Comments
on the Green Paper on Financial Services in the Single Market

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Summary
The German insurance industry welcomes any appropriate measures which facilitate the offer of insurance products across national borders in Europe. Further development of the single market in financial services is restricted by the fact that the national legal frameworks differ from each other. In addition to a desirable harmonization of contract law on European level, the creation of 28th product-specific regimes could be an alternative in the short term. With respect to consumer protection, in particular, maximum harmonization of the key elements is required on European level. A uniform revision of international private law applicable to insurance contracts in the Rome I Regulation could also facilitate cross-border sales of insurance products. However, in addition to the legal framework, local risk conditions are also relevant with respect to the design of insurance products and to the insurance companies’ own funds requirements (Solvency II). It is important that the companies can continue to decide on their own with which products they want to operate in the markets of their choice.
1. Introduction

While in the 90ies the 3rd Directives helped to deregulate the insurance markets with respect to companies, the Green Paper has been designed to place the consumer in the focus of the European Commission’s single market strategy. Both approaches must be merged to a coherent overall concept in order to enable the insurance industry to continue to provide a sustained contribution to the Lisbon Strategy\(^1\).

The reasons for the lack of cross-border business in the insurance market (2.) as well as potential fields for further development of the European legal framework (3.) will be presented in the following paragraphs. And finally, this document will deal specifically with motor insurance (4.).

2. Reasons for a Lack of Cross-Border Insurance Business (question 1; numbers 7, 9, 10)

The Green Paper is right when stating that cross-border business through subsidiaries clearly dominates in the insurance sector while cross-border transactions are the exception. In the framework of its comment on the sector inquiry, the German Insurance Association has just recently presented current explanations on the status of the single market for insurance services in the non-life sector. The general part refers to retail business (annex 1). It can be summarized as follows:

2.1. Non-Life Sector

In many cases, if insurance companies want to operate across borders the acquisition of stock abroad is the most sensible way from a corporate policy and economic perspective. Otherwise, an initially only marginal market share would be confronted with significant investments for building the required structures, specific market knowledge and the necessary level of awareness. When an insurance company intends to enter a foreign market, significant costs will arise due to the different national legal frameworks, the different risk situations and the different languages. Providers cannot develop any uniform products, but they have to tailor their products to the requirements of the individual target market. Moreover, advertising, sales and ongoing customer service is required. If the costs arising at the

\(^1\) Cp. CEA – The contribution of the Insurance Sector to Economic Growth and Employment in the EU (www.cea.assur.org)
market entry and the risks associated with the market entry are not balanced by an appropriate profit expectation, the insurance company will not invest.

These circumstances are of particular relevance to private health insurance. The market of private health insurance is determined by the type and scope of the respective social security system, which means that insurance companies have to provide specific products for each country. The large number of events insured in the term of a contract, the required support and, if applicable, the provision of medical assistance as benefit in kind or service always require on-site presence and communication with the insured person in this person’s native language. Moreover, health insurers must also be involved in the respective national health system.

2.2. Life Sector

In addition to the aspects already mentioned, with respect to the life sector reference is to be made to the large relevance of the national tax and social security law. The introduction of the so-called “Riester pension” in Germany in 2002 is a good example: the Riester pension was introduced as replacement for the reduced pension expectancies from old-age pension insurance, and thus it follows the concept of the old-age pension insurance closely (e.g., group of persons eligible for allowances, exclusive rights of use, regulation of the age at which allowances could be received). Moreover, the personal mutual trust that develops through spatial proximity is particularly relevant in the life sector.

Nevertheless, reports by British life insurance companies, for example, show that the branch business can be operated quite successfully in Germany (Standard Life: German branch accounts for about 400,000 German and Austrian contracts; Canada Life: increase in the premium income from EUR 170 million to EUR 413 million in the period between 2003 and 2006; 2

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2Cp. Beckmann et al. Financial integration within the European Union: Towards a single market for insurance, 2002, p. 19: “The advantages of shopping across borders can be offset by the fact that the taxation regime remains that of the country where the customer has his residence.”

3Cp. Müller-Reichart et al., Auf dem Weg zur Exzellenz, Versicherungswirtschaft 1/2005. Also cp. Beckmann et al., (ibid.), p. 18: “Since insurance is essentially based on trust, i.e. the customers confidence in the ability of the insurer to honour its obligations, the average consumer is extremely risk averse. Preferences thus are highly biased towards local structures and established channels of distribution. The more complex an insurance product the lower is the willingness of a customer to sign a contract with an unknown foreign supplier or even without “handshake”.
Legal & General: increase of 16.8% as compared to 2005). According to statements of international insurance companies which joined forces in the Association of International Life Offices (AILO) they have a market share of 6% in new business in Germany\(^4\).

3. **Measures to Further Develop the Single Market**

The following measures would have a positive impact on cross-border distribution of insurance products:

3.1. **Appropriate Harmonization of Contract Law**

So far the European legislator has approached issues of contractual obligations by taking legislative measures that focussed on the type of contract or the sector. However, this approach often did not result in the desired uniformity. In cases in which a total harmonization could not be implemented for political reasons, the member states often used their scope of action with respect to implementation extensively which led to new fragmentation.

3.1.1. **Common Framework of Reference (CFR)**

Against this background, the European Commission already started to prepare a coherent European contract law in 2003. At the end of 2007 a common framework of reference (CFR), which has been designed by scientists and which has been reviewed by market experts, is to be submitted. The scientists’ preliminary work includes specific insurance contract law as well as general civil regulations. The CFR’s purpose is to serve as “tool box” for the legislative activities of the European institutions. Moreover, there is some discussion going on whether the CFR might have any further impacts as optional tool\(^5\).

The intended use as a tool that helps the institutions of the European Union to achieve a standardized legal language within the European Union and consistency in terms of content with respect to civil legal acts is to be welcomed. A legal standardization would reduce the costs for developing and managing the products most effectively, and thus it would also lead

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\(^5\) The term “28\(^\text{th}\) regime” is often used in this context. In order to avoid any confusion with product-specific 28\(^\text{th}\) regimes (see below) it only refers to an optional tool in this context.
indirectly to lower premiums. As long as such a harmonization fails for political reasons due to the resistance of the Council and of many industry representatives, at least the introduction of a contract law that could be chosen optionally would be very important\textsuperscript{6}.

However, choosing the optional tool as legal framework for insurance contracts would only be a smooth solution if the regulation on the law applicable to contractual obligations (‘Rome I), which is currently in the process of preparation, enabled the parties to choose a supra-national legal system. This was provided for in the Commission’s draft\textsuperscript{7} (Article 22 (b)), but unfortunately it seems as though the political discussion would go into another direction.

However, as long as no agreement on the basic principles of a European contract law is achieved, a harmonization of special fields (e.g., special liability rights) should be abstained from by any means since some of the member states’ concepts are completely different with respect to this point (e.g., with respect to causality requirement, fault requirement, the issue of the distribution of the burden of proof, etc.).

3.1.2. 28\textsuperscript{th} Regimes

Since it is questionable whether an (arbitrary) European legal framework can be implemented in political terms, the creation of 28\textsuperscript{th} product-specific regimes might be a short-term alternative. The most prominent examples are the plans concerning a pan-European pension plan which is currently prepared in the European Financial Services Round Table (EFR)\textsuperscript{8}. These efforts are highly welcome and should be received positively by the European Commission. However, it will probably not be easy to achieve an agreement among the member states in areas in which classic means of harmonization failed due to a lack of agreement.

The term pan-European old-age pension insurance product brings about a connotation with products that shall be subject to uniform deferred taxation (EET) in the member states of the European Union. However, the quality criteria for deferred old-age pension taxation, which were determined by


\textsuperscript{7} Proposal on a regulation on the law applicable to contractual obligations (Rome I) KOM (2005) 650, dated 15\textsuperscript{th} December 2005.

\textsuperscript{8} See most recent document on the pan-European pension plan of 26\textsuperscript{th} June 2007.
the member states for socio-political reasons, are to be respected by all means at this point. The German legislator has decided to link deferred taxation (EET) as well as allowances that are paid by taxes and that depend on the amount of income and number of children, to the criteria “capital maintenance guarantee” and “lifelong benefits” in order to make sure that the money is available when needed.

3.2. In particular: Harmonization of Consumer Protection (question 11; number 26)

Maximum harmonization of consumer protection rules in the member states encourages fair cross-border competition which results in favourable conditions for the consumer. The four key areas of consumer protection – information, advice, withdrawal rights, and control – should be finally determined on European level in the course of maximum harmonization. In this respect, according to the legislation of the European Court of Justice (ECJ), the responsible consumer must be the focus to which all efforts should be targeted, i.e. an average consumer who disposes of a normal amount of information, and who is characterized by attentive and rational behaviour.

a) Information

Different specifications in the Life and Non-life Directives as well as in the Directive concerning the distance marketing of financial services impose reporting requirements on insurance companies, some of which are to be met when signing the contract and some during the term of the contract. The regulations on consumer information have been inconsistent and sometimes even confusing so far. A focus on important information would be desirable. A confusing flood of information, which can lead to disinformation, should be avoided at all times.

b) Advice

Policyholders often turn to the insurance broker in order to obtain comprehensive, competent, and demand-oriented advice. Providing such advice is a supplement to the reporting requirements. However, any such advice shall not be forced on the policyholder. Patronizing the policyholder contradicts the model of a responsible consumer. The possibility to do without such advice must be maintained.
c) Cancellation Rights

Cancellation rights with respect to contracts and their prerequisites vary in Europe. There is the danger that policyholders are prevented from realizing their legal interests because the regulation is confusing. A consolidation of the cancellation rights would be desirable. Following the requirements of the Life Directive (Article 35: Right to cancel the contract within 14 to 30 days) would be advisable in this connection. Of course, following the Directive concerning the distance marketing of financial services (Article 6) would also be possible. Anyhow, a uniform legal regime applying to all contracts, and no differentiation according to distribution channels or insurance lines seems to be important.

d) Control

The possibility to settle disputes out of court by turning to a complaints office is an important tool in the consumer’s hand. Such an extrajudicial arbitration body was established under the name “Ombudsmann e.V.” in Germany in 2001. The recommendation made by the European Commission in April 2001, which determined the principles for extrajudicial institutions which participate in the concerted settlement of consumer disputes, certainly gave momentum to the establishment of such an institution. However, we advise against a legal regulation since the initiatives taken by the industry could be damaged and the procedure could be bureaucratized this way. With respect to cross-border consumer complaints (question 5), an efficient network for extrajudicial settlements of disputes has been established with the FIN Net in the financial services sector. This network can be used conveniently by the consumer (Internet). Nonetheless, current activities taken on CEIOPS level, aiming at encouraging the cooperation between supervisory authorities concerning cross-border complaints (revision of the Siena Protocol) are welcome.
3.3. Reduction of National Regulations on the General Good (numbers 22, 23)

A review of the regulations on the general good can be a sensible exercise; however, this is probably a rather time-consuming endeavour. The EU Directive legislator has included several references to the general good at various places in the insurance directives, but it has not defined it any further. The German supervisory authority has done this in a very general way (VerBAV 1996, 51) by generally listing entire laws (such as the German Civil Code, for example). As far as is known, other European supervisory authorities have pursued a similar approach. Therefore, a large number of regulations of these laws, including their interpretation, will have to be examined by science and legislation.

Only the following fact restricting the insurance single market shall be mentioned as an example from other countries: France has already known for quite some time national regulations in non-life insurance, which prohibit taking on exemptions with respect to defined natural catastrophes and terrorism. Respective exemptions are of no effect. Even if an industrial policyholder comes to the conclusion that in his/her point of view the coverage of the risk of terror is not necessary he/she cannot elude it, because the extended cover is mandatory. In the case of multinational insurance programs, in which usually no local basic insurance exists, it can happen that the parent companies which are located out of France also do not want the so-called master cover to be extended by terror risk for risks that are located in France. In this case, French law also demands this kind of cover.

3.4. Cross-Sector Issues (question 2; numbers 23, 39, 40)

In connection with the study on long-term savings vehicles (number 23) and the currently discussed question of cross-sector consumer information and advice (numbers 39/40), we would like to point to the fact that the products’ diversity must be taken into account further on. An undifferentiated application of the reporting requirements for funds to unit-linked life insurances is not indicated (annex 2).

Event though it is not mentioned in the Green Paper, the issue of the so-called guarantee funds shall also be mentioned in this context. These funds promise guarantees, but they are neither subject to any comparable capital requirements that insurance companies have to cope with, nor do
they have any comparable insolvency protection (compensation is limited to EUR 20,000 in Germany). For the purpose of consumer protection, there is need for action in this context (annex 3).

3.5. International Private Law (number 31)

Due to a lack of the desirable harmonization of the contract laws, a uniform reform of the existing international private law rules would be of particular importance for the insurance industry. So far, with respect to insurance contracts covering risks that are located within the European Union, a very complex special international private law exists in the 2nd Non-Life Directive and the Life Insurance Directive, which apparently shall not be changed by the codification efforts taken in connection with Solvency II. The implementation of the directive led to a fragmentation in 30 acts within the countries of the European Economic Community (EEC). Moreover, contracts that cover risks that are located outside of the European Union or that have been taken out with non-EU insurance companies or a reinsurance company are subject to a different regime (namely the 1980 Rome Convention).

The German insurance industry therefore demands that all insurance contracts – irrespective of the location of the risk – are included in the Rome I regulation (integration of the 1980 Rome Convention in EU law), and that they will be regulated consistently. In particular with respect to standard products it must be easy and obvious for insurance companies to determine which law is applicable; otherwise low profit margins do not justify the required effort for identifying the applicable law.

An amendment of the Rome I regulation would also offer the chance to abandon superfluous options of the member states and to simplify existing rules. Due to the structure of the insurance contracts, the law of the country in which the risk is located should be applicable\(^9\). This is the location where the insurance contract is defined and positioned in life circumstances and legal system, which is usually the place of residence of the policyholder. Additional involvements due to binding law shall not be possible.

\(^9\) Therefore, the first approaches made by the European Parliament (draft report of 22nd August 2006 (PE 374.427v01-00)) and the Council (draft of the German presidency to Art. 5 a (new) document 8935/1/07) are welcome. However, they lack the ultimate consequence with respect to a uniform regulation of all cases.
In the long term, the option to choose the law should not only be restricted to large risks and reinsurance contracts, but it should be extended to businesses and self-employed persons. From the contract law perspective it would then be possible to offer identical products throughout Europe. The product development which was required due to the complex international private law situation has led to the fact that insurance companies did not make much use of the freedom to provide services for anything less than coverage of large risks\textsuperscript{10}.

3.6. Increasing Financial Capability (question 10; number 38)

As shown by the conference organized by the European Commission in March 2007, in which the German Insurance Association participated with a presentation on the activities of the German insurance industry, the subject of increasing financial capability attracts wide interest. The German Insurance Association welcomes the project of a summarizing overview of institutions which operate in this field, as well as the description of their activities. This overview has also contributed significantly to building the network which is necessary for an effective exchange of information. Basically, increasing financial capability should be given more importance in the schools’ curricula. In addition to encouraging the motivation to actively deal with financial issues, imparting knowledge on product types as well as on possibilities for obtaining further information should be in the focus of the efforts.

4. “Fragmentation of the Motor Vehicle Market” (question 13)

A large number of companies compete on the German motor insurance market. According to statistics compiled by the German Insurance Association, 106 insurance companies, which generated a total premium volume of EUR 22 billion, operated in the field of motor insurance in 2005. The market leader contributed 17% to this premium volume; the other 105 competitors had – for the most part significantly – fewer market shares. According to the German Insurance Association’s statistics, 19 companies, the parent companies of which were located abroad, operated in the German motor insurance market in 2005. The market share of these companies amounted to 16 percent.

\textsuperscript{10} See comment of the European Economic and Social Committee (EESC) on Rome I (INT/307) of 13\textsuperscript{th} September 2006.
As stated correctly by the Green Paper, the national and regional markets differ significantly.

4.1. Current features of Motor Insurance

The CEA\textsuperscript{11} says in this context:

\textit{“The rating of an insurance product is much more "sophisticated" than that of numerous other services”}

It is based on a whole series of elements which vary substantially from one country to another - which is also demonstrated by the example of motor liability insurance:

- risk profiles are very different depending on the European country (driver habits, average age, road condition, soundness of vehicles…) and claims rates are therefore very different;
- the size of the population, and hence the number of insureds concerned, affects the possible level of risk sharing, and therefore the tariffs applied;
- the same applies to compensation rates: given the higher level of wages and higher social and tax charges, it is for example twice as costly to repair a vehicle involved in an accident in Denmark as in Germany or Sweden; similar differences can be recorded with regard to care costs or compensation for moral tort - hence the unavoidably varying premium levels in given EU countries;
- the varying importance of fraud may also explain differences in price;
- finally, the different tax systems in the various EU countries, which also impact on rates for motor insurance products.

All these variables considerably affect the rates applied by retail insurers. Their inclusion largely puts into perspective the use of price indicators to compare different national retail insurance market situations.”

\textsuperscript{11} The European retail insurance market(s), rapporteur: Yves Bertoncini, CEA 2004, p. 10.
For example, in Germany one can observe a spread of the loss susceptibility from 76.3 to 126.2 (100 being the market average) in motor liability insurance within the 445 regions when looking at regional class as tariff criterion. The regional differences are in some cases even significantly larger in the comprehensive insurance. With respect to car type as tariff criterion it must also be observed that the results from one country may not be applied to the situation in another country without review due to different buyer structures and diverging cost of repairs.

The regional differences within the German market play such an important role that providers which only operate in a regional submarket dispose of relatively high market shares. This is probably caused by the fact that these providers know the risk structure in their tariff area very well, and respond to the individual needs of their customers to a particularly large degree when giving advise or settling a claim.

The statement that a comparison between prices in motor insurance would be made more difficult by the fact that the amount of coverage and the local risk conditions were different (number 7) thus is not quite clear against this background. For one thing, the insurance directives did aim at achieving a large variety of products (number 22). And for another thing, this variety is largely used: in 2006, 5.21 million customers (approximately 10%) changed their motor insurer in Germany! Therefore, it would be good to know which target the Commission pursues by investigating the price variation in the motor insurance sector in its announced study.

4.2. Cross-Border Motor Insurance is Possible in Legal Terms and it is also Exercised

At present, 20 foreign insurance companies (countries of origin: NL, LU, BE, UK, IE, FR, AT) operate in Germany in the framework of Articles 49-55 of the EC Treaty, which guarantee the freedom to provide services. These insurers have their headquarters or agencies exclusively in EU-countries outside of Germany, and they only have to give the name of a representative based in Germany to the Federal Financial Supervisory Authority (BaFin). This representative can at the same time be the representative for settling claims according to the 4th Motor Insurance Directive. The Federal Financial Supervisory Authority is obliged to provide these insurers with the necessary information material, which enables the companies to comply with the laws that are relevant for motor insurance in Germany.
The market share of these insurers is marginal. The reason for this is not legal obstacles, but the above mentioned appearance of foreign insurers in the German motor insurance market focuses on a certain group of customers, which justifies to follow a customer abroad in the framework of the freedom to provide services from an economic point of view, for example if the customer only lives and works temporarily in Germany. A stronger involvement in the German motor insurance market is not attractive for the mentioned insurers because, as already explained, a detailed analysis of the claims risks in the German road traffic together with a respective premium calculation would be essential, and this would not be possible with the mentioned small office units (one person and an office is enough).

4.3. Cross-Border Claims Settlement does Work

The 1st Motor Insurance Directive (Article 3, Paragraph 2) already introduced the so-called European cover: it was specified in the 3rd Motor Insurance Directive (Article 2), and it was finally amended by Article 4 No. 3 of the 5th Motor Insurance Directive, according to which European cover has to be granted that “(must) cover on the basis of a single premium and during the whole term of the contract, the entire territory of the Community, including for any period in which the vehicle remains in other Member States during the term of the contract …”

European cover is the result of the single market and the free crossing of the internal borders without border checks with respect to the fulfilment of compulsory insurance. It offers comprehensive protection for temporary stays abroad and it enables the allocation of a vehicle to a certain national market – the market in which it is usually located – and its guarantee fund by means of the licence plate and insurance. In terms of conception it is not designed for temporarily unlimited or permanent stays, but explicitly for temporary stays abroad.

There exists a large network for settling road accidents with cross-border dimension, which provides information and claims settlement services to persons who suffered a loss or damage in cross-border accidents at home and abroad: the information office, the responsible insurer, its claims settlement representative, the compensation office, the “green card” office and finally the guarantee fund.
4.4. Summary

The current legal framework of the motor insurance market in Europe has resulted in high competition in the German market, which is intensely used by consumers. The bureaucratic effort of changing the insurer is not too large. If a temporarily unlimited, cross-border “entrainment” of a motor insurance shall be made possible in legal terms the currently working system must not be damaged. Under Solvency II insurance companies have to observe the actual risk situation in order to meet the solvency requirements, which thus represent important factors for calculating the premiums. For a large number of companies the effort required for evaluating risks abroad will probably not be justified from an economic point of view. Advantages for the customers would hardly be expected. It is more likely that the companies would include a “security add-on” in the premium calculation because they are not familiar with the risk situation abroad.

Brussels, 13th July 2007

Appendices