PRINCIPLES OF INSURANCE SUPERVISION

by Professor Dr. Reimer Schmidt

My paper deals with the principles of insurance supervision and their changes, the past twenty years - during which I have been especially concerned with EEC problems - being in the foreground of interest. I shall make no reference to the British supervisory practice. My remarks are in parts necessarily somewhat overstated.

It is a known fact that before the EEC era there were basically different systems of insurance supervision, each one embedded in the national legal system. As is generally known British supervision is essentially a supervision of solvency - a system the Netherlands and Belgium were also close to - whereas the remaining countries on the Continent had various forms of a so-called material state supervision, that is to say an insurance supervision exerting a more or less perfect control of companies in their daily work, from authorisation to the winding up of the company. If these systems were to be brought closer together, it was logical to apply the basic idea of solvency to the total area of the European Common Market, and as for the rest, to make the more liberal systems more strict.

Here we make the first statement: if the Common Market wanted to stimulate competition by the various liberties of the Treaty of Rome, in the insurance industry this went hand in hand with a stricter state supervision indirectly questioning - for whatever good or less good reasons - the fulfilment of the original purpose of the Treaty.

The picture, however, is still incomplete due to the fact that the legal provisions of the member countries dealing with restraints of competition by cartel agreements in a wider sense show quite different "degrees of penetration" so that the regulations concerning the actual functioning of the markets reach to quite a different extent into the field of state regularisation on the one hand, and private agreements (of associations and companies) which are "undesired surrogates", as it were, of state regularisation on the other. By the fact that the EEC cartel law, Art. 85 ff, has proved to be of extremely low feasibility for having a largely absolute prohibitive character, there is no removal of the criticised general condition of the European Common Market.

Second statement: the regulation systems applicable today can only be judged appropriately if state supervision law, as well as the entire cartel practice in a wider sense, are also included in these considerations.

Any insurer or reinsurer operating outside the country where he has his Head Office knows that national laws are turned into practice in quite different manners. Often perfectionist rules do not even reach the threshold of everyday business, while general clauses are sometimes by practice put into effect in a very detailed way. Of course, the significance of jurisdiction is also part of this context. This is so important a fact since the zeitgeist (the spirit of the times), which I will turn to later, has an extraordinary influence on the process of translating law into practice.

Third statement: In the every field of state supervision of insurance it is not so much the abstract formulations of legal provisions but rather their handling in practice that is of significance.

It is a known fact that since the creation of the first legal provisions concerning the supervision of insurance companies, there has been consideration as to the actual purpose of supervision. Today it is sufficient for me to point out that for any supervision rules one basic purpose can be stated, that is the protection of the insured against the potentially dangerous mechanism of insurance companies. In this context, supervision has above all to ensure as well that insurance contracts can be permanently fulfilled. In the individual countries this "technical purpose of protection" is to varying degrees of intensity overlaid with general economic considerations. The basic concept followed in the individual countries with regard to the relationship between state and economy denatures to a certain extent the original "primitive" technical purpose of protection. At this point we should note that in the individual countries there is a different attitude of public opinion about the question whether failures of insurance companies are in principle to be avoided altogether in order to shield the insured from damage, or whether a certain scope should be left for a natural selection of insurance companies by failures and bankruptcies.

As a fourth statement it may be said that today, the more state controlled elements determine government economic policy, the less acceptable failures of insurance companies seem to be. To that extent there is an interdependency between the discussion on nationalisation and the form of insurance supervision.

If we proceed from the consideration that insurance supervision is to protect the insured from dangers, and in particular is to ensure that contracts can be continuously fulfilled, the emphasis is placed on the protection of creditors with regard to the insured. But not only did many thoughts concerning cartel law come from the United States, but also the heart comforting idea of consumerism. This means that the consumer has a basic right, as it were, to be uninformed, that he has to be advised, instructed and protected, so that not only the idea of creditors' protection plays a part, but also the protection when concluding the contract and the protection of debtors. In fact, guaranteeing for contracts being permanently fulfilled (protection of creditors) is sometimes thrust into the background against the principle of the state attending to consumers in general worthy of protection. Public opinion is tending more towards no longer differentiating between actual insurance supervision and this general consumerism.

Fifth statement: Insurance supervision is not only affected by the fundamental oil-style discussion within economic policy, in particular on nationalisation but above all by the idea of a general consumerism. The German Federal Supreme Administration Court has just critically dealt with this extension of the concept of supervision.

As the important principles of insurance supervision are in the foreground of this paper, I have not yet mentioned one item that appears to be regarded as essential in all countries subject to insurance supervision. I am talking of sociological differentiation. For if insurance supervision is to serve for protecting insurance clients, it immediately becomes evident that the different sociological groups of insured merit a different degree of protection.

By the way, this idea is also expressed by reinsurance in some countries being only subject to a reduced supervision, if any, and by Marine insurance having also been subject to a modified supervision before a new regulation of this question by the EEC. This principle of sociological differentiation, however, being evident as such, immediately causes difficulties when it is turned into practice, as for instance in connection with the threshold values in Common Market coinsurance, or when establishing the freedom of services. Unfortunately, the term "merchant" which is fixed quite differentialy in the individual countries, is not suitable for use as a criterion.

Sixth statement: The economically weak evidently need the full protection of insurance supervision, the economically strong should in principle be able to do without this protection; there is, however, no criterion for economic strength, for the mere size of risks is quite inadequate as a yardstick. It may be added that even important insurance clients are sometimes inclined to fall back on the intellectual ideas of consumerism, although from the sociological point of view they are surely not entitled to use these.

At this point it should also be noted that in some countries insurance brokers and insurance agents are not covered by this supervision. Here sociological and functional contemplations meet, if we disregard the merely practical consideration that the intensity of supervision would in general be carried too far if the state had to take measures necessary for supervising agents. Here the path is taken of making insurance companies fully responsible for their agents, which is a doubtful matter with regard to multiple agents. Surrogate activities towards professional regulations for insurance intermediaries are difficult to reconcile with market economy.

The present stage of development in insurance supervision is characterised by the fact that the supervisory authorities have adopted the findings of micro-economic methods and categories and are putting them into effect. It is obvious, in fact, that the complete pervasion of insurance companies with the principles of modern economy, especially management theory, planification, controlling and computerisation, has also to find its reflection among those having to supervise these companies. This means, at the same time, that in the supervisory authorities of the European Continent mathematicians and economists have replaced

lawyers to a certain extent. This natural and correct development, however, involves the problem that the economist or mathematician, being less experienced in making careful assessments, might not always be sufficiently aware of the limits of his supervisory tasks.

In my opinion this seventh statement has, up to now, not been expressed sufficiently.

The supervisory system, as it exists today as a frame within the Common Market, proceeds from the necessity of granting authorisation to a company proposing to conduct insurance business before it starts its operations. The legal provisions themselves are arranged in a very clear way. It is much more difficult, however, to design the legal instruments that have to be available if state intervention into business operations becomes necessary. Here it is not sufficient to have those legal instruments which can be used if a company no longer fulfils solvency requirements. The German insurance lawyer, Erich R. Prölss, once said that a supervisory office was always in danger of doing either too little or too much. The latter seems to be more frequent. Determining the right extent of intervention in current business operations is a question still unsolved on Common Market level. Let us, for instance, think of a manager continually violating regulations or conducting his business operations in a "careless" way, or not doing justice to his policyholders when settling claims, but at the same time keeping up solvency. In these cases, apart from legal prosecution by the injured parties, there is an interest to intervene on the part of the supervisory authorities.

Part of this context of creditors' protection is also the very laborious discussion on the so-called separation of classes which has been going on for about two decades and which seems to be resolved for life assurance. As you know, the point is to protect the insured of less exposed classes from the dangers which might be impending by losses the same company makes in other classes. Especially in the field of life assurance contracts with savings components, the assured are regarded as particularly worthy of protection. There are similar considerations being made for private health insurance and - with quite a different argumentation - for legal expenses insurance. Although there are some arguments against the separation of classes, it is a known fact that those companies specialising and practising separation have developed so extraordinarily well in their markets that in the countries concerned more and more companies practising the separation of classes are being founded, while at the same time loud protest is raised against the separation of classes.

All these abstract considerations do not cause any worries if supervision, on the one hand, and the finally surveyable and determinable circle of those under supervision, that is the insurance companies in any one country, on the other, are united by experience and the willingness to co-operate. This harmony can be disturbed by various circumstances; by an extensive use of economic power on the part of the insurance companies, by too strict a supervisory legislation due to considerations within the economic policy, but also by the supervisory authorities enforcing the formal contents of law in a schematic and, at the same time, rigorous way. In numerous European countries the zeitgeist does not seem to be particularly favourable for a more liberal insurance supervision.

I have just mentioned the influence of economic policy. Due to the fact that the insurance industry has "something to do with money", insurance supervision is often not only executed by the department of finance but is also subject to a common judgement with the banking business. Surely, there are reciprocal influences between banking and insurance supervision, and it seems that in some countries banking supervision is rather focussing on the outline context, whereas insurance supervision is rather directed towards details. But here the point is not only the attribution to ministeries and the technique of supervision, but above all the incorporation within the current tendencies of the economic policy existing in the country concerned, for instance within the scope of a foreign exchange policy or by incorporation into a general autarchy. Just think of the discussion with the developing countries on the general terms of trade concerning insurance.

Eighth statement: Independent of the special legal regulation of insurance supervision there are in the individual countries essential influences from export, monetary, financial and tax policy.

If we consider the development of insurance supervision in the past twenty years, it is, on the one hand, characterised by an increased strictness in the sense of finer meshes in the network of control and supervision. On the other hand, however, in nearly all the countries there has been a decay of premiums caused by keen competition stimulated by the state. This decay, in turn, might involve a danger for the interests of the insured. After all, the guarantees that a contract can be continuously fulfilled is in principle still conditional upon a certain equivalence of performance and consideration resulting from the insurance contracts. If we consider the various motivations for the supervisory authorities to shift this equivalent in favour of lower premiums for the insured, state supervision as an institution reminds us of those parliaments which - created for controlling the expenses of monarchs - distinguish themselves as a source of expenses; the institution created separates from its purpose and displays opposite attitudes.....

In concluding I repeat the theses of my paper:

1. Antimony between the necessity to execute the liberties of the Treaty of Rome and a tightening of insurance supervision to avoid abuses.
2. No isolated reflections on insurance supervision are possible without including Anti-Cartel Law.
3. It is supervisory practice not prescriptions which count.
4. The practice of insurance supervision in each state is amalgamated into the general economic policy.

5. In this respect consumerism plays a main role which endangers the fulfilment of the general aims of insurance supervision.

6. Insurance supervision has to deal with powerless and powerful insurance clients. The latter do not need protection, but it is difficult to decide which client belongs to which category.

7. The introduction of micro-economic methods and categories into the business leads to a take-over of these methods by the supervisory authorities. In consequence, there is an increase of supervision.

8. Finally, there is the influence of the general export, monetary, financial and tax policies on insurance supervision.