provide a review of the cedent's claims settlement. Concerning the rights of the reinsurer under the reinsurance agreement – see question 37.

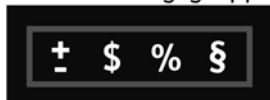
The follow-the-settlement clause leads to a commitment of the reinsurer to the claims handling and management of the insurer. The bordereau service covers the continuous information of the reinsurer about the reinsured risks. In some agreements a claims cooperation clause is included, which allows the reinsurer to participate in claims handling.

40 Reimbursing of commutation payments

What type of obligation does a reinsurer have to reimburse a cedent for commutation payments? Must a reinsurer indemnify its cedent for 'incurred but not reported' claims?

There are no legal requirements for an obligation to reimburse a cedent for commutation payments. However, according to the follow-the-settlement doctrine a settlement, in general, leads to the duty to reimbursement.

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