Brokers / Intermediaries - German Issues

by Dr Reinhard Dallmayr

Is an agent an employee of the insurer, or is a broker an agent, or is an employee a broker? This question may sound silly but the recent flow of cases and the legal discussion in Germany justifies it.

A. Types of intermediaries in the German market

I. The classical types

1. A "tied agent"

This agent is exclusively bound by contract to one insurer; he distributes only the products of this insurer. He is not allowed to work for other insurers. This means he is part of the distribution organisation of the insurer although he is not employed but self-employed.

In mass- and household insurance lines the agents are the most important sales force: There are about 60.000 full-time-agents and about 300.000 part-time-agents. Most agents are member in the Bundesverband Deutscher Versicher-ungskaufleute e.V.

2. Multiple agents

Such agent has agency contracts with various insurers which are competitors to each other. He is relatively independent from these insurers but not as independent as a broker: It is in his discretion with which of these insurers he places a certain insurance contract; however on the other hand he is obliged towards these insurer to safeguard their interests vis-à-vis the insured.

3. The broker

The insurance broker is independent of the insurer; he is the interest-representative of the insured vis-à-vis the insurer although he receives the commission from the insurer.

There are countless small and medium broker-firms in Germany. 260 of the more important ones are member in the Bundesverband Deutecher Versicherungsmakler e.V. which represents approximately 65 % of the premium income derived by insurance brokers in Germany.

II. Other distribution channels

Apart from the classical agents and brokers a variety of other distribution channels exist:

1. Direct selling

Direct or tele-sale distribution is not new in Germany; some companies have started over 20 years ago. However, only recently has direct selling gained a substantial market share (currently approximately 5 - 6 %) due to the success of this method in other countries (especially the UK) and the increased efforts of the insurers in this field. Almost every insurance group now has its direct selling-line.

2. Structural distribution (Strukturvertrieb)

This kind of distribution very often consists of "pressure sales-groups" (with appropriate bad reputation). Normally the distributor is a private limited company (GmbH) and acts as agent, sometimes as broker, for one or just a few insurers or is even owned by an insurer. Such groups tend to have a strong hierarchy which in the lower levels, employs part-time-agents who hope to make fast money by selling - often unneeded - life insurance contracts to relatives and friends. However these groups are very successful, the largest has more than 16.000 representatives. Some of the biggest German life insurance companies depend almost entirely on the results of these intermediaries.

3. Banks and Savings Banks

The distribution through banks has been an important channel for years although some critics say that the average bank teller does not understand insurance. This distribution channel can give rise to a case of "unfair practice". The bank representative can easily see from the account data what kind of insurance the bank customer has in place and what the premium was. Consequently, he could offer an alternative. The use of the account details for this purpose infringes the Data Protection Law and accordingly the Code of Unfair Competition.

4. Associations, Clubs, Credit-Card Companies and Employers

These organisations distribute insurance contracts on preferred conditions through group-insurance contracts. The largest automobile association, the ADAC, is very successful in the selling of motor-, legal expenses and assistance insurance forcing other competitors into substantial premium reductions.

5. Company connected intermediaries

Large corporations often outsource their insurance department and create their own intermediary (brokers or agents) in order to collect the very often large commissions on their insurance portfolio.

6. Franchising

This is usually an inter connecting-system of brokers with a central purchasing power. The franchiser negotiates with the insurers for its members all conditions and premiums on the contracts.

7. Shops, Department Stores and Mail Order Houses

The distribution of insurance contracts to consumers at the point of sale is a new form which has gained some ground especially for standardised household policies which can be purchased at a retail outlet.

III. Qualification of intermediaries

Generally speaking intermediaries do not need a professional qualification to start their business. However, insurers normally demand that their agents and employees have training as "Versicherungskaufmann" or similar education or that they at least take part in an internal training programme. Furthermore the agents have to take part in the AVAD-Information scheme which collects data of the practice of every single agent. When an agent changes to another insurer it will receive the latest data on the agent. On the other hand brokers, in principle, do not need any education or training. But of course larger broker firms still demand substantial educational qualifications as well.

Germany has not implemented the Directive-Recommendation of the EU-Commission of 18.12.1991 concerning intermediaries (92/48/EEC) and obviously does not intend to do so. However, the regulatory office (Bundesaufsichtsamt für das Versicherungswesen) has, as a result, issued a notice to the insurers that they have to safeguard the reliability of their intermediaries. It has also issued specific requirements as to how this task is to be carried out (Rundschreiben R 1/94 und R 2/94). Similarly, it has introduced the same requirements on the reliability of brokers.

B. Legal framework

All these various types of insurance distributors can be classified either as broker, agents or employee.

I. Insurance brokers

By law the insurance broker is a member of the commercial business community (Kaufmann) in accordance with § 1 Abs. 1 HGB (Commercial Code). As a consequence he is obligated to keep proper records, § 238 HGB, to deliver an annual statement of accounts, § 242 HGB, and to store business documents for a certain minimum period, § 257 HGB. He is commercial broker according to § 93 HGB. This means that he acts for other parties for profit. His obligation is to place insurance contracts for his clients with the most suitable insurer. He is not appointed permanently; and were he appointed on a permanent basis he would be an agent. However in practice it is somewhat different. The client in most cases appoints the broker not to organise cover for an individual risk but for a portfolio of risks or for his whole coverage needs. Furthermore, broker contracts often run for a fixed period of time.

Over the years the classical role of the broker as neutral intermediary between insured and insurer has been transformed into the position of representative of the insured. He is in a similar position to a trustee with a substantial responsibility and liability/exposure.

According to German law the broker may not represent the insurer at the conclusion of the contract or during the existence of the contract. However, there may be exceptions if the broker has received a power of attorney to issue a (preliminary) covernote or policy on behalf of the insurer or to accept notices and declarations of the insured with effect for the insurer (so-called technical broker). It is obvious that in such cases there may be a conflict of interest.

II. Agents

The insurance agent is appointed by an insurer to solicit insurance contracts. The legal relationship is determined by an agency contract between insurer and agent. The position and rights and duties of the insurance agent are subject to various codified rules:

1) §§ 84 ff. HGB provides for the basic rules for commercial agents and some specific rules for insurance agents. Paramount is that the agent must safeguard the interests of the insurer, § 86 HGB. On the other hand, if the agency contract is terminated by the insurer he has to compensate for the loss of income to the agent on a basis fixed by law, § 89b HGB. This does not apply, however, if the agent has given reason for the termination.

2) Other rules concerning insurance agents are contained in §§ 43 ff. VVG (Code on Insurance Contract Law). The agent for instance is empowered by law to act on behalf of the insurer to receive proposals for the conclusion, prolongation or the alteration of insurance contracts, he can also receive private acts or notices of the insured which have to be made during the existence of an insurance contract, to receive notices of termination or applications for claims, and, unless otherwise stipulated, to collect premium. He can also have a power of attorney to conclude insurance contracts on behalf of the insurer (although in practice this is never the case). Due to the strong representative nature of the relationship for the insurer there is also place of jurisdiction for law suits against the insurer at the business place of the agent.

3) Beyond of the codified rules case law has enlarged the role of the agent as representative of the insurer even further:

   a) It is common practice in Germany that the agent fills out the insurance proposal forms according to the oral information provided by the prospective insured who then signs the proposal form. Very often, answers in the proposal form are inaccurate with the consequence that the insurer (at a later stage) wants to withdraw from or terminate the contract or refuses to pay a claim based on non-disclosure or misrepresentation, § 16 VVG. The Federal Court of Justice (BGH) has held the agent the „eyes and ears" of the insurer (BGHZ 102, 194; NJW RR 89, 690, BGH VersR 92, 217). That means every agent (and employee) of the insurer has a power of attorney to receive pre-contract information from the proposer. Everything the prospective insured tells the agent is deemed to be knowledge of the insurer. The sole exception is the private knowledge of the agent which he has gained without any connection to the insurance contract in question.

      In the case of differences between the written proposal form and the oral declarations of the prospective insured, the insurer has to prove in court that the agent filled out the proposal form exactly according to the information provided by the insured. The BGH instituted this reversal of proof with arguments which can be hardly understood legally. But it has significant consequences since most agents cannot remember the exact meeting when the proposal form was taken down. Accordingly, the insurers lose most of these cases. To make things

worse the BGH has also stated that the insurer cannot deny knowledge, attributed to the agent of the insured in the proposal form or in his wording (BGH VersR 92, 217).

4) On the contrary, the knowledge of the broker is not attributed to the insurer if the broker has not informed him (OLG Köln RuS 92, 32; also BGH VersR 92, 484).

However, if the broker has withheld a material fact from insurers he may be liable to the insurer. Although the main contractual connection of the broker is with his client, the broker has a contractual relationship with the insurer too so that there is a double-contractual-relation (BGH VersR 95, 93). According to § 98 HGB the commercial broker is liable to both parties for any damage he negligently causes. This means that although the broker is regarded predominantly as trustee and representative of the interests of the insured he may also, by law, have a duty to inform the insurer about any important circumstances connected with the risk and to safeguard the interests of the insurer (BGH VersR 95, 93; OLG Frankfurt VersR 95, 93). Thus the broker must disclose any material facts to insurers which are necessary to calculate the risk, and not only what he positively knows but also what is apparent to him.

According to § 16 VVG the prospective insured has to disclose all material facts. These are the facts, which enable the insurer to decide if he wishes to execute the proposed contract or not. If the insurer has explicitly asked in writing, the circumstance or fact is deemed material. Whereas agents normally use proposal forms provided by the insurer which contain the questions the insurer wants to have answered, brokers tend to send a covering note to the insurer which contains the information the broker thinks the insurer may want to know. In a recent case the Munich Court of Appeal granted damages of one third of the total amount to the insurer against a broker who had not disclosed an exceptionally high loss ratio of previous claims of his client. The court ruled that the broker is obliged in his own capacity to disclose such facts but that the insurer has to bear a substantial part of the damage himself (contributory negligence) because he did not ask about the previous claims.

5) If the broker promises a prospective insured that a certain risk will be covered by the insurance contract he may liable to his client if the client does not have a claim against the insurer. On the contrary, where an agent

states the risk is bound the insured has a direct claim against the insurer based for breach of contract if

a) there is no substantial negligence of the insured. Negligence is deemed to exist if the promise of the agent is contrary to the clear wording (OLG Köln RuS 91, 6).

b) only the insured was unaware of the exact scope of the cover or if the cover applied for did not fulfil the insured's expectation although he knew better or could have easily known better.

Similar rules apply to preliminary cover notes, if the agent did not have thepower of attorney to give cover or if he gave the prospective insured the wrong expectation (OLG Hamm VersR 92, 1492). However, if the proposal form contains a clause under which the agent may not give preliminary cover the prospective insured cannot rely on a promise contrary to this clause (OLG Frankfurt VersR 90, 792).

The insurer is further liable through the legal doctrine of *culpa in contrahendo* if the agent provides incorrect advise as to the best possible wording of the insurer, the correct calculation of the insured sum or to the extent of cover if he knew what the wishes of the prospective insured were. Again, if the contract was placed by a broker there is no liability of the insurer.

III) Liability of the intermediaries towards the insured

1. Agents are only personally liable to the insured in exceptional and rare cases where they had a special financial interest in the conclusion of the insurance contract or created a relationship of personal trust with the proposer (BGH VersR 90, 753, 157; VersR 91, 157, OLG Köln VersR 95, 1173). This special financial interest in the contract does not mean the mere potential to earn a commission but rather that the agent has such close connection to the contract that he acts more or less in his own capacity (quasi as insurer). Here it is required that the agent offers an additional guaranty that secures the conclusion and the performance of the insurance contract, e. g. that he provides the proposer the impression that he personally will guarantee the correct performance of the insurance contract. These rules do not apply to employers or agents (BGH VersR 91, 1052).

2. On the other hand, brokers are liable to the insured for all such shortcomings. The liability is broad but not yet as extensive as it is under the EU rules of Best Advice. The idea behind the liability of the broker arises out of the trust which the client has in him. Since this trust is extensive (the brokerage contract normally covers all insurance needs of the client) the liability is extensive and includes the following main areas:

   a) Advising the client
   b) Choice of the right insurer and risk analysis
   c) Proper execution
   d) Administration of the contracts
   e) Continuing advice of the client

   The most common areas of liability are:

   a) Incorrect advice or wrong information
   b) Incompetent, inaccurate or incomplete risk analysis
   c) Delayed or negligent forwarding of proposal forms of the insurer
   c) Errors in cover notes
   e) Delayed or incorrect transfer of premium with the consequence that the insurer does not pay the claim
   f) Mistakes concerning the diarying of renewal or termination dates of insurance contracts
   g) Non-surveillance of alterations in the risk / not adapting of the cover to changing needs of the insured
   h) Missed deadlines
   i) Loss of insurance documents
   j) Insufficient insurance
   k) Choice of incorrect insurance products
   l) Additional costs to the client because of delayed claims management

C. Distinction between broker and agent

The above outline shows how important it is to define in which capacity an intermediary acts. It does not matter how an intermediary (be it agent, broker or employee) is named. It only matters what he does. For the insured the legal capacity determines against whom he can claim damages and how solvent his opponent is.

1. Basic distinction between broker and agent

In principle the solution is simple: One must examine with whom the intermediary has a contract: If with the insurer then he is an agent or with the prospective insurer than he is a broker.

However, there are some important decisions which have a negative impact for insurers:

In the first case the Hamm court of appeal (OLG Hamm VersR 92,1462) held that any notices or promises of a broker (although he had a valid brokerage agreement with the client) binds the insurer as if the broker were insurer's agent if the insurer provide proposal forms in advance and a power of attorney to complete them, to calculate the premium and receive (but not necessarily accept) the proposals on its behalf. Accordingly, the preliminary cover note the broker provided without power of attorney bound the insurer because it was relied upon (Vertrautenshaftung).

In a recent decision of the Nuremberg court of appeal (OLG Nürnberg VersR 95, 94) an intermediary mainly trading with private health insurance contracts had explicit brokerage contracts with the prospective insureds. Nonetheless the court defined the intermediary as (multiple) agent for the following reasons:

a) The broker was included in the so called AVAD-information scheme where the insurers collect and distribute data about agents (and, what the court overlooked also brokers).

b) The broker had proposal forms of the insurer which he could use. However, he had proposal forms from over 40 other insurers as well.

c) The broker explained and filled out the proposal forms for the proposer.

d) The broker did not persuade the prospective insured to conclude an insurance contract.

e) The broker had a commission agreement with the insurer

f) The broker and insurer had agreed via an incentive scheme according to which the percentage of the commission would depend on the overall premium income.

On the other hand the court found it irrelevant that the broker had made computerised premium and tariff comparisons among more than 40 insurers.

Although the judgement is not convincing in many respects - the broker did exactly what most brokers do - it is very dangerous for both insurers and brokers since many of the factors which the court used to define the broker as an agent are common nowadays between brokers and insurers: Many brokers, especially the big ones, demand the right to issue cover notes and policies (they even draft their own wordings), stock the proposal forms of the insurers, settle claims (at least up to a certain amount), most of the brokers have agreements on the amount of the commission they get from the insurer, all brokers are subject to the AVAD information scheme. Consequently, in the eyes of the OLG Nürnberg there are hardly any brokers left in Germany.

2. The broker-agent

To confuse things even more nowadays the broker-agent is not an uncommon hermaphrodite. He acts towards prospective insured as broker and claims to be independent of any insurer whereas he in fact is bound by contract to one or more insurers to meet certain sales targets. By virtue of such agency agreement he has to represent the interests of his insurance company. The German regulatory office (Bundesaufsichtsamt für das Versicherungswesen) has declared such entity as non grata in accordance with § 81 Code on the Supervision of Insurance Companies (VAG) and the Intermediary-Directive-Recommendation of the EU-Commission of 18.12.1991. However they still exist. In a more refined set-up the insurance company holds the majority of the stock of the broker but has no explicit agency agreement. There are no decisions whether, in such cases, the broker is regarded as the facto agent of the parent but there is hardly any doubt that, in the long run, this will be the case.

3. Distinction between agents and employees

Recently quite a number agents, following termination of their agency agreements sued the insurer claiming that they were not agents but employees since sometimes the compensation they obtain as agents is rather low. Had they been employers, the insurer would have to pay a much higher amount to the social security system. In Germany both, employer and employee have to pay 50 % each of the premiums for public health insurance, pension and redundancy insurance which together amount to more than 40 % of the gross income. However after termination of the employment contract the former employer has to pay the full premium alone. Accordingly such agents use such law suits as leverage to settle with the insurer at a much higher sum than the compensation under § 89b HGB would be. For instance: In a pending case we handle the compensation for the agent would be

DM 60,000 whereas the payment to the social security system would be DM 450,000 . The agent suggested to settle at 50 % of this sum, which still is about four times as much as he would get as compensation. The obstacle, of course, is that he is not entitled to the money which was due to the social security system nor can he define by retrospective agreement the nature of his position. If the insurer settled with him the social insurers could still claim the premiums for the whole employment duration if the intermediary was an employee.

This frenzy was caused by one judgement of the Nürnberg Labour Court of Appeal in which it found a certain life insurance agent to be an employee.

Previously, the distinctive facts when an insurance intermediary was regarded as employee, were:

1. He could not freely determine his working time
2. The insurer could issue directives as to the nature of his activities.
3. He was part of the inner organisation of the insurer.
4. He could not appoint sub-agents.
5. He had no entrepreneurial scope.
6. The insurer wished that the intermediary qualified as Versicherungstaufmahn (a professional qualification)
7. The intermediary could only sell the lines of insurance the insurer was in and was not allowed to sell non-insurance products

The Nuremberg court conceded that most of these facts were not applicable or decisive in this case. The intermediary could freely decide his working-time. The intermediary was not bound by directives of the insurer in any unusual way. In the contrary a complicated product like health- or life-insurance must entitle the insurer to give a certain amount of directives to his intermediaries regardless of their legal position. Furthermore the intermediary was not part of the inner organisation of the insurer; he could work from his home-office. The court found it decisive that the intermediary did not receive any entrepreneurial freedom but only entrepreneurial risks. He should only work on addresses of prospective insured the insurer provided. In the opinion of the court he did not receive means to build up his own business with his own organisation, own premises and own employees or sub-agents. The intermediary, in the eyes of the court, accordingly did not have the chance to build up a substantial business with "unlimited" income possibilities.

It has to be noted that the insurer stated that he did not forbid the appointment of employees or sub-agents but the court did not take evidence on this obviously decisive point. Furthermore the intermediary was not allowed, without prior approval of the insurer to represent other insurance companies. The fact that the representative was restricted to the lines of business the insurer offered and was not allowed to carry on any business other than insurance would limit the scope of the self-employment of the agent and indicate a position as employee. Also the fact that the intermediary was only allowed to advertise with the approval of the insurer would indicate that he had no entrepreneurial perspective. In other words the fact that the intermediary was not allowed to create his own pallet of insurance products and to fix the premium (!) according to his choice would indicate that he was no entrepreneur. From these „circumstances" the court followed that the intermediary did not have a real entrepreneurial opportunity with corresponding possibilities of earnings.

Although some of the factors definitely indicate a position of employee, (especially the pressure to qualify as Versicherungskaufmann and to use mailing lists which the insurer provided, the judgement is nonetheless completely irrational. No agent or broker, not even the biggest one can determine the kind of products or the premium for the insurers(although they have maybe negotiating power). The court obviously did not hear evidence as to the possibility of the agent using sub-agents to extend his business. Recently this decision was reversed by the third instance and remanded to another judge of the second instance for a new hearing for formal not material reasons.

D. Conclusion

If this judgement would become a leading precedent it would have dramatic effects on the insurers who have an agent-force. Every agent could be a potential employee: The sums the insurer would have to pay to the social security system for the past as well as for the future might be so large that it could ruin a business.

However, there is hope that it will remain a single decision on rather unusual facts and will not lead to a complete change of long established structures. More likely the judicature will look even more keenly to the contents of the very contractual situation between intermediary-insurer-policyholder and "punish" any dilution of clear legal concepts. But this would also bring new dangers to the insurers as to their exposure towards the insured since in a soft market, especially, the brokers

seem to have a substantial purchasing power not only as to the premium but also as to their position.

On the other hand it can be assumed that the liability of the brokers towards their clients will be defined further and expanded in the long run similar to the rules of Best Advice.

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