THE EU POLICY ON INSURANCE AND REINSURANCE LAW AND THE PROSPECT OF HARMONISATION: FACT OR FICTION?

Abstract

In an effort to promote further the internal market, the European Commission has proposed the Common Frame of Reference (CFR) and the creation of an optional model for an optional European Civil Code. Within the CFR, insurance law is prominent due to the importance of the insurance sector for the EU economy, the character of insurance contracts as a special bread of cross-border trade, and the need to complete the internal insurance market. To this effect, the Reinsurance Directive 2005/68/EC and the Solvency II Directive have been shaped in an effort also to fill the gap for homogenous insurance and reinsurance regulation.

In examining the current status of EU insurance and reinsurance law, the EU policy and reasoning behind it, and the latest developments regarding the proposed CFR and optional instrument for an optional European Civil Code, we assess the future of European insurance law, the best way to achieve harmonisation in the insurance sector and the anticipated impact of harmonisation on the internal market.

Key words: EU policy, Common Frame of Reference, contract law, directive, insurance, reinsurance, harmonization

1. INTRODUCTION

Although the Community has always perceived contract as a simple means to complex policy ends and has nurtured the idea of European contract law and a European Civil Code, nevertheless it is only in the last years that a considerable progress has been made in the movement towards harmonisation. Of the strong arguments for the promotion of harmonisation of contract law have been the existing tensions between the national contract laws, the EC contract law and the idea for a Common Frame of Reference and an optional model for an optional European Civil Code in the light also of the completion of the internal insurance and reinsurance market.

European insurance law is highly placed within the CFR due to the trans-national character of insurance contracts, the major economic role of insurance at European level and the need to finalise the completion of the internal insurance and reinsurance market. In terms of the same objectives, the CFR apart, further initiatives include the Reinsurance Directive 2005/68/EC and the proposed Solvency II Directive.

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1 In effect, the Community has used it to achieve various goals such as the completion of the internal market.


3 Hereinafter “CFR”.
This article initially discusses the current status of European contract law and the EU policy with regards to its harmonisation. It then goes on to critically analyse the current condition of European insurance and reinsurance contract law and the best way to achieve the proposed harmonisation. Finally, it assesses the overall impact on the European insurance and reinsurance market and the implications for the internal market.

2. EUROPEAN CONTRACT LAW

2.1. The Nature and Current State of European Contract Law

The nature of European contract law, according to the statement by Prof. Stephan Vogenauer, is that of a spectre. Although it does not exist anymore in the same format it has existed in the past, many favour its reinstallation through the means of recognition of its surviving features, whilst others object to the furtherance of harmonisation.

In this section we firstly examine the current status of European contract law. Then, we consider the necessity of harmonisation, the EU policy and competence in relation to it, the process of harmonisation and the various implications involved.

The first attempt to harmonise European contract law was through the Hague Conventions, i.e. the Uniform Law on the International Sale of Goods and the Uniform Law on the Formation of Contracts for the International Sale of Goods, which were agreed in 1964 and came into force in 1972. These Conventions acted as a basis for the 1988 Vienna Convention for the International Sale of Goods. Although the extent of harmonisation of sales and contract law by the CISG has often been doubted, nevertheless its success in creating an agreed framework for the analysis of complex legal issues in sales law and contract law has always been recognised. Following the CISG, the Principles of European Contract Law and the UNIDROIT Principles of International Commercial Contracts were introduced. Later on, the various Communications issued by the European Commission have further encouraged the idea to develop European Contract Law. In particular, the Communication of 11 October 2004 of the European Commission has prompted the decision for the creation of a CFR designated to act as a "tool box" from which the Commission would draw as it chose and improve the quality of legislation and the coherence of EC law in relation to contract law. Also, the idea for an optional instrument, to be created in the long run, was introduced. A Draft CFR was published in early 2008, which was made available in its final outline form in

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6 Hereinafter “CISG”.
8 Hereinafter “PECL”.
13 Hereinafter “DCFR”.
December 2008 with the hope that it will lead to the creation of the actual CFR, to be adopted in 2009, and of an optional instrument in the form of a European Civil Code. It is supported that, even if the CFR is only ever used as a “tool box” and not as an introductory instrument in preparation for an optional instrument, it will have the effect of reinforcing the awareness of other laws and making nationals of the European Member States more critical of their own domestic law.

2.2. The Case for the Harmonisation of European Contract Law

There are many arguments in favour and against the harmonisation of European contract law.

Arguments in favour of the idea of harmonisation of European contract law are firstly the growth of the need for trans-national, cross-border transactions, secondly the impediment caused to trade by the various national contract laws which slow the flourish of cross-border trade and thirdly the increasing need for the use of standard terms and clauses in commercial or international commercial contracts whereby the frequent choice of non national laws to govern any arising arbitration procedure further proves the need for harmonisation.

Arguments against the idea of harmonisation of European contract law are firstly the fear of diminution of common law and its importance in international commercial contracts, secondly the absence of evidence – save in a few exceptions such as in the case of consumer contracts – purporting that the variety of national contract laws impediments trade, thirdly the argument that any existing problems can be circumvented without the need for the creation of a European contract law to substitute national contract laws, fourthly the argument that the expense and time to be consumed and the doubtful character of the result to be achieved outweigh the possible benefits of such a gigantic project, and fifthly the argument that the multiplicity of contract laws, especially where the latter is chosen due to its tradition and prevailing character in the specific sector, offers a diversity which is beneficial for the contracting parties.

According to data, resulting from a survey conducted in 2005, a majority of European businesses are in favour of a harmonized contract law although they express the view that the new harmonized legal instrument should not be mandatory. Member States also have, in many ways, expressed various reservations on many issues such as the level at which harmonisation would

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16 Ibid, n 15.

17 Although the multiplicity of available contract laws applicable to cross-border transactions gives European businesses a far-reaching variety of possibilities, nevertheless the existence of various legal systems results in imposing costly obstacles to cross-border transactions which in their turn deter cross-border trade; See S Vogenauer, S Weatherill, The European Community’s Competence for a Comprehensive Harmonisation of Contract Law - An Empirical Analysis, E.L. Rev. 2005, 30(6), 821-837, 835-836.

18 Such as, for example, the common law of England and Wales which is often the international choice of law in terms of insurance and shipping contracts; Baronness Ashton of Upholland, The UK Government’s Thinking on Harmonisation, 245-248, 246 in S Vogenauer, M Weatherill (Eds), The Harmonisation of European Contract Law, Implications for European Private Laws, Business and Legal Practice, (Oxford, Hart Publishing, 2006).


21 Such as the UK.
operate or the actual and practical efficacy of the proposed CFR as a harmonising instrument. In effect, those opposing the idea of harmonisation fear that the proposed CFR will simply replicate previous harmonisation products and suggest that its intended content be reconsidered on the basis of its primary operation, in an effort also to enable a clear response to the real problems within the aquis.

It follows that there are many reasons equally in favour and against the idea of harmonisation. Any discussion of the need for greater coherence in contract law and for the subsequent need for the initiation of the harmonisation process is complex, not least because many issues have to be addressed in the process of it.

2.3. The EU Policy and Competence in Relation to the Harmonisation of European Contract Law

The existence of an EU policy in relation to European contract law has always been apparent, in many respects. Firstly, the EU policy exists within the EC Treaty’s competition rules which render non abiding contracts as unenforceable. Secondly, it exists within the rules of the EC Treaty on the free movement of persons which have been interpreted as affecting the activities of private parties, including contracts. Thirdly, it exists within the gender and wider equality rules which affect private relations and any related contracts. Fourthly, it exists within Articles 94,95 EC and within the Council Directives 93/13/EEC and 99/44/EEC which have created a platform to harmonise contract law. Fifthly, it exists within the three communications issued by the Commission between 2001 and 2004 which have further promoted the discussion on harmonisation of European contract law, by confirming that the adoption of the various EC Directives has enhanced harmonization, albeit in a limited way and with a narrow scope and have provoked a wide reflection on the future of European contract law. In particular, the Commission in its third Communication of 2004 “European Contract Law and the Revision of the Acquis: The Way Forward” underlined the central role of the proposed CFR in terms of improving the acquis and its coherence in the area of contract law.

The policy behind the proposed CFR entails that it will supply definitions of legal terms, set fundamental principles and model contract law rules, offer guidance for any required exceptions

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22 For example, it has been argued that harmonisation, should it occur, must not take place at a European but at a global level and that in any case this is a goal which has already been fulfilled by the CISG.
23 Such as the Principles of European Contract Law.
26 Art. 81(2) EC.
27 According to the interpretation of the ECJ (Case C- 415/93 URBSFA v Bosman, ECR – I 4921).
31 Only in relation to rules on certain types of contracts or on certain forms of marketing.
and become highly influential in the drafting and interpretation of legislative measures, proposed in parallel to the CFR, i.e. the promotion of the use of EU wide standard terms and conditions and the creation of an optional instrument in European contract law. In addition, the competence of the European Commission to enact a comprehensive European contract law and establish harmonisation is verified by Art. 95 EC and the two requirements set in it. In effect, it will have to be demonstrated that any further steps in the area of contract law will eliminate existing obstacles to the free movement of goods or the freedom to provide services and secondly, that the enactment of such a European contract law will be proportionate - according to Art. 5(3) EC - in that it will be appropriate for the removal of such obstacles and it will not go beyond what is necessary to achieve the required objectives and will not have any effects disproportionate to the aims.36

2.4. Impact Assessment of the Proposed CFR

The impact assessment of the proposed CFR has provoked multiple reactions. On the one hand and in spite of the attributed to it political knowledge, the CFR is believed to be rather ambiguous. It is further argued that whilst the practical objectives of the CFR might be largely feasible nevertheless harmonization does not necessarily flow from the articulation of rules at a surface level. Moreover, although the CFR may well succeed in promoting mutual understanding of our respective systems, the repercussions of such understanding might well call into question the very concept of harmonization as a feasible goal.

The Commission has emphasized that the substantive content of harmonization is to be be determined primarily by reference to the need to increase the coherence of the acquis and in accordance with the principal goal for the CFR to serve as a terminological model in the drafting and revision of European legislation. The Commission believes that consistency will be promoted in this way and that the functioning of the internal market will be improved. Moreover, the Commission hopes that the CFR will be used by national legislators as a point of reference when enacting contract law legislation, by arbitrators when resolving conflicts between contractual parties and by the ECJ as a source of inspiration when interpreting the acquis on contract law and that it will also act as a testing ground for a possible optional instrument which parties could choose to use as applicable law. Within the proposed CFR, the formulation of core aims and fundamental principles helps reveal the underlying model of society and of the economic system and clarify the position of the proposed CFR in the spectrum between free market and fair competition theories and more invasive approaches in favour of consumers, victims of discrimination, small and medium sized enterprises and the many other possibly weaker parties to contracts and members of the society. All areas of law covered by the CFR bear the double aim of promoting general welfare by strengthening market forces and at the same time allowing individuals to increase their economic wealth. In many cases, the proposed draft CFR is simply setting out rules that reflect an efficient solution – what the parties might have agreed but for the costs of trying to do so. This is most obviously true for many of the rules of contract law: they are simply “default rules” to apply when the parties have not agreed anything on the point in question However, the rules in the proposed draft CFR are intended to promote efficiency and economic welfare; and this is a criterion against which any legislative intervention and new initiative should be double checked.37

In conclusion, although it has been argued that the CFR contains abstract terms, it nevertheless constitutes a necessary response to already-identified problems of inconsistency and

lack of coherence and as such it should be seen as essential for stimulating competition and improving the internal market. Not least, another argument in its favour is the “hands-off” approach of the Commission in relation to it, which alleviates the tension that further incursion into national contract law rules can trigger.  

3. EUROPEAN INSURANCE AND REINSURANCE CONTRACT LAW

3.1. European Insurance Contract Law

3.1.1. The Current State of European Insurance Law

The prominent position of the insurance sector in the European economy, the special features often contained in insurance contracts and the need to complete the internal insurance market have all resulted in the special placement and treatment of insurance within the CFR. The CFR does not represent the first attempt to harmonise insurance law, because the aim of harmonisation has always been apparent. Following the Treaty of Rome of 1960, several EC Directives encompassing this aim, were adopted. In particular, the three generations of insurance Directives, adopted between 1973 and 1992, constitute efforts which were aiming at the establishment of a common insurance market and the abolishment of obstacles to cross-border transactions.

The first generation of insurance Directives tried to obtain the freedom of establishment. While it retained the requirement for duplicate control by the supervisory authorities of both the member and host states, it abolished any discrimination on the basis of nationality. In this way, some degree of harmonisation was achieved. Moreover, in four judgments of 4 December 1986, the ECJ decided that the applicability of Articles 59 and 60 of the EC Treaty is not dependant on the harmonisation of the laws of the member-states. Following the above judgments of the ECJ, the second generation of Directives was adopted in order to enhance the promotion of the freedom to provide services in the insurance sector. The third generation of Directives introduced the principle of the country of origin and the single-licensed “passport” system, in an effort to achieve the completion of the internal insurance market. Although hopes were raised in relation to the latter goal, the adoption of the third generation of insurance directives has not managed to substantially alter or increase existing patterns of cross-border trade by insurance companies because of reasons such as the fact that the majority of the large insurance undertakings likely to be interested in expanding in other Member States had already set up branches in other member states prior to the implementation of the third directives or the fact that the absence of harmonization of contract law or the need of long term business for contracts able to be subjected to the local law of the host state.

39 Such as the fact that they usually cover long periods and as such require a high level of protection on behalf of the insured or the fact that they constitute a product which is suitable by nature for international cross-border trade.
41 Adopted in 1973 (non life) and 1979 (life).
Following the adoption of three generations of Directives and in terms of the Commission’s initiative for “Simpler Legislation for the Internal Market”, the consolidated Directive 2002/83/EC was adopted in order to facilitate the application of the previously adopted. The latest developments in the efforts for harmonisation have been the proposals for a CFR, an optional instrument and a standard set of rules to replace all Directives, prevent divergent national implementation and enhance simplification.

3.1.2. The Case for the Harmonisation of European Insurance Contract Law

Although insurance supervisory law is largely harmonised in the EU, the same does not apply to insurance contract laws of the various member states. The existence of the multiplicity of insurance regulations at member state level, the absence of harmonisation on consumer protection and the lack of a European contract law has resulted in the number of cross-border insurance transactions being rather limited.

A harmonised insurance contract law would augment the number of such transactions and benefit all parties involved. In particular, it would enable insurers to apply the same designs and calculations to their policies, pool mass risks on an EU-wide basis and it would allow . On the other hand it would allow policyholders to acquire foreign insurance products without having each time to adjust their insurance policies and coverage to the different requirements imposed by the Member States.

The case for harmonisation which was put forward by the various Communications of the Commission resulted in the proposal for the development of a CFR, of a set of standard terms and conditions to be applied to cross-border insurance contracts and of an optional instrument in European contract law. The Commission asked the various stakeholders not only to suggest instruments to effect harmonisation but to express their opinion on the proposed harmonising instruments and on their possible structure and legal nature. Within the views expressed, a common ground has been the realisation that all solutions should be considered before any decisions are made, that all parties related to the insurance sector should be involved in an effort to achieve the maximum potential of the benefits for the internal market, and that the risks or benefits and implications of such a process should be thoroughly assessed prior to the adoption of any instrument or other solution. It was also stated that although the CFR will definitely contribute to a more coherent current and future acquis, nevertheless the existing deficit of the internal insurance market urges for a swift solution which may not be feasible if one awaits the completion of the harmonisation process of European insurance contract law.

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44 Hereinafter “SLIM”.
46 D Weber-Ray, Harmonisation of European Insurance Contract Law, 207-234, 226-227 in S Vogenauer, M Weatherill (Eds), The Harmonisation of European Contract Law, Implications for European Private Laws, Business and Legal Practice, (Oxford, Hart Publishing, 2006); With regard to cross-border contracts, an insurer usually has to face two categories of special risks, i.e. the overall damages in a given sector may differ from domestic experience due to particular economic, social, and cultural conditions of the foreign environment and the foreign contract law of the policy-holder's country which is applicable under the relevant conflict of laws rules and which determines the interpretation and effects of the policy. In addition, insurance companies operating from their home bases must either invest in the costly adaptation of their policies to the foreign insurance contract laws, or must abandon the idea of expanding their activities to the foreign markets if they are unwilling to incur such costs, See J-A Tarr, A A Tarr, Some Critical Legal Issues Affecting Insurance Transactions Globally, J.B.L. 2001, NOV, 661-702, 664.
At present the Draft Common Frame of Reference\(^{48}\), which was published in December 2007 in an interim outline edition and which appeared in its final edition in late 2008, constitutes an interim stage in the process of harmonization. It amounts to the compression into rule form of decades of independent research which aims at reflecting aim to reflect the underlying values to be found in the existing laws, revealing the underlying model of society and of the economic system and helping in the process of improving the existing acquis and at the same time constitutes a possible model for an actual CFR. To this effect, it has not been structured on an “everything or nothing” basis, so as to allow the political institutions – in case they decide to go on with an official CFR on the basis of the DFCR – to be able to deviate from it.\(^{49}\)

3.1.3. The Solvency II Directive

The solvency margin is the amount of regulatory capital an insurance undertaking is obliged to hold against unforeseen events. Solvency margin requirements have been in place since the 1970s and the need for their revision was acknowledged in the third generation insurance Directives. In effect, the Commission was required to conduct a review of the solvency requirements, following which a limited reform known as Solvency I was agreed by the European Parliament and the Council in 2002.

Notwithstanding the above reform, it became apparent that a more fundamental and wider ranging review of the overall financial position of an insurance undertaking was required, which would take into account the latest developments in insurance. As a result, the proposed Solvency II, which is based on a three pillar approach, was created. The first pillar contains the quantitative requirements - i.e. the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR) which are both capital requirements and represent different levels of supervisory intervention - and sets out the methods for their calculation. The second pillar contains qualitative requirements on undertakings such as risk management as well as supervisory activities. The third pillar covers the sphere of supervisory reporting which entails that firms will be required to report greater amount of information to their supervisors and the sphere of disclosure which entails that firms will need to disclose certain information publicly so as to enhance market discipline and help ensure the stability of insurers and reinsurers. In this way, it is hoped that Solvency II will streamline the way that insurance groups are supervised and at the same time recognise the economic reality of groups operation.\(^{50}\)


In conclusion, Solvency II is designed to help respond to the expectations of consumers, supervisors and companies. It is a major step in a process that started over 30 years ago, with the adoption of the first generation of Directives. It is hoped to provide companies with more freedom than before, strengthen supervision, and verify the rationale which exists behind all EU insurance legislation, i.e. the facilitation of the development of a single insurance market.

\(^{48}\) Hereinafter “DFCR”.
\(^{50}\) http://ec.europa.eu/internal_market/insurance/solvency/architecture_en.htm accessed on 13 April 2008.
3.2. European Reinsurance Contract Law.

3.2.1. The Current State of European Reinsurance Contract Law, the EU Policy on Reinsurance and the Case for Harmonization

Contrary to insurance where the adoption of three generations of Directives have secured some degree of harmonization and have served as the necessary requirement for the completion of the internal insurance market, in the reinsurance sector the non-existence of a common regulation prior to the adoption of the reinsurance Directive 2005/68/EC had resulted in the EU member-states applying their own varied rules.\(^{52}\) Even in cases where attempts to harmonize reinsurance had been made, such as the adoption of Directive 64/225/EEC, such attempts had failed to abolish existing restrictions on reinsurance, to create a common regulatory framework for its supervision and to establish requirements which would be observed by Member States in relation to the authorisation of reinsurers.\(^{53}\) Following recommendations by the Organisation for Economic Co-operation and Development, the Financial Stability Forum, the International Association of Insurance Supervisors and the World Trade Organisation, Europe started to feel the need for a common approach and harmonisation of reinsurance. It was also felt that harmonisation would help spread the reinsurance risk globally, establish a much more uniform approach as to the reinsurance regulatory framework and complete the internal reinsurance market.

In drawing its policy reasoning for a harmonized EU reinsurance supervision regime, the European Commission established three principles, i.e. firstly, the principle that the system should promote a sound and prudent regime in the interest of insurance policyholders\(^{54}\), secondly the principle following from the combination of an essential coordination of the legislation of the Member States and from the mutual recognition of the supervision in the Member States where the reinsurance undertaking would be licensed,\(^{56}\) and thirdly the principle that the introduction of a harmonized system for reinsurance supervision would lead to the abolishment of systems with pledging of assets to cover outstanding claims provisions.\(^{57}\)

In effect, all of the above policy reasoning is reflected on the reinsurance Directive 2005/68/EC.

3.2.2. The Reinsurance Directive 2005/68/EC

Prior to the enactment of Directive 2005/68/EC and owing to the non-existence of a common regulation of reinsurance at an EU level, EU member states applied their own rules regarding reinsurance business regulation. In effect this signified a wide range of diversity in the way reinsurance was regulated, as some EU members chose not to regulate insurance at all while other EU member states had for a long time regulated insurance much like primary insurance.\(^{58}\)


\(^{52}\) Some EU member-states, such as Belgium and Greece, chose not to regulate reinsurance at all whilst other member states, such as Denmark, Finland, Portugal and the UK, had since long regulated reinsurance much alike primary insurance.


\(^{55}\) As it was thought that the establishment of strong and well-supervised reinsurers would result in a stronger internal market and in international financial stability.

\(^{56}\) Which would automatically allow reinsurance undertakings at the post-licensing stage to conduct reinsurance business all over the European Community under the freedom of establishment and the freedom to provide services.


Of its principal innovations is that reinsurers are to be supervised in their home state by the relevant authority and on that basis solely operate throughout the EU. The reinsurance Directive 2005/68/EC affects pure reinsurers, mixed insurers and direct insurers. Because prudential regulation of reinsurance also affects consumers, the reinsurance Directive 2005/68/EC also affects consumers or consumer groups indirectly.

The reinsurance Directive 2005/68/EC aims to establish a new European wide applied regime in the conduct of reinsurance business via the application and introduction of harmonizing measures.

It also aims to ensure minimum common standards for the regulation of reinsurers established in the European Union and to incorporate reinsurance into the European Union’s supervisory system of the insurance sector and thus strengthen the European Union’s position in negotiation with third countries.

It applies to pure reinsurers, captive reinsurers and special purpose vehicles. While it follows the overall model of the insurance supervisory regime for direct insurers and mixed insurers, it also introduces a requirement for authorisation by home Member States, lays down a solvency regime and general principles on investment rules for assets and requires Member States to abolish gross reserving and pledging of assets, i.e. collateral requirements, in an effort to regulate cedants’ relationships with reinsurers and to intensify the international debate on the use of collateral. Not least, it provides that a Member State shall not apply more favourable treatment to non-EU reinsurers than the treatment provided to reinsurers with a head office in this Member State and leaves the treatment of non-EU reinsurers to the individual Member State control.

The reinsurance directive requires either separate licenses for life or non-life reinsurance or a license for all kinds of reinsurance: i.e. life and non-life reinsurance.

The reinsurance directive offers reinsurance undertakings true “passporting” rights which allow their Europe wide operation subject to a prior official authorization from the competent authorities of their home member-state. The minimum necessary conditions for the official authorisation are that a) the reinsurance undertakings have a specific legal form b) they submit a scheme of operations with essential information on their business plans c) they possess a minimum guarantee fund d) they are effectively run by managers who have adequate technical qualifications or experience e) they limit their objects to the business of reinsurance and related operations and f) they possess sound administrative and accounting procedures as well as adequate internal control mechanisms which ensure an orderly and financially stable pursuit of their activities. Furthermore, prior to the granting of the authorisation, the competent authorities must be informed of the identity of the members or shareholders with a qualifying participation in the reinsurance undertakings so that they can assess the suitability of the shareholders and ensure the sound and prudent

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59 Insurers writing only reinsurance business, including captive reinsurers which only accept business from a single firm.
60 Insurers covering direct insurers who also write a significant amount of reinsurance business.
61 In the sense that the provisions on the insurance special purpose vehicles (ISPVs) and on financial reinsurance affect the way insurers use reinsurance to mitigate risk.
62 As a result of the dependency of the ability of direct insurers to meet policyholder claims on the reinsurers financial security.
63 Consultation Paper 06/12** Financial Services Authority, Implementing the Reinsurance Directive, FSA, June 2006.
66 In contrast with the life and non-life directives, it does not provide a harmonised list of reinsurance classes and, therefore, it allows member-states, in their capacity as home-states, the discretion to introduce licenses for different reinsurance classes; European Commission: “Main Conclusions of the transposition meeting regarding the Reinsurance Directive 2005/68/EC on 13 November 2006”, MARKT/2520/07-EN.; K Noussia, The Impact of the Reinsurance Directive 2005/68: So Far So Good?, J.B.L. 2008, 5, 415-431, 418.
68 Such as statistical or actuarial advice, risk analysis or research for its clients or a holding company function and activities with respect to financial sector activities within the meaning of Article 2 point 8 of Directive 2002/87/EC.
management of the reinsurance undertakings. Authorization is granted only upon satisfaction of the competent authority on the suitability of the shareholders. Where close links between the reinsurance undertaking and other natural or legal persons exist and where those links impede the competent authorities in effectively exercising their supervisory functions, the authorization is refused. The competent authorities of reinsurance undertakings may not refuse a retrocession contract which is concluded between reinsurance undertakings covered by the reinsurance directive, strictly on grounds related directly to the financial soundness of the undertakings, because such an indirect supervision would suggest an interference with the supervisory powers of the competent authorities and question the fundamental principle of mutual recognition. The objective behind all of the requirements is to ensure a sound management and an effective supervision of the reinsurance undertakings. The granted authorisation is valid for the whole of the EU, in effect allowing reinsurance undertakings to conduct business at a European wide level on the basis of the rights to the freedom of establishment and the free provision of services. Home member-states, in their turn, ought to establish the conditions for meeting the above requirements.

With regards to technical provisions, for life reinsurance activities, the home member-state may lay down specific rules in accordance with the principles set up in Article 20 of Directive 2002/83/EC on life assurance. In addition, home member-states ought to require from their own reinsurance undertakings to set up an equalisation reserve in respect of credit reinsurance activities. They also have the discretion to exempt reinsurance undertakings with no substantial credit reinsurance activity from the obligation to set up such an equalisation reserve or to require their reinsurance undertakings to set up equalisation reserves for classes of risks other than credit reinsurance.

Although the introduction of a supervisory regime for reinsurance undertakings has resulted in the abolishment of the requirement of pledging of assets for unearned premiums and of the outstanding claims provisions of a reinsurance undertaking, nevertheless, member-states remain competent to impose the pledging of assets which are used to cover the above technical provisions of its own reinsurance undertakings, in case of reinsurance s concluded by non European reinsurance undertakings which are not subject to the supervisory regime of single authorisation and mutual recognition provided for by the reinsurance directive. In relation to the solvency margins, for non-life reinsurance business the requirements of the non-life insurance directive 73/239/EEC apply.

Due to the particular nature of some types of reinsurance contracts or the specific lines of business, there is the possibility of increasing the required solvency margin up to 50% in respect of

72 This provision sets out the actuarial principles to be followed to establish the technical provisions for life assurance activities.
73 The amount of which is to be calculated in accordance with the rules provided for in Directive 73/239/EEC.
74 This is in line with Directive 73/239/EEC as well as Directive 91/674/EEC on insurance undertakings annual accounts.
76 Article 37 of the non-life insurance Directive 73/239/EEC.
specific types or classes of business other than liability classes. In an effort to ensure a level playing field between reinsurance undertakings and insurance undertakings carrying on reinsurance activities, there are also provisions for subsequent adaptations to the non-life insurance directive 73/239/EEC and life assurance directive 2002/83/EC.

In life reinsurance the required solvency margin is to be calculated in accordance with the rules laid down in the life insurance directive 2002/83/EC and, where a reinsurance undertaking conducts simultaneously life and non-life reinsurance business, the required solvency margin need cover the total sum of required solvency margins in respect of both non-life and life reinsurance activities.77

The competent authorities of a reinsurance undertaking may take actions against reinsurance undertakings whose financial situation deteriorates. In particular, the competent authorities are eligible to ask for certain documentation, such as a financial plan or a restoration plan or a financial recovery plan to be furnished to them, or prohibit the free disposal of assets of the reinsurance undertaking and, in certain cases, withdraw the authorisation granted to the reinsurance undertaking.78 The reinsurance directive also allows reinsurance undertakings to apply for judicial review of any competent authority decision affecting it.79

EU member-states are permitted to regulate the treatment of third-country reinsurance undertakings commencing or carrying out reinsurance activities in their territory, via a company branch or via the provision of services, so long as they do not receive a more favorable treatment than the EU reinsurers. However, member-states are expected to consider their national obligations under other applicable international agreements and achieve a higher degree of harmonization with regard to the treatment of third country reinsurers.80

The possibility to conclude agreements with third countries regarding the supervision of reinsurance undertakings, which aim to promote the exchange of information between the competent authorities of the EU and the third countries concerned and the mutual recognition of the supervisory rules and practices on reinsurance between the EU and the third countries, is also expected to rise the number of bilateral agreements for third country reinsurers in major markets such as the US, Bermuda and Switzerland. However, to be able to start such negotiations the third country has to have a reinsurance regime close to EU standards, a requirement which places Switzerland high in the rank of prospective candidates for negotiations because its reinsurance supervisory regime mirrors many EU standards and, conversely, the U.S. lower in the same rank so long as its strict collateralization rules continue to apply.82

80 To this end the Commission is looking into different ways of establishing a common procedure for equivalence assessment of regulatory and supervisory regimes in third countries as well as the treatment of reinsurance recoverables and aims to include some provisions on this issue in the Solvency II Directive. See European Commission: “Main Conclusions of the transposition meeting regarding the Reinsurance Directive 2005/68/EC on 13 November 2006”, MARKT/2502/07-EN.
82 G Soussan, P Woolfson, Implications of directive, L.L.I.D. 2007, Jan 19, 4
A reinsurance undertaking entitled or authorised to conduct reinsurance business in accordance with the provisions of its home member-state before the date of implementation of the reinsurance directive, may continue to do so without requesting an authorisation which would have to be subjected to the provisions of the Reinsurance Directive, with regards to the financial soundness of the reinsurance undertakings i.e. technical provisions, provisions on the solvency margin and the guarantee fund, the status of their professional capacity and the good repute of their managers or the suitability of their qualifying shareholders.

Given that these undertakings shall not subject themselves to the single authorisation regime laid down in the reinsurance directive, and for reasons of transparency and legal certainty, it is essential that the member states draw up their list of the reinsurance undertakings concerned and communicate it to all member-states.  

The reinsurance directive obliges the competent authorities of the member-states to keep confidential all received information and use them in the course of their duties only where it is necessary so as to ensure that the necessary regulatory requirements are met and maintained, or in order to impose penalties in administrative appeals or court proceedings. However, this does not prevent the competent authorities from exchanging information in the discharge of their supervisory functions or from disclosing information to bodies responsible for the detection and investigation of breaches of company law or to central banks or similar bodies in their capacity as monetary authorities.

All natural or legal persons, holding directly or indirectly 10% or more of the capital or voting rights in a reinsurer undertaking or proposing to increase their holding up to 50% or to a percentage level that would make the reinsurer their subsidiary, are under the obligation to inform the competent authorities of the home state of their holding and of its size. The competent authorities have a period of three months in which to oppose such an acquisition, should they consider that it would be detrimental to their ability to ensure sound and prudential management of the reinsurance undertaking in question. In case of no opposition raised in relation to the acquisition, the competent authorities are entitled to fix a maximum period within which the acquisition need be implemented. Where the proposed acquirer is either an insurance undertaking, or a reinsurance undertaking, or a credit institution or an investment firm authorised in another member state or the parent undertaking of such an entity, and where the acquisition would result in the reinsurer becoming a subsidiary of the proposed acquirer, member-states must consult with the other member-states competent authorities. There is also the requirement for notification, although it need not be accompanied by an approval, where a person intends to dispose of a holding up to a maximum of 50% of the boundaries or where, following a disposal, the reinsurer is no longer its subsidiary. The member-states are also required to inform the European Commission and the competent authorities of all other member states, in case a non-EU parent undertaking acquires a holding in an EU reinsurer which would result in the EU reinsurer becoming its subsidiary.

The reinsurance directive contains also specific provisions relating to finite reinsurance, in that it characterizes the former as a separate type of reinsurance activity, to which the reinsurance directive is fully applicable and in relation to which member-states are given the option to further regulate the insurance types and the conditions needed to be abided to, so that they can meet the conditions of the reinsurance directive's definition of reinsurance or any sound administrative and

85 See Articles 27.28.53 of the Directive.
accounting procedures or lastly any separate rules relating to the solvency margin and minimum guarantee fund which are to be applied in respect of finite reinsurance contracts.\textsuperscript{88}

With regards to the insurance special purpose vehicles (ISVPs) which - though not reinsurance undertakings, conduct reinsurance-like activities – the directive provides as follows: for the purposes of the directive, an ISPV is a not necessarily incorporated undertaking, other than an existing insurance or reinsurance undertaking, which fully funds its exposure to the reinsurer through the issue of debt securities or some other funding mechanism, such as a reinsurance securitisation vehicle.

The reinsurance directive enables member-states to introduce rules on the establishment of ISPVs. If member-states choose to permit such ISPVs they must require their prior authorisation and lay down specific rules in relation to mandatory conditions for inclusion in all contracts issued, the good repute and appropriate professional qualifications of the managers of the ISPV, or in relation to the requirements for sound administrative and accounting practices and rules relating to solvency requirements.\textsuperscript{89}

However, even member-states not willing to allow ISPVs to be established within their territories have to introduce detailed qualitative or quantitative rules setting the conditions for the use of amounts outstanding from an ISPV as assets covering technical provisions. This is a necessary requirement as there is no obstacle for ISPVs wanting to assume risks from insurance undertakings established in other member-states. Although ISPVs are not explicitly subject to supplementary supervision under the insurance groups directive 98/78/EC\textsuperscript{90}, however, they receive their authorisation in accordance with article 46 of the reinsurance directive and there is nothing in the reinsurance directive to prevent member-states from subjecting ISPVs to supplementary supervision within the scope of their national legislation.\textsuperscript{91}

In relation to financial reinsurance, the reinsurance directive establishes that in order to ensure that appropriate standards are maintained, any reduction in the capital under a financial reinsurance contract has to be no greater than is justified by the reduction in risk and in addition effective risk transfer is required. In this way innovative transactions that truly transfer risks to the capital markets are encouraged.

In practice, the risk-transfer process encompasses that firms ensure that the legal documentation associated with the transaction identifies the level of risk actually being transferred and reflects the economic substance of the transaction, including that the risks being transferred are incontrovertible and that there are no conditions to fulfil that would be outside the firm’s control as this is essential to ensure that the level of risk-transfer arising from a transaction is rightly assessed.\textsuperscript{92}

Overall, the reinsurance Directive 2005/68/EC promotes worldwide financial solidity via the establishment of supervision of reinsurers by competent authorities in their home country. It also sets down the conditions for a true “single passport”, which enables reinsurance undertakings to carry on their business anywhere in the EU, either by establishing themselves in other member-states or by providing services directly from their home country or another member-state. Overall, the reinsurance Directive is an interim measure, introduced in advance of the Solvency II Directive,

\textsuperscript{89} K Freeman: The EU Directive on Reinsurance : Guidance Note, March 2006
\textsuperscript{90} Because this directive refers only to reinsurance undertakings with an authorizing received in accordance with Article 3 of 2005/68/EC.
which aims at the promotion of the harmonisation of reinsurance law and contributes to the completion of the internal insurance and reinsurance market. \(^{93}\)

### 3.3. Impact Assessment of the Proposed Instruments for the Harmonisation of Insurance and Reinsurance

Until the adoption of the reinsurance Directive 2005/68/EC the minimum requirements for a single licensing system for insurers\(^{94}\) were insufficient and member states had to implement their own measures and reforms. This also meant that the functioning of the single market was hampered.

The central idea behind the inception of the reinsurance Directive 2005/68/EC was to even supervision levels, abolish existing trade barriers, increase reinsurance financial activity, internationally strengthen the voice of the EU, facilitate internal mechanisms of financial control, risk management and disciplined underwriting and strengthen the capacity of reinsurance companies to deal with extreme modern challenges. It constitutes a significant step directed in harmonising reinsurance regulation, achieving the completion of the internal insurance and reinsurance market and materializing the need for a European-wide consistent regulatory reinsurance regime. Following the innovations introduced by the reinsurance Directive 2005/68/EC, the Solvency II Directive replaces the old requirements with more harmonized ones. It aims to ameliorate insurance regulation and promote a level playing field of harmonization through the codification of all of the existing insurance Directives into a single one which – albeit principle based – will aim at a high level of harmonization through its implementing measures by the development of proposals in transparency with stakeholders and finally by the drafting of a text capable of encompassing the anticipated impact.

It is hoped that the combined effect of the reinsurance Directive 2005/68/EC and the proposed Solvency II Directive will make simpler the conduct of insurance business in Europe, promote competitive equality at a European and global level, contribute to the creation of a worldwide standard in insurance, endorse higher and more uniform levels of consumer protection\(^{95}\) and deepen the integration of the European insurance market.\(^{96}\)

### 4. CRITICAL DISCUSSION

In its attempt to ensure the coherence of the *aquis* the Commission has proposed the adoption of various harmonizing instruments. However, these proposals were not left non-criticized and were often not welcomed. Nevertheless, harmonization is often required because there are differences in the various national laws which are per se undesirable and which cause difficulties for business and for the operation of a common market. Within this context, harmonization appears to be a virtue which needs no further justification. Secondly, harmonization may be required to respond to the need for the removal of serious impediments in cross-border transactions.\(^{97}\)

Whatever their need, harmonization efforts cast fears and doubts. In the present case, it is feared that, ultimately, nothing will be achieved or that the solution adopted will be based on the wrong propositions and as such will severely detriment the trading parties.

It is admitted however that any sort of reform abolishing anachronistic national law, should respect national identities. It is also admitted that the proportionality of any such reform should be

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\(^{94}\) As these were established by the third generation insurance Directives.


proven\textsuperscript{98}, that the reform should not simply repeat pre-existing positions but provide essential answers to the existing problems\textsuperscript{99}, that empirical evidence will have to be acquired which will demonstrate the actual contribute of harmonization to the removal of cross-border obstacles to trade and that the rules drafted are reconsidered so that they are not of the “surface” type\textsuperscript{100} but able to provide the most sensible answers to typical questions.\textsuperscript{101}

The envisioned toolbox function of the envisaged CFR goes well beyond the review of the \textit{acquis communautaire} and serves as a “draftman’s handbook” in shifting towards a horizontal approach in harmonizing European contract law. This horizontal approach is bound to a) be significantly broader in scope and coverage as compared to the piecemeal-type legislation adopted so far and b) to entail a (partial) shift from the existing approach of setting “minimum standards” towards “full harmonization” within its scope of operation. Moreover, the true and final aim of the CFR is to serve as a blueprint for the drafting of a “European Civil Code” or a single European contract law.\textsuperscript{102}

\begin{itemize}
\item[98] Regardless of any bias against economic analysis.
\item[102] H Grosse Russe-Khan, \textit{The European Draft Common Frame of Reference – A Source of Comparative Law; A New Option for Choosing the Applicable Law; Or A Template For a European Civil Code?}, pp. 11-12,16, available at \url{http://ssrn.com/abstract=1319247}, accessed on July 1\textsuperscript{st}, 2009.
\end{itemize}
5. CONCLUSION

All legal systems develop either by reformulating existing rules and principles or by adapting them to the changing political, economic and social circumstances.

The proposal for a CFR in relation to European contract law is a good development. Such an instrument will establish common principles and terminology in the area of European contract law and in this way improve the contract law acquis. Although it is expected to act only as a point of a reference, it will nevertheless diminish any divergences between the different contract laws in the EU, promote harmonisation and help advance the intended internal market.

Presently, the draft CFR signals a positive follow up in the process of harmonisation of European contract law and there are indications that it may also, in the long run, lead to the adoption of an optional European Contract Code alongside the final format of the CFR. In the process of creating a European internal market, the search for common rules in contract and insurance law is an indispensable part of the above described process. With regard to insurance and reinsurance, partial harmonisation has been effected via the various adopted Directives, such as the currently proposed Solvency II Directive. The Directives apart, the proposed CFR also attributes a special role to insurance in the light of the accomplishment of the internal insurance market. In addition to the proposed CFR, the Commission promotes the idea for the creation of an optional model for an optional European Civil Code.

All of the initiatives are encouraging and they are anticipated to have a positive impact. It remains to be seen what the overall progress and impact of the above discussed initiatives and measures will be. As is the case with all harmonisation efforts, it should be borne in mind that such processes are difficult, lengthy and complex in nature as well as immensely time-consuming.

Bismarck is reputed to have said: "If you like laws and sausages, then you should never look to see how they are made." The EC Commission's attempts to ensure the coherence of European contract law remind us of Bismarck's scepticism towards law-making: the prospect may be appetising, but the product dubious. The danger is great that either nothing will happen at great expense; concluding the exercise with the observation that the time is not opportune for change or that chaos will ensue to the detriment of trading parties and consumers. The principal source of chaos is that the debate will proceed on the basis of the wrong propositions: the EC must respect national identities whilst sweeping away anachronistic and market-fragmenting national law; the proportionality of reform must be proven, notwithstanding any bias against economic analysis.

Debates relating to harmonisation of European laws should continue to be prioritised within the EU. However, the currently discussed reform project should be based on a balancing of such complex yet reciprocal problems which demand subtle responses rather than the assertion of pre-existing positions. Similarly, the Commission's linguistic contortions should be understood as a warning: what does the Commission mean by arguing for a frame of reference and an optional instrument, yet insisting that this is not to be understood as a nascent pan-European Civil law? Whilst the traditional approach finds approval, the Commission also identifies the need to avoid the risks associated with the outbreak of a new legal particularism in Private law. Do such positions signal a strategy or is the Commission unaware of the contradictory signals it is sending? Are the more subtle balances which are being identified, dealt with inadequately? The Commission should not be surprised, recalling Bismarck, if there is simply no market for such an expensive and dubious sausage.

The Draft CFR has the potential to be highly successful, on the condition that it surpasses the obstacle of being nothing more than a surfaced and superficial set of optional rules which will fail to answer critical contemporary questions detected by the modern market circumstances. So long as the above requirement is met and all interested parties involved are allowed to participate at the harmonisation process, there will be no winners or losers.