The Solvency II Capital Requirement for Insurance Groups – On the Tension Between Regulatory Law and Company Law

Britta Behrendt Jonsson
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On the Tension Between Regulatory Law and Company Law

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At the Faculty of Arts and Sciences at Linköping University, research and doctoral studies are carried out within broad problem areas. Research is organized in interdisciplinary research environments and doctoral studies mainly in graduate schools. Jointly, they publish the series Linköping Studies in Arts and Sciences. This thesis comes from the division of Commercial and Business Law at the Department of Management and Engineering (IEI).

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Abstract

Since 2016, supervision of insurance undertakings in the European Union has been based on the Solvency II legal framework. Insurance undertakings that are part of an insurance group must be sufficiently capitalized both at company level and at group level. For the calculation of the group solvency capital requirement, insurance groups are regarded as if they were a single economic entity, whereas company and insolvency law apply a legal entity perspective and focus on each single company that is part of a group. The underlying expectation that excess own funds within a group will be used to support a group undertaking in financial difficulties is not reflected by a corresponding legal obligation.

This tension between regulatory and company law is discussed in the thesis. The rules on the calculation of the group solvency requirement and the eligibility of own funds at group level are analyzed against the background of German and Swedish company law and possible solutions to align the two areas of law are discussed de lege lata and de lege ferenda. Despite the full harmonization approach of the Solvency II Directive and the aim of reaching supervisory convergence throughout the EU, the study reveals differences in the application of Solvency II in Germany and Sweden.

Keywords: Solvency II, insurance group, group SCR, solo SCR, own funds, hierarchy of norms, group supervision, Insurance Business Act, consolidation method, limited liability, German company law, Swedish company law, Limited Liability Put Option
To Anders and Siri
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Writing a thesis in an area of law that has received relatively little attention by Swedish legal scholars, the comments of the opponents at the mid-term and final seminars were particularly important to me. Carina Andersson, Finansinspektionen, commented on my mid-term text and Professor Torbjörn Ingvarsson acted as opponent at my final seminar. I want to thank them both for their constructive comments. The seminars reinforced my confidence in my work and motivated me to continue working on the thesis.

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Linköping, July 2018
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Abbreviations

ABL  Aktiebolagslag
AktG  Aktiengesetz
BaFin  Bundesanstalt für Finanzdienstleistungsaufsicht
BFH  Bundesfinanzhof
BFHE  Sammlung der Entscheidungen des Bundesfinanzhofs
BGB  Bürgerliches Gesetzbuch
BGBI.  Bundesgesetzbblatt
BGH  Bundesgerichtshof (German Federal Court of Justice)
BRRD  Banking Resolution and Restoration Directive
BVerfG  Bundesverfassungsgericht (German Federal Constitutional Court)
CEO  Chief Executive Officer
cf.  conferre
CEIOPS  Committee of European Insurance and Occupational Pensions Supervisors
ECJ  Court of Justice of the European Union
EBA  European Banking Authority
EC  European Community
ECJ  Court of Justice of the European Union
ed  editor
eds  editors
EEA  European Economic Area
EEC Treaty  Treaty establishing the European Community
et al.  et alia/et alii
EIOPA  European Insurance and Occupational Pensions Authority
ESAs  European Supervisory Authorities (EBA, EIOPA and ESMA)
ESFS  European System of Financial Supervision
ESMA  European Securities and Markets Authority
EU  European Union
EuR  Europarecht
FRL  Försäkringsrörelselag
FSA  British Financial Supervisory Authority
GAAP  Generally Accepted Accounting Principles
GmbHG  Gesetz betreffend die Gesellschaften mit beschränkter Haftung
HGB  Handelsgesetzbuch
HD  Högsta Domstolen (Swedish Supreme Court)
ibid.  ibidem
ABBREVIATIONS

i.e. id est
IFRS International Financial Reporting Standards
IORP Occupational Pension Funds Directive
HGB Handelsgesetzbuch
KF Kooperativa Förbundet
KK Kölner Kommentar zum Aktiengesetz
LO Landsorganisationen (Swedish Confederation of Trade Unions)
MCR Minimum Capital Requirement
MHdGR AG Münchener Handbuch des Gesellschaftsrechts, vol 4
NJA Nytt Juridiskt Arkiv
NJW Neue Juristische Wochenschrift
OECD Organisation for Economic Co-operation and Development
OF own funds
ORSA Own risk and solvency assessment
p. page
para. paragraph
pp. pages
PRA British Prudential Regulation Authority
prop. proposition
QIS5 Fifth Qualitative Impact Study
RechVersV Verordnung über die Rechnungslegung von Versicherungsunternehmen
SCR Solvency Capital Requirement
SOU Statens Offentliga Utredningar
Sub Subparagraph
TFEU Treaty on the Functioning of the European Union
UK United Kingdom
VAG Versicherungsaufsichtsgesetz
VaR Value at risk
VVaG Versicherungsverein auf Gegenseitigkeit
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PART I

INTRODUCTION AND METHOD
INTRODUCTION

1 Introduction

Insurance regulatory law in the European Union is in the process of undergoing a significant change towards a wide-reaching harmonization, to a large extent even a uniformization.

1.1 From Solvency I to Solvency II

After more than ten years of discussion and several delays in the implementation, the Solvency II regulatory regime has finally replaced the Solvency I system originating from the 1970s. The move towards full harmonization\(^1\) is supposed to create a “level playing field” for all European insurers.\(^2\) Solvency II has introduced *inter alia* a risk-based calculation of capital requirements, harmonized corporate governance requirements, the obligation to conduct own risk and solvency assessments (ORSA), and extended reporting requirements for insurance undertakings and insurance holdings. The density of regulatory requirements for insurance groups has increased significantly in order to prevent that group-wide risks that could threaten the insurance undertakings belonging to a group are overlooked. All this is supposed to reduce the risk for insurance failures and market disruption.

For both insurance regulators and insurance companies, Solvency II has required a huge amount of preparations to be able to meet the new standards. Insurance groups spent many years to accommodate their structures, decision processes and IT systems to the new demands, and have been struggling for a long time to meet the requirements. Due to that the focus of many insurers has shifted to mere compliance rather than trying to achieve business benefits through Solvency II, which initially was the aim of many insurers.\(^3\) Many large insurance groups started to develop group internal models to calculate their group Solvency Capital Requirements already long before the directive had been passed, aiming not only at improving their risk management with it, but also at being able to reduce the group Solvency Capital Requirement to save capital costs.\(^4\) To

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\(^3\) See the report on a study involving 49 life insurers conducted by PwC, Delivering your model expectations, 2011, p. 5.

\(^4\) However, a considerable number of insurers seem to have given up or at least postponed their ambitions to develop internal models, cf. Solvency II News: Internal Model take-up lower than expected, (3 July 2016), citing a spokesman of Finansinspektionen according to whom “Undertakings found the processes surrounding the models disproportionate compared to the benefits.”
justify the enormous investments made by regulators and insurance companies, Solvency II should be significantly better than its predecessor Solvency I. And it is true that already before its start, Solvency II has led to an increased risk awareness for the importance of risk management in the insurance industry. But increased security is not cost-neutral, so insurers were expecting their customers to accept higher premiums in the future.\(^5\)

The initiative for Solvency II was taken in the course of the implementation of the 1999 Financial Services Action Plan\(^6\), presented by the European Commission at the request of the European Council. The Action Plan formulated strategic objectives to further promote the single market for financial services and identified a large number of concrete steps to be taken by the European Union in order to achieve this aim. One of the objectives was “state-of-the-art prudential rules and supervision” which included the adoption of the directive on the winding-up and liquidation of insurance undertakings and the amendment of the solvency margin requirements in the insurance directives – relatively modest suggestions compared to what was to come later. In 2002, during the initial review of the solvency requirements for insurance companies, a need for a “more fundamental overhaul” of the Solvency I legal regime was identified, which became known under the term “Solvency II”.\(^7\) The initial time plan envisaged the definition of the new solvency framework to be in place by 2005.\(^8\) The project proved to be much more time consuming, and the Solvency II Directive\(^9\) finally was passed in 2009.

In 2014, the directive was amended by the Omnibus II directive\(^10\), primarily to reflect the foundation of the European Insurance and Occupational Pensions Authority (EIOPA), but also to align the directive to the Lisbon Treaty which entered into force shortly after the directive was enacted. The transposition date for implementation into national law was postponed in several steps from 31 October 2013 to 31 March 2015 and the date of application from 1 January 2013 to 1 January 2016.\(^11\) So now, after a phasing-in period in 2015, Solvency II is finally applicable.\(^12\)

\(^5\) Kathleen Ehrlich, Positions of European Insurers on Solvency II, Munich Re Knowledge Series, 2011; Representing the view of the Swedish insurance group Länsförsäkringar: Claes Thimrén, ‘Försäkringstagare tjänar inte på detaljreglering i Solvens II’ Dagens industri (2010-04-30).


\(^8\) European Commission, ibid. p. 17.


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The Solvency II legal system was enacted by using the Lamfalussy process which had originally been developed in the field of securities law and since 2002 also has been applied with regard to so-called level 3 measures in the banking and insurance sector. In accordance with the Lamfalussy process, the Council and the Parliament adopt the framework legislation setting out the core principles (“level 1”). For the Solvency II regulatory framework, the Solvency II Directive constitutes level 1. On the basis of the directive, so-called “level 2 provisions” containing details have been enacted by the European Commission, further specifying certain areas of regulatory law. The level 2 provisions have been taken in the form of Commission regulations, the most important in the context of this study being Delegated Regulation 2015/35. The Commission has been assisted by the European Insurance and Occupational Pensions Authority (EIOPA) in the drafting of the level 2 provisions. In addition, EIOPA has complemented the directive and level 2 regulations with non-binding so-called “level 3 guidelines”, forming some kind of “soft law”. At the fourth level, the Commission enforces the timely and correct transposition of the directive into national law. The idea of the Lamfalussy process is to converge supervisory practice and to enable “[…]Community financial services legislation to respond rapidly and flexibly to developments in financial markets”. One characteristic feature of the Lamfalussy process is that rules are adopted after open consultations with interested parties.

Both supervisory authorities and insurance companies have prepared themselves for the new demands for many years. Whereas actuaries had been very actively engaged in the discussion about the Solvency II requirements for a long time, legal professionals discovered the importance of the subject only much later when the drafting process was already well advanced. It seems as if many legal practitioners working with insurance regulatory law initially underestimated the impact of the Solvency II regime on insurance undertakings. As a consequence, legal arguments may have received too little attention in the drafting progress. Attention by legal scholars has also been limited. My impression is that the largest number of contributions has been made by legal academics in Germany, with the majority of publications dating from 2009 to 2015. In Sweden, only a handful publications on Solvency II issues have been published by legal scholars so far. A reason for the limited attention is probably that the Solvency II legal regime is very

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16 Ibid., p. 2.
technical and complex. For example, one of the most debated issues during the discussions on Solvency II in the aftermath of the financial crisis concerned the interest curve applicable for the valuation of the assets and liabilities on the solvency balance sheet. This concerns very technical matters that are difficult to grasp even for legal academics with some knowledge in the field of insurance regulation.

Nevertheless, the Solvency II regime involves a large number of legal questions to which the study is supposed to provide a contribution.

1.2 Problem background

Solvency II is a multi-faceted system too large to be covered completely in one thesis. Therefore, this study has to concentrate on just a few issues. For the purposes of the present work, I find those questions interesting which put insurance regulatory law into a larger legal context.

Insurance regulatory law in the context of this study means the body of norms that apply on the taking-up and pursuit of insurance business specifically, where a regulatory authority monitors compliance. It comprises those norms that govern the competences of insurance regulators. Insurance companies may also be subject to regulatory law in other areas, such as stock exchange regulation if they are listed companies, or data protection legislation. However, such kind of regulatory law does not fall under the term “insurance regulatory law” because they are not specifically imposed on the insurance industry. To facilitate reading, I will use the term “regulatory law” rather than “insurance regulatory law” in the thesis.

As every field of law, regulatory law is not isolated, but part of the entire legal system. The credibility and acceptance of a legal system depends also on how well its parts fit to each other – an incoherent legal system will be perceived as arbitrary and will be followed only reluctantly by its addressees.
The Solvency II regime is often described as a building with three pillars (see Figure 1.2 no. 1). The first pillar contains the quantitative requirements for insurance undertakings, i.e. capital requirements, rules on investments and the calculation of technical reserves. The second pillar contains the rules on the corporate governance of insurance undertakings and the third pillar rules on reporting and transparency. The system is completed by similar rules for insurance groups (“the roof”), which address insurance undertakings that are part of an insurance group. The ultimate parent undertakings of such groups can be insurance holdings or insurance undertakings that have other insurance undertakings as subsidiaries. To facilitate reading, I will use the term insurance holding for both kinds of ultimate parent undertakings, unless the distinction is of importance.

The thesis deals with the tension between company law and regulatory law with regard to the calculation of the group capital solvency requirement according to Solvency II. To use the metaphor described above, it deals with the “roof” of the Solvency II building, but since many of the rules for insurance undertakings at solo level are applicable on insurance groups, it will be necessary to look at the first two pillars frequently.

In some cases, regulatory law deliberately complements and amends company law. In the context of the thesis, the term “company law” is applied in such a way that it encompasses the general rules applying to the organization of companies, the

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18 Often, insurance practitioners and regulators speak of the “solo” level, when they refer to the requirements applicable to each single insurance undertaking as opposed to the requirements applicable at group level, for instance the “solo SCR” or the reporting requirements at solo level.
relationship between their organs and between companies and related undertakings. For instance, if an insurance undertaking has the form of a Swedish limited company (aktiebolag), it has to follow the rules in the Swedish Companies Act (Aktiebolagslagen – ABL), as far as they have not been set aside by special regulatory rules for insurance undertakings. This is the case, where regulatory law for instance contains corporate governance rules for insurance companies and insurance holdings, with the consequence that these companies have to follow more or different requirements than other companies. Examples are requirements for a certain minimum number of directors, the need to appoint certain specialists, such as a risk manager, or specific requirements concerning their professional qualification. This kind of specific requirements is not alien to company law, because - depending on specific circumstances - additional organizational requirements are not uncommon, for instance employee rights to elect representatives to supervisory boards or administrative boards, or additional requirements for listed companies.

An implicit connection between regulatory law and company law arises in the context of the calculation of a group Solvency Capital Requirement (group SCR). This group capital requirement comes in addition to the solvency requirements which need to be fulfilled by the insurance undertakings of the group “at solo level” (solo SCR). The Solvency II Directive requires ultimate parent companies of an insurance group in the European Union to ensure that the group has own funds covering at least the group SCR. Both the solo and the group SCR need to be calibrated with a value-at-risk (VaR) of 99.5 % over a period of one year.

In case of the solo SCR of an insurance undertaking, this calibration with a VaR of 99.5 % means that – somewhat simplified – the SCR represents the amount of own funds that the insurance undertaking needs in order not to become insolvent within the course of one year, with a probability of 99.5 %. If all insurance undertakings had own funds to cover exactly 100 % but not more of their SCR, statistically, one out of 200 per year would fail. Since insurance groups are not legal persons, they cannot become the subject of insolvency proceedings, so that the group SCR represents such an amount of own funds available at group level, that has a 0.5 % risk to be entirely consumed within the course of one year.

Even though the legal obligation to calculate the group SCR lies with the ultimate parent undertaking, this does not mean that the own funds covering the group SCR have to be in the direct possession of the ultimate parent undertaking. To the contrary, a certain and often very large part of the group solvency capital will always be held by subsidiaries. Since company law may restrict the transferability and fungibility of own funds in a subsidiary, the directive provides for a number of adjustments to reflect these restrictions.

19 van Hulle, Solvency II: state of play and perspectives, p. 180.
According to Article 230 (1) Solvency II Directive, the group SCR needs to be calculated “on the basis of the consolidated accounts”. In the insurance industry and among insurance supervisors, there has been a wide-spread view that, generally, the same consolidation methods should be applied for solvency purposes as for group accounting purposes. Accordingly, at level 2, Article 335 Delegated Regulation\textsuperscript{20} requires the full consolidation of subsidiaries for the Solvency II balance sheet forming the basis for the calculation of the group SCR.

This is consistent with accounting law, where the term “control” is one of the concepts used to define whether a company shall be fully consolidated or not. When a parent company is deemed to have control over another company, all of the assets and liabilities have to be consolidated in the group accounts, even if the parent company owns less than 100 % of the shares in the other company. The concept underlying consolidation in accounting law is that the group is regarded as if it was a single entity. This “enterprise” or “economic entity approach” has also been endorsed by the Solvency II legislator.

The tension with the company law rules applicable to insurance groups is most striking in a situation where the parent undertaking holds less than 100 % in an insurance undertaking, but also exists with regard to wholly-owned subsidiaries: Applying full consolidation on the calculation of the group SCR means that an insurance holding with a 55 % share in an insurance undertaking in principle has to hold solvency capital for 100 % of the insurance undertaking’s risk, even though it may not be legally obliged to save its subsidiary from insolvency. Supposing that this is so, the question is then whether the adjustment rules in the Solvency II rules are adequate enough to mitigate this effect, because if they are not, insurance holdings would be required to hold solvency capital at group level, which they might not want to invest (or might even be legally be inhibited from investing) into a subsidiary in need.

If this were the case, there would be a risk that such a group capital requirement would be deceptive and the question arises if it makes sense then to oblige an insurance holding to hold any solvency capital for shares it does not own or that may not be used to save a subsidiary. Or is there a more adequate way of calculating the group SCR by using a different consolidation method? In this context, an understanding of how consolidation is applied in economics and how economists look at groups will be essential. The applicable IFRS consolidation principles have been developed for group accounting purposes. The idea of group accounting is, in short, to inform about how the balance sheet and the annual result of a group of companies would look like if they were a single company. Even though companies may be legally obliged to set up consolidated accounts, there are, at least in Germany and Sweden, no statutory legal consequences

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connected with the results shown in the consolidated accounts. Solvency II now uses these group accounts as a basis for a purpose which they did not originally have, i.e. calculating the group Solvency Capital Requirement, giving them a significance different from their original one.

1.3 Purpose and Research questions

The purpose of this thesis is to contribute to an understanding of the tension between regulatory law and company law, specifically between the regulatory consolidation requirement laid down in the Solvency II regulatory regime and company law, and to analyse possible solutions to reconcile both areas of law in this respect.

The overarching research question can be formulated as follows:

How shall we understand the group Solvency Capital Requirement against the background of the company law provisions applicable to insurance undertakings?

The Swedish Council on Legislation (Lagrådet) was in 2015 consulted by the Swedish government to give its opinion on the draft legislative proposal for transposition of the Solvency II Directive. In its introductory remarks, the Council stated the following:

“The proposals submitted are based on EU law that at least in parts is very complicated. Not least is this true with regard to the new rules on group supervision. Particularly in this area, the directive seems to have considerable flaws concerning the rules’ clarity and coherence with each other. […] During the presentation of the draft proposal, it has often been difficult to clearly establish how the rules are supposed to interact and which objective the individual rules have. With regard to group supervision, even the most fundamental principles lead to insecurity, for example concerning the scope of the rules, the level at which group supervision shall take place and how the legal systems of the different EU member states interact“ [own translation].

21 Until 2006, Swedish law provided that the dividends that could be distributed by a parent company being obliged to set up consolidated accounts, were limited by the results shown in the consolidated balance sheet (chapter 12 § 3 ABL1975:1385). It is acknowledged that the consolidated accounts often are given a legal significance by contracting parties, for instance when the distribution of bonuses to directors is tied to certain results in the consolidated balance sheet or in the consolidated profit and loss statements, or when a lender and a borrower in a credit arrangement agree on specified rights and duties for the case that certain financial ratios derived from the consolidated accounts are not met.

22 Lagrådet, Utdrag ur protokoll vid sammanträde 2015-06-18, p 3 f. Original wording: ”De förslag som nu lämnas grundar sig på en EU-reglering som åtminstone delvis är ytterst komplicerad. Inte minst gäller detta det nya regelverket om grupptillsyn. Särskilt på det området förefaller direktivet också ha betydande brister vad gäller
With this study, I hope to cast some light on this complicated legislation and thereby to contribute to a better understanding of the regulatory framework that insurance groups and regulators have to apply. Therefore, I hope that the study will be of interest not only for academics, but also for practitioners working with insurance regulatory law. I am convinced that insurance regulatory law despite of its complexity should be given more attention by legal academics than what has been the case so far in Sweden, and hope to fill this gap at least partly with this thesis.

Ideally, the findings could be of interest also in other areas where groups of companies are regulated, such as the banking sector. Insurance regulation and banking regulation are in many respects similar to each other and banking regulation has often been a model for insurance regulation. Especially the methodology applied for the calculation of the regulatory capital requirements for banks and insurance undertakings is quite similar. At a more general level, the results of the study are supposed to increase the awareness for the interplay between different areas of law and the consequences of conflicts.

To develop an understanding of the tension between the enterprise approach underlying the calculation of the group Solvency Capital Requirement and the legal entity approach applied in company law, it is necessary to understand both the regulatory requirements and the company law requirements that may collide with them.

The research question can be broken down into the following three questions:

The first research question relates to the regulatory requirements:

What is the exact content of the Solvency II rules regarding the treatment of affiliated undertakings for the purposes of calculating the group SCR and its coverage with own funds?

The second question relates to company law:

How does company law regulate the relationship between affiliated insurance undertakings, in particular with regard to the exercise of control over subsidiaries, the transferability of assets between affiliated undertakings and attempts to save a subsidiary in financial difficulties?

reglernas tydlighet och inbördes sammanhang. […] Det har vid föredragningen av lagrådsremissen ofta varit svårt att klart fastställa hur reglerna är tänkta att samverka, och vilket syfte de enskilda bestämmelserna har. När det gäller grupptillsynen har även de mest grundläggande principerna visat sig leda till osäkerhet, så t.ex. när det gäller regleringen av bestämmelsernas räckvidd, på vilken nivå i olika företagsstrukturer som tillsynen ska ske och hur olika EU-länders regelverk samverkar.”

Numerous other questions will be dealt with in the study.
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On the basis of the findings to these two main research questions, the third research question will be dealt with:

What is the relationship between regulatory law and company law, and can and should they be aligned with each other with regard to the calculation of the group SCR?

1.4 Delimitations

The research project will be limited to legal questions. Nevertheless, it will be necessary to understand the consolidation concept used in accounting as this will serve as a reference object in the study. However, this does not involve any scientific research in the field of business administration or economy.

A licence to conduct insurance business can only be obtained by undertakings incorporated in certain legal forms. In Sweden, försäkringsaktiebolag (limited insurance companies, including European Companies), ömsesidiga försäkringsbolag (mutual insurance companies) and försäkringsföreningar (insurance mutuals) can obtain insurance licenses. Since 2011, understödsföreningar (friendly societies) cannot obtain licenses anymore. Friendly societies are obliged to either dissolve or convert into insurance mutuals until 2017. Since the majority of, including all larger, Swedish insurance undertakings are either försäkringsaktiebolag or ömsesidiga försäkringsbolag, the law applying to försäkringsföreningar is not analysed in this study. In Germany, insurance licenses can be obtained by Aktiengesellschaften (stock corporations), European Companies, Versicherungsvereinen auf Gegenseitigkeit (insurance mutuals) and Körperschaften oder Anstalten des öffentlichen Rechts (corporations or institutions under public law). The latter are usually regionally active insurance undertakings. Since they are formed under legislation at Land level, for instance the Land of Lower Saxony’s Gesetz über die öffentlich-rechtlichen Versicherungsunternehmen in Niedersachsen, they are not considered in this study – to analyse the legislation of all sixteen Länder would go beyond the scope of this study. Any eventual particularities applicable to undertakings with shares listed on a regulated market are not presented either. European Companies are not considered separately, because in all relevant aspects in the context of this study, the same principles as for limited liability companies apply. In Sweden, the practical relevance of SEs is very small with only five SEs registered at all in 2017, none of them being insurance undertakings. In Germany, a few (re)insurance undertakings, including large ones like Allianz and Hannover Re, are SEs. European Cooperative Societies do not have any practical relevance in the insurance sectors of neither Sweden nor Germany and are therefore not taken into consideration either.

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25 Result of a search in the Swedish Companies Registration Office’s database, Bolagsverket (Swedish Companies Registration Office) Statistik om företag och föreningar, data retrieved on 2018-06-12.
Companies do not only have to comply with company law, but their business decisions are often influenced by their tax effects. Asset transfers within a group may raise important corporate tax questions. But in contrast to company law, which sets up legal barriers for certain transactions, tax law does not hinder any capital transfer as such, as long as the transaction is declared correctly. Admittedly, large taxes may have a prohibitive effect on certain transactions and cause the board of management or the board of directors to choose other alternatives or to abstain from transactions that might otherwise be well-motivated. To give an example, for companies subject to Swedish corporate income tax, a transfer of assets may result in exit taxation (uttagsbeskattning) or give rise to withholding tax (utdelningsbeskattning). For the purposes of this study, even an infavourable tax impact is simply regarded as a cost rendering a transaction more expensive. It does not constitute a legal hinder for a transaction, even if it influences the group solvency by leading to a reduction in own funds both at both solo and group level. Against this background, an analysis of the tax effects of asset transfers within a group is left outside the scope of this study. It is important to note, that an important principle of Swedish tax law is that business conducted by companies belonging to a group shall be taxed equally as if the business is conducted by one single undertaking. To the extent this ambition really is fulfilled, group-internal transfers do not increase the overall tax burden within the group. To exclude tax issues from the study should therefore not have a significant impact on the outcome of the study and allows the author to focus on the most relevant questions.

Since Solvency II (partly) needs to be implemented in national law, differences in the national implementation laws could be of interest. A classical comparative study of these laws lies, however, outside the scope of the project because the full harmonisation directive is relatively detailed and therefore does not leave much room for substantially different national rules. This does not exclude that national norms (or legal practice) from other states would be entirely disregarded if relevant for the research project, or that eventual inconsistencies between national law and the directive would be discussed. That applies also mutatis mutandi to a systematic comparison with regulatory law applying to the banking sector.

Some of the issues to be treated in the study are also very interesting from a law and economics perspective. While qualitative law and economics arguments are applied, quantitative law and economics research does not form part of the research project.

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26 In extreme situations, of course, one could imagine board members to be liable for a transaction connected with a very high tax cost, especially if there would have been less costly alternatives.

27 A study of the tax effects of asset transfers would have to take many circumstances that are relevant for taxation into consideration, such as the group structure, the financial situation of the parties, cross-border taxation issues involving other jurisdictions, previous transactions, and, for German companies, the existence of a profit and loss transfer agreement.

28 SOU 2014:40 Neutral bolagsskatt - för ökad effektivitet och stabilitet, slutbetänkande av företagsskattekommittén, p. 25.
Finally, many issues that are of interest in connection with insurance regulatory law in general are left outside the scope of this study. One of these questions concerns the definition of insurance. While it is clear that the traditional products offered by the insurance industry (e.g. fire insurance, accident insurance, third-party liability insurance, traditional life insurance) also constitute insurance, there are other products that are more difficult to classify. For the purpose of studying group supervision, this question may be left aside. Group supervision applies to insurance undertakings that are licensed either in a member state of the European Union or in a third country outside the European Union, so that this formal requirement suffices to distinguish insurers from non-insurers. Questions particularly involving groups with undertakings outside the EEA are not dealt with at depth.

As mentioned above, the requirement to comply with capital requirements at a group level and on a fully consolidated basis is not unique for the insurance sector, but also applies both to credit institutions according to Articles 11 to 24 Capital Requirements Regulation\(^29\) specifying the corresponding requirement in the CRD IV Directive\(^30\) and to financial conglomerates according to Article 6 Financial Conglomerates Directive\(^31\). Of course, there are many commonalities between the insurance sector and the banking sector, both belonging to the financial sector and providing so-called financial services. To the financial sector belong banking services, such as the granting of loans or taking deposits from the public, insurance services and investment services related to financial instruments, such as portfolio management, investment advice and transmission of orders concerning the acquisition and sale of financial instruments. Also, certain activities closely related to these activities belong to the financial sector, for example insurance intermediation or the services rendered by credit rating agencies. The EU Commission Financial Services Action Plan from 1999 announced legislative actions not only in all these fields – except credit rating agencies which were not mentioned but were added to the Commission’s Financial Services Policy later\(^32\) – but also with regard to the regulation of capital markets, i.e. concerning financial reporting requirements for the issuance of certain financial instruments.\(^33\) To find a definition of “financial services” is, however, surprisingly difficult. What financial services provider have in common is that they neither deliver tangible goods or “concrete” services (such as music teaching,

\(^29\) Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.
\(^30\) Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.
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legal consultancy services, or the streaming of a movie), but rather deal with their customers’ financial interests. With the exception of intermediation services, the financial services provider receives money from its customer and promises to return money if certain conditions are met, i.e. when the customer wants to withdraw funds from its bank account, when the customer (insured) has an insurance claim, or when he wants to sell the financial instruments the investment services provider had bought at his request.

Despite the similarities in many regulatory aspects, the thesis is limited to insurance regulatory law. Banking and financial conglomerates regulation are not analysed in depth, not only because of the necessity of limiting the material forming part of the study, but also because there are important differences between banking and insurance. These are shortly described in chapter 1.9.

Solvency II applies both to primary (life and non-life insurance) and reinsurance. Rules that are specific to reinsurance undertakings are also left out of the scope of this study because they are not deemed to be significant for the outcome. Most rules in the Solvency II regime apply to both primary and reinsurance undertakings.

Many life insurers also write occupational pensions business. Occupational pensions schemes where all or part of the premiums are paid by the insured’s employer are important layers in both the German and Swedish pension systems complementing the general public pensions systems and private pension saving. Regulatory requirements for so-called institutions for occupational retirement provision are laid down in the Occupational Pension Funds Directive (“IORP II”). For life insurance undertakings, in principle, the Solvency II requirements are applicable also to the occupational pensions business, but Article 4 IORP II and 308b (15) Solvency II Directive allows member states to apply many of the old provisions on the occupational pensions business instead for a transitional period until 31 December 2022. In contrast to Germany, Sweden has made use of this option, so that Swedish life insurers until 2022 are allowed to continue to use the IORP capital requirements, which are very similar to the Solvency I requirements. The treatment of occupational pension insurance with regard to solvency capital requirements is therefore left outside the scope of this study. This concerns the

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34 By 2046, Germany expects occupational pensions to have a share of roughly 25% of the overall pension system. The corresponding percentage for Sweden is about 35%: European Commission, Revision of the Occupational Pension Funds Directive – frequently asked questions 1 July 2016, p. 5.
36 The question whether the IORP Directive (repealed by IORP II) is subsidiary to the Solvency II Directive or insurance undertakings conducting occupational pensions business may choose to apply IORP instead of Solvency II has been debated in Sweden. See Finansmarknadsavdelningen Finansdepartementet, Promemoria Förhållandet mellan Solvens II direktivet och tjänstepensionsdirektivet, April 2012, and the answers to the public consultation on the memo.
larger part of the Swedish life insurance undertaking’s business,\(^{37}\) which is important to know when comparing Swedish and German life insurer’s SCR ratios.

### 1.5 Choice of relevant legislation

Through Solvency II, insurance regulatory law has become almost fully harmonized throughout the EU and the EEA\(^ {38}\). The Solvency II Directive has been incorporated into the EEA Agreement by decisions 78/2011 and 82/2013 of the EEA Joint Committee. EEA member states therefore have the same legal position as EU member states in the directive. In the following, when reference is made to undertakings with their head office in the EU, or supervisory authorities in EU member states, the reference is meant to encompass EEA member states, as well.

Company law, on the other hand, is harmonized to a much smaller extent. Despite the various EU company law directives that have been enacted over the last five decades harmonizing certain aspects of company law, company law still differs considerably between EU member states. To examine the national company law regimes of all 31 EEA member states exceeds the possibilities of a single researcher. A limitation to Swedish law alone, on the other hand, would be a too narrow approach. Besides Swedish company law, German company law therefore serves as reference point for the analysis.

The choice of German law is based on the following considerations:

- Germany has one of the largest insurance markets in the EU with a large number of insurance undertakings and insurance groups:
  - According to OECD statistics, Germany is the third-largest insurance market in the EU after the UK and France with gross-written premiums amounting to 194 billion EUR in 2016 (Sweden: 34 billion EUR).\(^ {39}\)
  - With 399 registered insurance undertakings incorporated in Germany in 2016, Germany is one of the EU member states with most insurers (Sweden: 177).\(^ {40}\)
  - Only the UK had more insurance undertakings incorporated in their territories in 2015, however with a much larger percentage of them being foreign-controlled.\(^ {41}\)
  - In the context of this study, group affiliation is particularly interesting. Of the 92 insurance groups for which so-called colleges of supervisors have been established by 30 November 2016, because they are composed of insurance undertakings in several member states, sixteen have the German insurance

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\(^{37}\) About 75 % of the Swedish life insurance business consists of occupational pension insurance, Finansinspektionen, Remissvar till En ny reglering för tjänstepensionsföretag (SOU 2014:57), 2014-12-19, p. 2.

\(^{38}\) All 28 EU member states plus Norway, Iceland and Liechtenstein are members of the EEA.


\(^{40}\) OECD.Stat, Insurance statistics, Insurance companies and employees (domestic and foreign controlled insurance life, non-life, composite and reinsurance companies), data retrieved 2018-06-12.

\(^{41}\) Ibid. For 2016, the number of foreign controlled insurance undertakings is not indicated. The number of domestic controlled insurance undertakings in the UK has decreased significantly from 441 in 2015 to 298 in 2016.
regulator BaFin as their group supervisor, for example the Allianz group, Munich Re group and HDI group. Only the French regulator is group supervisor more often, namely 17 times. The Swedish insurance regulator Finansinspektionen is group supervisor for six international insurance groups (Folksam ömsesidig sakförsäkring, Handelsbanken Liv Försäkringsgrupp, Nordea Liv Försäkringsgrupp, Nordnet, SEB Life, Skandia).

- In the context of this study, the company laws on the relationship between parent undertakings and subsidiaries are of particular interest. Swedish law – as many other legislations – does not have a particular legislation on groups of companies, whereas German law is the schoolbook example for a company law legislation with a specific group law. German company law thus represents a fairly different tradition than Swedish law and is therefore an interesting study object for the purposes of this study.
- Since I have law degrees from Germany, I am familiar with German legal method which facilitates the analysis of German company law compared with any other legislation.

1.6 Readership

The readership of this thesis will not be limited to academics and practitioners with a profound interest in and knowledge of regulatory law. Readers will have different national and thematic backgrounds.

This is the first reason why many issues are presented in more depth as might be considered necessary by one or the other reader. But since a Swedish reader not necessarily has knowledge about German company law and vice versa, and a company law specialist of any nationality might never have come into contact with insurance regulatory law before, my intention is to give all of them the possibility to get the same information background on which the analysis is based.

The second reason is that I hope that more depth leads to a sounder foundation on which the analysis is based. For the reader, this foundation hopefully becomes visible, even if not every piece of information is explicitly taken up in the analysis. This is also the reason why I have chosen to describe some aspects in more detail than what is customary in legal publications. Examples are the calculation of the group SCR or the

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42 EIOPA, List of identified insurance groups for which a college of supervisors is in place, November 2016.
43 Klaus J. Hopt, Groups of Companies - A Comparative Study on the Economics, Law and Regulation of Corporate Groups, Max Planck Institute for Comparative and International Private Law and ECGI, Law Working Paper No. 286/2015 (2015), p. 8 f. Hopt explicitly mentions Sweden “[…] where no need seems to be felt to deal with group agency problems in more detail”, something he finds “[…] astonishing because in Sweden the shareholding structure is characterized by strong owners and weak minorities.”
44 Doctoral theses in law defended at a Swedish university are usually read by legal scholars in Sweden of all kinds of legal disciplines, i.e. not only those who are active within the same area of law.
functioning of a limited liability put option. I find that such excursions into more technical areas have enhanced my own understanding and hope that they will contribute to a better interdisciplinary dialogue.

A third reason is that I find it acceptable in a legal dissertation – as opposed to some other genres of legal writing – to answer questions “along the way” even if their full exploitation is strictly speaking not required by the research questions. I have therefore chosen to take a few deviations – for example with regard to certain questions concerning the definition of insurance groups – because I found them interesting and because I believe that they contribute to a better “background understanding”.

1.7 Perspective

The Solvency II legislation applies throughout the European Union and European Economic Area. My general perspective when analysing EU law is therefore mainly that of a European legal researcher. My background as a German researcher in Sweden explains, however, why I discuss certain questions against the background of specific German or Swedish phenomena. The conflict between regulatory and company law is studied from both a German and a Swedish perspective.

1.8 Some conceptional departure points

Most insurance undertakings belong to a group, which in many cases can be classified as an insurance group.45 The term “group” is used in this thesis referring to legally separate entities that are connected through certain qualifications, usually a majority shareholding, i.e. a definition focusing on the interrelations between different legal persons is applied. A more economic approach does not focus on the legal identity, but on the variety of activities undertaken. According to this economic approach, a group could consist of a single company with branches in other states.46 According to my usage of the term group, such an undertaking is not a group, however.

Insurance groups may be organized very differently, from groups with few large undertakings and many foreign branches to groups consisting of many individual entities which in turn may have many subsidiaries. Legal restrictions may even make the formation of a group necessary: Because of the separation principle, a group must consist of at least two different legal entities if it conducts both life and non-life insurance business, unless it falls under one of the exemptions for “old” insurance undertakings.

Apart from the separation principle, European insurance regulatory law does not contain any rules on how groups need to be structured. Consequently, there are many ways how a group can be structured.

One option is to have separate legal entities for each major line of business, for different distribution channels, customer groups and geographic markets. For instance, one insurance undertaking in a group may be specialized on fire insurance for large businesses in Sweden, which is sold exclusively via independent insurance intermediaries, whereas another undertaking specializes on motor insurance for private car owners in Finland and sells its policies exclusively via a bancassurance partner.

Another possibility is to bundle different distribution channels and lines of business in one entity. Instead of having separate entities in each country, branches can be established in other EEA countries. An insurance undertaking could, for instance, offer both industrial and private non-life insurance via a multitude of distribution channels, including brokers, agents and direct distribution via the internet to customers throughout the world.

In reality, most insurance group structures are not placed at one of these two extremes but lie somewhere in between. There are many aspects that may influence a group’s structure: Tax implications, access to capital markets, or managerial responsibility are examples. Countries outside the EU may allow the conduct of insurance business in their territory only for insurers that have their seat in that country, or they may limit the maximum shareholding of foreign investors in insurance undertakings in their territory. Customers may be reluctant to buy insurance from companies that have their head office in a foreign country, or the group structure is supposed to reflect the chosen management responsibility. Sometimes, a group’s structure can only be explained by historical reasons, particularly if it has grown through acquisitions.

Management styles may also vary from centralized with the parent undertaking closely steering the subsidiaires to decentralized where subsidiaries are given more freedom. With the Solvency II governance requirements at group level, however, a certain level of involvement of the parent undertaking is obligatory. In many groups, external financing is raised only by the parent undertaking and downstreamed to the subsidiaires whereas in others, subsidiaries take loans or issue bonds themselves. Subsidiaires may be wholly owned or have external shareholders.

Based on this group understanding, the departure point for the analysis is that differences in the legal group structure are not irrelevant, but to the contrary may justify a different treatment according to regulatory law.

A different approach is taken by Erdélyi who argues that groups are unreasonably discriminated compared to stand-alone undertakings because the group undertakings need to hold own funds amounting to the sum of solo SCRs whereas a stand-alone undertaking (with the same risk structure as the group)

47 India is an example for the latter. As of 2013, foreign investors were not allowed to hold more than 26% in Indian insurance undertakings, (with an increase to 49 % having been announced), see J. Sagar Associates, Doing Business in India - An Overview, 2013-06-15, p. 18.

48 With respect to the German insurance market: Mirko Kraft, Gruppenaufsicht, in: Helmut Gründl and Mirko Kraft (eds), Solvency II - Eine Einführung Grundlagen der neuen Versicherungsaufsicht (2nd edn 2016), p. 133.
may use the diversification effects to lower its solo SCR. According to the approach taken here, this is not discriminatory per se because each legal entity is treated equally – it has to hold own funds amounting to its solo SCR – and differences in the legal structure between a group and an insurance undertaking could justify to treat groups and stand-alone insurance undertakings differently.

Another starting point connected with this focus on individual entities within a group is that I consider the supervision of insurance undertaking at solo level – including the imposition of a solo SCR – as indispensable. Of course, some aspects of solo supervision, such as certain reporting requirements, can be replaced by corresponding regulatory requirements at group level, but I am convinced that the limited liability of the shareholders of an insurance undertaking makes it necessary to supervise insurance undertakings individually. Supervision at solo level cannot entirely be replaced by group supervision. From a policyholder protection perspective, it is necessary that insurance undertakings need to cover an individual solo SCR, notwithstanding whether they belong to a group or not.

1.9 Method and material

A complex study of this kind cannot restrict itself to one method only or apply the same method throughout the whole study. Rather, different parts require different and sometimes several methods. In the following, the main methods and choices concerning the material applied are described.

Additional comments with regard to the method applied are sometimes made as an introductory remark in the beginning of a chapter.

1.9.1 Descriptive parts

Several parts of the thesis have a largely descriptive character, namely the chapters on the historical development of insurance regulation and on the overview on Solvency II. Also, the chapter on the company law reality of groups is largely descriptive.

Insurance regulatory law does not fall into those areas of law that practitioners and academics outside the financial sector usually come into contact with. A considerable part of the study therefore consists of a description of the Solvency II regulatory framework to gain a basis for the subsequent analysis. This exercise is demanding because it requires that the key features of Solvency II are described in such a way that non-expert academics get a sufficient understanding of the regulatory framework without neither over-simplifying nor overloading the readers with too many technical details. Solvency II is very complex and in many areas very technical. The whole Solvency II legal package including the directive, delegated acts, technical standards and guidelines and recommendations consists of several thousand provisions. To take account of all

49 Erdélyi, p. 128.
details would go far beyond what is possible to do in a thesis. The aim is therefore to provide a basic understanding of the regulatory framework with a focus on those areas relevant in the context of this thesis.\textsuperscript{50} I therefore take the risk that experts on Solvency II or other issues will miss detail in the description of regulatory law while non-experts might consider the presentation still too complicated despite all efforts to provide an understandable overview. A particular difficulty in the description of Solvency II is that many of the technical aspects are hard to understand without knowledge particularly in accounting and statistics and the existing literature in most cases presupposes a fair understanding of these issues. To describe the solvency capital requirement and provide an understanding of how it is calculated, has for these reasons been one of the major challenges.

Even though the overview on Solvency II is mainly descriptive, some issues are nevertheless analysed in greater depth where this is considered of interest, for instance the definition of insurance group in the Solvency II Directive. In these parts, the overview gets more interpretive than descriptive, partly due to the fact that little legal literature exists on these topics. One could ask whether this depth is really necessary, but I hope that a deeper understanding of those issues enhances the quality of the subsequent study of the research questions. For instance, a study on the group solvency requirement would be incomplete without a thorough analysis of the various forms of insurance groups falling under the Solvency II Directive.

For the overview on the Solvency II legal regime, a traditional legal method is applied, involving the interpretation and systematization of the Solvency II legislation on the basis of the legislative texts, and various kinds of literature.

1.9.2 Hierarchy of norms

The Solvency II legislative package consists of norms of different origin. This poses questions concerning the hierarchy of norms. When interpreting a norm, it is helpful and at times indispensable to have an understanding of its hierarchical position as it makes a difference whether a norm is equally-ranking with a conflicting other norm or not. After the amendments introduced by the Omnibus II directive, the Solvency II legal regime consists of the directive, enacted by the European Parliament and the Council, (level 1) delegated acts and implementing acts\textsuperscript{51}, adopted by the EU Commission in accordance with Article 290 and Article 291 TFEU, (level 2) regulatory technical standards


\textsuperscript{51} The terminology concerning the level 2 provisions is not entirely coherent. Some authors differentiate depending on which institution passes the provisions: they call delegated and implementing acts adopted by the Commission “level 2a” and regulatory and implementing technical standards “level 2b”, cf. Gerrit Krämer, Das neue VAG im System von Solvency II, in: Meinrad Dreher and Manfred Wandt (eds), Solvency II in der Rechtsanwendung (2011) p. 5 f.
implemented by the EU Commission with the EU Parliament and the Council each having a right of objection, implementing technical standards drafted by EIOPA and endorsed by the EU Commission, (level 3) non-binding guidelines and recommendations as well as technical information issued by EIOPA and national implementation norms enacted by the competent organs of the member states.

Historically, EU law has not known a clear hierarchy of norms similar to the one that has developed in national legal systems, where a lower-ranking norm that is incompatible with a higher-ranking norm is invalid. Consequently, it is far from clear how a conflict between, for instance, a delegated act and the directive needs to be solved. Chapter 2 will deal with this question in detail.

1.9.3 Material/sources of law

The sections above have dealt with methodological issues related to the legal norms constituting the object and primary source of material of the study. Case law is not an important source of law in the context of this study, since the rules on Solvency II are too new to have given rise to court proceedings yet. Besides, legal disputes on insurance supervision law are extremely rarely brought to court, because insurance companies in general are reluctant to appeal against decisions rendered by their regulators.52

Apart from the norms at levels 1 to 3, CEIOPS53 and EIOPA’s advice form another important source of material for the study. CEIOPS and its successor EIOPA have been asked by the EU Commission to provide advice on a large number of issues concerning the Solvency II Directive and level 2 norms. Between 2004 and 2012, more than sixty such publications were rendered to the EU Commission after consultation with the public. In this context the question arises whether more weight should be attributed *per se* to the advice rendered by CEIOPS/EIOPA because one can assume that the EU Commission, Parliament and Council in their respective roles as legislators have followed EIOPA’s reasoning, unless the wording of the final norms is incompatible with EIOPA’s advice, or whether this kind of material should be given the same weight as any other publication.

In the prevailing Swedish theory on legal sources, preparatory works form a very important source of material, especially if the norm in question is not particularly old yet. Notwithstanding whether they form a source of law or merely a source of

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52 On the reasons for this with respect to the reluctance to litigate in the financial service industry, see Takis Tridimas, EU Financial Regulation: Federalization, Crisis Management, And Law Reform, in: Paul Craig and Gráinne de Búrca (eds), The Evolution of EU Law (2nd edn, 2011), p. 795.
53 Committee of European Insurance and Occupational Pensions Supervisors. CEIOPS was established through Commission decision 2004/06/EC as an independent advisory body composed of high level representatives from the national insurance supervisory authorities and served until 2010 as the level 3 committee for insurance regulatory issues.
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information, preparatory works are considered highly authoritative in Swedish legal theory and practice. Swedish preparatory works are much more detailed than, for instance their German counterparts, reflecting their respective weight in the two legal systems. Reports comparable to Swedish preparatory works do not exist in the European Union. The reports prepared by the respective rapporteurs of the European Parliament and its Committees or the minutes of the Parliament’s plenary or Committee meetings might in some cases help to understand the background of a certain EU provision, but are not given any superior status by the ECJ. The same should be true for CEIOPS’ and EIOPA’s advice. In this respect, European legal method differs considerably from Swedish legal method.

Besides the legislative texts and CEIOPS’ and EIOPA’s advice, publications by other regulatory authorities, scholars and practitioners have been used as material. A considerable part of the publications on Solvency II has not been written by academics but by consultants, actuaries, inhouse lawyers or lobbyists, who often have a good understanding of the practical implications of a certain rule or method, but – as the other side of the coin – often have a personal professional interest in a particular solution. Although this does not per se diminish the quality of such material, a researcher needs to be aware of this.

A few times, I have also used national Solvency II implementing legislation and the Swedish preparatory works to the implementing legislation as material for the interpretation of the Solvency II legislation. Since national law (including implementing legislation) ranks below EU law, this material is, of course, not authoritative for the interpretation of EU law, but merely provides a source of information on how others (the German or Swedish legislators) have understood EU law. Since the Swedish preparatory works are more exhaustive, they can be compared to doctrine for this purpose.

1.9.4 Interpretation of Solvency II legislation

During the course of the study, norms belonging to the Solvency II legislation have been interpreted. The Solvency II legislation is the result of a long legislative process, developed and influenced to a considerable degree by actuaries. It is highly technical, and many provisions are the result of compromises. It is applied by practitioners at

\[54\text{ See Stig Strömholm, Rätt, rättskällor och rättstillämpning (5th edn 1996), pp. 311 ff., on the discussion of what can be considered a source of law. According to Strömholms hierarchy of legal material (he speaks of “factors of sources of law” – rättskillefaktorer), preparatory works rank after codified norms – lagbestämmelser – and before court practice. In this context, it is also worth noticing that the term “source of law” has different connotations in Swedish and German legal theory and is applied much more frequently by Swedish lawyers. The German scholar Rüthers distinguishes between legal sources in a narrow sense and in a wide sense, which – to some extent – reconciles the different views; cf. Bernd Rüthers, Rechtstheorie: Begriff, Geltung und Anwendung des Rechts (1999) p. 123, para. 217.}
\[55\text{ Carlsson in: Finna rätt, p. 110.}
\[56\text{ Bernitz in: ibid, p. 71.} \]
supervisory authorities and insurance undertakings. Disputes in the field of insurance regulatory law are very seldom brought to court. Insurance undertakings that are reluctant of challenging the application of the law by their supervisor in court, usually follow the interpretation by the regulatory authority. Consequently, a “practitioners’ understanding” of Solvency II has developed, influenced by prior supervisory practice and experience, by a (pre-) understanding of Solvency II that has evolved during the legislative process, and by EIOPA’s supervisory practice and its level 3 advice.

This understanding could be called “law in action”. Often, the practitioner’s understanding will be identical to a legal interpretation applied by a judge, for instance, but I am convinced that that this is not always the case. For instance, practitioners will usually not question the legal validity of a norm, so that they would continue to apply an invalid norm until it has been declared invalid by a competent court. An “autonomous” legal interpretation might come to the conclusion that a certain rule is invalid and must not be applied.

By this, I do not mean to say that practitioners deliberately set aside legal interpretation rules, but merely that they are influenced by their professional role as representatives of a stakeholder.

To understand the content of Solvency II, it needs to be interpreted in accordance with the interpretation methods established in EU law. Another question is, in how far the knowledge (or expectations) by specialists, for example actuaries, should or may influence the interpretation. With its highly technical character and complexity, it is almost impossible to understand Solvency II without any expertise in insurance regulatory law. However, to fully leave the interpretation to such experts, and therewith largely to the practitioners applying Solvency II, would violate the rule of law for several reasons: The constitutional balance of powers would be at risk if the understanding of the addressees of the legislation had priority over other interpretations, for instance if the interpretation of the executive prevailed even if it was not sufficiently reflected in the legislation. Apart from that, it is often not possible to find a clear common understanding of how a provision was meant. Also the predictability of the law would suffer, since new professionals mainly have the legislative texts at their disposal and lack the pre-understanding gained by those who played an active role in the creation of Solvency II, for instance by commenting on the consultation papers issued by CEIOPS/EIOPA.

I therefore agree with Conway when he writes:

“[...], it is important to guard against an excessive differentiation of interpretative considerations relative to the substantive context of the law:

57 On the notion of "law in action" as opposed to "law in the books", see Roscoe Pound, Law in Books and Law in Action, 44 American Law Review (1910), pp. 12-36.
Even highly technical law must therefore be accessible and subject to an interpretation. In the CILFIT decision, the ECJ states its interpretation techniques where recourse to the wording, the context and the objectives of the provision and Community law as a whole are required, in other words grammatical or literal interpretation, systemic and teleological interpretation.59

Any interpretation starts with the wording of the provision in question (literal or grammatical interpretation), which leads to a methodological issue related to the European nature of the object of the study: The fact that EU legislation is published in all 23 official languages of the EU, all of them being authoritative.60 When interpreting EU legislation, the ECJ does not give preference to any language, but tries to extract the legislative purpose or legislative intent from the wording of the norm, by comparing various language versions.61 Solan contends that the Court has deliberately refrained from resorting to the language in which a legislative act was drafted, since this would imply raising one language above the others and offending the concepts of sovereignty and equality among the member states.62

An interpretation of EU law thus requires in principle the consultation of the legislative text in all official languages.63 Since my language proficiencies put limits to this exercise, and for practical reasons, the English versions will nevertheless form the starting point for any literal interpretation. After all, English has been the predominant, if not the only, language used during the drafting process. Other language versions will only be consulted occasionally, when the researcher finds the English version to be unclear or has otherwise become aware of possible differences in the language versions.64 In those cases, after the English version, the German and Swedish language versions will be consulted in the first place. The French and Spanish versions will be consulted in the second place.

The other two interpretative methods applied by the Court are systematic, i.e. interpretation with particular regard to coherence, and teleological interpretation, i.e.

59 ECJ, Judgment of 6 October 1982, Case C-283/81 (CILFIT), para. 18 ff.
60 The official languages are determined in Article 1 of the Regulation determining the languages to be used by the European Economic Union, Regulation No. 1, 1958 (with subsequent amendments following the accession of further member states).
61 See, for instance, ECJ, Judgment of 27 September 2001, Case C-253/99 (Bacardi GmbH v. Hauptzollamt Bremerhaven), para. 41
63 Pechstein and Drechsler in: Karl Riesenhuber (ed), Europäische Methodenlehre - Handbuch für Ausbildung und Praxis, (2nd edn 2010), § 8 para. 19 f. with references to the case law of the ECJ.
64 To proceed like this is also suggested by Bernitz in Finna rätt, p. 73 f.
interpretation with regard to the implicit or explicit objectives of the norm or the set of rules to which it belongs.

The Court is usually associated with teleological interpretation, but purpose-oriented reasoning is very common even in other continental European legal systems and consequently nothing particularly special for a continental lawyer.\(^{65}\) From a Swedish perspective, where interpretation with the help of the preparatory works\(^{66}\) is of paramount importance, the interpretation methods used in European law seem less familiar.\(^{67}\) An important source of information for the objectives of a particular provision of secondary EU law can usually be found in the recitals to the legislative act. From a Swedish perspective, the recitals could again be compared to the preparatory works insofar as they contain information about the legislator’s intention. Nevertheless, recitals are often formulated in such a way that they merely take up the same wording used in the provisions of the legislative act. One also has to bear in mind that the enactment of EU legislation often seems to be steered by political mechanisms which also influence how the corresponding recital to a politically sensitive issue is formulated – sometimes the sensitivity simply lies in a suboptimal timing with which a proposal is made during the legislative progress. Therefore – although undeniably important – the recitals to the Solvency II Directive should only be regarded as one source of information among others for a teleological interpretation.

Itzcovich cautions against trying to extract the will of the EU legislator from preparatory documents because what will be found “is not necessarily the will of the legislator, but it is often an incoherent and inconclusive plurality of viewpoints and opinions”.\(^{68}\) This makes it difficult to extract the will of the legislator. Consequently, a

\(^{65}\) Joxerramon Bengoetxea, Neil MacCormick and Leonor Moral Soriano, Integration and Integrity in the Legal Reasoning of the European Court of Justice, in: Gráinne de Búrca and J.H.H. Weiler (eds), The European Court of Justice (2001) p. 48. On the interpretation of English law, Finch and Fafinski differentiate between a purposive approach to interpretation and a teleological approach. Whereas the purposive approach “involves seeking an interpretation of the law which gives effect to its general purpose”, according to them, the teleological approach is broader and requires that not just the purpose but the spirit of the legislation is considered. Emily Finch and Stefan Fafinski, Legal skills (2007) pp. 80 - 81. I have chosen not to follow this differentiation. See also Conway, who uses the terms as synonyms, Conway, p. 20, and the usage of the term “teleological interpretation” in Franz Bydlinski, Juristische Methodenlehre und Rechtsbegriff (1982), pp. 453 - 455.

\(^{66}\) Whether this kind of interpretation is considered to be a kind of teleological interpretation or rather a historical interpretation, is not entirely clear. Hellner describes historical interpretation also as “legal-genetic” interpretation, involving the circumstances under which a norm was created, Jan Hellner, Rättsteori: en introduktion (2nd edn 1994), p. 79. Therefore, it seems more likely that he considers the consultation of preparatory works as part of teleological interpretation. In Bydlinski’s terminology, it would count as historical-teleological interpretation, which he considers to be a certain form of historical interpretation; Bydlinski, p. 451. Also in Larenz’ terminology, the consultation of the legislator’s objectives is an element of historical interpretation, not of teleological interpretation, which according to him involves an interpretation consistent with objective legal aims which are independent from the legislator’s objectives; Karl Larenz, Methodenlehre der Rechtswissenschaft (2., neu bearb. Aufl., verkürzte Studienausg. der 6. Aufl. 1992), pp. 216 - 221.

\(^{67}\) See Bernitz in: Finna rätt, p. 71: “Unionsrätten tolkas och tillämpas på ett sätt som i viktiga hänseenden avviker från svensk rätt.” From a German perspective, it is interesting to note that the book contains a chapter on the interpretation of precedents, but – apart from the chapter on EU law – not on statutory interpretation.

\(^{68}\) Gulio Izcovich, The Interpretation of Community Law by the European Court of Justice, 10 The German Law Journal (2009), pp. 537-559, at p. 555.
teleological interpretation of the Solvency II Directive will have to focus on the objectives which can be derived from the legislative text in question.

1.9.5 Interpretation of German and Swedish law

The interpretation of national law requires the application of the prevalent legal method in the respective jurisdiction. While details on what are correct or acceptable interpretation methods and types of legal argumentations are debated and also depend on the area of law concerned, the general outlines of the legal methods in Germany and Sweden are clear, and it suffices to describe them in short.

With regard to Swedish law, interpretation is closely connected to the question of which material represents a relevant source of law. According to the prevalent theory of legal sources (rättskälleläran), the following material is usually considered to be legal sources, in (a more or less hierarchical) order:

1. Legal rules
2. Preparatory works
3. Precedents (from the highest courts)
4. Customary law
5. Doctrine

When interpreting a rule, the legal sources need to be taken into consideration. The high value attributed to the preparatory works in Sweden reflects the willingness of Swedish lawyers to enforce the will of the legislator. The value of preparatory works diminishes, however, the older they are. The situation envisaged in the theory of legal sources is where the preparatory works to a certain legal norm are consulted to interpret this particular norm. Where the preparatory works to such a norm do not provide an answer to the question, it may be fruitful and necessary to consult the preparatory works to other legal norms with a corresponding content. In this thesis, this becomes relevant with regard to the rules in the Swedish Insurance Business Act (Försäkringsrörelselagen – FRL) on value transfers from insurance mutuals and their corresponding norms in the ABL and the EFL (Lag om ekonomiska föreningar). In such a case, the preparatory works of another statute cannot automatically be attributed the same high value as usually, but it must be assessed for each relevant question whether they can be deemed applicable or not.

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71 Pezcenik and Bergholz in: MacCormick and Summers (eds), Interpreting Statutes, p. 326 f.
The obligation to interpret national law in conformity with EU law, requires a two step operation when interpreting Swedish implementing acts, such as the implementation of the Solvency II Directive. One step is an interpretation of the underlying EU law, in accordance with EU law interpretation principles. The other step requires an interpretation of the Swedish legislation by using the national interpretation method. For Swedish law, this means, that the implementing legislation needs to be interpreted by applying the Swedish doctrine on legal sources and accepted interpretation principles and methods. If there are several alternative interpretations possible, the alternative that conforms best to EU law, must be applied. The requirement of conformity with EU law requires, however, that the Swedish preparatory works are not authoritative if they are contradictory to an interpretation of EU law.

With regard to German law, it has been argued that interpretation in conformity with an EU directive is already interwoven in the ordinary interpretation process: Both for a genetic and for a teleological interpretation, the objective of implementing an EU directive needs to be taken into consideration. Sometimes, an interpretation in conformity with a directive is applied as an additional interpretation method that needs to be given priority in case of conflict. A clear wording, however, cannot be overridden with such an interpretation. The main interpretation methods applied by German law are linguistic interpretation, systematic, and teleological interpretation. Genetic, historical, and comparative interpretation are also applied, but are less common. While these interpretation methods, as well as legal argumentation rules (such as analogies, e-contrario arguments etc.) in principle also are known in Swedish law, I see an important difference in that ethical arguments are given more significance in German than in Swedish legal method. The requirement that laws must comply with the German constitution including the basic rights guaranteed there enables ethical considerations. In Sweden, value judgements are regarded with some suspicion if they cannot be based on clear preparatory works. Both Swedish and German law know, of course, similar legal

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72 See ECJ, Judgment of 10 April 1984, Case 14/83 (von Colson and Kamann), para. 26; ECJ, Judgment of 13 November 1990, Case C-106/89 (Marleasing), para. 8; ECJ, Judgment of 5 October 2004, Joint Cases C-397-403/01 (Pfeiffer and others v Deutsches Rotes Kreuz), paras. 113-119.

73 Strictly speaking, the requirement to interpret national law in conformity with EU law applies to all national law, notwithstanding whether it implements EU law or not, Paul Craig and Gráinne de Búrca, EU Law - Text, Cases and Materials (6th edn 2015), p. 212, with references to case law.

74 Kristina Ståhl, Fusionsdirektivet - Svensk beskattning i EG-rättslig belysning (2005), p. 68.

75 Ibid, p. 68.


77 Ståhl, p. 68.

78 HD, NJA 2012 p. 975 (Bonnier Audio), para. 35; cf. also Carlsson in: Finna rätt, 112; Kellgren, p. 53.

79 Roth in: Europäische Methodenlehre, § 14 para. 39.

80 See the references in ibid, § 24 footnote 107.

81 Ibid, § 24 para. 44 with references to case law of the German Federal Constitutional Court.

82 On statutory interpretation of German law, see Alexy, Robert and Dreier, Ralf in: MacCormick and Summers (eds), Interpreting Statutes, pp. 73-119.

83 See Alexy and Dreier in: ibid, p. 90.

84 See ibid, p. 112.
principles, such as legal certainty, equality and the proportionality principle, but my impression is that the weight attributed to them differs: In Germany, the proportionality principle seems to be more often invoked than in Sweden, whereas legal certainty and formal equality seem to be given more importance in Sweden.

To fully apply a legal method including its more or less implicit value judgements is difficult to achieve, if one’s ”legal socialisation” has taken place in a different legal system. It is therefore possible that my German way of legal thinking influences my interpretation of Swedish law, despite my attempts to apply a Swedish legal method, among other by following the Swedish theory of legal sources.

1.9.6 Method and material applied with regard to the company law reality

The presentation of the company law reality applying to the companies belonging to an insurance group in Part IV combines a traditional legal approach with a problem-based approach. The presentation is limited to those areas of company law that regulate either explicitly or implicitly the relationship between a parent undertaking and its subsidiary.

Concerning the central question of the possibility to move assets around within an insurance group, a problem-based approach is taken. A fictitious example has been developed with several situations that may arise where a subsidiary is in a crisis and the parent undertaking and other group companies are contemplating different measures to help the subsidiary. In the chapter on the company law reality of insurance groups, it is analysed whether and how each of these situations can be solved according to German and Swedish company law. The examples are supposed to give the reader a sense of the type of conflicts that may arise in a crisis situation. A difficulty connected with this kind of problem-based approach is that the examples need to be realistic and comprehensive. Though entirely fictitious, the scenario has been developed on the basis of the experience of the author as an inhouse lawyer in the insurance holding of a large insurance group. The measures forming the object of the company law analysis are selected to cover the most common situations that arise in such a situation. The motivation of the parties involved in the scenario is described in such a way that conflicts of interest between the managements of parent undertaking and subsidiaries are illustrated (disregarding whether such a conflict is relevant according to company law or not).

Since the presentation of the company law reality merely serves to form the background of the analysis of the suitability of the group solvency requirement, it is of a descriptive character and does not need to have the ambition to achieve the same depth that a thesis in company law would have.

This purpose also influences the material on which the presentation is based. The traditional Swedish legal methodology would in principle require to refer to higher-ranking sources of law besides the wording of legal statutes – case law of the highest
court and preparatory works – in the first place and to legal literature in the second place with dissertations often being considered to be more authoritative than textbooks. Due to the limited ambition of the chapter to merely provide an overview, this hierarchy of legal sources is not always strictly followed.

1.9.7 On the use of examples

As explained above, in the part on the company law reality, examples are applied in a problem-based approach. Also for the assessment of the consequences of the consolidation requirement including the corresponding rules on the eligibility of own funds at group level, fictitious examples are used, albeit with the purpose to provide empirical material on the economic impact of a calculation of the group SCR based on fully consolidated accounts as opposed to alternative consolidation methods. The examples are intended to provide an understanding how different calculation methods affect the group solvency ratio for differently composed groups (groups composed of wholly-owned, majority-owned or a combination of majority and minority-owned subsidiaries).

Some Solvency II rules are also analysed with regard to their applicability on real insurance undertakings. These insurance undertakings have often been selected because their structures often fit poorly to the concept implicitly underlying the rules on group supervision in the Solvency II framework. At the same time, these insurance undertakings are important players on their respective regional market and not simply small specialists active in a narrow niche. The analysis is in these cases solely based on selected publicly available information and the insurance undertakings mentioned merely serve as examples for the possible effect of certain rules. For a full legal assessment, other circumstances may have to be taken into consideration.

To try to apply legislation on real or fictitious cases helps to understand how law works in practice and to assess the consequences of its application. It is therefore a useful tool for consequentialist reasoning, or, as expressed by Nästegård, an application of “fact-based arguments” helps to reach well-founded conclusions.85 Conway refers to consequentialist reasoning as an approach – also used by the ECJ – to choose between competing interpretations by taking into account the consequences of the possible interpretations.86

1.9.8 Parallels to accounting theory

In chapter 8.5, I analyze whether the group SCR as prescribed in the Solvency II legislation applies a parent undertaking perspective, or whether it is calculated from a

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86 Conway, pp. 20, 266 f.
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policyholder perspective. The purpose of this chapter is to achieve a better understanding of the perspective underlying the group SCR and to detect the unspoken background of the rules on group solvency. With this objective, the analysis could be called a hermeneutic approach to the rules on group supervision. This analysis is inspired by the theories applied in accounting on the perspective of consolidated financial accounts. Since the calculation of the group SCR is based on modified IFRS consolidated accounts, it seems obvious to draw parallels to accounting theory.

1.9.9 Proposals de lege lata and de lege ferenda

The understanding gained on the group Solvency Capital Requirement and on the company law reality form the basis for the discussion of a number of solutions how regulatory and company law could be aligned, both de lege lata and de lege ferenda. De lege lata solutions are those that could be applied without any statutory changes, i.e. for instance by interpreting rules differently as is done today or by giving priority to other principles.

There is, of course, a clear resemblance to arguments de sententia ferenda, i.e suggestions how judgements should be made. Due to the lack of existing case-law, I have chosen to use the term de lege lata to depict those solutions that would not require any change of legislation.

For the sake of completeness, I have chosen not to exercise any self-contraint and therefore also discuss possible solutions that only have a minimal likelihood of finding support among legislators and practitioners. The solutions are assessed with regard to their capability of resolving the conflict between regulatory and company law and the possible consequences of their implementations. For the prognosis of these consequences, my reasoning has been inspired by law and economics theory, particularly agency theory87.

1.10 Disposition

The study is divided into six parts.

Part I introduces the reader to the subject and method applied (chapter 1), including on the method applied with regard to the hierarchy of norms (chapter 2).

Part II provides background knowledge, specifically a historical background of insurance regulatory law (chapter 3), a chapter on the main differences between German and Swedish company law (chapter 4), and an overview of different perspectives on

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87 Agency theory analyses the conflicts of interest between principals (i.e. the shareholders of the company) and agents (i.e. the managers of a company), and the agent’s ability to promote its own interest rather than the one of its principal. For an overview on agency theory, see Michael C. Jensen and William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 Journal of Financial Economics (1976), pp. 305–360.
groups applied in various areas of law (chapter 5). Since the group Solvency Capital Requirement is supposed to provide a buffer against risks, a description of the risks faced by insurance undertakings, in particular those risks connected with group affiliation, is also included (chapter 5). The purpose of this part is to acquaint the reader with the key features of insurance regulatory law and their origin, and to get a broader picture on various legal group concepts before narrowing the analysis later on to a company law perspective.

Part III is titled “The Solvency II regulatory regime” and starts with an overview of the Solvency II framework, including an analysis of the group definition applied in the Solvency II Directive (chapter 7), before continuing with a chapter on Solvency Capital Requirements, including a detailed analysis of the consolidation requirements and the eligibility of own funds at group level (chapter 8). Chapter 8 concludes with an analysis of the economic effects of various consolidation methods on insurance groups with several different structures.

Part IV discusses the company law reality\textsuperscript{88} of insurance groups with regard to the control of subsidiaries, transferability of assets and the admissibility of rescue attempts (chapter 9).

Part V discusses the relationship between company law and regulatory law. The existing debate in Germany is presented first in chapter 10 before possible solutions to align the group Solvency Capital Requirement with company law are analysed (chapter 11).

Part VI contains concluding remarks (chapter 12).

1.11 On the terminology used

The Solvency II Directive has been incorporated into the EEA Agreement by decisions 78/2011 and 82/2013 of the EEA Joint Committee. EEA member states therefore have the same legal position as EU member states in the directive. For simplification purposes, when reference is made to undertakings with their head office in the EU, or supervisory authorities in EU member states, the reference is meant to encompass EEA member states, as well.

\textsuperscript{88} From a philosophical perspective, the term "company law reality" can, of course, be as paradoxical, depending on the perception of "reality". Law itself can be considered to be a mere social construction, and both companies and groups of companies are in principle nothing but fictitious constructs that are being accepted thanks to social and legal norms. What the term "company law reality" is supposed to express in the context of this study, is that the area of law endorsing the very existence of companies, namely company law, constitutes a legal reality in the sense that insurance undertakings are obliged to comply with if they want to continue doing business and that may constitute a conflict with the group perception applied for the calculation of the group Solvency Capital Requirement.
Acts of EU legislation are designated by their English names. This applies also to guidelines and recommendations issued by EIOPA. For national legislation, the original names are used, most often with an English translation, unless indicated below.

With regard to the following Swedish acts, the well-established national abbreviations are applied:
- Aktiebolagslag (SFS 2005:551) (Companies Act): ABL

In the course of major revisions of Swedish statutes, the entire act is sometimes repealed and a new act with the same title is enacted. In that case, Swedish scholars sometimes refer to the year of the revision to designate which version they refer to. In accordance with this tradition, in the following, the year is indicated with regard to these acts, when reference is made to such older versions of the ABL or FRL (for instance “ABL 1975” or “FRL 1982”). Sweden has transposed the Solvency II Directive by amending FRL 2010. In order to distinguish FRL 2010 pre-Solvency II to the one transposing Solvency II, the latter is referred to as “FRL 2016”, even though the SFS-number has not changed.

In Swedish-language legal literature, references to Swedish acts usually refer to the act first, then designate the chapter and then the provision, for example “ABL 2 kap. 2 §” meaning the second provision in the second chapter of the ABL. A short reference to the same provision would be “ABL 2:2”. I have chosen to apply a system of reference where this provision is referred to as “chapter 2 § 2 ABL” which I understand to be more in consistence with how legal statutes are referred to in the English language. For the following acts, the respective English term will be applied:
- Lag (1995:1560) om årsredovisning i försäkringsföretag: Insurance Accounting Act

The following German statutes are referred to by their established abbreviations:
- Aktiengesetz (Stock Corporation Act): AktG
- Versicherungsaufsichtsgesetz (Insurance Supervision Act): VAG
- Handelsgesetzbuch (Commercial Code): HGB

The transposition of the Solvency II Directive into German law was done by replacing the VAG then in force with a new VAG. In order to distinguish the “Solvency II version” of the VAG from the older version of the act, the new VAG is hereinafter called VAG 2016.

As already mentioned, insurance undertakings may be organised in several legal forms, whereas other forms, such as partnerships are excluded. The German Versicherungsverein auf Gegenseitigkeit and the Swedish ömsesidig försäkringsbolag have in common that the policyholders are members of the undertaking. These legal
forms will be referred to as “mutuals” in this study. German mutuals are not companies, but associations.\textsuperscript{89} For simplification purposes, however, the term “companies” is applied as encompassing even Versicherungsvereine. The term “company law” consequently encompasses the corresponding norms for mutuals. For Swedish \textit{aktiebolag}, the Swedish term and the term “limited company” are used. To avoid confusion with another form of limited companies, namely Gesellschaften mit beschränkter Haftung (GmbH), Aktiengesellschaften are referred to as “stock corporations” unless the German term is used. \textit{Försäkringsaktiebolag} is translated as “insurance company”.

Insurance groups can be headed by different kinds of undertakings: Participating insurance or reinsurance undertakings, insurance holding companies, mixed financial holding companies or mixed-activity holding companies. The definitions of the different types of holding companies are explained in chapter 7.4.1.2. To facilitate reading, a reference to the participating insurance undertaking includes reinsurance undertakings, and the term insurance holding includes both insurance holding companies and mixed financial holding companies, unless otherwise indicated.

Beneficiaries of insurance contracts, i.e. the persons entitled to receive insurance compensation, are usually called “the insured”. Often, policyholders are insured, but this does not have to be the case, for instance in life insurance. My use of the term “policyholders” is meant to include the insured, even if they are not policyholders.

1.12 Shortly on the differences between banking and insurance

In short, insurance business consists of providing insurance protection to policyholders, usually with the insurer promising to pay a certain sum of money – either a predetermined sum independent of any actual loss, or the sum of money required to compensate for a loss suffered – if a risk covered under an insurance policy materializes. Examples are the risk of being involved in a car accident (covered by motor insurance), of a factory standing still because of a machine failure (business interruption insurance), of being liable for having caused damage to a third person (liability insurance), or of dying before or reaching a certain age (life insurance). The insurer’s main performance accordingly consists of providing insurance protection and of paying the agreed compensation\textsuperscript{90} if an insured event occurs during the insurance period.\textsuperscript{91} By insuring a

\textsuperscript{89} This is also true for Swedish “försäkringsföreningar”, which are left outside the scope of this study.
\textsuperscript{90} The insurer’s main obligation does not necessarily consist in a monetary payment. For certain kinds of insurance policies, the insurer is obliged to provide certain specified services, travel insurance for instance usually includes the insurer’s obligation to organise and pay for the transport of a hospitalised insured to his home country.
\textsuperscript{91} For an instructive overview of the main theories on the nature of insurance, however with citations of German-language publications only, see Thomas Kottke, \textit{Fair Value Bilanzierung versicherungstechnischer Verpflichtungen vor dem Hintergrund und der Implementierung eines einzuführenden IFRS für Versicherungsverträge} (2006), pp. 11 - 18.
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large number of policyholders, most of whom will not have any insurance claims during
the insurance period, the insurer is (in most cases) able to provide insurance protection
at a premium which is considerably lower than the potential loss. Thus, insurers use “risk
pooling” to spread costs among their policyholders and turn risks whose occurrence
seem rather random to each individual policyholder into calculable risks for the insurer.
Despite this aspect of mutuality, of course, the insurer needs to bear the cost if insurance
claims exceed premium income. In other words: The insurer bears the risk that its
calculation of an adequate premium proves wrong, for instance because more insurance
claims than expected arise, or because the insurance claims are more expensive than
expected. In addition to the risk spread among the policies belonging to a certain
insurance portfolio, risk is also spread over time: For example, damages caused by
hailstorms may be frequent during one year and seldom during other years in a given area.

Chapter 6 deals in more detail with the types of risks faced by insurance undertakings.

Since insurance undertakings with actuarial methods can anticipate relatively well when
payments become due, liquidity risk is considerably less important compared to the
technical risks. Besides, insurers aim at matching the duration of their assets (such as the
premiums received) with the anticipated liquidity needs. Especially in life insurance,
this is, however, not entirely possible, because life insurance policies have very long
durations – often several decades – and there are not enough assets with similarly long
durations available on the market.

In retail banking, banks attract money from consumers for savings or current bank
accounts and lend money to the same or other consumers. Consumers pay for a loan by
paying interest and are remunerated (in theory) by the bank for their deposit by receiving
interest.

However, in the current low-interest environment, often, consumers do not receive any or very little
interest for their deposits – in that case depositing money on a bank account fulfils a function of parking
funds for later needs.

With current bank accounts, customers participate in today’s increasingly cash-less
society by receiving and settling payments. Banks therewith fulfil an important social
function. While loans have a long duration (i.e. the bank is now allowed to demand
repayment until after an agreed time or when the borrower is in default), most customer

93 Finansinspektionen, Sårbarhetsindikatorer inom försäkringssektorn, 2016-09-15, p. 3.
94 With the exception of the possibility to demand extra payments by members in the case of mutuals, see in more
detail chapter 4.4.
95 Kottke, p. 28.
96 Cf. Finansinspektionen, Sårbarhetsindikatorer inom försäkringssektorn, p. 3 f.
98 Other forms of banking are private banking (management of customer deposits and advisory services to "high-
net-worth individuals"), commercial banking (banking services for small and medium-sized enterprises) and
investment banking (risk management and financing solutions for large corporations), de Weert, p. 10 f.
deposits have a short duration because customers may withdraw their deposits on demand or with relatively short notice.99 Banks thus have an inherent liquidity mismatch100 and are subject to liquidity risk to a much larger extent than insurance companies.101 With regard to their lending business, banks also have a considerable default risk, i.e. a risk that customers cannot repay their loans. This default risk is directly connected to the macroeconomic situation: For instance, an increase in the unemployment rate will probably lead to increases in customer defaults.

Insurance-technical risk, in comparison, correlates in general not at all with the macro-economic situation, such as the risk for the occurrence of natural catastrophes, or at least to a more limited extent. An economic crisis may, of course, to a certain extent influence individuals’ interest in buying insurance – they may to a larger extent than usual for example choose to cancel insurance policies or refrain from investing in new property, such as cars, and therefore need less insurance. But in that case, the insurance company only loses the corresponding premium income and therefore is less affected by its customers’ economic situation compared to a bank that will have to write off loan receivables.

99 Ibid, p. 16.
100 Ibid, p. 17.
101 An exception is credit insurance, that is connected with a significant liquidity risk and where losses are closely correlated with the macroeconomic situation. See SOU 1992:30, Kreditförsäkring - Några aktuella problem. Betänkande av utredningen om kreditförsäkring, p. 34 f.
Hierarch of norms

For any interpretation of norms that form part of a larger normative system, it is essential to be aware of how norms are related to each other in the event of a conflict. Lower-ranking norms may not derogate from higher-ranking norms, so that in case of a conflict with another norm, the hierarchical status of the norms in question may have an impact on their validity and applicability.\(^{102}\) The hierarchy of Solvency II norms, however, is not obvious. A closer look at the normative character of the Solvency II legislation therefore is in order.

2.1 General remarks

As mentioned above, the entire legislative package consists of the Solvency II Directive, which was based on Articles 47 (2) and 55 EEC Treaty, the national (Swedish, German, etc.) implementation laws, delegated acts and implementing acts as well as guidelines, recommendations and technical information.

The directive is commonly referred to as “level 1 legislation” and the delegated acts and implementing acts as “level 2 legislation”. This implies that the directive is higher ranking than the delegated acts and implementing acts. However, it is doubtful whether and to what extent this really is the case. Whereas it is clear that primary EU law ranks higher than secondary law, it is debated whether a hierarchical order exists at all within secondary law.

The Solvency II Directive is based on the legal situation before the Lisbon Treaty: It was enacted on 25 November 2009 — only a few days before the Lisbon Treaty entered into force — and envisages a normative system enacted on the basis of the Lamfalussy process. A characteristic feature of this process is that the Council and the European Parliament as legislators of the Solvency II Directive have empowered the EU Commission in the directive to adopt more detailed implementing measures for certain specified topics.

The delegating norms (“basic acts”) required the Commission to apply the so-called “regulatory procedure with scrutiny” (PRAC) in accordance with the Council Decision 1999/468/EC (“Comitology Decision”). In addition, the original wording of Article 301 (1) Solvency II Directive asked CEIOPS to assist the Commission in the procedure. In short, the regulatory procedure with scrutiny required the Commission to send its proposal for a level 2 act after consultation with member state representatives to the European Parliament and the Council. If neither the Parliament nor the Council opposed the proposal within a certain period of time, the Commission was entitled to adopt the measure.\(^{103}\)

\(^{102}\) Cf. Strömholm, p. 216 with respect to Swedish law.

\(^{103}\) Art. 5a Council Decision 1999/468/EC.
With the Lisbon Treaty, the Treaty of Rome was renamed Treaty on the Functioning of the European Union (TFEU) and received a chapter on the legal acts of the European Union and their adoption procedures (Articles 288 – 299).

Since Article 291 (3) TFEU required the European Parliament and the Council to lay down rules and principles for member state control of the Commission’s exercise of implementing powers, the Comitology Decision was repealed by Regulation 182/2011 and replaced by procedural norms in the same regulation. Although Article 12 of the regulation excludes the regulatory procedure with scrutiny for existing basic acts from the repeal, the Commission proposal for the Omnibus II directive intends to align the delegating norms in the Solvency II Directive to the TFEU, together with further amendments concerning the role of EIOPA as successor of CEIOPS.

Following the new distinction in Articles 290 and 291 TFEU, the directive’s delegating norms for the adoption of implementing measures were amended in 2014 by the so-called Omnibus II Directive so that they allow for the adoption of delegated and implementing acts respectively. Furthermore, the adoption of regulatory technical standards according to Articles 10 to 14 Regulation 1094/2010 (EIOPA Regulation) and of implementing technical standards according to Article 15 EIOPA Regulation (see Figure 2.1 no. 1) was introduced in the Solvency II Directive, as well as the possibility to issue technical information, guidelines and recommendations to be produced by EIOPA.

Implementing measures after the Lisbon Treaty

To complicate things further, under the so-called trilogue discussions between the European Commission, the Council and the European Parliament on the Omnibus II directive, which took place in 2012, it had become a highly political issue which legal form the level 2 implementing measures should have in each single case, with the Parliament's proposal deviating in many cases from the
HIERARCHY OF NORMS

Commission’s. Whereas the Commission mainly wanted to see ordinary delegated acts, the Parliament frequently favoured regulatory technical standards to be incorporated as delegated acts in accordance with Articles 10 to 14 EIOPA Regulation. The political sensitivity lies in the procedural roles attributed to EIOPA and the Commission respectively: For delegated acts, the Commission provides the draft. For technical standards, the draft is provided by EIOPA, and the Commission’s task is to adopt them in the case of regulatory technical standards as delegated acts, or to endorse them in the case of implementing technical standards. Consequently, EIOPA is “in the driving seat” when it comes to the enactment of technical standards.

Since technical information, guidelines and recommendations are not be formally binding, they form some kind of soft law, and thus rank below binding Solvency II rules. The more complicated part lies in the relationship between the directive and the level 2 measures.

The discussion on the hierarchical order of secondary EU law can hardly be understood without taking its historical development into consideration. I will therefore start with a short account of the debate on the situation before the Lisbon Treaty entered into force.

2.2 Hierarchy of norms before the Lisbon Treaty

Before the Lisbon Treaty, according to the prevailing view among legal scholars, there was no hierarchical order among EU legal acts below primary law. In this respect, EU law differed from national legal systems that usually have developed a hierarchical order, where laws enacted by a parliament are higher-ranking than regulations incorporated by an executive organ such as the government, and where legal acts that are based on other legal acts rank below those basic acts.

In EU law, to the contrary, it was considered irrelevant from which institution a directive or regulation originated, so that a regulation adopted by the European Parliament ranked equally with a regulation adopted by the Council or the Commission. Neither did the form of the legal act matter, i.e. whether it was a directive, regulation or decision. In principle, this was also the case with implementing norms that supplemented or amended a basic act. An implementing act was characterised by being based upon another legal act of secondary law, whereas basic acts found their

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104 ‘Political chess: debate over form of level 2 implementing measures hots up’, Insurance Risk (June 2012).
105 Ibid, p. 10.
106 See chapter 2.5 on level 3 guidance.
109 Bast, p. 36; Nettesheim, p. 762.
legal basis in primary EU law. As long as the implementing act was in a formal and material respect consistent with the basic act, it was ranking at the same level as the latter, regardless whether it took the form of a directive, regulation or decision. This consistency requirement was formulated by the ECJ in the Tradax case, where the court ruled that a provision in an implementing norm cannot derogate “from the provisions of the basic regulations to which it is subordinate”. However, this decision merely dealt with subordination to the specific basic act, on which the implementing act in question was based, but did not imply that implementing norms were subordinated to secondary law in general. This has been called a “relative” or “relational” hierarchy, where in case of conflicts with other secondary law, the lex posterior rule applied. According to this rule, in case of a conflict between two norms, the one that has been enacted later prevails over the older rule.

The lack of a legal hierarchy met a lot of criticism not only from academics, but also from the European Parliament. Schütze considered it “‘suspect’ to give the same value to a parliamentary act and an executive act” and called this situation a “constitutional anomaly”. During the discussions for a European Constitution, the European Convention grasped the opportunity to bring forward a proposal that was supposed to clarify the hierarchy of legislation. It envisaged three levels of binding EU legislation with “legislative acts” forming the top level, “delegated acts” forming the middle level and “implementing acts” the lowest. Legislative acts would take the form of “laws” (comparable to regulations) or “framework laws” (comparable to directives), delegated acts would be enacted as “delegated regulations” and implementing acts as “implementing regulations” or “implementing decisions”.

2.3 Hierarchy of norms after the Lisbon Treaty

As is known, the project of the establishment of a European Constitution failed. Instead, it was replaced by the Lisbon Treaty, which took over some of the proposals of the European Convention concerning legislative acts.

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110 Bast, p. 38.
111 Ibid, p. 38; Nettesheim, p. 766.
112 ECJ, Judgment of 10 March 1971, Case 38/70 (Deutsche Tradax GmbH v Einfuhr- und Vorratsstelle für Getreide und Futtermittel), para. 10.
113 Bast, p. 41.
114 Schütze, p. 8.
116 Schütze, p. 17.
118 Ibid, pp. 8 – 12.
Particularly, the distinction between legislative acts, delegated acts and implementing acts proposed by the European Convention found its way into the Treaty on the Functioning of the European Union. According to Article 289 TFEU, a legislative act is a regulation, directive or decision which has been adopted by “legislative procedure”, generally by codecision of the European Parliament and the Council. Delegated acts according to Article 290 TFEU are non-legislative acts which “supplement or amend certain non-essential elements of the legislative act”. Also implementing acts are non-legislative acts. They are the instrument of choice when “uniform conditions for implementing legally binding Union acts are needed” (Article 291 TFEU). Especially in the German and Swedish language versions, this could be read in such a way that implementing acts contain rules that necessarily have to deal with areas not covered by the binding Union act (in this case the Solvency II Directive), because they are supposed to provide uniform conditions for implementation. “Uniform conditions” could be understood as referring to the legal background in which a rule is implemented and not implementation itself. However, the common understanding supported by practice seems to be that implementing acts specify details of the basic act.

According to Articles 290 (1) and 291 (2) TFEU, both delegated acts and implementing acts require a delegation of power to the Commission in the basic act. The European Parliament and the Council have discretion whether they confer power to adopt a legislative or implementing act. Contrary to the proposal by the European Convention, the legal instruments as such have remained unchanged in the TFEU, so that both legislative and non-legislative acts still may take the form of directives, regulations or decisions. At first sight, implementing acts in the form of a directive seem rather meaningless, because then norms that aim at creating uniform conditions of implementation in turn require implementation into national law. However, there are examples of implementing directives. In these cases, directives can be regarded as adequate instruments because the diverging structure of national legislation in the respective area seems to require national implementation acts.

119 The differentiation between legislative and non-legislative acts reminds of the concepts of “formelles Gesetz” (a law in a formal sense, i.e. an act that has been passed through parliament) and “materielles Gesetz” (a law in a material sense, i.e. an act which is legally binding for an undefined number of legal subjects) in German law. In contrast to the terminology in European law, however, where a legally binding act can be either a legislative act or a non-legislative act, the German terms do not exclude each other, so that almost all formal laws are also laws in a material sense whereas the latter do not necessarily have to be formal laws, for instance government regulations.

120 Swedish: “Om enhetliga villkor för genomförande av unionens rättsligt bindande akter krävs”; German: “Bedarf es einheitlicher Bedingungen für die Durchführung der verbindlichen Rechtsakte der Union”.

121 See, for instance, Paul Craig and Gráinne de Búrca, EU Law, p. 117: “implementing acts execute the legislative act”.


When it comes to implementing acts based on directives, Schütze argues that constitutional limits for the exercise of implementing powers can be derived from the very nature of directives, in such a way that implementation of directives through EU implementing norms shall be the exception rather than the rule. Consequently, he contends that the Commission only may exercise its power to adopt implementing acts after the time limit for implementation of the directive into national law has passed.\textsuperscript{125} From a formalistic point of view, Schütze has a valid point. On the other hand, however, the Council and the Parliament have been criticised in the past for “issuing very detailed rules, for which the legislative procedure is really unsuited”.\textsuperscript{126} Given that implementing norms often contain detailed technical rules, it seems appropriate to leave the adoption of such rules to an institution other than the Parliament. The wording of Article 291 (2) TFEU also suggests that implementing norms can be enacted already before the time period for implementation has passed.

At any rate, the Solvency II legislation does not follow Schütze’s proposal. To the contrary, several implementing regulations were enacted before the national implementing legislation became applicable because they deal with issues that were important to have in place at that time, for instance the procedure for the application of the use of undertaking-specific parameters for the calculation of the solvency capital requirement.\textsuperscript{127}

Concerning the hierarchical order between legislative and non-legislative acts after Lisbon, three possible solutions are thinkable.

First, the situation pre-Lisbon may have remained unchanged so that delegated acts and implementing acts rank equally with secondary law and consequently, the basic acts from which they derive enjoy only relative superiority. Bast seems to hold this view. He places implementing acts at the same level as delegated acts (unless a delegated act forms the basic act of an implementing act).\textsuperscript{128} He contends that Article 291 TFEU does not hinder that implementing acts amend non-essential provisions of their basic acts, so that this feature would not be a unique for delegated acts, and therefore would not justify a hierarchical order between delegated and implementing acts.\textsuperscript{129} Concerning the relation

\textsuperscript{125} Robert Schütze, From Rome to Lisbon: ‘Executive Federalism’ in the (New) European Union, 47 Common Market Law Review (2010), pp. 1385-1427, at p. 1417 f. Somewhat less pronounced (“executive subsidiarity”): Robert Schütze, European Constitutional Law (2\textsuperscript{nd} edn 2016), p. 320. A similar point was raised by Craig, who held that there was no reason to empower the Commission in a legislative act in the form of a regulation or directive to adopt implementing acts, because a regulation is already directly applicable, and in the case of a directive, it is the task of the member states and not of an EU organ to implement it, Paul Craig, The Role of the European Parliament, in: Stefan and Ziller Griller, Jacques (ed), The Lisbon Treaty - EU Constitutionalism without a Constitutional Treaty? (2008), p. 120 ff.


\textsuperscript{127} The directive with its more than 300 Articles, however, already contains very detailed rules on many issues so that there is only little room for national variance. Only in a few cases, room has been left explicitly for national options, so that one may question whether a directive is the most suitable instrument for this type of legislation or whether it would be more adequate to put at least the larger part of the directive’s content in a regulation. However, as Article 47 (2) EC-Treaty, forming the legal basis of all directives in the insurance sector so far, only allows for the adoption of directives, the EU did not have this option.


of delegated and implementing acts to their basic legislative act, he sees a clear hierarchical distinction, which is however only partial in nature and not general towards other legislative acts.\textsuperscript{130}

According to the second possible solution, the situation may have remained unchanged with regard to \textit{delegated acts} only. According to this view, only delegated acts may amend the basic act. Consequently, they need to enjoy “relative and limited parity”,\textsuperscript{131} which is basically the same as “relative inferiority”. Even when delegated acts are intended to merely supplement the legislative act, this constitutes “amendment through the inclusion of additional rules” according to \textit{Schütze}.\textsuperscript{132} He contends that insofar \textit{implementing acts} represent supplementary rules, these have a different character and may not amend the basic act, so that implementing acts necessarily rank below the legislative act.\textsuperscript{133} From this point of view, it is not far to the conclusion that implementing acts not only stand below the legislative act on which they are based but below secondary law in general, so that they form a tertiary level of law.\textsuperscript{134}

As a third possibility, one could consider delegated and implementing acts as being subordinate to secondary law in general, in the same way as executive norms in national law usually rank below laws enacted by parliament.\textsuperscript{135} Based on the Constitution proposal, \textit{Nettesheim} expected a development of the jurisdiction of the ECJ in this direction.\textsuperscript{136} \textit{Craig} and \textit{de Búrca} conclude this directly from the TFEU. According to them, delegated acts rank below legislative acts, and implementing acts rank below delegated acts.\textsuperscript{137} \textit{De Witte} considers that the drafters of the Lisbon Treaty did not intend to give up the hierarchy of norms proposed in the draft constitution and shares \textit{Craig} and \textit{de Búrca’s} view on a clear hierarchical order between legislative acts, delegated acts and

\begin{footnotesize}
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\item[130] Bast, New categories of acts after the Lisbon reform: Dynamics of parliamentarization in EU law, p. 921; Bast, Is There a Hierarchy of Legislative, Delegated and Implementing Acts?, p. 169.
\item[134] See also Rudolf Streinz, Christoph Ohler and Christoph Herrmann, Der Vertrag von Lissabon zur Reform der EU (3rd edn 2010), § 10 III no. 4, who hold that delegated acts rank equal with the basic act when the Commission has been given power to amend it. If this is not the case, delegated acts (as well as implementing acts) rank below it.
\item[135] Cf. von Danwitz in: Markus Ludwigs (ed), Handbuch des EU-Wirtschaftsrechts, (42. EL August 2017) B II 6 a), paras. 72-75, where delegated and implementing acts are referred to as tertiary law ranking below legislative acts.
\item[136] Nettesheim, p. 36. After adoption of the Lisbon Treaty, Nettesheim holds that only implementing acts are subordinate to other secondary law and that delegated acts rank equal to the basic act, as long as they comply with the essential elements of the basic act, and are subordinated to other legislative acts belonging to EU secondary law, Nettesheim in: Grabitz/Hilf/Nettesheim, Das Recht der Europäischen Union, vol 1, EAV/AEUV (62. EL July 2017), AEUV Art. 291 paras. 55-58.
\item[137] Craig and de Búrca, EU Law, p. 119; see also Craig, The Role of the European Parliament, p. 112 f.; Niels Skovmand Rasmussen, Samspillet mellem formelle og uformelle retskildetyper med fokus på gråzoneområdet mellem regeludstedelse og tilsyn (2015), p. 103; Ruffert in: Callies/Ruffert AEUV, Art. 288 para. 11.
\end{enumerate}
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implementing acts. Hettne and Otken Eriksson also seem to consider that legislative acts in general are higher-ranking than non-legislative acts. They see a classical separation of powers doctrine reflected in the TFEU provisions, so that it is decisive which institution can be considered legislator in each single case. This view can find some support in the Inuit case, where the ECJ referred to the traveaux préparatoires to the Draft Constitution to interpret a norm that had been reproduced in identical terms from the Draft Constitution. However, the Court remained silent on the hierarchy of norms in its judgement.

Certainly, the differentiation between “legislative acts” and “non-legislative acts” seems to imply that the latter generally are subordinate to the former. Also from a constitutional law perspective, I sympathise with the view that a clear hierarchy between legislative, delegated and implementing acts should exist, but it is not clear at all whether such a clear hierarchy – beyond relative superiority of basic acts – has been established by the Lisbon Treaty.

Where a delegated act may amend a basic act, it must necessarily rank at the same level with the basic act (provided that it is compliant in all other respects with the delegating norm), because otherwise the amended norm would suddenly change its position in the normative hierarchy. One solution is to treat delegated acts differently depending on whether they may amend the basic act or not. Before the Omnibus II directive, the delegation norms in the Solvency II Directive stated explicitly whether the delegation encompassed the right to amend the directive. After Omnibus II, there is only one delegation norm that explicitly encompasses amendments to the directive, namely Article 308b (15) that explicitly allows delegated acts to “amend” a certain transitional period laid down in the directive. Article 17 (3) empowers the Commission to adopt delegated acts “relating to the lists of forms” in Annex III to the Directive, listing the permitted forms of association for insurance undertakings in the respective member states. This must reasonably be interpreted as including amendments to the list. Article 143 is the only norm where “supplement” is explicitly used and. Most other delegation norms contain expressions that the delegated acts shall “specify” some aspects of the

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140 See ECJ, Judgment of 3 October 2013, Case C-583/11 P (Inuit Case), para. 59.

141 Peers and Costa consider that the Court could have invoked the hierarchy of norms “as developed by the drafters of the Lisbon Treaty” to support its decisions. Obviously, they are also supporters of the view that a clear hierarchy between legislative and non-legislative acts has been established; see Steve Peers and Marios Costa, Court of Justice of the European Union (General Chamber) Judicial Review of EU Acts after the Treaty of Lisbon; Order of 6 September 2011, Case T-18/10 Inuit Tapiriit Kanatami and Others v. Commission & Judgment of 25 October 2011, Case T-262/10 Microban v. Commission, 8 European Constitutional Law Review (2012), pp. 82-104, at p. 94.
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directive, for example certain key aspects (Article 31 (4)) or certain information (Articles 35 (9), 56), or that they shall “lay down further specifications” (Article 37 (6)). Other delegation norms empower the Commission “to set out” certain requirements (Article 114 (1)), to “lay down” certain methods (Article 75 (2)), or to “determine” the equivalence of third-country prudential regimes (Article 260 (3)). Based on the ECJ’s case law, these wordings must be interpreted that – with the exception of acts based on Articles 17 (3) and 308b (15) – delegated acts may not amend the Solvency II Directive. For regulatory technical standards, this can also be implied from Article 10 (1) of the EIOPA Regulation, to which the Solvency II Directive refers, where it says that the content of regulatory technical standards “shall be delimited by the legislative acts on which they are based”.

An exact distinction between “supplementing” and “amending” a basic act has not been established yet. In Connecting Europe Facility, the Court suggested that “supplementing” means “fleshing out” the details of the basic act, “[…] by developing details that were not defined by the legislature, while remaining obliged to comply with the provisions laid down by that regulation as a whole”\(^\footnote{See ECJ, Judgment of 17 March 2016, Case C-286/14 (Connecting Europe Facility), paras. 47-50, where the Court held that the power to adopt delegated acts to “detail” certain elements of the basic act constitutes a delegation of power to supplement, but not to amend it.}^\footnote{Ibid, para. 50.}\footnote{Ibid, para. 42.}\footnote{Ibid, para. 53.}^\footnote{A.P. van der Mei, Delegation of Rulemaking Powers to the European Commission post-Lisbon, European Constitutional Law Review (2016), pp. 538-548, at p. 548.}^\footnote{Ibid, para. 53.}^\footnote{A.P. van der Mei, Delegation of Rulemaking Powers to the European Commission post-Lisbon, European Constitutional Law Review (2016), pp. 538-548, at p. 548.}^\footnote{This has been interpreted as a purely formal distinction: A delegated act in a separate act supplements, whereas a delegated act that changes the text of the basic act amends. However, it seems doubtful that ”supplementing” includes de facto amendment in a separate act, for instance by limiting the applicability of provisions in the basic act to very exceptional cases. The Court’s definition of ”supplementing” also seems to support this view. When exactly the line between supplementing and amending has been passed, is therefore still not clear.}

Thus, the delegated acts relevant in the context of this study may only supplement, but not amend the directive. I will therefore treat delegated acts within the Solvency II legal regime as ranking below the Solvency II Directive for the purposes of this study, bearing in mind, however, that “supplementing” may involve the introduction of specifications that may come close to a \textit{de facto} amendment of the basic act. Concerning the relationship between delegated acts and legislative acts other than their basic act, the
argument is convincing that delegated acts rank below other legislative acts because the delegation does not include the power to amend other legislative acts.147

Implementing acts do not play a role for this study, so that the question whether implementing acts rank below or at the same level as delegated acts may remain open.

Another question concerns the relationship between the national implementing norms and delegated and implementing acts. In its famous judgment in the Costa vs. ENEL case, the ECJ has established supremacy of EU law over national law.148 Since national implementing norms are considered national law, they rank below delegated and implementing acts because these are EU law, notwithstanding which position in the hierarchy among secondary EU law they have been attributed. If a delegated act, for instance, is incompatible with a national implementing norm, it nevertheless needs to be applied, unless it has been declared invalid by the Court. Reasons for annulment would be incompliance with the formal requirements in the basic act, e.g. in case the delegated acts deals with issues not covered by the delegating norm, invalidity of the delegating norm as the legal basis for the delegated act, incompatibility with essential elements of the basic act, or breach of primary EU law. The relation of the national implementing norms to the Solvency II Directive and the delegated and implementing acts shows that it is misleading to speak of different levels of EU legislation because this could imply that the national implementing norms “inherit” the directive’s level and are higher-ranking than the “level 2 provisions”.

However, since the use of the terms “level 1 to 4” is very common and even made by EU institutions, I will continue using them, asking the reader to bear in mind that the levels do not imply a fully-fledged hierarchical order and that national implementation norms are not categorised into any such level.

2.4 Consequences for the interpretation method

From the analysis above follows that it is in principle necessary to examine the validity of the delegated act to be applied.

As described above, delegating norms need to state the area, in which delegated acts may be adopted, thereby limiting the areas which may be regulated by delegated norms. This is a consequence of Article 290 (2) TFEU which requires the “objectives, content, scope and duration of the delegation of power” to be explicitly defined in the directive. A delegated act covering areas not included in the delegating norm would be invalid, because the Commission would not have the competence to adopt the specific implementing measures. Furthermore, Article 290 (1) and (2) TFEU state that the “essential elements of an area” are reserved for the legislative act and, accordingly, that

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147 Nettesheim in: Grabitz/Hilf/Nettesheim, EAV/AEUV, AEUV Art. 290, para. 56; Streinz, Ohler and Herrmann, § 10 III no. 4.
only “non-essential elements of the legislative act” may be supplemented or amended by delegated acts. If a basic act delegated the adoption of essential elements to the Commission, the delegating norm would be invalid and any corresponding delegated acts would have to be declared invalid by the ECJ in an action for annulment according to Article 263 TFEU at the request of a member state, the European Parliament, the European Commission, the Council or a natural or legal person directly affected by the act in question.

2.4.1 Essential and non-essential elements of an act

Since delegated acts only may supplement non-essential elements of the basic act, the question arises, what exactly the essential elements of the Solvency II Directive are. May one conclude from a conferral of power to adopt delegated acts on certain issues to supplement a certain part of the directive, that this area in its entirety is considered “non-essential” by the legislator? Or could there be essential elements even within such areas? And if the directive has essential and non-essential elements, does this mean that the essential elements are more important than the non-essential elements? Do the non-essential elements of the directive thus have to be interpreted in the light of the essential ones if a conflict arises, so that there would be a hierarchy of norms within the directive? The answers to these questions depend on how narrow or wide the term “essential elements” is to be interpreted.

Craig seems to imply from Article 290 TFEU that the Council and the Parliament need to specify the essential elements in the basic act. Indeed, it would be helpful if the legislator had stated explicitly which parts of the Solvency II Directive it regards as essential, but this is not the case. Article 290 TFEU merely requires that the scope and content of the delegation of power is specified. Anyhow, from a constitutional law perspective, a classification made by these institutions could not be authoritative, because this would imply that they themselves could determine the areas that belong to their own exclusive legislative competence. This is confirmed by the settled case law of the European Court of Justice, according to which the classification as essential must be based on objective factors amenable to judicial review. Therefore, the denomination of certain areas as “non-essential elements” in the empowerment norms of the Solvency II Directive cannot be authoritative.

From a historic perspective, it is noteworthy, that the concept of essential elements already was reflected in the Comitology Decision and originally dates back to the ECJ’s decision in the Köster case from 1970, where the Court distinguished between “the basic

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elements of the matter”, which were reserved for the basic act, and “provisions implementing the basic regulations”.\footnote{151 ECJ, Judgment of 17 December 1970, Case 25-70 (Köster), para. 6.}

The early case law of the ECJ did not contribute much clarity.\footnote{152 See the account on the case law until 2010 by Driessen, p. 846 f.} The Court applied a wide interpretation of “non-essential elements” arguing that an implementing measure was valid because it fulfilled the aims of the basic act.\footnote{153 ECJ, Judgment of 11 March 1987, Joined cases 279/84, 280/84, 285/84 and 286/84 (Walter Rau Lebensmittelwerke and others), para. 14.} This implies that at least the objectives of an act are essential elements, but does not give any guidelines if the essential elements are limited to the objectives or if these merely constitute a part of them.

The definition used in Case C240/90 does not provide much clarity either: “Such classification [as essential] must be reserved for provisions which are intended to give concrete shape to the fundamental guidelines of Community policy”.\footnote{154 ECJ, Judgment of 27 October 1992, Case C-240/90 (Germany v Commission), para. 37.}

As I see it, there are two different situations where the classification of rules as essential elements is relevant:

The first situation concerns the question whether a norm in a delegated act contains an essential element. In several recent cases, the Court pointed out that the adoption of provisions that require “political choices falling within the responsibilities of the EU legislature” are essential elements that cannot be delegated.\footnote{155 ECJ, Judgment of 5 September 2012, Case C-355/10 (Schengen Borders Code), para. 65; ECJ, Judgment of 10 September 2015, Case C-363/14 (Europol), para. 46; Case C-44/16 P (Dyson), para. 60.}

This parameter had already been brought up in legal literature: Lenaerts and Verhoeven considered the Köster jurisdiction as “appropriate and sufficient”, which

> “should serve as a guide for the legislature when deciding what to regulate itself and what to leave to faster forms of public action. The distinction between ‘essential’ and ‘ancillary’ will often coincide with what is political and what is technical.”\footnote{156 Lenaerts and Verhoeven, p. 661 f.}

Driessen uses a similar language distinguishing between “the core political principles” and “the details”.\footnote{157 Driessen, p. 846.} If Lenaerts and Verhoeven meant to suggest that only the essential elements should be regulated by the legislator and the rest should be left to delegated acts, however, this does not comply with Article 290 (1) TFEU because this article presupposes that a legislative act contains non-essential elements which can be supplemented or amended by delegated acts.

However, the Court also noted that a decision may involve ”certain compromises with technical and political dimensions” without requiring a political choice that falls within the domain of the EU legislature.\footnote{158 Lenaerts and Verhoeven, p. 661 f.} This case law provides rather limited guidance for identifying essential elements. Rules may look purely technical at first glance, but may reveal a considerable political background at a closer look. For instance, in 2010, the
Commission assumed in the Fifth Quantitative Impact Study\textsuperscript{159} (QIS5) that government bonds from EU member states did not have a default risk and consequently did not need to be stressed.\textsuperscript{160} At that time, a possible Greek state default was discussed in the media, but EU institutions did not yet admit in public that a Greek default was not an entirely unrealistic scenario. If this assumption had found its way into the final standard formula, it would have entailed a clear political statement. But would it also constitute an essential element or would it merely be a compromise with political dimensions without involving political choice? The difficulty with regard to identifying essential elements outside the basic act is that recourse cannot be taken to the basic act itself, for instance the Solvency II Directive, and that the notion of “political choice” in the ECJ’s case law is still rather blurry.

The second situation concerns the identification of essential elements in the basic act. Here, the question is whether a norm in a delegated act amends or disregards an essential element in the basic act. In the \textit{DK Recycling} and \textit{Dyson} cases, the Court derived the essential character of a directive provision from the recitals and the aims laid down in the text of the respective directive.\textsuperscript{161} In \textit{Dyson}, the Court held that a delegated regulation prescribing a certain way of measuring the energy efficiency of vacuum cleaners disregarded an essential element of the directive, namely the requirement that the information provided to customers with the energy efficiency label must reflect the energy consumption during use. The prescribed measuring method based on the energy consumption with an empty dust container disregarded this essential element of the directive, because it was not based on conditions as close as possible to actual conditions of use.\textsuperscript{162} This essential element was explicitly laid down in the directive and closely connected, if not identical to its aim: The harmonisation of national law on information for consumers on energy consumption during use to enable them to buy more efficient products. In \textit{DK Recycling}, the essential element in question lacked such a close connection to the principal objective of the basic act, namely the reduction of greenhouse gas emissions, but could be derived from the sub-objective to preserve competition in the scheme for emission allowance trading.\textsuperscript{163}

These two cases suggest that in this second group of cases, it is possible to derive relatively concrete essential elements from a directive. It is nevertheless not an easy task to apply the Court’s legislation on the Solvency II Directive. One could argue that already the decision to introduce harmonised rules on insurance supervision with a risk-

\textsuperscript{159} A study where insurance undertakings and groups were given the opportunity to calculate their Solvency Capital Requirement according to a presumed Solvency II standard formula.

\textsuperscript{160} European Commission, QIS5 Technical Specifications, Annex to Call for Advice from CEIOPS on QIS5, 5 July 2010, section SCR 5.88.

\textsuperscript{161} Case C-540/14 P (DK Recycling und Roheisen GmbH), paras. 49-53; Case C-44/16 P (Dyson), para. 64.

\textsuperscript{162} Case C-44/16 P (Dyson), para. 68.

\textsuperscript{163} Case C-540/14 P (DK Recycling und Roheisen GmbH), para. 50. The essential element derived from a sub-objective was the requirement that distortions of competition must be avoided, prohibiting the possibility to allocate free emission allowances to market actors based on “undue hardship” in delegated acts.
based approach together with just a few of the cornerstones of the Solvency II regime give Articles 47 (2) and 55 a TFEU as the legal bases for the Directive sufficiently concrete shape when it comes to insurance business. In that case, there would be only a handful of essential elements in the directive. With a higher degree of concretisation, more elements would have to be considered essential. At this point, one should remember that the essential elements have to be enacted by the Council and the Parliament in a legislative act and may not be made the object of delegated or implementing acts, which could – again from a constitutional law perspective – speak against a very low level of concretisation.

In legal doctrine, the question of essential elements with regard to Solvency II has been discussed in a few publications, however, without particular attention to the case law of the Court.

2.4.1.1 Change of essential elements by cumulative effect of small changes?

Sasserath-Alberti and Hartig pose the question whether a number of small changes of the directive by level 2 rules, all of which by themselves are not essential, taken together could constitute a change of essential directive provisions. At first glance, I am inclined to support their conclusion that such an assumption would not be consistent with Article 290 TFEU, since the treaty provision is not concerned with how many delegated acts are enacted. However, the provision presupposes that each basic act has some essential elements that may not be changed by delegated acts. The question is therefore not, whether a change is significant or not, but whether an essential element of this act is changed or not. This does not mean, however, that the possibility can be excluded entirely that several smaller changes taken together could have such an impact that they constitute a change of an essential element of the Solvency II Directive.

2.4.1.2 Capital add-ons

With a view to the jurisdiction of the European Court of Justice, Wandt and Sehrbrock observe that European law limits the legislator’s ability to delegate to a lesser extent than German constitutional law does before going on to discuss the question in how far enumerations in the Solvency II Directive are exhaustive and therefore may not be extended at level 2. They refer to an example that emerged during the legislative process and concerned the question whether the delegation to the Commission in Article 37 (6) to adopt delegated acts “[…] laying down further specifications for the circumstances under which a capital add-on may be imposed” would enable the Commission to add

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further situations to the three situations laid down in the directive under which a capital add-on may be imposed. Wandt and Sehrbrock come to the conclusion that the situations listed in the directive constitute essential rules and therefore must be exhaustive, since according to recital 26, capital add-ons are reserved for exceptional circumstances only. Put it differently, they contend that delegated acts supplementing the directive with new situations allowing capital-add-ons would constitute essential elements whose adoption is reserved to the legislator.

2.4.1.3 The interest curve projection

Another interesting contribution to the discussion has been published by Dreher, who has taken a closer look at a particular issue involving the question what essential elements are. His criticism concerned the suggestions concerning the projection of the interest curve applied for the calculation SCR based on the Solvency II Directive prior to the amendments by the Omnibus II directive.

The interest term structure was an even more politicised issue than the question concerning a default risk for government bonds and one of the most important reasons for the postponement of the application date of the Solvency II Directive. The interest term structure is particularly relevant for the calculation of the own funds required to cover the obligations connected with insurance products with long-term guarantees in favour of the insured. This is the case with certain types of capital life insurance and pensions insurance. Such traditional life insurance policies are connected with a guaranteed minimum interest on the insurance capital. Whereas Swedish life insurers determine the guaranteed interest on the premiums themselves, the guaranteed interest rate in Germany is determined in a government regulation (“Deckungsrückstellungsvorschrift”). It is valid for the whole duration of a life insurance policy.

After the guaranteed interest rate for new life insurance policies by German insurers has been lowered in several steps from 4% in 2000, the current level (as of February 2018) is at 0.9%. In 2015, the whole traditional life insurance portfolio in Germany had an average guaranteed interest rate of 2.79%. Since most life insurers face a so-called duration mismatch, i.e. their insurance obligations have a considerably longer duration than adequate investment assets available on the market, they have increasing difficulties to generate a return on the insurance capital that covers the guaranteed interest rate when market interest rates are low over a longer time period.

For the calculation of the solvency ratio, the value of the assets and liabilities needs to be calculated taking into account the duration of the liabilities. For insurance obligations, insurance companies need...
to establish technical provisions. Since life insurance policies often have a duration of several decades, it is necessary to calculate the amount of the obligations at the end of their duration and then calculate the present value to be inserted into the solvency balance sheet by using an adequate discount rate. Whereas, in case of traditional life insurance, the guaranteed interest rate is already known and is applied for the calculation of the obligation for the remaining duration of the insurance policy, the difficulty lies in determining an adequate discount rate. The discount rate is supposed to reflect the interest that can be received on risk-free investments, i.e. sovereign bonds without a default risk. Since such risk-free instruments usually (depending on the currency) are not available for durations over 20 years, it is necessary to apply a projection of the risk-free interest rate for the valuation of the assets for time periods beyond the 20-year-horizon. The mechanism of this projection, called extrapolated yield curve, was highly debated because the results have an enormous effect on the valuation of the technical reserves and thus on the solvency ratio of life and pensions insurance undertakings. Depending on the calculation mechanism, the extrapolated yield curve could have a high volatility which in turn would lead to a volatile valuation of the technical provisions in the insurance balance sheet and hence to higher capital requirements. Rules on the interest curve projection are laid down in Articles 43 to 54 Delegated Regulation. If the applicable discount rate is rather low, the present value of the insurance obligations (and hence the technical reserves) is bigger than with a higher discount rate. The QIS5 study has shown that already small variations in the forward rates have the consequence that one and the same life insurance undertaking could be undercapitalized or severely overcapitalized, all other circumstances remaining the same.

Dreher argues that since the method of determination of the risk-free interest curve has important consequences for the competition situation among insurers and even may cause life insurers to exit the insurance market, it is an essential element of the Solvency II legislation and not merely a technical detail that may entirely be regulated at levels 2 and 3.

One of the instruments discussed in this context was the “counter-cyclical premium”. It was suggested in an earlier draft of the Delegated Regulation, but not upheld during the so-called Trilogue discussions between the Commission, the Council and the European Parliament on the Omnibus II directive. It was an instrument intended to soften the procyclical effects of the volatility of solvency capital requirements. For example, if equity markets go down and equities are downgraded, insurers with investments in those equities are faced not only with a decrease in value due to the lower market prices but also with a higher capital charge applied on own funds invested in such equities, both of which lead to an increase of the Solvency Capital Requirement. This might incentivize insurers to sell these equities and to reallocate their assets in other forms of investments, which would put further pressure on the equity market. Solvency II thus has a procyclical effect, i.e. the mechanism of calculating the solvency capital requirement reinforces market cycles.

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171 Dreher, p. 397. The BaFin speaks of a high sensitivity to small changes in the interest structure curve: BaFin, Ergebnisse der fünften quantitativen Auswirkungsstudie zu Solvency II (QIS 5), Zusammenfassung der Auswertung durch die Bundesanstalt für Finanzdienstleistungsaufsicht, p. 14 f.
172 Dreher, p. 398.
173 CEIOPS issued already in 2005 a consultation paper dealing with potential procyclical effects of the Solvency II regime and which measures could soften these effects, but was rather cautious in its conclusions. See CEIOPS, Consultation Paper no. 9 - Draft Answers to the European Commission on the third wave of Calls for Advice in the framework of the Solvency II project, 09 December 2005, para. 22.42 to 22.45.
Another mechanism to soften the effects of this problem is the matching premium. The matching premium increases the discount rate applied for the calculation of insurance liabilities and thus leads to a lower solvency capital requirement. It shall be applicable to insurance liabilities that are matched by assets held to maturity and requires, *inter alia*, that the assets are held in a ring-fenced portfolio or are otherwise held separately. The matching premium leads to an elimination of the spread risk of assets that are held to maturity, because holders of such assets are not concerned about volatility in the market prices but with default risk.\(^\text{174}\)

*Dreher* critiziced that the counter-cyclical premium had not been provided for in the Solvency II Directive\(^\text{175}\), which was also true for the matching premium, for that matter, until it got a legal basis in Articles 77b and 77c inserted by the Omnibus II directive. He considered it problematic that the Commission proposed to enact a delegated act in which power would be delegated to an authority (EIOPA) to determine whether a period of stressed markets existed as a condition for the application of the counter-cyclical premium, the size of the premium, as well as any subsequent adjustments of the premium. According to *Dreher*, these are central issues of insurance regulation because they concern criteria for the calculation of the solvency capital requirement.\(^\text{176}\)

### 2.4.2 Essential elements: Conclusions

*Dreher* discusses a situation concerning the essential character of a delegated act. His understanding of essential elements seems to be influenced by German constitutional law. One feature of the legality principle laid down in Article 20 of the German Constitution (Grundgesetz) is the requirement that the enforcement of law against citizens requires that all significant decisions need to be based on laws enacted by parliament – in other words, rules that are of particular importance for citizens or legal subjects, particularly if they concern fundamental rights, may not be laid down in government regulations.\(^\text{177}\)

With this understanding, the differentiation between essential and non-essential elements does not go along a line of “political decision” and “details”, but is based on the impact on the citizen. *Dreher* seems to imply that the classification as essential or non-essential is not an “either/or-decision”, but rather a linear assessment, which would be in line with the German legality principle. This would explain that he considers the extrapolated rate structure curve to be so important that its formation cannot be decided in a delegated act, and why he criticized that the counter cyclical premium did not have an explicit basis in the directive, but did not seem to require that all aspects concerning the application of the premium needed to be laid down at level 1.

As mentioned above, I do not find a differentiation between “political decisions” and “details” very helpful, because even rules that look purely technical may have significant

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\(^{174}\) Challenges to discounting liabilities for Solvency II, (25 June 2012).

\(^{175}\) Dreher, p. 401.

\(^{176}\) Ibid, p. 402.

\(^{177}\) See BVerfGE 49, 89 (Kalkar I), para. 79; BVerfGE 88, 103 (Streikeinsatz von Beamten), para. 50; Sommermann, Karl-Peter, in: Christian Starck (ed), Kommentar zum Grundgesetz, vol 2, Artikel 20 bis 82 (2005), Art. 20 Abs. 3, para. 274.
political impact. Dreher’s approach to consider those rules as essential that have a significant impact on the solvency capital requirement and therefore, indirectly on the market entry or exit of financial institutions, is therefore appealing. In most cases, such a significant impact will coincide with decisions of political relevance.

An ambiguity connected with the wording of Article 290 TFEU is whether it simply allows the delegation of power to supplement or amend non-essential elements, or whether it allows essential elements to be supplemented at level 2, as well – an amendment of essential elements is excluded by virtue of the last sentence of Article 290 TFEU. The only reasonable reading can be that it must be possible to supplement essential elements at level 2, because otherwise all essential elements would have to be regulated in their entirety in the legislative act, even when they consist of non-essential elements supplementing essential elements – any other reading would make it even more difficult to assess which decisions can be subject to regulation in a delegated act and which not.

To sum up, I have found that the Solvency II Directive contains both essential and non-essential elements. The objectives of the directive form essential elements. Whether an element is otherwise essential needs to be assessed by taking into consideration its impact on the legal or financial situation of insurance undertakings. The essential elements may not be amended by delegated or implementing acts.

So, are the essential elements of Solvency II Directive generally higher-ranking than the non-essential elements, i.e. is it necessary to put special weight to the essential elements when interpreting the directive? The term “essential elements” seems to suggest this, and the advocates of a very restricted application might come to this conclusion. However, with the understanding developed above, according to which the impact on the addressee of a norm is decisive for the classification as essential or non-essential, the question has to be answered in the negative. The same is true when referring to the exercise of political choice. The classification as essential simply means that an issue is so important that it needs to be decided by legislative procedure and may not be delegated, but it does not imply that it generally overrules any conflicting non-essential rules in the directive. The principle that, for a teleological interpretation, special consideration needs to be given to the objectives of the directive, remains of course unaffected by this.

In this study, questions concerning the validity of specific Solvency II provisions are only explicitly taken up, when I have doubts concerning the validity of level 2 provisions that are central to the study.
2.5 Level 3 guidance

After having discussed the hierarchical status of those Solvency II norms that undoubtedly constitute in principle binding norms, it is time to have a closer look at the level 3 guidance to be issued by EIOPA.\footnote{An earlier version of this chapter 2.5 including its subsections has been published as: Britta Behrendt Jonsson, EIOPA’s guidelines and recommendations: Mere proposals or some kind of binding law?, Europarättslig Tidskrift (2014), p. 266-288.}

At level 3, EIOPA issues guidance that takes the form of guidelines or recommendations. In the following, for the sake of simplification, the terms guidelines or guidance shall encompass both forms of guidance. For the sake of completeness, another instrument explicitly made available to EIOPA shall also be mentioned: Opinions to be issued to the European Parliament, the Council or the Commission according to Art. 34 of the EIOPA Regulation. These do not constitute level 3 guidance, because they are not directed to national supervisors or financial institutions and are therefore left aside in the following.

As of July 2018, EIOPA has issued 29 guidelines on Solvency II issues. Most of the guidelines are formally addressed to national supervisors.\footnote{See, for instance, EIOPA, Guidelines on group solvency, EIOPA-BoS-14/181EN, 2 February 2015, para. 1.3.} A few are ambiguous whether they are addressed only to supervisory authorities or also to insurance undertakings.\footnote{See EIOPA, Guidelines on own-risk and solvency assessment, EIOPA-BoS-14/259 EN, 14 September 2015, para. 1.1: “[…] EIOPA issues these guidelines addressed to the supervisory authorities […]” and para. 1.9: “The relevant Guidelines for individual undertakings apply mutatis mutandis to the group ORSA. Additionally, groups need to take into consideration the group specific Guidelines.”} Since they contain obligations which national supervisors are asked to impose on insurance undertakings, the insurance industry follows their development very closely. The question of their legal bindingness is therefore equally relevant to regulators and insurers.

What is clear is that level 3 guidance is not binding in the same way as legislative acts or delegated or implemented acts are. Often, the term “soft law” is applied to characterize rules made by public authorities or private organisations. There is no generally accepted definition of soft law, and the term encompasses many different kinds of norms.\footnote{See van der Sluijs for a description of the various features of soft law relevant in Swedish insurance law, Jessika van der Sluijs, Soft law-reglering av försäkringsrätten, Juridisk Tidskrift (2010/2011), p. 296-326, at pp. 296-326.} A common feature of soft law is that it consists of rules made by others than parliament or the government. The degree of bindingness of these rules varies, but notwithstanding their legal status, their practical relevance is very high because addressees usually follow them, be it because they agree with the rules, or because they want to avoid negative publicity or discussions with a regulatory authority or auditor. Clearly, this will also be the case with EIOPA’s level 3 guidance. Nevertheless, situations will arise where national insurers and insurance undertakings consider it
important to be able to deviate from EIOPA’s guidelines, and for these situations, legal certainty requires that their legal relevance is determined.

To start with, I will outline the various provisions dealing with level 3 guidance in the Solvency II Directive and in Regulation 1094/2010, hereinafter referred to as “EIOPA Regulation”, where EIOPA’s tasks and powers are laid down. I will then discuss the legal status of EIOPA’s guidance, where several situations will have to be distinguished.

2.5.1 Norms dealing with level 3 guidance

The purpose of EIOPA’s guidelines is to enhance consistent and convergent insurance supervision throughout the EU and to prevent diverging national solutions. Article 16 (1) of the EIOPA Regulation uses a similar wording:

“The Authority shall, with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law, issue guidelines and recommendations addressed to competent authorities or financial institutions.”

Before being deleted by the Omnibus II directive, Article 71 (3) of the Solvency II Directive contained a general delegation to CEIOPS as predecessor of EIOPA to issue guidelines and recommendations concerning the implementation of the provisions of the Solvency II Directive. After its deletion, the Solvency II Directive only contains very specific delegation norms for the issuance of level 3 guidance. Article 35 (11) empowers EIOPA to issue guidelines on the method for determining the market share of insurance undertakings in the context of possible exemptions of supervisory reporting for undertakings with a market share below 20% in a member state. Article 231 (7) authorizes EIOPA to issue guidelines on group internal models, and Article 248 (6) empowers it to develop guidelines for the operational functioning of the colleges of supervisors. The Delegated Regulation does not contain any assignment to EIOPA to issue guidelines on any particular issue.

Article 16 EIOPA Regulation constitutes the central norm on guidelines, but they are also explicitly mentioned as appropriate instruments for the achievement of some of EIOPA’s tasks laid down in Articles 8 (1) and 9, namely the contribution to the “establishment of high-quality common regulatory and supervisory standards and

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182 Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority).
183 See, for instance, EIOPA, Guidelines on Forward Looking assessment of the undertaking’s own risks (based on the ORSA principles), EIOPA-CP-13/00, 31 October 2013, paras. 1.3 – 1.4.
184 Committee of European Insurance and Occupational Pensions Supervisors, the level 3 committee for the insurance regulatory issues in the Lamfalussy procedure.
practices” and the promotion of “the safety and soundness of markets and convergence of regulatory practice”. According to Article 21 (3), EIOPA may issue guidelines to promote supervisory convergence with regard to colleges of supervisors, and according to Article 22 (3), EIOPA shall draw up guidelines to take account of the systemic risk posed by financial institutions.

As customary in the Lamfalussy process, guidelines and recommendations shall, where appropriate, be subject to open consultation before being issued. This is even explicitly required in Article 16 (2).

Before being deleted by the Omnibus II directive, Article 71 (3) of the Solvency II Directive stated that guidelines and recommendations were “non-legally binding”. The deletion removes a friction that was created with the enactment of Article 16 (3) (Sub 1) of the EIOPA Regulation, according to which “the competent authorities and financial institutions shall make every effort to comply with those guidelines and recommendations.” Instead, Article 71 (2) (b) requires member states now to ensure that

“[…] the supervisory authorities shall make every effort to comply with the guidelines and recommendations issued by EIOPA in accordance with Article 16 of Regulation (EU) No 1094/2010 and state reasons if they do not do so”.

The provision aligns the wording in the directive with Article 16 of the EIOPA Regulation and makes sure that the directive does not impose stricter obligations on the member states and regulators than Article 16 (3) of the EIOPA Regulation does.

Article 16 (3) (sub 2) of the EIOPA Regulation introduces a “comply or explain” approach, requiring each national insurance regulator to confirm within two months after issuance of a guideline or recommendation that it complies or intends to comply with the guidance, or to state the reasons why it does not intend to do so. The supervisors’ statements may be made public by EIOPA. If provided for in the level 3 guidance, also insurance undertakings will have to report whether they comply or not, but EIOPA is not allowed to publish their statements.

2.5.2 Legal questions

Article 16 (3) of the EIOPA Regulation demands that the national insurance regulators and the insurance undertakings “shall make every effort” to comply with EIOPA’s guidelines and recommendations. Is this merely an expression of the legislator’s wish that compliance with level 3 guidance should be better than in the past, without any legal relevance, or does it lead to a legal obligation? After all, in its review of the Lamfalussy
process in 2010, the Commission criticized that national supervisors had not applied level 3 measures consistently enough in their supervisory practice.\textsuperscript{185}

For national supervisors and financial institutions, it is important to know whether Article 16 (3) limits their discretion to deviate from EIOPA’s guidelines and recommendations and whether the provision applies to both supervisors and insurance undertakings equally. Connected to these issues is the question whether a decision not to apply a guideline or recommendation would be subject to judicial review.

\subsection*{2.5.3 Limits of EIOPA’s competence}

As will be shown below, the question of the legal status of EIOPA’s guidelines is closely interrelated with the scope of its competence to issue guidelines and recommendations. EIOPA’s mandate is laid down in Article 1 of the EIOPA Regulation. Whereas Article 1 (2) allows EIOPA to act within the powers conferred by certain enumerated directives, primarily the Solvency II Directive, paragraph 3 extends the mandate as follows:

“For The Authority shall also act in the field of activities of insurance undertakings, reinsurance undertakings, financial conglomerates, institutions for occupational retirement provision and insurance intermediaries, in relation to issues not directly covered in the acts referred to in paragraph 2, including matters of corporate governance, auditing and financial reporting, provided that such actions by the Authority are necessary to ensure the effective and consistent application of those acts.”

Sasserath-Alberti and Hartig convincingly argue that Article 16 (1) needs to be read together with the provisions in Article 1 (2) and (3) of the regulation, because the competence to issue guidelines cannot go beyond EIOPA’s mandate.\textsuperscript{186} They call for a restrictive reading of Article 1 in order to preserve the institutional balance between EIOPA and the EU organs and refer to recital 25 of the regulation, according to which

“In areas not covered by regulatory or implementing technical standards, the Authority should have the power to issue guidelines and recommendations on the application of Union law.”

From this, the authors draw the conclusion that, where EIOPA has the competence to draft technical standards, it may not take recourse to guidelines or recommendations.

\footnotesize{\textsuperscript{185} European Commission, Review of the Lamfalussy Process, p. 9.\textsuperscript{186} Sasserath-Alberti and Hartig, p. 531. Gal argues that EIOPA’s competence to issue guidelines and recommendations needs to be interpreted restrictively in order to meet the institutional balance: Jens Gal, Legitimationsdefizite und Kompetenzen der EIOPA im Lichte der Meroni-Rechtsprechung, Zeitschrift für die gesamte Versicherungswissenschaft (2013), pp. 325–351, at pp. 343 – 346.}
EIOPA would be obliged to respect the legislator’s decision that these issues should be dealt with in the form of technical standards. However, this would not apply to areas, where the Commission has been authorized to issue delegated acts, so that EIOPA would not be hindered to issue guidelines on issues addressed in delegated acts or in the directive only.\textsuperscript{187}

The authors consider that EIOPA does not need a special competence norm in another EU legal act to be able to issue guidelines, but that Article 16 constitutes a general competence norm.\textsuperscript{188} The regulation contains a few other norms that can be understood as competence norms for the adoption of guidelines, and it is not entirely clear, how these norms relate to Article 16. On the one hand, the regulation distinguishes between tasks and powers to achieve these tasks, with Article 8 (2) (c) stating that EIOPA has the power to issue guidelines and recommendations, “as laid down in Article 16”. This could be understood in such a way that the requirements of Article 16 in its entirety always have to be fulfilled. On the other hand, there are norms outside Article 16 explicitly stating that EIOPA may or shall draw up guidelines on certain issues, notably Article 21 (3) concerning guidelines on the functioning of supervisory colleges, Article 22 (3) concerning guidelines for financial institutions to take account of systemic risk and Article 9 (2) concerning the safety and soundness of financial markets and convergence of regulatory practice. These norms could be understood as separate special competence norms for the adoption of guidelines apart from the general norm in Article 16 (1). Since the procedural requirements in Article 16 apparently shall apply to all guidelines and recommendations, it would be consequent to interpret the regulation so that also Article 16 (1) needs to be fulfilled, which would then be the only competence norm for issuing guidelines.

Article 16 (1) can be read in two ways.\textsuperscript{189} According to the first possible interpretation, it contains only one competence norm and consequently, all of its requirements need to be fulfilled cumulatively, i.e. EIOPA may issue guidelines and recommendations if these are aimed at “establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law” (emphasis added). According to this reading, EIOPA would act \textit{ultra vires} if it issued guidelines that are not interpreting or concretizing the legal acts listed in Article 1 (2), because such guidelines would go beyond the application of EU law. The other possible interpretation would be to read Article 16 (1) in such a way that it contains two competence norms, one allowing EIOPA

\textsuperscript{187} Sasserath-Alberti and Hartig, p. 531.

\textsuperscript{188} Ibid. Platzer calls Article 16 to be one of the competence norms (“\textit{eine der wesentlichen Ermächtigungsnormen}”): Alexander Maximilian Platzer, Versicherungsaufsicht in der Europäischen Union (1st edn 2015), p. 157.

\textsuperscript{189} See also Marie Jespersen, Genomförande av de europeiska tillsynsmyndigheternas riktlinjer och rekommendationer (February 8, 2013), pp. 10 - 11.
to issue guidelines to establish consistent, efficient and effective supervisory practices, and the other to ensure the common, uniform and consistent application of Union law.

*Sasserath-Alberti* and *Hartig* do not explicitly deal with this question, but they express doubts whether EIOPA has acted within its competences when issuing the “Guidelines on Complaints-Handling by Insurance Undertakings” in 2012. They argue that because the imposition on insurers to have a central complaints management function goes beyond what is required in Articles 183 and 185 of the Solvency II Directive, the guideline does not fulfill the necessity requirement laid down in Article 1 (3) EIOPA Regulation.

I share the authors’ view that a restrictive interpretation of EIOPA’s mandate and competences is in place. Considering that the comply-or-explain obligation will put considerable pressure on national supervisors to declare compliance and in turn to require compliance from insurers, it is important that EIOPA’s competence to issue guidelines is limited. Otherwise, EIOPA might use guidelines as an instrument to introduce new, politically motivated requirements that, in principle, should be enacted by a democratically legitimized legislator. The requirement that guidelines need to be issued in order to harmonize supervisory practices could be invoked for virtually any guideline in the field of insurance regulatory law. Therefore, it is not suitable to define any limits.

That this risk is not purely theoretical can be seen when taking a look at the genealogy of the German rules on remuneration for insurance managers. During the financial crisis, in December 2009, the German Financial Supervisory Authority issued a circular on remuneration issues as one of the first steps in implementing the Financial Stability Board’s Principles for Sound Compensation Practices. Applied literally, this circular would have required insurance undertakings to change existing employment contracts with some of their managers. A clear legislative basis for this kind of requirements was only enacted half a year later, when a provision on the remuneration of insurance managers was inserted into the VAG. On the basis of this provision – § 64b VAG – a government ordinance with more or less the same content as the circular was enacted, and the circular was repealed. From a constitutional law perspective, it would have been better to wait until the competence norm for the rules on remuneration were in place, instead of issuing a circular without a legal basis. In fact, the German insurance industry had not even been accused of applying over-onerous remuneration policies that could incite managers to take huge risks, but in the midst of the financial crisis, the symbolic value of fast reactions on potential risks was given preference. It seems as if the German government was well aware of the lack of a legal basis for the circular, because it motivated the changes with the need to be able to apply sanctions against

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190 Sasserath-Alberti and Hartig, pp. 531 – 532.
191 Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).
192 BaFin-Rundschreiben 23/2009 (VA).
194 Verordnung über die aufsichtsrechtlichen Anforderungen an Vergütungssysteme im Versicherungsbereich, BGBI. I S. 1379
undertakings in case of non-compliance.\textsuperscript{196} If EIOPA already had been established at that time, politicians might have been tempted to urge EIOPA to issue a guideline instead of national regulators acting individually.

Connected to Sasserath-Alberti’s and Hartig’s argument for a restrictive reading of EIOPA’s competences to issue guidelines and recommendations is the fact that the ECJ’s \textit{Meroni} doctrine is still considered to have some relevance,\textsuperscript{197} even if the scope of its significance for the allocation of powers between the Commission and the ESA’s has been contested.\textsuperscript{198} In its \textit{Meroni}-decisions from 1958, the ECJ held the delegation of discretionary powers to an agency implying a wide margin of discretion to constitute a breach of primary European law, since it would render the institutional balance set up in the Treaty Establishing the Coal and Steel Community ineffective.\textsuperscript{199}

From this line of argument follows that EIOPA’s competence to issue guidelines should be interpreted restrictively in the light of Article 1 and that the two requirements in Article 16 (1) EIOPA Regulation need to be fulfilled cumulatively – which is also closer to the provision’s wording. Against this reading, it could be argued that a limitation of EIOPA’s competence to issue guidelines would unduly limit EIOPA’s flexibility to respond quickly to new developments in the financial system. However, the EIOPA Regulation contains a specific norm in Article 18 conferring special decision powers to EIOPA in emergency situations. Herewith, the legislator has regulated EIOPA’s power in extraordinary situations exhaustively.

If EIOPA wants to issue statements on matters falling outside the scope of Article 16 (1), it may of course do so, but not in the form of a guideline or recommendation.

\textsuperscript{196} Bundestagsdrucksache 17/1291, p. 9.
\textsuperscript{198} Most authors see the establishment of the European Supervisory Authorities in conformity with the \textit{Meroni}-jurisdiction of the ECJ, for instance Despina Chatzimanoli, A Crisis of Governance? – From Lamfalussy to de Larosière or Bridging the Gap between Law and New Governance in the EU Financial Services Sector, European Journal of Risk Regulation (2011), pp. 322-239; Sasserath-Alberti and Hartig, p. 525; Busuioc criticizes that the quasi-rule-making powers of the ESAs “stretch the boundaries of the [Meroni] doctrine to the maximum”, Madalina Busuioc, Rule-Making by the European Financial Supervisory Authorities: Walking a Tight Rope, 19 European Law Journal (2013), pp. 111-125, at p. 114. According to Gal, the decisive question today is whether the delegation of powers to EIOPA is in compliance with democratic standards and the institutional balance rather than with the \textit{Meroni}-jurisdiction, Gal, p. 340. Not referring to EIOPA specifically, Chiti argues that Union law has evolved in such a way that the \textit{Meroni} jurisdiction no longer hinders the delegation of discretionary powers to agencies, Edoardo Chiti, An Important Part of the EU’s Institutional Machinery: Features, Problems and Perspectives of European Agencies, 46 Common Market Law Review (2009), pp. 1395-1442, at p. 1424.
2.5.4 Legal doctrine on the status of guidelines and recommendations issued by the European Supervisory Authorities

Following the establishment of the European Supervisory Authorities in 2011, several authors have commented on the legal status of guidelines and recommendations issued by these authorities.

Lehmann and Manger-Nestler consider that at least guidance with a general-abstract character, although formally not-binding, forms a category of norms of its own and therefore is binding “to a certain degree”. Sonder speaks of a “factual bindingness” and qualifies guidelines as measures of “binding character”, whereas Baur and Boegl point out that guidance is not binding, but that the obligation to explain non-compliance will put considerable pressure on the addressees. With regard to ESMA’s guidance, Moloney expects that the comply-or-explain requirement will lead to a hardening of the “soft guidance” issued by the authority, and that ESMA’s other formal powers to address individual decisions and to exercise supervisory powers will have the effect that compliance with such guidance will be more likely than before. According to Hartig, the comply-or-explain approach only makes sense, if both insurance undertakings and regulators have a realistic possibility to deviate from EIOPA’s guidance. Such deviations could be justified with the proportionality principle, which requires insurance supervisors to take the size and risk structure of insurance undertaking into account in the application of regulatory law. The opinion that EIOPA’s guidelines would be entirely non-binding disregards the considerable practical importance attributed to guidelines. If guidelines and recommendations were entirely non-binding and constituted nothing more than EIOPA’s opinion, it would be unnecessary to conduct consultations as required by Article 16 (2) of the EIOPA Regulation. The “every-effort obligation” to follow guidelines also speaks a different language. That level 3 guidance is binding to a certain degree is too vague to be helpful when a concrete question concerning the applicability of a guideline arises.

Two analyses may help to shed further light on the legal character of EIOPA’s guidelines and are therefore presented in more detail in the following.

202 Baur and Boegl, p. 183; similarly with respect to ESMA’s guidelines and recommendations: Schammo, p. 1882.
205 Ibid, p. 2961.
2.5.4.1 Munck’s memorandum

In a memorandum written for Finansinspektionen in 2012, Munck proposes that EIOPA’s guidelines and recommendations in principle need to be treated like general recommendations issued by Swedish public authorities. Finansinspektionen has declared that it shares Munck’s opinion.

Such general recommendations are issued by Swedish authorities, often the tax authority, but also by Finansinspektionen, and contain the authority’s interpretation of a legal rule and specify how citizens should act in order to comply with the provision. It is generally accepted that general recommendations are not binding on citizens. According to Påhlsson, they are not even binding on the authority that has issued them, although he admits that an authority usually should follow its own recommendations in order to promote the crediblity of the legal system. He attributes to general recommendations the same importance as legal doctrine. Where the public authority not only describes existing law, but presents its point of view on a certain legal question, the recommendation has the character of an interpretation proposal. Påhlsson contends that the high courts generally follow the tax authority’s general recommendations, since these are an expression of administrative practice. According to Munck, financial institutions would not have to follow Finansinspektionens general recommendations, if they can show that they fulfil the purpose of the recommendation in a different way. According to this view, consequently, EIOPA’s guidelines are authoritative with regard to their purpose.

As already mentioned, Article 16 (3) EIOPA Regulation stipulates an obligation to comply with the guidance on an “every-effort basis”. Munck points out that what he calls “reinforcing wording” in this provision cannot change the non-binding character of level 3 guidance. He derives this from Article 288 TFEU. This provision stipulates that recommendations issued by an EU institution are not binding. Since recommendations issued by EU institutions are not binding, this must also be true for recommendations by the European Supervisory Authorities.

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206 In Swedish: allmänna råd.
208 Jespersen, p. 8.
209 Holmberg et al., Grundlagarna Kommentar till Regeringsformen (Zeteo) (Norstedts Juridik 1 January 2012), Kap. 8, para. ”Allmänna Råd”.
213 Ibid. p. 107.
214 Munck, p. 9.
215 Ibid. p. 6 ("Oavsett vilka förstärkningsord […]")
216 Ibid.
Article 16 (3) EIOPA Regulation requires national supervisory authorities to give a “comply-or-explain statement” within two months of issuance of a guideline. Munck recommends that upon the issuance of new guidance, Finansinspektionen should examine whether there are reasons that would speak against applying the guidance. Such a reason could be that the authority wants to maintain a different solution already implemented in Sweden. If Sweden wanted to keep stricter requirements, this would not automatically imply that non-compliance needs to be reported. Neither would it be necessary to repeal an existing law with corresponding content. Munck considers that financial institutions need a valid excuse for not following a guideline. In this respect, he calls for some generosity and provides examples for what could be regarded as valid reasons: An insurance undertaking meets the aim of the guidance in a different way, or an insurer is in principle committed to the guidance, but is hindered from following it due to circumstances outside its control.

Munck differs between guidelines that are based on Article 16 (1) EIOPA Regulation as a general competence norm and those that are based on a special competence norm. As it seems, he expected that special delegation norms would be laid down in the level 2 regulations. If Finansinspektionen wants to take regulatory measures against an insurer for not following one of EIOPA’s guidelines based on a special delegation norm, Munck claims that it would need to base its measures on a breach of the (binding) norm on which the level 3 guidance is based. If the guidance in question were based on the general competence norm in Article 16 (1), Article 16 would form a sufficient legal basis to take regulatory measures against an insurer, since it has not followed its obligation to make every effort to comply with the guideline. In the consultation process on Munck’s memorandum initiated by Finansinspektionen, Insurance Sweden, the Swedish insurer’s organization, criticized this statement because it would give recommendations a legal impact which would not be in line with EIOPA’s mandate.

2.5.4.2 The doctrine of secondary sources of law

Mainly with respect to German company and accounting law, Möllers and Fekonja regard guidelines and recommendations as “secondary sources of law” as opposed to

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218 Ibid. However, considering that Solvency II is a full-harmonization directive, an overlap of level 3 guidance with national norms should not be very common if the restrictive interpretation of EIOPA’s competence to issue guidelines and recommendations is followed as suggested in this paper.
220 Ibid, pp. 7-9.
221 Ibid, p. 9.
222 Ibid.
223 Svensk Försäkring.


227 Deutsches Rechnungslegungs Standards Committee.

228 Möllers and Fekonja, pp. 792 – 793. In this respect, a similarity to Hart’s rule of recognition can be noted.


231 Ibid, pp. 786 – 787; see also Möllers, Juristische Methodenlehre (2017), § 3 para. 73, where the distinction between intra, extra and contra legem rules is not mentioned.


233 Möllers and Fekonja, p. 798; Möllers, Juristische Methodenlehre, § 3 para. 13.
authority to follow the guidance, unless it has good reason. Consequently, according to the doctrine of secondary sources of law, this must also apply to insurance undertakings as addressees of a guideline or recommendation.

2.5.4.3 Briefly on similarities to norms in other legal areas

Above, some similarities between EIOPA’s guidelines and other forms of soft law have already been mentioned, namely resemblances with allmänna råd (“general recommendations”) issued by Swedish authorities and the comply-or-explain approach which is known from national corporate governance codes. Under which circumstances the addressees may deviate from the codes, is debated in both German and Swedish legal doctrine. A major difference to EIOPA’s guidelines is that the corporate governance codes are issued by more or less self-regulating bodies, whereas the guidelines are issued by a public authority. Likewise, similarities exist with accounting standards issued by private or semi-private standardsetters. One could also draw parallels to the concept of god redovisningssed (freely translated as “generally accepted accounting principles”) which companies have to comply with according to chapter 4 § 2 Swedish Book-Keeping Act (Bokföringslag).

Sources for god redovisningssed are norms formulated by a variety of actors, mainly the Swedish Accounting Standards Board (Bokföringsnämnden), a state authority, and FAR, the organisation for public accountants, but also by Finansinspektionen and industry confederations. The binding effect of these norms is discussed in Swedish literature where differentiations are made depending on the origin of the norms.

2.5.4.4 Assessment: Analysis of legal character of level 3 guidelines

To treat level 3 guidance similar to allmänna råd, as suggested by Munck and Finansinspektionen, would probably in many cases lead to the same result as the doctrine developed by Möllers.

Munck expresses doubts whether the every-effort obligations stated in Article 16 (3) of the ESA regulations have any legal significance at all. If this line of argument was
pursued consequently, supervisors and insurers would not have an obligation to follow guidance. However, this does not fit together with Munck’s suggestion that Finansinspektionen could impose sanctions against an insurance undertaking because of a breach of its every-effort obligation to follow guidelines and recommendations, provided the insurer’s inability to provide a valid explanation for its non-compliance.

I am not sure whether the distinction made by Munck between guidelines based on a general or a special competence norm is really helpful. When deciding upon regulatory measures against an insurer breaching a guideline, would it really make a difference whether there was a special competence norm authorizing EIOPA to issue such a guideline or not? Or should a breach against a guideline, which – as the existing complaints’ handling guideline - is based on Article 16 (1) and not on a special competence norm, not lead to any consequences at all, as suggested by Swedish Insurance?

I assume that what Munck means, is that if a guideline is based on a special delegation norm, Finansinspektionen would have to motivate a sanction with a breach of a norm that provides the material, and not the formal, basis for the guideline. If, for instance, the Solvency II Directive contained an article empowering EIOPA to issue guidelines on complaints handling, Finansinspektionen would base any regulatory measures against non-compliance with the guideline on the national norms implementing Article 41 (1) Solvency II Directive on an effective system of governance, Article 46 (1) requiring insurers to have an effective internal control system, and Articles 183 (1) and 185 (3)(l) containing information requirements on the arrangements for handling complaints of policy holders. There is no reason why this should be different just because the guideline is based on the general competence norm.

This predicament could be solved by always taking recourse to Article 16 (3), i.e. any time an insurer would not be able to provide a satisfactory excuse for not following a guideline, it would breach against its every-effort obligation, provided that a breach could be sanctioned with regulatory measures. If a guideline fell outside EIOPA’s mandate and competence, there would be no obligation to follow it – in the terminology of the doctrine on secondary legal sources, this would presumably be an extra legem rule.

The doctrine of secondary sources of law is intriguing because it provides a well-needed differentiation depending on the level of legitimacy of a rule and helps to provide structure to the many facets of soft law. Applied on EIOPA’s guidelines and recommendations, we find the required legislative act of recognition in Article 16 (3) EIOPA Regulation.

The classification of the content into intra legem and extra legem reminds of the classification of rules in the German Corporate Governance Code, but puts another systematic layer on top of the Code’s classification of proposals, recommendations and
duplication of the law. The theory implies that addressees of EIOPA’s level 3 guidance need to classify it as *intra*, *extra* or *contra legem* in order to assess its level of bindingness. This is admittedly not an easy task. Nevertheless, such practical difficulties are by themselves not sufficient to rebut the theory’s validity. That *contra legem* guidance cannot be binding follows already from the *lex superior* principle, so this assessment always needs to be done anyway. Since norms usually do not explicitly purport to be contrary to a higher-ranking norm, this assessment is always connected with an intellectual challenge.

What remains is the difficulty of classifying an EIOPA guideline or recommendations as *intra legem* or *extra legem*. Here again, one may expect that EIOPA will consider its guidance as being interpretations or concretizations of the law, i.e. as being *intra legem*. According to the doctrine of secondary legal sources, *intra legem* guidance would be attributed a status as secondary sources of law and enjoy a presumption of legitimacy, whereas *extra legem* guidance would not enjoy this status, and therefore, arguably, would not have to be followed at all. As far as *extra legem* guidance is concerned, a friction with the every-effort obligation in Article 16 and the comply-or-explain approach remains, because these would still be formally applicable. One could argue that the every-effort obligation does not have any significance in such cases, but the negative publicity connected with a non-compliance statement could still prevent an addressee from exercising its right not to comply.

This illustrates the importance of limiting EIOPA’s competences to issue guidance. If EIOPA applied a restrictive interpretation of its mandate and competences and its guidance stayed within these limits, the room for *extra legem* guidance would be considerably smaller. A more generous approach to the scope of competences could have been taken, if the EIOPA Regulation had not contained the every-effort obligation and the comply-or-explain approach.

### 2.5.5 EIOPA’s guidelines from the addressee’s perspective

At this point, we have come a little closer to getting an understanding of how EIOPA’s guidelines could be dealt with. However, so far, this analysis has mostly neglected the perspective of the addressees, and hopefully, the picture will get even clearer after a further differentiation of the problem.

Guidelines may be addressed to national supervisors only, or to both supervisors and insurance undertakings. They do not necessarily need to have the same degree of bindingness on both of them. In addition to that, for insurance undertakings, for instance,

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238 The German Corporate Governance Code consists of three kinds of rules: rules that merely duplicate statutory obligations and therefore have to be followed by all companies applying the Code, recommendations (*Empfehlungen*) and suggestions (*Anregungen*). If companies do not comply with a recommendation, they have to explain this in a public statement, whereas they may remain silent on non-compliance with suggestions.
it might make a difference whether its national supervisor has explained compliance or non-compliance.

As mentioned above, national supervisors have an every-effort-obligation to follow EIOPA’s guidelines and are obliged to declare compliance or non-compliance. Following Möllers’ doctrine of secondary sources of law, an \textit{intra legem} guideline enjoys a presumption that it is correct. A national supervisor would therefore only be allowed not to apply the guideline if the guideline did not contain a correct interpretation or concretization of the law, for instance because important circumstances have not been taken into consideration. In the case of \textit{extra legem} guidelines, for instance rules that stipulate new obligations going beyond existing law, national supervisors would not have to comply at all.

Another question is, if a national supervisory authority’s failure to apply \textit{intra legem} guidelines without a good reason would have any legal consequences. Article 17 of the EIOPA Regulation provides for an intervention mechanism if national supervisors fail to comply with the EU acts enumerated in Article 1 (2) or with regulatory technical standards or implementing technical standards established according to Articles 10 to 15 of the regulation. It does not refer to guidelines and recommendations. However, following the reasoning outlined above, an \textit{intra legem} guideline interprets and concretizes higher-ranking binding norms, so that a national supervisor by failing to apply such guidelines might breach against these higher-ranking norms. This would presuppose, however, that the national authority itself is addressee of the higher-ranking norm. Only when this is the case, Article 17 would be applicable and would give EIOPA the right to investigate the breach and address a recommendation to the national authority. In case of non-compliance with the recommendation, the Commission could issue a formal opinion to the authority requiring the authority to apply the guideline. The same would apply if a national supervisor would change its mind after having declared compliance and would cease to apply the guideline (generally or in particular cases) without having good reasons.

From an insurance undertaking’s perspective, several situations need to be distinguished.

If there was a binding national norm requiring insurance undertakings to comply with those of EIOPA’s guidelines that its national supervisory authority has declared to comply with, the insurance undertaking would presumably have a general obligation to follow the guidance. Ultimately, this question would have to be answered by national law.

The situation would be generally the same if the guidelines were implemented into national law. At least with regard to the interim guidelines, EIOPA seemed to expect national supervisors to proceed this way, and BaFin had announced to implement the
guidelines on complaints-handling into a circular and a generally applicable administrative decision.239

Nevertheless, national supervisors in most cases declare to comply with a guideline without any act of implementation. Provided that the guideline’s character is such that it is applicable also to insurance undertakings,240 the doctrine of secondary sources of law would presume that an *intra legem* guideline contains a correct interpretation of the law and an insurance undertaking would need good reasons to rebut this presumption.241 Such a reason could be that the application of the guideline would not be proportionate with regard to the size of the insurance undertaking in question or with regard to its risk structure.242 The presumption would not apply to *extra legem* guidelines, so that with respect to these, compliance would be in the free discretion of the insurer. It follows already from Article 16 (3) (Sub 4) EIOPA Regulation that the national supervisor’s statement of compliance in this case cannot hinder the insurance undertaking from deviating from a guideline. This provision requires financial institutions to report compliance or non-compliance to EIOPA if provided for in the guideline. It would make little sense if there was no room for non-compliance at all.

An interesting situation arises if the national supervisory authority renders a statement of non-compliance. It would be contradictory to demand compliance from insurance undertakings, although their regulator has declared that it would not enforce the guideline. A teleological interpretation requires Article 16 (3) to be understood restrictively in such way, that an insurance undertaking cannot be required to make every effort to comply with a guideline that its national supervisor has declared not to apply, notwithstanding whether the guideline is addressed only to the national supervisors or to insurance undertakings as well. Therefore, EIOPA should refrain from demanding compliance statements from insurance undertakings, since these would merely place insurance undertakings in a dilemma if their national regulator declared non-compliance. If EIOPA considers it important to receive information on the level of compliance among insurance undertakings, it may require national supervisors in the guidelines to demand compliance statements from insurance undertakings.

239 BaFin, EIOPA-Leitlinien zur Beschwerdebearbeitung: BaFin empfiehlt Unternehmen Bestandsaufnahme, 8 May 2013.
240 A counter-example could be a guideline dealing exclusively with issues concerning the cooperation between supervisors.
241 This does not imply that the burden of proof to rebut lies with the insurance undertaking, because the question whether a guideline constitutes a valid interpretation or concretization of the law is a legal question which ultimately would have to be decided by the competent courts. Nevertheless, national supervisors and courts do not need to question the applicability of an *intra legem* guideline in a specific case unless the non-compliant insurance undertaking provides arguments to rebut the presumption, cf. Möllers and Fekonja, p. 797.
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Consequently, national supervisory authorities may only take regulatory measures against insurance undertakings for non-compliance with *intra-legem* guidelines, if the national supervisor has declared to comply with the guideline.

2.5.6 Conclusion

EIOPA’s competence in Article 16 (1) of the EIOPA Regulation to issue guidelines and recommendations needs to be read restrictively, because otherwise there is a risk that new, politically motivated requirements are implemented through guidelines issued by a European agency rather than through democratically legitimized legislation. This leaves little room for guidelines that go beyond the interpretation and concretization of binding law in the acts listed in Article 1 (2) EIOPA Regulation. In this context, it is important to note that Article 16 (1) EIOPA Regulation further obliges national supervisors and insurance undertakings to “make every effort” to comply with EIOPA’s guidelines and recommendations. Together with the “comply or explain” approach in Article 16 (3), this will lead to high degree of compliance with EIOPA’s guidance. However, its legal bindingness depends on its content and, for insurance undertakings, on the compliance statement given by the national supervisor or whether national norms require compliance. In the absence of the latter, an insurance undertaking cannot be obliged to comply with guidelines that its national supervisor has declared not to apply. For this reason, EIOPA should refrain from requiring insurance undertakings to issue “comply or explain” statements.

Where guidelines fall within EIOPA’s mandate and competence and contain concretizations of existing law, they can be classified as *intra legem* in the terminology of the doctrine of secondary sources of law. Such *intra legem* guidelines enjoy a presumption of containing a correct interpretation of the law, so that national supervisory authorities are required to apply them unless they have good arguments to rebut this presumption. The presumption also applies to insurance undertakings, if their national supervisory authority has declared compliance. A valid reason not to apply a guideline would be if it was obviously disproportionate with regard to the size and risk situation of the undertaking. Guidelines that go beyond existing law, for instance by establishing entirely new obligations without a basis in binding law, do not enjoy this presumption, so that the every-effort obligation to follow guidelines and recommendations does not apply.
PART II

BACKGROUND
3 On the development of insurance regulation in Sweden and Germany

That a look back to the historical development of insurance regulation is fruitful for understanding today’s regulatory law has been contested. With regard to insurance regulation in Germany during the first three decades of the 20th century, Ruge laconically states that a historical continuity from the early 19th century to the present is hardly perceivable anymore and knowledge of this period of insurance regulation does not help in tackling today’s challenges.243

With the fast development of insurance supervision law during the last decades, I am nevertheless convinced that it is instructive to take a step back and have a look at how we have arrived where we are now. Compared to more “traditional” areas of law, insurance regulatory law has in common with other areas of financial regulatory law that many significant impulses have come from the EU. If one is not aware of their origins, there is a risk that certain features of regulatory law are taken for granted by legal scholars and practitioners. Brand observes a still-existing pride in the early development of German insurance regulatory law prior to 1914 and notes that the German legislator in the course of the Solvency II negotiations “jealously defended” some genuine features of German insurance supervision law against “alien” influences from other member states.244 Against this background, it is not surprising that different legal traditions influence the interpretation and application of Solvency II in the member states,245 despite all attempts of achieving supervisory convergence.

I will therefore try to give an overview of the development of insurance supervision law in Germany and Sweden and the European Union. The focus will lie on those features of regulatory law that still are considered important today and on issues that will be of special interest for the present study, notably solvency requirements, the supervision of insurance groups, including features that influence how insurance groups are structured. Since regulation of reinsurance is a considerably new phenomenon, all statements in this chapter shall be understood as referring to direct insurance, unless otherwise stated.

243 Ruge, Die Entwicklung des Versicherungsaufsichtsrechts bis zur Novelle in 1931, in: Müller et. al., 100 Jahre materielle Versicherungsaufsicht in Deutschland, p. 37
244 Brand in: Brand and Baroch Castellvi (eds), VAG, Einführung para. 9.
245 With regard to German law: Brand in: ibid, Einführung para. 9. Examples are the German and Swedish rules implementing Article 34 Solvency II Directive in § 298 VAG 2016 (Misstandsaufsicht) and chapter 16 FRL 2016.
3.1 Introduction: Legislation on insurance regulation in Sweden and Germany

Insurance in the modern sense emerged in the 17th century when mathematical methods were developed that enabled insurance undertakings to calculate risks. Parallel to the development of such actuarial methods, the demand for insurance increased started to increase in the course of the industrial revolution. Licensing requirements for conducting insurance were introduced in Sweden and the German states, but an ongoing supervision of insurance undertakings did not take place during the 19th century.246

After two decades of discussion, the German Empire enacted in 1901 the first act on private insurance undertakings247 valid for the entire German territory. This put an end to the fragmentation of regulatory requirements in the various German states having resulted in an ever-increasing bureaucratic burden for German insurers.248 Supervision was to be conducted by a newly established insurance supervision authority (Kaiserliches Aufsichtsamt für Privatversicherung). The 1901 Act had been in force until 2016, but had, of course, undergone substantial amendments over time.

The Swedish parliament enacted a similar law in 1903249 and established an insurance supervision authority (Försäkringskommissionen) in 1904.250 Before that, regulations on supervision of insurance companies from 1886 and the 1895 Act on insurance companies limited by shares251 covered only a few areas of insurance regulation law. According to Falkman, the main objective behind the 1903 act was to protect policyholders from insurance companies becoming insolvent. The implementation of special norms on insurance regulation was justified with the economic and social function of insurance and the public’s limited possibilities to assess the quality of insurance.252 The German VAG 1901 was motivated with very similar arguments referring to the economic and social importance of insurance, based on the argument that a solid insurance sector would be in the public interest. This in turn would carry with it the state’s duty to prevent misuse

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246 Licencing requirements varied considerably from state to state. Pearson and Lönnborg categorize Sweden as very liberal with only minimum requirements, and Prussia and some other German states as very restrictive: Robin Pearson and Mikael Lönnborg, Regulatory Regimes and Multinational Insurers before 1914, 82 Business History review (2008), pp. 59-86, pp. 74, 81.
247 Gesetz über die privaten Versicherungsunternehmungen of 12 May 1901, RGBl. 139.
248 See the motives to the VAG 1901 with a lively description of the obstacles faced by insurers that were active in more than one German state, cited in: Franz Büchner, Die Entwicklung der deutschen Gesetzgebung über die Versicherungsaufsicht bis zum Bundesgesetz vom 31. Juli 1951, in: Walter Rohrbeck (ed), 50 Jahre materielle Versicherungsaufsicht, vol 1 (1952) pp. 7 - 9. For a short account of the development of insurance supervision law on the German territory until 1901, see also Peter Koch, Der Weg zur einheitlichen Staatsaufsicht über Versicherungsunternehmen in Deutschland, in: Helmut Müller et al. (eds), 100 Jahre materielle Versicherungsaufsicht in Deutschland 1901-2001, vol 1 (2001), pp. 5 - 24.
249 Lagen den 24 juli 1903 om försäkringsrörelse.
250 For a more detailed presentation of the development of insurance regulation legislation, see Falkman, Försäkringsrörelse, pp. 45 ff
251 Lagen den 28 juni 1895 om aktiebolag, som drifva försäkringsrörelse.
252 Falkman, Försäkringsrörelse, p. 51 f.
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on the side of the insurance companies, because even a careful citizen usually would not be capable to assess insurance companies on his own.253 For these reasons, the German legislator considered it necessary to establish an on-going insurance supervision by a specialized regulatory authority with wide competences and a large degree of discretionary freedom.254

In 1917, a new insurance supervision act was enacted in Sweden,255 followed by yet another act from 1948.256 This act was replaced by the 1982 FRL257 which was applicable until 1 April 2011, when the 2011 FRL258 entered in force. The two latter acts were accompanied by government ordinances259 on matters like licensing procedure and registration, empowering Finansinspektionen to adopt administrative rules on specified issues.

To apply the categorization used by Pearson and Lönnborg, the enactment of the insurance supervision acts from 1901 in Germany and 1903 in Sweden mark the transition to monitorial systems of insurance supervision. A monitorial system is characterized inter alia by the existence of standing insurance commissions or inspection departments, general licensing and deposit requirements.260 The two other categories according to this classification are prohibitive systems, for which Prussia prior to 1859 can serve as example, and liberal systems such as Great Britain, or Sweden before the adoption of the 1903 act.261 According to this classification, prohibitive systems limited entry into the insurance markets by restricting access of (foreign) insurers or exercising strict controls over insurance companies, agents or policyholders, whereas liberal systems only had minimal or no regulation and supervision at all.262

Another categorization differs between systems based on transparency, systems based on the formal compliance with rules, and systems based on “qualitative regulation” (“materielle Versicherungsaufsicht”).263 Systems based on transparency require insurance undertakings to publish certain financial data in order to enable the public, such as independent actuaries, policyholders and prospective customers, insurance intermediaries or agents, to determine themselves whether an insurance undertaking is solid.264 The insurance regulatory system in the United Kingdom was historically an

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254 Motives to the VAG 1901, cited in: Büchner, p. 17 f.
255 Falkman, Försäkringsrörelse p. 47.
256 Lag om försäkringsrörelse, SFS 1948:433-435.
260 Pearson and Lönnborg, p. 80.
261 Ibid, p. 81.
262 Ibid, p. 80 f.
264 Müller, p. 156.
example for this liberal regulation method, often described with the term “freedom with publicity”. Instead of threatening with measures to be taken against the insurer by the supervisory authority, regulation based on transparency expects that fear of public pressure will be an incentive strong enough for insurers to conduct their business in a solid way.

Systems based on formal regulation require insurers to comply with a limited set of rules, but do not give supervisors the possibility to apply discretion or to take (repressive or preventive) measures based on a general rule, as qualitative regulatory systems do. Already several decades ago, qualitative systems were considered to be predominant.

Since the 1901 VAG, German insurance regulatory law has always comprised such general provisions enabling the regulator to take action against an insurance undertaking if “irregularities jeopardize the interests of the insured” and in order to “adequately safeguard the interests of the insured”, making it a system of qualitative regulation. Similarly, chapter 4 § 3 FRL 2016 contains a general clause, requiring insurance undertakings to follow “good insurance standard”, a term that is not concretized in the act itself. Non-compliance would constitute a breach of insurance regulatory law which may be sanctioned by Finansinspektionen according to chapter 18 § 1 no. 1 FRL 2016.

3.2 Licensing requirements

One of the common features of modern insurance supervision law is that only authorized insurers may conduct insurance business. Closely connected to this is the question under which circumstances a foreign insurer may conduct insurance business in another state. Until the enactment of the FRL 1903, the Swedish crown, i.e. the government, was entitled to review whether an insurance company’s corporate charter was in compliance with the law based on the Regulation on limited liability companies (aktiebolagsförordning) from 1848.

Neither the FRL 1903 nor the FRL 1917 contained any formal licensing requirement. However, only certain forms of associations were allowed to conduct insurance business: companies limited by shares and mutuals. A license requirement was not introduced until 1948. According to the 1948 FRL, a concession was granted if there was a demand for the insurance business to which the application applied (behovsprincipen) and if the

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266 Müller, p. 156.
267 Ibid, p. 156.
268 Schmidt and Sasse (eds), Pröss VA, 7th edn., Vorbem. IV2, p.13.
269 See Falkman, Försäkringsrörelse, pp. 199-201, on good insurance standard.
270 Ibid, p. 47.
271 Ibid, p. 52.
provisions on financial soundness were complied with (sundhetsprincipen). Already in the 19th century, concessions on the basis of demand had been a means of limiting access to the insurance industry in Prussia and some other German states. In Sweden, the introduction of the demand principle was a reaction to perceived shortcomings in the insurance industry attributed to the large number of undertakings active on the Swedish insurance market at the time. The principle of demand was abolished in Sweden for most types of insurance companies (companies limited by shares and mutuals) in 1985, after authorizations for reinsurance captives had already been granted in violation of the demand principle. For “friendly societies” (understödfsföreningar), a certain kind of mutual, the principle continued to be applicable until as late as 2011, when this form of association was closed for new registrations.

The activities of foreign insurers in Sweden were since 1903 regulated in a various special acts. Foreign insurance undertakings needed a license issued by the Swedish government to conduct insurance business through a general agent or branch in Sweden or through intermediation of an insurance undertaking that was authorized in Sweden and belonged to the same insurance group as the insurer or with which the foreign insurer had a cooperation agreement. These requirements still exist for insurers from non-EEA countries.

Similarly, German law required foreign insurers to seek authorization if they wanted to conduct cross-border insurance business into Germany or establish a branch in Germany. An exception was transport insurance, which was not subject to regulation at all until 1975. Until then, the legislator did not consider it necessary to supervise transport insurance undertakings, because their policyholders usually were business undertakings, which were considered to be able to protect their interests themselves.

273 In Prussia, the demand principle was abolished by decree from 2 July 1859, C. Doehl, Versicherungs-Wesen des Preußischen Staates (1865), p. 59.
274 Pearson and Lönnborg, p. 79 f. It can be assumed, however, that the requirements for proving that there was a demand for a line of business, were based on more objective grounds in 20th century Sweden as in 19th century central Europe where a testimony of a local administration was required to demonstrate the demand, cf. ibid, p. 80.
276 Eckerberg, p. 96
279 Ibid, p. 80.
With the same argument, reinsurance undertakings were subject only to a very limited form of supervision in Germany until 2002.  

Initially, the insurance sector was exempted from the freedoms of services and of establishment in the EEC Treaty for a transitional period connected to the implementation of the freedom of capital (Article 61 EEC Treaty). Due to fundamental differences in the regulatory systems in the member states and structural differences in the insurance markets, it took several decades to accomplish the freedoms of services and establishment for insurance undertakings in the European Union. The first step was taken in 1964 with the Directive 64/225/EEC requiring member states to abolish provisions that restricted the freedoms of services and establishment of reinsurance undertakings.

Nine years later, the First Non-Life Insurance Directive harmonized licensing requirements for non-life insurers to a certain extent, *inter alia* by requiring insurance undertakings to submit a scheme of operations including policy conditions and tariffs and to maintain a sufficient solvency margin. Article 10 (4) precluded the continued application of the demand principle. Insurance undertakings that wanted to establish a branch in another member state, needed a license issued by the member state where they had their head office and an authorization of the host country where the branch was to be located. In 1979, the First Life Insurance Directive set up corresponding requirements for life insurance undertakings. However, these directives only dealt with the freedom of establishment.

Freedom of services in the insurance sector continued to be a controversial issue. Whereas some member states argued that the home country regulator should supervise also the cross-border activities of an insurance undertaking, others were still skeptical of the need of supervision at all. A small step forward was reached in 1978, when the Co-Insurance Directive established freedom of services for co-insurance operations, allowing insurers to participate in co-insurance policies on risks located in another member state if the leading insurer was established in that member state. However, Germany, Denmark, Ireland and France were accused by the Commission of not having implemented the directive correctly and the European Court of Justice decided in 1986 that the freedom of services in the insurance sector had become directly applicable upon...
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expiry of a transitional period and that restrictions were only allowed if they were justified by imperative reasons in the public interest. Finally, an agreement was reached in 1988 for non-life insurance and 1990 for life insurance. The second directives provided that in non-life insurance, cross-border insurance of so-called large risks was subject to supervision of the member state of establishment. For the insurance of other risks, where policyholders were considered to be in greater need of protection, the member state where the insurance activity was undertaken had regulatory powers. It was entitled to demand a license from insurers for incoming cross-border insurance and to punish irregularities committed within its territory (Article 19 (5)). For other regulatory sanctions, the directive required the supervisor of the state of provision of services to cooperate with the supervisor of the state of establishment. For life insurance, it was differentiated between cross-border insurance business that was written at the initiative of the policyholder in another member state and such business where the insurance undertaking actively solicited its services in another member state. In the first case, supervision was undertaken by the member state of establishment, and there was only a notification requirement in the member state of provision of services. This meant that a life insurer had to refuse requests by residents in member states if it had not notified its intent to accept insurance requests from customers in the respective member state. In the second case, insurance undertakings were subject to supervision by the state of provision of services which could require authorization.

However, the supervisory system envisaged by the first and the second directives did not encourage insurance undertakings to make use of the freedoms of establishment and services. The supervision of foreign branches by the member state of establishment required insurance undertakings to take various differing national financial requirements into account. Another problem was that some member states required the approval of insurance conditions whereas others did not.

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287 ECJ, Judgment of the Court of 4 December 1986, C-205/84 (Commission v Germany), paras. 25 – 29.
289 Definition in Article 5 Second Non-Life Insurance Directive. Large risks encompassed certain insurance classes where policyholders typically were corporations, such as the insurance of aircraft, ships, liability for ships or goods in transit and for most other classes of non-life insurance where the policyholder exceeds certain thresholds with regards to the balance-sheet total, net turnover and average number of employees.
290 The state of establishment is the territory where the legal entity that writes the insurance business is established, which often, but not always coincides with the state where the head office is located. Where a branch in another member state writes cross-border insurance, the state of establishment is not identical with the head office member state. For direct non-life insurance, a cross-border situation applies if the member state where the insured risk is situated is different from the member state where the insurance undertaking is established (Article 12 (1) Second Non-Life Insurance Directive). More detailed specifications on where the risk is situated depending on the kind of risk – vehicles, other property, travel risks and other risks – can be found in Article 2 (d).
291 Donhausen, p. 136.
With the third generation of insurance directives from 1992, these shortcomings were corrected and another important step towards a common market in the insurance sector was achieved. The third directives\(^{292}\) provide that insurance undertakings needed a license only from the member state of their head office (“single European license/passport”). The supervisory authority of the head office state is primarily responsible for the supervision of all activities of the insurance undertaking within the European Community. For the establishment of a branch or the provision of services in another member state, a notification to the head state supervisor is sufficient. The supervisor in turn is obliged to inform the supervisory authority in the other member state of the notification.

After its accession to the European Economic Area in 1994, also Sweden had to implement the EUs insurance directives. It did so by amending the 1982 FRL and by adopting a separate act on the activities of EEA-insurers in Sweden\(^{293}\).

A number of jurisdictions, such as many U.S. states, require foreign reinsurers to provide collateral with respect to their operations in the respective country, i.e. to deposit assets\(^{294}\). EU member states are, of course, not allowed to require collateral from EU insurers, since this would be incompatible with the internal market, but they are not hindered to do this from insurers from outside the EEA. Whereas Germany has not made use of this possibility, Sweden requires non-EEA insurers to deposit assets corresponding to the gross premium income of the preceding accounting year for non-life insurers and three hundred times the Swedish price base amount\(^{295}\) for life-insurers.\(^{296}\)

- **Licensing requirements according to Solvency II**

Articles 14 to 26 Solvency II Directive deal with licensing requirements. In general, they uphold the legal situation established by the third directives concerning licensing requirements, establishment of branches in other member states and cross-border provision of services. Annex III of the directive lists the legal forms that insurance undertakings may adopt, being försäkringsaktiebolag, ömsesidiga försäkringsbolag and understödsföreningar in Sweden, and Aktiengesellschaft, Versicherungsverein auf


\(^{293}\) Lag (1983:1302) om EES-försäkringsgivares verksamhet i Sverige. The act was repealed in 1998.


\(^{295}\) One price base amount corresponds to 45,500 SEK in 2018. The deposit requirement for non-EEA life insurers thus amounts to 13.65 million SEK at present.

\(^{296}\) One price base amount corresponds to 45,500 SEK in 2018. The deposit requirement for non-EEA life insurers thus amounts to 13.65 million SEK at present.

\(^{297}\) Chapter 5 § 2 Lag 1998:293 om utländska försäkringsgivares och tjänstepensionsinstituts verksamhet i Sverige. According to chapter 5 § 3, Finansinspektionen may in certain cases set lower deposit requirements.
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*Gegenseitigkeit* and *Wettbewerbsversicherungsunternehmen* in Germany. According to A.28 and B.28 of Annex III, European Companies (SE) are eligible legal forms in all member states.

### 3.3 Approval of insurance conditions and premiums

For the greater part of the 20th century, one of the cornerstones of German insurance supervision had been the prior approval of insurance conditions and premiums. Insurance conditions were part of the scheme of operations that insurance undertakings had to submit to the supervisory authority for approval. Changes in the conditions constituted a change of the scheme of operations and therefore needed approval by the supervisory authority.

For many product types, standard insurance conditions had been developed with the insurance organizations. This led to a considerable degree of uniformity. Only in industrial insurance, variations were more frequent. Since market transparency was one of the regulatory objectives of German insurance supervision, uniform conditions were strongly supported. For life, health and motor liability insurance, not only the insurance conditions needed prior approval, but also the level of premiums. Premiums had to be sufficient to make sure that insurers were able to fulfill their obligations. In order to prevent that insurers would profit too much from the required high level of premiums, they had to distribute considerable parts of their profits to the policyholders.

Although it was acknowledged that greater freedom to set insurance standards and premiums would lead to more competition and lower premiums, prior approval was considered necessary to prevent insurers from becoming insolvent, which was the foremost objective of insurance regulation in Germany. Since the Third Directives required member states to abolish any requirements of prior approval of insurance conditions and premiums, the German insurance regulator’s competences are insofar limited to the imposition of regulatory measures if features of an insurance product jeopardize the interests of the insured.

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299 Hennies, p. 160.
300 Ibid, p. 161. In life insurance, 90 % of the profits had to be distributed. In motor liability insurance, profits up to 3 % of the premium income were allowed to be retained.
301 Ibid, p. 164.
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Swedish regulatory law did not require the prior approval of insurance conditions and premiums.\(^3\) An exception were the premiums and technical assumptions underlying the premium calculation for compulsory traffic insurance, which were subject to regulatory approval until Sweden’s entry into the EU. A committee, installed by the government in 1978 to investigate the need for changes in insurance regulatory law, recommended not to introduce a general obligatory prior approval.\(^4\) Instead, it proposed to examine the possibility of extending the control of insurance conditions on a case-by-case basis. Since 1971, the Consumer Ombudsman had competence to check whether insurance conditions breach against the Unfair Standard Terms Act\(^5\), whereas the insurance supervisory authority was competent to take measures against an insurance undertaking that used unreasonable standard terms. This competence was based on the “equity principle” (skälighetsprincipen)\(^6\) which was partly abolished as a mandatory regulatory principle in 1999.\(^7\)

Despite the lack of a prior approval requirement, also in Sweden, insurance terms had a great degree of conformity because they were the result of a co-operation between insurers. After the implementation of the Third Directives, cooperation between insurers, often coordinated by insurance organizations, continued in Germany and Sweden as well as in other EU member states on the basis of Commission regulation (EEC) 3932/92. This regulation exempted certain practices in the insurance industry from the competition rules in the EC Treaty, allowing insurers among others to establish standard insurance terms, which insurers could apply on a voluntary basis. When the regulation expired in 2003, the exemption was renewed in Commission regulation (EC) 358/2003. However, after its expiry in 2010, the Commission did not see any justification any longer to continue to exempt the establishment of standard insurance terms from the competition rules. Presumably as a reaction to this, the insurance industry stopped this practice in order to comply with competition law.\(^8\)

Outside the European Union, the prior approval of insurance terms and tariffs is still a widely-used regulatory means. For instance, product licenses are required by many U.S. states. However, it has been reported that applications often only receive a cursory review due to lack of personnel.\(^9\)

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\(^3\) The prior approval of insurance conditions needs to be distinguished from the supervisory authorities’ competence to examine the reasonableness of technical assumptions which form the basis for premium calculations.


\(^5\) Lag (1971:112) om förbud mot oskäliga avtalsvillkor.


\(^7\) See Eckerberg, p.102 f. on the skälighetsprincipen.

\(^8\) Exemptions in the current regulation apply to the compilation of certain statistical data, coinsurance and insurance pools.

\(^9\) Elizabeth F. Brown, The Development of International Norms for Insurance Regulation, 34 Brooklyn Journal of International Law (2009), pp. 953-997, at p. 985, citing a study published in 2004 by the University of Massachusetts Isenberg School of Management. According to the study, it may take up to two years to receive product approvals in the United States for traditional insurance products, ibid., p. 986.
- No approval of premiums and conditions according to Solvency II

The Solvency II Directive upholds in Article 21 (1) the prohibition to require supervisory approval or systematic notification of insurance conditions and premiums established by the third directives. For life insurance supervision, the provision allows member states to require the systematic notification of the technical bases that are used for calculating premium scales and technical provisions. However, such notification requirements may only be used for verifying compliance with national provisions concerning actuarial principles.

3.4 Prohibition to conduct non-insurance business

Another principle known both in Germany and Sweden is the prohibition to conduct non-insurance business (in German: Verbot des Betreibens versicherungsfremder Geschäfte; in Swedish: förbud mot försäkringsfrämmande verksamhet) with the exception of operations that are related to the insurance business. In Germany, the principle was codified for the first time in the VAG and Sweden implemented the principle in § 2 FRL 1948. The prohibition was also laid down in the First EU Non-Life and Life Insurance Directives. For reinsurance companies, Article 6 (a) Reinsurance Directive\(^\text{310}\) allowed member states to adopt a broad view of what are “reinsurance business and related operations”: According to this provision, member states may allow reinsurance companies to have a holding function and to conduct certain so-called financial sector activities in the meaning of Article 2 (8) Financial Conglomerates Directive. This includes activities conducted by credit institutions and investment firms.

The principle limits the activities of direct insurance undertakings to those insurance classes they are licensed for and to such activities that are closely connected to their insurance business. The rationale behind the principle is to protect policyholders from the risk that such activities jeopardize their insurer’s ability to pay insurance claims. For this reason, the prohibition is not applicable to insurance holdings.

The principle also limits investments in derivatives, options and other financial instruments\(^\text{311}\) and prohibits insurers from carrying out banking services.\(^\text{312}\) Also, participations in non-insurance companies that would lead to an unlimited liability of the insurance undertaking for the participation’s debts may be incompatible with the principle.\(^\text{313}\) Normal capital investments, to the contrary, for instance in real estate or state bonds are considered to be a necessary part of the insurance business and are not forbidden. Another example of a permitted non-insurance activity could be a garage


\(^{311}\) Special norms on this can be found in chapter 6 § 32 FRL 2010 and § 7 (2) VAG (now: 15 (1) sentences 2 and 3 VAG (2016)).


\(^{313}\) See below on the application of the principle on limits in shareholding other companies.
service where an insurer repairs damages cars itself instead of settling claims by paying a financial compensation to the insured.314

However, there are differences in the application of the principle in Germany and Sweden. According to BaFin’s interpretation and regulatory practice, the principle hinders insurance undertakings from taking loans other than in exceptional cases.315 In 2009, the prohibition to take loans was codified in § 7 (2) VAG stating that loans are presumed to be non-insurance business. This does not encompass subordinated loans that are accepted as own funds, such as the emission of subordinated bonds, because the policyholders’ claims are higher-ranking than the lender’s. Swedish law is more generous in this respect and allows insurers according to chapter 4 § 5 FRL 2010 to take loans in the interest of an efficient asset management or if it is otherwise justified by the insurance business. Another requirement is that the size of the loan has little significance in relation to the insurer’s capital base and the size of its business. With this provision, the legislator wanted to prevent insurers from taking too large risks without hindering them from taking up loans in the ordinary course of business and in the policyholders’ interest.316

Occupational pensions insurers may only take loans if these are necessary to fulfil the capital requirements or to solve temporary liquidity problems.317

The principle also puts limits to the group constellations for which domination agreements or profit and loss transfer agreements are permissible, because these could lead to an obligation of an insurance company to bear the losses of a non-insurance company.318 Such agreements are common instruments used by German insurance groups, but are unknown in Sweden and many other states.

§ 336 FRL 1948 contained a provision which required both life and non-life insurance companies to receive a permission by the Insurance Supervisory Authority if they wanted to acquire more than 5 % of the voting rights in a Swedish limited company. Before, the threshold had been considerably higher, at 20 %. The background for the decrease was that the expert committee, that had proposed the changes, feared negative consequences for the Swedish stock market if Swedish life insurers were free to invest larger sums in Swedish stock companies because it considered the Swedish stock market to be too small to handle the entry of a large group of new investors.319 Another concern was that insurance companies could gain control over companies outside the insurance

315 BaFin, Rundschreiben 4/2011 (VA) - Hinweise zur Anlage des gebundenen Vermögens von Versicherungsunternehmen (15 April 2011), sec. B 3.3. This interpretation had been criticized by Präve in: Pröls VAG (12th edn), § 7 para. 28.
316 Falkman, Försäkringsrörelse, p. 166.
317 Chapter 4 § 5 (2) FRL 2010.
318 Domination and profit and loss transfer agreements are discussed in greater detail in chapter 4.4.1.2.
319 SOU 1946:34, p. 164. Interestingly, the committee had suggested a threshold of 10 % which was considerably reduced during the legislative process.
business. In order to prevent circumvention by life insurers through non-life subsidiaries, the restriction was introduced even for non-life insurance companies. However, these rules could not be upheld any longer after the European Court of Justice in a preliminary ruling held them to be incompatible with the First Life and Non-Life Insurance Directives. The Swedish insurance company Skandia had challenged a decision by Finansinspektionen requiring it to reduce its indirect shareholding in a company active in dialysis to below 5 % of the voting rights. The Court held that the limitation could not be based on the prohibition to conduct non-insurance business because its purpose was not to protect insurance companies from the risks connected with non-insurance business, but to limit the influence that insurance companies could exert in public limited companies. As a reaction to the judgment, the 5 % limit was formally abolished in 2000.

German law did not know any explicit shareholding limits, although the German insurance supervisory authority in a statement from 1994 considered it an unlawful circumvention of the prohibition to conduct non-insurance business if insurance undertakings held 100 % participations in non-insurance companies that did not have a connection to the insurance business.

- Prohibition to conduct non-insurance business according to Solvency II

Article 18 (1) and (2) Solvency II Directive upholds the prohibition to carry out non-insurance activities by requiring insurance undertakings to limit their objects “to the business of insurance and operations arising directly therefrom, to the exclusion of all other commercial business”. As before, this is not to be understood as an obligation that only needs to be fulfilled at the time of licensing, but as an ongoing obligation, failure to comply with may lead to regulatory sanctions. Concerning reinsurance companies, the provision in Article 18 (2) is equivalent to Article 6 (a) Reinsurance Directive.

Whether member states may continue to apply diverging interpretations of what are non-insurance activities, for instance concerning the possibility to take loans or investments in non-insurance companies, is now more questionable than ever, considering that the Solvency II Directive is supposed to provide “a level playing field” for the European insurance industry. Since Solvency II is a full harmonization directive, Dreher and Lange consider the prohibition not to be compliant with Solvency II and

320 SOU 1946:46, p. 165.
322 ECJ, Judgment of the Court of 20 April 1999, Case C-241/97 (Försäkringsaktiebolaget Skandia), para. 53.
323 Prölss, p. 1266.
325 Case C-241/97 (Försäkringsaktiebolaget Skandia), and ECJ, Judgment of the Court of 21 September 2000, C-109/99 - (Association basco-béarnaise des opticiens indépendants v Préfet des Pyrénées-Atlantiques), where the Court ruled on the the corresponding provision in the First Non-Life Insurance Directive.
expected a change of supervisory practice into this direction. The German legislator does not seem to share this view, however, and has upheld the prohibition to take loans in § 15 (1) VAG 2016.

Präve stresses that in conformity with EU law, the prohibition must be interpreted narrowly and does not encompass socially adequate loans that are temporarily limited and limited in quantity.

3.5 Separation principle

Another basic feature of insurance supervision law is the separation principle (Swedish: specialitets-/separationsprincipen, German: Spartentrennung), which is justified with arguments similar to those put forward in favour of the prohibition to carry out non-insurance business.

According to the separation principle, non-life and life insurance business may not be carried out in the same insurance undertaking. The reason behind the separation has been described as lying in the political will to isolate non-life from life business because of the latter’s “importance for pensions provisions – intertemporal capital transformation – generates important positive external effects and therefore needs to be protected from negative spill-over” from non-life insurance. This has contributed to the creation of insurance groups conducting non-life and life insurance in separate companies.

Although the principle was not explicitly laid down in the German VAG 1901, the German insurance supervision authority motivated its rejection to grant a license for both life and non-life insurance business within the same insurance company with the higher volatility of the non-life business compared to life insurance. The latter was considered to be more stable because it was based on more sophisticated statistical evidence. Two decades later, the authority applied the principle also on health insurance and credit insurance which were not allowed to be conducted together with other forms of insurance. With regards to credit insurance, high loss ratios in credit insurance should not endanger the insurer’s ability to pay claims from other insurance policies. The prohibition to carry out legal expenses insurance and together with other forms of non-life insurance was supposed to protect policyholders from conflicts of interest that might otherwise arise if a policyholder claims coverage under a legal expenses insurance policy.

327 Präve in: Prölss/Dreher VAG, § 15 para. 43.
330 Ibid, p. 29.
331 Donhausen, p. 129.
for a lawsuit against the same insurer because of failure to pay under another policy, for instance a third-party liability insurance policy.\textsuperscript{332}

In Sweden, the separation principle was explicitly laid down first in § 2 FRL 1948, but had a slightly different content, because it allowed life insurance to be conducted by the same insurer as personal accident insurance due to a different classification of insurance.\textsuperscript{333}

Although there was no legal requirement, until Sweden’s entry into the EEA, Finansinspektionen and the Swedish insurance industry had an agreement to apply the separation principle also on credit insurance, so that licenses to conduct credit insurance only were granted to companies that did not conduct any other form of insurance business. Also life insurers with a traditional life insurance portfolio were initially not allowed to conduct unit-linked life insurance.

Article 13 (1) First Life Insurance Directive from 1979 established the separation principle for life and non-life insurance in the entire European Community. Until then, in some member states, such as Italy, it was permitted to conduct life and non-life insurance business in the same insurance company.\textsuperscript{334} The recitals to the directive do not provide an exhaustive motivation for the separation principle other than that the interests of life insurance and non-life insurance policyholders should be protected and that the minimum financial obligations connected with one activity should not be borne by the other activity. Germany was allowed to continue to apply the separation principle with regard to credit and suretyship insurance, health insurance and legal expenses insurance by virtue of an exception in the First Non-Life Insurance Directive. The exception was removed in 1987 with regard to credit and suretyship insurance\textsuperscript{335} and legal expenses insurance\textsuperscript{336}. Concerning the latter, the Council recognized a risk for conflicts of interests, but did not consider it necessary to extend the separation principle to legal expenses insurance.\textsuperscript{337} Instead, member states were required to choose one or more out of three measures to prevent interest conflicts in claims-handling.\textsuperscript{338} Germany has chosen the solution according to which insurers with legal expenses insurance and other non-life insurance need to outsource the claims management for legal expenses insurance to

\begin{itemize}
\item \textsuperscript{332} Ibid, p. 130.
\item \textsuperscript{333} The Swedish terminology distinguishes between insurance of persons (personförsäkring) including life insurance and personal accident insurance and damage insurance (skadeförsäkring), encompassing all remaining forms of insurance. In German usage, the term Schadenversicherung is usually applied in a way encompassing personal accident insurance, although the combined term Schaden-/Unfallversicherung is also used. This can be compared to the English term “property and casualty insurance”. I will use the terms life insurance and non-life insurance as applied in Article 2 (1) and (2) Solvency II Directive.
\item \textsuperscript{334} Thanks to the exception in Article 13 (3) First Life Insurance Directive for companies that carried out both life and non-life insurance at the time of notification of the directive, such combined insurers still exist, for instance the Italian insurance company HDI Assicurazioni S.p.A. Such insurers are, however, obliged to manage their life and non-life insurance activities separately.
\item \textsuperscript{337} Recital 8 of the Legal Expenses Insurance Directive.
\item \textsuperscript{338} Article 3 (2) Legal Expenses Insurance Directive.
\end{itemize}
a separate loss-adjustment company (§ 164 VAG 2016). The insurer is not allowed to give instructions with regard to the administration of individual claims.

With its accession to the EEA, Sweden had to adjust the separation principle to the content required in the insurance directives. For insurers that conducted both life and personal accident insurance on the date of Sweden’s signing of the EEC Agreement in 1992, Sweden has made use of the exception in Article 13 (2) First Life Insurance Directive which had been inserted the same year. However, companies conducting both life and personal accident insurance are obliged to manage their life and personal accident insurance activities separately.  

With regard to legal expenses insurance claims, Sweden chose to implement the third option affording the insured the right to entrust the defence of his interests to a lawyer of his choice.  

- The separation principle according to Solvency II

Solvency II upholds the separation principle as established by EU law prior to Solvency II, i.e. the prohibition to conduct life and non-life insurance simultaneously within the same legal entity.

According to Article 73 (5c) Solvency II Directive, the exception in Article 13 (3) of the first life directive may be upheld. Article 73 (2) equally allows member states to uphold the possibility to authorize insurance undertakings to conduct life insurance and accident and health insurance in the same company. Since Sweden already before the transposition of Solvency II Directive allowed life insurers to conduct so-called long-term health and accident insurance, it is not surprising that it upholds this possibility in chapter 2 § 12 FRL 2016.

With regard to the separation of claims handling in legal expenses insurance from other classes of insurance, Article 200 Solvency II Directive maintains the options provided for in the Legal Expenses Insurance Directive.

3.6 Treatment of insurance claims during winding-up proceedings

With the Insurance Reorganisation Directive from 2001, EU law required member states to choose one of two methods for ensuring that the claims of policyholders and beneficiaries arising out of insurance contracts are treated preferentially towards other

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339 Chapter 4 § 7 FRL 2010.
340 § 3 Lag (1993:1303) om vissa avtalsvillkor för rättsskyddsförsäkring.
341 Chapter 12 § 12 (4) FRL 2010. Characteristic for long-term health and accident insurance is that it has an insurance period of at least five years, or an undefined insurance period and that the insurer’s possibilities to cancel the insurance contract are limited.
creditors’ claims in a winding-up situation. Member States could ensure that such claims take preference either by

- granting absolute preference to insurance claims represented by assets covering technical provisions over all other claims (Article 10 (1) (a)), or by
- granting preference to insurance claims over all other claims with respect to all assets with possible exceptions for employee’s claims arising out of employment contracts, tax claims, claims by social security systems and claims on assets subject to rights in rem (Article 10 (1) (b)).

Both Sweden and Germany have chosen the first alternative. In Swedish law, the preference is laid down in § 4a Rights of Priority Act (Förmånsrättslag) in connection with corresponding provision in the FRL, since 1989 with respect of claims arising out of life insurance claims. Since 2006, preference is granted to claims arising out of all types of insurance.

- Treatment of insurance claims according to Solvency II

With Article 275, the Solvency II Directive has taken over the provisions on preference of insurance claims without changes. The current Swedish provisions are laid down in chapter 6 § 13 FRL and the corresponding German provisions can be found in § 315 VAG 2016.

3.7 Company law and insurance regulation

Apart from regulatory rules, both the German and Swedish insurance supervision acts include company law provisions as leges speciales for insurance undertakings. Until 2011, the Swedish Acts contained exhaustive sets of rules for mutual and insurance companies completely setting aside the rules in the ABL and the Cooperative Societies’ Act.

With the FRL 2010, Sweden introduced the same legislative technique already used by Germany since the adoption of the VAG 1901: Insofar as the Act does not contain special company law rules, the ABL applies for insurance companies limited by shares. With regard to mutuals, the Cooperative Societies’ Act applies only when provisions in chapter 12 FRL 2010 explicitly refer to them. A general reference to the Cooperative Societies’ Act was considered inadequate since the rules for mutuals had up to then been formed with the ABL as a model.443 Due to the cooperative character of insurance mutuals, however, with the 2011 reform, the Cooperative Societies’ Act was considered to be the appropriate legislation to form the background for the rules on mutuals, even if mutuals still are considered to be a special form of association.

For German insurance companies, the AktG is applicable for German insurance companies, and for mutuals, the VAG contains special rules with references to specific provisions in the AktG. For Societa Europaea, in both states, the respective acts on European Companies apply.

- Company law and Solvency II
Solvency II does not have any impact on the legislative technique applied for regulating company law applicable to insurance undertakings.

3.8 Financial requirements

Since the insurance business builds on trust in the capacity of the insurer to pay claims, a considerable part of insurance regulatory law is directly concerned with the financial stability of insurance undertakings and imposes financial requirements on insurers. Examples are requirements to set up certain reserves, limitations and restrictions with regard to the kind of assets that may cover these reserves, as well as solvency requirements.

3.8.1 Reserve and asset requirements

Insurance regulatory law requires insurers to hold technical reserves. The terms “reserves” and “provisions” are often used interchangeably in the context of insurance supervision law. The Solvency II Directive uses the term “technical provisions”, in conformity with the terminology used in the Insurance Accounts Directive from 1991.

Technical reserves are balance sheet positions on the liability side, referring to specific financial obligations that the insurer expects to have in the future connected with its insurance business, i.e. the obligation it expects to have towards the insured. The reserves are calculated according to actuarial standards and their size corresponds in principle to the size of the insurer’s obligations towards the insured. They need to be covered by assets, of course, (otherwise the balance sheet would not be in balance), and their purpose is to ensure that the insurance undertaking is able to settle insurance claims. Examples are reserves for claims that have been reported, but have not been settled yet, for instance because the insurer and the insured are disagreeing about whether the claim is covered, or because payment is not yet due for other reasons such as annuity payments. Also reserve for losses resulting from insured invents that have not yet been reported to

344 Cf. the British tax authority’s treatment of the terms as interchangeable in its General Insurance Manual: HM Revenue and Customs, General Insurance Manual, 16 August 2016. The German VAG uses the term Rückstellungen, whereas Swedish terminology knows the terms avsättningar, reserver and fonder. Whereas older Swedish insurance supervision law used the terms reserv and fond, in the 2010 FRL, the term avsättning is used, whereas the term fond is not used any more in this context.
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the insurer, but that have already occurred fall under this category (together “claims outstanding reserves”). In contrast to such claims or loss reserves, premium reserves are related to losses from events that have not yet occurred. They need to be made for existing insurance contracts for which the premiums to be collected during future insurance periods are estimated not to cover the estimated loss from future insured events. The size of reserves needs to be estimated by the insurer, using actuarial methods. One of the exceptions from this principle is the reserve that German insurers have to set up for terror claims, which needs to be filled each year with an amount calculated as a percentage of the surplus of premium income relating to terror insurance over costs, until the reserve amounts to fifteen times the earned premium income from terror insurance (§ 30 (2a) RechVersV). In life insurance, reserves need to be made for insurance payments to be collected in later years, for premium refunds, and bonus capital, for instance. Generally, the calculation for the amounts to be allocated to the technical reserves needs to be done for each single policy.

To put it simple: Reserves make sure that there are sufficient assets covering an insurer’s obligations towards the insured. However, this is not to say that the assets covering the reserves are earmarked for their specific purpose in the sense that they would be ring-fenced funds. This is usually not the case.

Already the Swedish 1948 FRL required life insurers to set up premium reserves, an equalization reserve (utjämningsfonden) and an emergency reserve (säkerhetsfonden). The 1982 FRL mentions even other reserves (ersättningsreserv, skadebehandlingsreserv, regleringsfonden, återbäringsfonden) and set up restrictions for life insurance undertakings in § 274 concerning the kind of assets allowed to cover the reserves. Permitted assets were among others Swedish state bonds, bonds issued by certain banks and securities backed by real estate. Company shares were not accepted to cover the reserves. For non-life insurance companies, there were apparently no similar requirements.

Also German law restricted investments to certain permitted asset classes, such as government bonds and fixed-rate bonds. Over the course of time, the catalogue of permitted assets was extended to encompass even other assets such as real estate, shares in listed companies, and, from 1987 on, other participations. In order to help insurance undertakings during the financial crisis after World War I to fulfil capital requirements, the differentiation between free and restricted assets was introduced. Restricted assets

346 Verordnung über die Rechnungslegung von Versicherungsunternehmen (Regulation on the Accounting of Insurance Undertakings).
347 Today, the "säkerhetsfond" must be regarded as an equalisation reserve.
348 Symreng, p. 1264.
351 Ruge, p. 33.
were those assets that cover the technical reserves, and only these had to consist of permitted asset classes. Free assets were those that were not required to cover the reserves. From the same period stems also the congruency principle, requiring insurers to match liabilities in foreign currencies with reserves covered by assets in the same currency. The rationale behind the congruency principle is, of course, to prevent that reserves become insufficient in case of currency devaluations.

Both Germany and Sweden also had quantitative restrictions for certain assets. Swedish law prescribed, for instance, in chapter 6 § 12 FRL 2010 that not more than 25% of the restricted assets were allowed to consist of shares issued by public corporations (with the exception of corporations that invest mainly in real estate). In both jurisdictions, limits were laid down for the investment into obligations of the same debtor in order to limit the impact in case of a debtor’s insolvency.

- Reserve and asset requirements according to Solvency II

The Solvency II Directive contains two important changes with regard to technical provisions: Articles 76 and 77 of the Solvency II Directive require insurers to use a combination of best estimate and a risk margin for the calculation of the technical provisions and to make use of market-consistent valuation methods.

Another very important change is that Solvency II does not know any asset restrictions, so that regulatory rules no longer exclude any kinds of assets from covering the technical provisions anymore. Instead, the “freedom of investment” principle applies. As a consequence, the restriction between free and restricted assets has been removed. Instead of quantitative restrictions, Article 132 (2) establishes the “prudent person principle”, requiring among other proper diversification in order to “avoid excessive reliance” on certain types of assets or debtors and the investment only in such assets,

“[…] whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs […]”.

This new investment freedom needs to be seen together with the norms on the own funds eligible for covering the solvency requirements, where the own funds are classified in three tiers according to certain criteria (see chapter 8.1.3).

3.8.2 Restrictions with regard to the distribution of dividends

A potential conflict inherent in the nature of insurance, is the question who should be entitled to the insurer’s profits: The shareholders or the policyholders?

352 Ibid, p. 33.
The Swedish 1948 FRL codified the equity principle (skälighetsprincipen) which caused Swedish life insurers to cease to distribute dividends.\textsuperscript{353} In the 1982 FRL, life insurers were explicitly forbidden to distribute dividends. According to Eckerberg, at that time, there was only one Swedish life insurance company incorporated as an insurance company (försäkringsaktiebolag).\textsuperscript{354} Since 1999, life insurance companies are allowed to distribute dividends, but only if this possibility is laid down in their articles of association.\textsuperscript{355}

Life insurance companies that are not allowed to distribute profit are also referred to as “hybrid life insurance companies” or “life insurance companies that are operated on a mutual basis”.

Non-life insurance companies were allowed to distribute dividends up to the net profit shown in the profit and loss statement of the last financial year. If the insurer was a parent company and had to set up consolidated accounts, the distributable result was also limited by the net result shown in the consolidated profit and loss statement (chapter 12 § 2 FRL 1982).

As it seems, German law has never known a general prohibition to distribute dividends. Instead, § 56a VAG 1901 (now § 139 VAG 2016) prescribed which portion of the profit may or need to be retained in favour of policyholders.

For life insurance products, a government ordinance required, somewhat simplified, that at least 90 % of the capital gains needed to be retained.\textsuperscript{356} If the management and supervisory board of an insurance undertaking wanted to allocate a larger amount to the policyholders as prescribed by the ordinance or in the insurance policy, they may do so as long as the remaining profit reaches at least 4 % of the subscribed capital. Following the much debated life insurance reform of 2014\textsuperscript{357}, the rules on profit allocation have been significantly changed in order to meet the challenges for the insurance industry resulting from the long period of low interest rates.\textsuperscript{358} The amounts retained in favour of the policyholders are shown as a technical reserve on the liability side of the balance sheet. The surplus remaining after such an allocation is available for a distribution to the shareholders, provided that they surpass the so-called “Sicherungsbedarf”, an amount required to meet the guarantees promised to policyholders (§ 139 (2) VAG 2016). In the current low-interest environment, for many life insurance companies, this has led to a factual prohibition to distribute dividends.\textsuperscript{359}

\begin{align*}
\textsuperscript{353} & \text{Eckerberg, FörsäkringsrörelseManualen 2014: en bruksanvisning till försäkringsrörelselagen, p. 95.} \\
\textsuperscript{354} & \text{Ibid, p. 67 f.} \\
\textsuperscript{355} & \text{See chapter 4.4.1.2 and 9.3.1.2 on this particular form of life insurance companies.} \\
\textsuperscript{356} & \text{§ 4 (3) Mindestzuführungsverordnung 2008 (replaced by Mindestzuführungsverordnung 2016).} \\
\textsuperscript{357} & \text{Gesetz zur Absicherung stabiler und fairer Leistungen für Lebensversicherte (Lebensversicherungsreformgesetz – LVRG) (Life Insurance Reform Act).} \\
\textsuperscript{358} & \text{Mindestzuführungsverordnung 2016.} \\
\textsuperscript{359} & \text{BaFin, 2014 Jahresbericht der Bundesanstalt für Finanzdienstleistungsaufsicht, p. 165. The listed life insurer Württembergische Lebensversicherung AG announced in an ad-hoc disclosure that it would not be able to distribute dividends in the coming years, Württembergische Lebensversicherung AG, Ad-hoc-Meldung nach § 15 WphHG: WürttLeben reagiert auf Lebensversicherungsreformgesetz (11 July 2014). The prohibition is not applicable to life insurance undertakings that have a profit transfer agreement with their parent undertaking.} 
\end{align*}
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- Distribution of dividends under Solvency II

The Solvency II Directive does not contain any provisions that explicitly limit the distribution of profits to shareholders.

3.8.3 Solvency requirements and their rationale

Solvency requirements are capital requirements for insurers which come on top of the requirement to have technical reserves. They are supposed to ensure that insurers have enough financial means to meet their obligations. In contrast to technical reserves, solvency requirements are not balance sheet or accounting positions, even if they are often calculated on the basis of the insurer’s accounts. Whereas technical reserves are calculated with regard to a specific sort of future obligations (e.g. to cover the claims arising from insured events that already have occurred), solvency requirements are based on an overall assessment of the risks, which includes the future potential losses covered by the reserves. Ideally, all the risks faced by an insurance undertaking are taken into consideration.

Solvency requirements were introduced in the European Community with the First Non-Life Insurance Directive in 1973 and the First Life Insurance Directive in 1979. Until their implementation into their respective national laws, neither Germany nor Sweden had any specific solvency requirements for insurers. Swedish law required insurance undertakings to hold “sufficient capital”. In 2002, the solvency margin requirements for life and non-life insurance undertakings were revised at EU level, without changing the calculation methods fundamentally.

The solvency rules established by the 2002 EU directives are commonly referred to as Solvency I. Initially, they were applicable only to non-life and life insurance undertakings. Solvency requirements for insurance groups were introduced in 1998 and for reinsurance companies in 2005.

Solvency I distinguished between two different levels: The higher level was called “solvency margin”, and the lower “guarantee fund”, amounting to the higher of one third of the solvency margin or a fixed amount depending on the insurance classes for which the undertaking is licensed. For non-life insurance, the minimum lied at 2 million EUR and for life insurance, at 3 million EUR. The minimum amounts were reviewed annually by the European Commission to take account of increases in the European index of consumer prices.

For non-life insurance, the solvency margin was calculated according to two specified formulas: One calculation was based on the premium income and the other on the claims paid and the reserves for outstanding claims. The higher calculation result represented the solvency margin. For life insurance, the

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361 Cf. Chapter 7 § 17 FRL 2010.

solvency margin was calculated on the basis of the technical reserves and the capital underwritten by the
life insurer. In both cases, the calculation did not take an insurance undertaking’s individual risk profile
into account, so that it was relatively simple (at least compared to Solvency II) and very standardized.\textsuperscript{363}

Somewhat simplified, in non-life insurance, the solvency margin corresponded to the higher of 16 to 18
% of the net premium income and 23 to 26 % of the net claims, whereby liability insurance was calculated
with a factor of 1.5.\textsuperscript{364} In traditional life insurance, the solvency margin corresponded to a percentage of
the technical reserves.\textsuperscript{365}

Contrary to what the term “margin” suggests, the solvency margin corresponded to a certain amount that
needed to be covered by “the assets of the insurance undertaking free of any foreseeable liabilities, less
any intangible items”\textsuperscript{366} (own funds). If the own funds did not exceed the solvency margin, the guarantee
fund or the minimum guaranteed fund, the supervisory authority was expected to demand that the
insurance undertaking set up a plan for the restoration of a sound financial position or a short-term
finance scheme for its approval.\textsuperscript{367} Failure to apply the plan could result in the withdrawal of the
authorization to conduct insurance business.

The directives contained non-exhaustive lists with the main categories of own funds. They had in
common that own funds must be able to absorb losses. Own funds included and went beyond the equity
shown on the balance sheet.\textsuperscript{368} Loans were recognized as own funds, if they were subordinated and had
a fixed maturity of at least five years. Loans without a fixed duration were only recognized if they were
repayable only with at least five years notice or if repayment was subject to the supervisory authority’s
consent. Gruschinske distinguishes between explicit own funds, which are shown on the balance sheet,
and implicit own funds, which may consist of the difference between undervalued assets and their market
value or of future profits.\textsuperscript{369}

The Reinsurance Directive from 2005 introduced the Solvency I requirements also for reinsurance
undertakings. Until then, the member states had diverging, usually lower, capital requirements for
reinsurance undertakings.\textsuperscript{370}

One may wonder why it was considered necessary to introduce solvency capital
requirements when insurance undertakings were already obliged to have technical
reserves, which – if calculated correctly – are supposed to be sufficient to enable the
insurance undertaking to meet its obligations towards the insured. The literature I have
analysed on this question usually contents itself with a description of the rules on the
solvency margin and their objectives, however, without illuminating the relation to the
technical reserves.\textsuperscript{371} The recitals to the First Non-Life Insurance Directive stated that

\textit{“[...]} it is necessary that insurance undertakings should possess, over and
above technical reserves of sufficient amount to meet their underwriting

\textsuperscript{363} See Farny, pp. 788-790, for details on the calculation method.
\textsuperscript{364} Ibid, p. 785.
\textsuperscript{365} SOU 2003:14, Principer för ett moderniserat solvenssystem för försäkringsbolag, p. 23.
\textsuperscript{366} Article 18 First Life Insurance Directive as amended by Article 1 (2) Directive 2012/12/EC, Article 16 First
\textsuperscript{367} Article 20 (2) and (3) First Non-Life Insurance Directive, Article 24 (2) and (3) First Life Insurance Directive.
\textsuperscript{368} Jennies, p. 80; Günther Gruschinske, Kontrolle der Eigenmittelausstattung, in: Helmut Müller et al. (eds), 100
\textsuperscript{369} Gruschinske, p. 273.
\textsuperscript{370} Jennies, p. 75.
\textsuperscript{371} Falkman, Försäkringsrörelse, pp. 172-174; Farny, pp. 777-805; Jennies, pp. 73-111; Gruschinske, pp. 271-281.
liabilities, a supplementary reserve, to be known as solvency margin, and represented by free assets, in order to provide against business fluctuations [...].”

Insurers in member states where an equalization reserve was obligatory, such as Sweden (säkerhetsreserv) and Germany (Schwankungsrückstellung), already had technical reserves at least for the fluctuations of the loss rates, but obviously, this was not considered sufficient – otherwise, the European legislator could simply have made equalization reserves obligatory in all member states. Another problem was that the methods for calculating the technical reserves were not harmonized.

In a press release from 1973, the Commission described the required solvency margin as “a supplementary reserve, [...] constituted of explicit items in the balance sheet and implicit items offering equivalent security” and expressed the expectation that the financial position of policyholders would be improved.372 An earlier press release from 1966 contains a hint that the solvency margin was intended to be covered by capital at the disposal of the insurer if the technical reserves proved to be insufficient.373 Consistent with this, the solvency margin is often described as a “buffer” against actuarial and market risks.374 In a report by a committee assigned by the Swedish government to analyse the need for a review of the asset restriction for covering the technical reserves, this buffer function is illustrated, which is most obvious in life insurance: Since the solvency margin amounted to a certain percentage of the technical reserves, its size was directly dependent on the size of and the calculation methods used for the technical reserves.375 If the technical reserves were calculated in a “realistic” way without a security margin, the solvency margin diminished and the own funds increased.376 The increase in own funds can be explained with the increase in equity as a result of the decrease in the reserves.

The need for a buffer can be explained with various reasons. In the calculation of the technical reserves, only actuarial risks were - and still are - taken into account. Future developments might show that the basis for these actuarial calculations has been incorrect, for instance because the frequency of natural disasters has increased or the mortality rate has changed. Furthermore, the reserves are covered with assets at their current value, so that the asset risk, i.e. the risk that the value of the assets will decrease in the future and therefore more assets will be needed to cover the technical reserves, is not taken into consideration. Also other risks lie outside the scope of technical reserves,

373 Official Spokesman of the Commiss, Information Memo - EEC Commission proposes directive on freedom of establishment in the field of insurance (other than life assurance) (1966).
376 Ibid., p. 25.
for instance pension liability risks or financial obligations that are not connected with the insurance business.

Consequently, there are risks not taken into consideration in the calculation of the technical reserves, which justify additional solvency capital requirements. An explanation given by de Weert is that technical reserves are calculated in such a way that they cover expected losses, whereas solvency requirements are supposed to provide a capital buffer against unexpected losses.\(^{377}\)

It was criticized that the solvency level required by Solvency I was the result of a political compromise rather than based on science.\(^{378}\) However, my impression is that this criticism was only partly valid. The problem with Solvency I was that the legislator failed to define the level of protection that Solvency I is supposed to give, i.e. was the solvency margin supposed to be a buffer to prevent insolvency in any case or was it just meant to give a little extra protection? Even though the number of insurance bankruptcies in the EU has been very small during the last decades\(^ {379}\), one cannot presume that Solvency I safeguarded the financial stability of insurance undertakings.\(^ {380}\) Without a defined level of protection, it is impossible to say whether the calculation method prescribed by Solvency I was adequate.

What is certainly true, is that the calculation mechanism was very schematized rather than based on risk-theoretical methods. This had the effect that existing risks were not correctly reflected in the solvency margin.\(^ {381}\) The following example can illustrate this: Two non-life insurers A and B had car insurance portfolios that were identical to each other with the only exception that insurer A collected higher premiums than insurer B. Under the assumption that for both insurers, the required solvency margin based on the premium index was higher than the one based on the loss index, insurer A’s required solvency margin was higher than B’s, with the consequence that A needed more own funds to cover its solvency margin than B, even though it received higher premiums for the same kind of portfolio than insurer B. Equally, the solvency margin did not reflect whether the premiums were invested in high-risk assets or assets with a very low market or credit risk and therefore only reflected the liability side of the balance sheet, i.e. it only reflected insurance risks but not other risks such as market risk.\(^ {382}\)

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377 de Weert, p. 37.
378 Farny, p. 796. Hennies points out that not even actuaries agreed upon an adequate solvency level, Hennies, p. 90.
379 For Germany, this is partly due to the fact that imminent bankruptcies in Germany usually were prevented in such a way that either another insurance company stepped in and took over the insurance portfolio, or that a newly established insurance company funded by the insurance industry took over the portfolio of a failed insurer (for example Protektor Lebensversicherungs-AG in the case of Mannheimer Lebensversicherung AG). In Sweden, the latest case of the near-bankruptcy of the life insurance company Aspis Liv Försäkring AB lead to the liquidation of the company at Finansinspektionen’s order.
380 Detlef Kaulbach et al. (eds), Versicherungsaufsichtsgesetz - VAG, (5th edn 2012), § 53c, para. 1.
381 See Farny, pp. 794 – 798, for a more detailed description of the weaknesses of the Solvency I system.
382 de Weert, p. 93.
A fundamental overhaul of the solvency requirements is one of the major changes that have come with Solvency II. The new requirements are described in chapter 8.

3.9 Group-related aspects of insurance supervision

For a long time, the fact that insurance undertakings often are members of corporate groups had not been reflected at all in insurance regulatory law. Prior to the Insurance Groups Directive from 1998\footnote{Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group.}, only very few group-related aspects met the legislator’s attention.

3.9.1 Shareholder control

During the larger part of the 20th century, after an insurance undertaking had been licensed, shares in German and Swedish insurance companies could be freely transferred without new shareholders being subjected to regulatory approval.

Similar to corresponding provisions in the ABL at the time, the Swedish 1982 FRL required the founders of an insurance company to be Swedish citizens and resident in Sweden (chapter 2 § 1), but did not demand that future shareholders had to be Swedish. Swedish insurance undertakings were, however, allowed to restrict transfers of shares to Swedish acquirers in their articles of association (chapter 18 § 1). In 1991, the citizenship requirement was abolished, but the founders of an insurance company still had to be either natural persons domiciled in Sweden or Swedish legal persons.\footnote{Lag (1990:1296) om ändring i försäkringsrörelslagen (1982:713).} After Sweden’s accession to the EEA, also natural persons domiciled in the EEA and legal persons from other EEA countries were allowed to become founders of insurance companies in Sweden.\footnote{Lag (1992:1241) om ändring i försäkringsrörelslagen (1982:713).}

German post World War II insurance regulatory law did not restrict participations by foreign shareholdings – with respect to shareholders from other EC member states, such restrictions would have violated the freedom of capital – and did not know any form of shareholder control, so that this concept was new, when it was introduced with the third EU insurance directives from 1992.

It requires persons who “propose” to acquire a shareholding amounting to or exceeding the thresholds of 20, 30 or 50 % in the voting rights or capital of an insurance undertaking to notify the insurer’s supervisory authority.\footnote{Article 15 Third Non-Life Insurance Directive as amended by Article 1 (2) (a) of Directive 2007/44/EC ("Notification Directive"). Article 15 Life-Insurance Directive (Recast) as amended by Article 2 (2) (a) of Directive 2007/44/EC. Instead of the 30 %-threshold, member states may apply a threshold of one third.} Within a time period of three
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months, the authority may oppose the proposed acquisition within 60 working days if it is “not satisfied as to the qualification of the person” (Article 15 (1) (2) Third Non-Life Insurance Directive) to be able to ensure a sound and prudent management of the insurance undertaking. A corresponding obligation to notify the supervisor exists for a shareholder who wants to reduce its shareholding below the thresholds. The obligation applies both to direct and indirect shareholders. In 2007, the rules were slightly amended\textsuperscript{387} and it was specified according to which criteria the assessment of the proposed acquirer was to be conducted.\textsuperscript{388}

In the assessment, the reputation of the proposed acquirer and of the person who will direct the insurance business and the financial soundness of the proposed acquirer shall be taken into consideration. Other criteria are whether the insurance undertaking can be expected to fulfil the solvency requirements and other regulatory requirements after the acquisition, whether the group of which it will become part has a structure that makes it possible to exercise effective supervision, and whether the proposed acquisition may be a means for money laundering or terrorist financing. Other criteria may not be invoked to justify the prohibition of a proposed acquisition.

In the past, it seems as if not all member states always have fully complied with this. A press report purports that the Polish insurance supervisory authority made the acquisition of Polish insurer Warta by the German insurance holding Talanx AG conditional upon Talanx’ agreeing to list its shares on the Warsaw stock exchange.\textsuperscript{389} If the press report is correct, this would constitute a clear breach of Article 15b (2) Third Non-Life Insurance Directive as amended by the Notification Directive.

With the introduction of the requirement of shareholder notification, supervision was extended – albeit in the very limited form of an entry control – to the shareholders of an insurance undertaking. This could be regarded as the first modest step towards a comprehensive regulation of insurance groups.

National supervisory authorities also had to be given the power to take any measures against the controlling shareholder of an insurance undertaking that are necessary to ensure that the undertaking continues to comply with the law.\textsuperscript{390}

\textsuperscript{387} Instead of the term “propose”, the notification obligation now arises when a person “has taken a decision to acquire” a qualifying shareholding. This may be a reaction to the diverging supervisory practice on the point in time when the notification arises. According to some supervisory authorities, it was sufficient to file the notification shortly after a share purchase agreement was signed – provided that the contract contains the usual condition that transfer of shares only occurs if the competent supervisory authority did not raise objections in due time. BaFin, on the other hand, requires acquirers to submit a notification already when the competent company organs had decided that they intend to acquire a shareholding, i.e. before signing of a share purchase contract. Whether the wording in the Solvency II Directive will be interpreted uniformly, remains to be seen.


\textsuperscript{389} Reuters, Polish watchdog agrees to Talanx' Polish buy, (8 May 2012).

\textsuperscript{390} Article 11 (3) (b) Third Non-Life Insurance Directive.
In the Third Directives, the existence of “close links” between an insurance undertaking and other legal or natural persons was introduced as an aspect to be taken into consideration during the authorisation process.

- Shareholder control according to Solvency II

Article 57 (1) Solvency II Directive upholds the notification requirements established in the third insurance directives as amended by the Notification Directive.

3.9.2 Supervision of parent companies and insurance groups in Sweden before 2000

The Swedish expert committee entrusted with preparing a proposal for a new FRL to replace the 1917 Act, noted in its report with the proposal for the 1948 Act that insurance undertakings often belonged to insurance groups. The committee considered it as inadequate if life and non-life insurance business were conducted within the same company. If a life insurer conducted non-life insurance through a subsidiary (or vice versa), the committee regarded it as a possibility of circumvention of the separation principle. Apart from that, the committee did not have any objections against the formation of insurance groups. Consequently, the 1948 Act did not contain any particular rules concerning the parent undertakings of insurance companies or the formation of insurance groups.

Already the 1948 FRL required insurance companies that are parent companies to take up consolidated group accounts. The 1982 Act specified further that the results of the so-called life insurance group (i.e. all life insurance companies and such subsidiaries that are not insurance companies) and the non-life insurance group (i.e. all remaining companies) had to be shown separately in the profit and loss statement. Dividends to be distributed by the parent company where not allowed to exceed the net profit shown in the unconsolidated and the consolidated profit and loss statement of the previous year. Apart from that, there were no particular supervisory requirements for parent undertakings.

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391 SOU 1946:34, p. 11, where not less than 17 business combinations (sammanslutningar) involving Swedish insurance companies were identified. However, some of these merely consisted of cooperation agreements between insurance undertakings.
392 SOU 1946:34, p. 298.
394 Chapter 12 § 2 FRL 1982.
3.9.3 Solo-plus supervision according to the Solvency I regime

In 1998, a further step towards group supervision was taken, with the EU adopting the Insurance Groups Directive. Both Sweden and Germany implemented the directive in 2000. The supervisory system established by the Solvency I regime was also called “solo-plus supervision” because insurance undertakings belonging to an insurance group were subject to both the “ordinary” supervision at solo level and to an additional supervision taking into account the group structure.

Depending on the kind of relationship between the insurance undertaking and other relevant undertakings, the scope of supplementary supervision varied. The most extensive scope applied to insurance undertakings that were participating undertakings, i.e. held at least 20% of the capital or voting rights in at least one other insurance undertaking or reinsurance undertaking with its registered office in- or outside the European Union. These insurance undertakings needed to report intra-group transactions and had to comply with an additional solvency requirement, the so-called adjusted solvency requirement.

The second kind of relationship concerned the situation where an insurance undertaking was a subsidiary of an insurance holding company or an insurance undertaking with its registered office outside the EU. Since 2011, also subsidiaries of mixed-insurance financial holding companies fell into this group. The scope of supplementary supervision over such an insurance undertaking encompassed intra-group transactions and the calculation of a group solvency requirement that needed to be done in analogy to the calculation of the adjusted solvency requirement.

Insurance undertakings that were subsidiaries of a mixed-activity insurance holding company, i.e. a company that is not an insurance or reinsurance undertaking and whose main purpose is not the holding of participations in insurance or reinsurance undertakings, were subject only to the supervision of intra-group transactions.

According to Article 4, the supervisory authority in charge of the supplementary supervision was the authority in the member state that has issued the license. If insurance undertakings were licensed in two or more member states and were subsidiaries of the same insurance holding, the authorities of the member states concerned could agree upon

395 For an account of the development of EU law on the supplementary supervision of insurance groups with a focus on the supervisory process, see Angelo Borselli, Keeping watch on giants: The supervision of insurance group and of insurance undertakings within financial conglomerates in European law, European Insurance Law Review (2012), pp. 26-47.
397 The definitions of “participating undertaking”, “subsidiary”, “insurance undertaking”, “insurance holding company”, “mixed-activity insurance holding company” and “mixed financial holding company” are to a large extent identical to those applied by the Solvency II Directive. Reference is therefore made to the analysis of these terms in chapter 7.4.1 on the definition of insurance groups.
which of them was responsible for the supplementary supervision. If several insurance undertakings belonging to the same insurance group would have to calculate the adjusted solvency requirement, member states were entitled to waive the obligation provided that the insurance undertaking was included in the calculation of another undertaking.

3.9.4 The adjusted solvency requirement

The adjusted solvency requirement was a form of group solvency requirement taking into account related insurance undertakings, participating insurance undertakings and related insurance undertakings of a participating insurance undertaking. Insurance holdings were treated like insurance undertakings, with a solvency requirement of zero. The calculation principles were laid down in Annex 1 of the Insurance Group Directive and gave member states the possibility to prescribe one of three possible calculation methods: The deduction and aggregation method, the requirement deduction method or the accounting consolidation based method. For Swedish insurance undertakings, chapter 7 § 5 FRL 1982 prescribed the deduction and aggregation method as the main method. The accounting consolidation based method was allowed to be used if there were good reasons. German law applied the accounting consolidation based method as the main method, but also allowed for the deduction and aggregation based method.

The calculation of the adjusted solvency situation of an insurance undertaking according to the deduction and aggregation method required the calculation steps shown in Figure 3.9.4 no. 1. If the result of the calculation exercise was zero or above zero, the insurance undertaking was in compliance with the adjusted solvency margin.

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Adjusted solvency situation: deduction and aggregation method

- Own funds of the participating undertaking
- Proportional share in the own funds of the related insurance undertaking
- Book value of the related insurance undertaking
- Solvency requirement of the of the participating undertaking
- Proportional share of the solvency requirement of the related insurance undertaking

Figure 3.9.4 no. 1

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399 See also the identical provision in chapter 9 § 5 FRL 2010.
400 § 1 Solvabilitätsbereinigungsverordnung, 20 December 2001, BGBl. I p. 4173, repealed as of 1 January 2016.
The accounting consolidation-based method required the calculation of the adjusted solvency situation on the basis of the consolidated accounts. Compared to Solvency II, the calculation was rather simple, as can be seen from the fact that the standard form to be filled in by German insurance undertakings only comprised five pages.

The most important principle for the calculation of the own funds eligible to cover the adjusted solvency requirement, regardless of the calculation method, was that own funds were not allowed to be counted twice (“double or multiple gearing”). The adjusted solvency margin therefore forced groups that applied double gearing to hold additional own funds. 401

The directive contained only a scarce motivation why the European legislator considered it necessary to prescribe the calculation of an adjusted solvency requirement. Recital 9 stated that the solvency of an insurance undertaking belonging to a group “[…] may be affected by the financial resources of the group of which it is a part and by the distribution of financial resources within that group […]” and recital 5 referred to a general objective to protect the interests of the insured. Recital 8 noted that some member states already used different methods to take into account that an insurer was part of a group, so that a perceived need for harmonization was another driver. However, the directive was criticized for giving member states the option to choose between three methods that did not lead to the same results. 402 This would not promote a fair competition between European insurance companies nor would it lead to a consistent level of consumer protection. 403 Apart from that, the same arguments that were brought forward against the calculation according to Solvency I at solo level could be brought forward against the adjusted solvency requirement, i.e. it was too schematized and only considered insurance risks, but not other risks. Furthermore, it did not take into account diversification effects.

The Insurance Group Directive required insurance undertakings that were part of an insurance group to annually report intra-group transactions to the supervisory authority. Intra-group transactions are transactions between the insurer and related undertakings, i.e. its subsidiaries and participations, its participating undertakings and related undertakings of participating undertakings. Also transactions with natural persons holding a participation in any of these companies had to be reported. If the supervisor on the basis of this information had the impression that the solvency of the insurer was jeopardized, it was supposed to take appropriate measures at the level of the insurance undertaking.

It is important to note that supplementary supervision was restricted to insurance undertakings and did not stretch to insurance holdings, mixed-activity insurance holding

401 Farny, p. 799.
403 Hennies, p. 128.
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companies, reinsurance companies or insurance companies outside the European Union. Neither did it apply to insurance undertakings that were subsidiaries of credit institutions, i.e. it only applied to homogenous insurance groups.

- **Group solvency requirements according to Solvency II**

The adjusted solvency requirement has been replaced by the group solvency requirement (group SCR) under Solvency II. The group SCR is described in chapter 8.2.

### 3.9.5 Financial conglomerates

Since the 1990s, the banking and the insurance industry have grown closer. The distinction between banking and insurance products has become less sharp. Life insurance products with their predominant savings component and savings and investment products offered by banks stand in close competition to each other, even more so with the entry of unit-linked life insurance products, i.e. life insurance policies without any guaranteed interest where the value upon the policy’s expiry depends on the development of the investment funds into which the premiums have been invested. In principle, all larger Swedish banks have entered the insurance market by founding or acquiring life insurance subsidiaries. In other cases, apparently more common in Germany, banks and insurance companies cooperate with each other, selling the cooperation partner’s products to their respective customers as each other’s intermediaries through their respective distribution networks (so called “bankassurance”). In some cases, insurance companies entered the banking sector. Examples for the latter are Skandia that founded Skandiabanken in 1994, and German insurer Allianz’ acquisition of Dresdner Bank in 2001 (one of the largest German banks until 2009, when Allianz in the aftermath of the financial crisis sold it to Commerzbank which merged Dresdner Bank into Commerzbank). The main goals behind this phenomenon which is called *branschglidning* in Swedish, are the realization of efficiencies and diversification effects to reduce the volatility of cash flows.  

As a reaction to this development, the EU adopted in 2002 the Financial Conglomerates Directive. The directive requires member states to apply supplementary supervision (similar to supplementary supervision on insurance groups) to groups with significant cross-sectoral activities, i.e. groups that are active in more than one area of the financial sector, i.e. insurance and banking or investment services. Financial institutions subject to supplementary supervision according to the Financial Conglomerates Directives need to fulfil a capital adequacy requirement, similar to the

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adjusted solvency requirement, and have to report intra-group transactions to the competent supervisory authority. In contrast to the Insurance Groups Directive, the Financial Conglomerates Directive requires regulated entities to report significant risk concentrations to their supervisor and contains rules on internal control mechanisms and risk management processes.

The Financial Conglomerates Directive also introduced fit-and-proper-requirements for managers of insurance holding companies as a first step towards supervision of this kind of companies.

It is important to note that supervision over financial conglomerates does not replace sectoral supervision, but constitutes an additional layer of supervision. If a financial conglomerate, for instance, comprises both a banking sub-group and an insurance sub-group, the sectoral rules on bank regulation apply to the banking sub-group and the insurance regulation apply to the insurance sub-group.

Some amendments to the Directive were made in 2011 and 2013: More companies are subject to supervision at conglomerate level such as mixed financial holding companies; one supervisory authority is appointed coordinator for the exercise of supplementary supervision; and the European Supervisory Authorities are given competence to issue guidelines and recommendations on the supervision of financial conglomerates.
4 Overview of the company law framework

The insurance groups falling under the Solvency II rules on group supervision consist of undertakings that have been formed and are organized in compliance with the applicable national company law rules. The purpose of this chapter is to provide an understanding of some of the main differences between German and Swedish company law (limited to the rules applicable to mutuals, German stock corporations and Swedish limited companies) and of the concept of limited liability, its economic rationale and the exceptions to it in both jurisdictions.

4.1 Some major differences between German and Swedish company law

In the following, an overview of the major differences between German and Swedish company law will be given, namely on the rules concerning groups, board structures, the division of competences between company organs and the company interest with which all board actions must be in compliance.

4.1.1 Group law

Germany is one of few jurisdictions with a special “Konzernrecht”, i.e. a specific body of law on the relations between parent companies and subsidiaries. The rules for groups are laid down in §§ 291 – 338 AktG. German law distinguishes between two forms of groups: groups based on contract (Vertragskonzern) and de facto groups (faktischer Konzern). The most important form of contract is the domination and profit transfer agreement (Beherrschungs- und Ergebnisabführungsvertrag), which will be dealt with in detail in chapter 4.4.1.2. A de facto group relationship exists in the absence of such contract and is based on the controlling interest of the parent undertaking in the subsidiary, which is presumed to exist in the case of a majority shareholding (§ 17 (2) AkG). The legal relationship between parent companies and subsidiaries depends on whether they form a contractual or a de facto group. In both cases, the group company law provisions set aside the capital maintenance rules when the legitimacy of asset transfers between group companies is assessed.

Sweden belongs to those jurisdictions that do not have a special group law. Only a few provisions in the ABL (and other laws) relate to a group affiliation, particularly a

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406 The German scholar Hopt names Sweden as an example of a jurisdiction without special group rules: “This is the case in Sweden, for example, where no need seems to be felt to deal with group agency problems in more detail.”
group definition in chapter 1 § 11 ABL and the exceptions from the prohibition to grant loans to a shareholder in chapter 21 ABL. Asset transfers between group companies are subject to the general capital maintenance rules, so that these play an important role in the in the legal assessment of asset transfers.

4.1.2 Board structures

In company law, it is distinguished between so-called one tier (monistic) and two tier (dualistic) board systems. In a monistic board system, a company has two main organs\footnote{Other functions that may have the status of a company organ according to national law, but that are not involved in the decision-making process of a company, are disregarded here. In Swedish law, this concerns the external auditor.}: the general meeting and a board of directors. A dualistic system has three company organs: the general meeting, a supervisory board and a management board.

4.1.2.1 German law

Germany applies a dualistic board structure with a management board (\textit{Vorstand}) and a supervisory board (\textit{Aufsichtsrat}). Only natural persons can be appointed as members. The management board of an insurance undertaking consists of at least two members (§§ 188 (1), 33 (1) VAG 2016) who are appointed by the supervisory board (§ 84 (1) AktG, 188 (1) VAG 2016). This applies to both mutuals and insurance companies.

The articles of association of an insurance company may give certain shareholders or holders of certain shares the right to appoint up to one third of the shareholder representatives among the supervisory board members (§ 101 (2) AktG). The practical relevance of this possibility in the German insurance industry seems to be very small. For insurance mutuals, this possibility does not exist.

The supervisory board consists of at least three members. Any higher number must be a multiple of three. For mutuals, § 189 (1) sentence 2 VAG 2016 states a maximum of 21 members. The supervisory board members are elected with simple majority by the general meeting, with the exception of eventual employee representatives who are elected by the employees.

As already mentioned above, with regard to German subsidiaries, the situation may arise that even a sole shareholder may elect only half of the supervisory board members, namely if the subsidiary (together with its respective subsidiaries) has more than 2000 employees. In that case, the employees have the right to elect 50 \% of the supervisory board members. It is not very common that subsidiaries reach this size, but there are examples of large groups with subsidiaries that fall under this provision, for instance Axa Konzern AG (being an insurance holding bundling the German insurance activities of the French Axa Group) or Hannover Rückversicherung S.E. (a listed subsidiary of Talanx AG and HDI Haftplichtverband der Deutschen Industrie V.a.G.). More subsidiaries will, however, fall under the One-
OVERVIEW OF THE COMPANY LAW FRAMEWORK

Third-Participation Act (Drittelbeteiligungsgesetz), according to which employees in companies with more than 500 employees have the right to elect one third of the supervisory representatives, or will fall below the 500-employee-threshold and therefore do not have any employee representatives at all. The articles of association may provide that the chairman has the casting vote in the event of a tie.\textsuperscript{408}

The members of the management board are the legal representatives of the company (§ 78 (1) AktG) and are responsible for the management of the company (§ 76 (1) AktG). The supervisory board’s main task is to supervise the work of the management board (§ 111 AktG). Accordingly, members of the supervisory board may not be members of the management board at the same time (§ 105 (1) AktG). The supervisory board convenes at least four times a year, unless it has decided to meet only once per half calendar year. This option is only permissible for companies that are not listed on a regulated market (§ 110 (3) AktG).

4.1.2.2 Swedish law

Sweden applies a modified monistic board structure with two company organs that are in charge of the management of the company: the board of directors (styrelse) that in turn appoints the CEO (verkställande direktör).

A CEO is obligatory in public limited companies (publika aktiebolag, chapter 8 § 50 ABL), försäkringsaktiebolag (chapter 11 § 9 FRL 2016) and ömsesidiga försäkringsbolag (chapter 12 § 27 FRL 2016). The CEO of an insurance undertaking may be a director, but not chairman of the board of directors. In most of the large Swedish insurance undertakings, the CEO is not a director in the same company.\textsuperscript{409} The CEO is responsible of the day-to-day management of the company (chapter 8 § 29 ABL) and represents the company towards third parties in these matters. The board of directors is responsible for the company’s organisation, strategic planning and internal controls (chapter 8 § ABL). In contrast to the supervisory board of a German company, the board of directors is authorized by law to represent the company towards third parties (chapter 8 § 35 ABL, chapter 6 § 11 EFL). It corresponds with the wider responsibilities of the boards of directors that they often convene more frequently than German supervisory boards. According to Sandström, large listed companies often hold about nine meetings per year, whereas the boards of directors of smaller companies may convene less often.\textsuperscript{410} Many of the large Swedish insurance undertakings reported ten meetings during the year 2015.

\textsuperscript{408} Jens Koch, Hüffer/Koch, Aktiengesetz (13th edn 2018), § 108 para. 8 with further references.
\textsuperscript{409} This conclusion is based on the information on the board of directors and CEO of the annual reports 2015 of the Swedish insurance companies If Skadeförsäkring AB, If Livförsäkring AB, Skandia livförsäkring AB and Länsfosäkrings AB and Länsförsäkringar Östgöta, and on the information available on the websites of Folksam Skadeförsäkring AB and Folksam Livförsäkring AB.
\textsuperscript{410} Torsten Sandström, Svensk aktiebolagsrätt (6th edn 2017), p. 219 footnote 5.
The general meeting has the right to elect the directors (chapter 8 § 8 ABL). The candidates who receive most votes are elected (chapter 7 § 41 ABL). In companies with an average of at least 25 employees during a financial year – calculated on a group-wide basis –, the employees have the right to elect two employee representatives.\textsuperscript{411} If the average number of employees reaches at least 1,000 employees, the number rises to three employee representatives. The number of employee representatives may not exceed the number of directors elected by others. Consequently, the articles of association can be drafted in such a way to ensure that the general meeting has the right to elect the majority of the directors. In the articles of association, the right to appoint directors may be granted to others, for instance to interest groups.\textsuperscript{412}

Limits to the shareholders’ right to elect the directors exist also with regard to life insurance undertakings that are operated on a mutual basis. According to chapter 11 § 7 FRL 2016, at least one shareholder representative must be elected by the policyholders or by an interest organization representing the policyholders. This shareholder representative may neither be employed by or hold shares in the company or a company belonging to the same group. For both hybrid life insurance companies and insurance mutuals, the employment prohibition also applies to more than half of the members of the board of directors, i.e. even to some of those representatives elected with the votes of the general meeting. According to the preparatory works, the restriction refers to half of the members of the board of directors including the employee representatives.\textsuperscript{413}

In contrast to German law, where the employee representatives are members of the supervisory board, 8 chapter § 2 ABL merely states that employee representatives shall be treated equally with members of the board of directors, unless otherwise stated. Swedish law thus distinguishes between members of the board of directors and employee representatives. Also § 11 Board Representation Act states that rules in other acts on the qualifications of members of the board of directors also shall apply to employee representatives, unless otherwise stated. The fit and proper requirements in the Solvency II legislation thus also apply to employee representatives.

The CEO appoints the members of the management group (ledningsgrupp), for example the Chief Financial Officer, Compliance Officer, Chief Risk Officer, Head of Sales, or Head of Communication. The management group, sometimes even called “koncernledning” (group management), is not a company organ provided for in the ABL and is not given any particular rights and functions in the ABL. The responsibility for the day-to-day management remains with the CEO, however, and decisions by the management group cannot override the dissenting opinion of the CEO.

\textsuperscript{411} § 4 Lag (1987:1245) om styrelserrepresentation för de privatanställda (Board Representation Act).
\textsuperscript{412} Cf. Chapter 8 § 8 ABL.
\textsuperscript{413} Prop. 2003/4:109, Förstärkt skydd för försäkringstagare i ivförsäkringsbolag, p. 34 f.
4.1.3 On the division of competences of company organs

In a company with several company organs, there is a need to allocate (exclusive or overlapping) competences to the company organs and to determine their relationship to each other.

4.1.3.1 German law

The relationship between the three company organs of a German Aktiengesellschaft, i.e. management board, supervisory board and general meeting, is characterized by a balance of powers, giving each organ exclusive competences with which the other organs may not interfere. The general meeting does not have competence to decide on management matters unless it has been explicitly asked to do so by the management board (§ 119 (2) AktG). If the general meeting decides upon a management matter without having been asked, the decision is invalid according to § 241 no. 3 AktG and the management board may be liable if it executes the resolution and thereby causes damage to the company.

This is an important difference to GmbH (private limited liability companies), where the general meeting has competence to take decisions on any issue that affects the company. Insurance undertakings, however, may not be organised as a GmbH.

Valid resolutions by the general meeting must be executed by the management board, for instance resolutions on the distribution of profits or on the changes of the articles of associations which need to be notified to the company register by the management board. A resolution may be invalid (nichtig) or may be contested (angefochten) and annulled by a competent court. The reasons for invalidity are exhaustively listed in § 241 AktG and include infringements of certain formal requirements, an unethical (sittenwidrig) content of the resolution and violation of provisions in the interest of the creditors of the company or the public interest.

The management board’s exclusive competence for the management of the company also hinders the supervisory board from giving binding instructions on management issues to the management board. The supervisory board may, however, adopt a list of management actions that require the supervisory board’s consent. Thus, the supervisory board has a veto right for these issues as part of its duty to control the management board, but it does no have the right to instruct the management board to take a particular action.

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414 The same applies to insurance mutuals by way of reference to the relevant provisions in the AktG in §§ 188, 189, 191 VAG
416 Hüffer/Koch AktG, § 241 para. 17 with further references.
417 Ibid., § 76 para. 25 with further references.
Such a list may, for instance, require the consent of the supervisory board for taking up loans, capital increases, acquisition or sale of subsidiaries exceeding a certain purchase price, or for opening branches.

4.1.3.2 Swedish law

In contrast to their German counterparts, Swedish companies are characterised by a clear hierarchy between the company organs. The general meeting is the highest organ. The general meeting is the highest organ. To its non-delegable competences belong the right to change the articles of association, to resolve on the profit distribution, to grant discharge to the board of directors and to elect the external auditor, who is a company organ according to Swedish company law.

In Swedish corporations, the general meeting may give binding instructions to the board of directors through majority decision on basically all issues. This right is limited by chapter 8 § 41 section 2 ABL, according to which instructions may not conflict with the ABL, the Annual Accounts Act or the articles of association. The preparatory works to the 2011 FRL imply that the legislator considers the general meeting also to be bound by regulatory law.

The general provision (generalklausulen) in chapter 7 § 47 ABL further states that a resolution may not give a shareholder or a third person an inappropriate advantage to the detriment of the company or another shareholder. For insurance companies, chapter 5 § FRL extends the general provision to the effect that the advantage may not be connected with a disadvantage for a policyholder or other persons who have a right to a share in the accumulated profit in the insurance subsidiary. However, according to the preparatory works, this provision is only relevant for life insurance undertakings that are operated on a mutual basis. For insurance mutuals, the general provision in chapter 7 § 37 EFL has been extended accordingly in chapter 12 § 29 FRL. The general provision also applies to decisions by the board of directors and the CEO (chapter 6 § 13 EFL and chapter 12 § 29 FRL for insurance mutuals; chapter 8 § 41 ABL and chapter 11 § 38 FRL for hybrid insurance undertakings).

The ABL does not contain any precise division of competences between the board of directors and the CEO. The board’s task is therefore to adopt by-laws on the division of competences (chapter 8 § 46a ABL, chapter 11 § 7a FRL). The board of directors is entitled to give binding instructions to the CEO on all matters (see chapter 8 § 29 ABL), as long as he is not deprived of his competence to take care of the day-to-day

421 Dotevall, p. 41 f.; Stattin, p. 199.
422 Prop. 2009/10:246, En ny försäkringsrörelselag, p. 240: "Det kan här även påpekas att stämmobeslut i strid med försäkringstekniska riktlinjer eller placeringsritlinjer inte sällan torde komma i konflikt med den lagfästa principen om stabilitet eller med de särskilda bestämmelserna om rörelsen, bl.a. föreskrifterna om försäkringstekniska avsättningar och placering av tillgångar".
423 Ibid. p. 470.
management. The board of directors may also delegate some of its duties to specific directors or to the CEO (chapter 8 § 4 ABL). When the board of directors makes extensive use of this right, it has in practice a predominantly controlling rather than managing function.

A consequence of the hierarchical structure is that the general meeting of a Swedish aktiebolag has considerably more competences than the general meeting of a German Aktiengesellschaft. The same is true with regard to the board of directors compared to the supervisory board. Even though the division of competences between CEO and board of directors in practice seems to be relatively similar to the one between management board and supervisory board, an important difference lies in the independence granted to the management board compared to the CEO’s obligation to follow the board of director’s instructions.

4.1.4 On company interest

A relevant question in the course of this study is whose interests the members of the company organs have to, are allowed to, or are not allowed to take into consideration when taking decisions concerning the company, such as a decision to support a subsidiary or sister company in distress.

4.1.4.1 German law

With respect to German company law, the answer to the question whose interests need to be taken into consideration depends on which company organ is taking a decision.

Shareholders have a duty of loyalty (Treuepflicht) towards both the company, and to a lesser extent towards the other shareholders. The scope of the duty of loyalty depends on the character of the membership rights that are being exercised, whether it concerns a self-serving or a selfless right. Other factors that might influence the scope are the company’s shareholder structure and its economic situation. When exercising selfless rights (uneigennützige Mitgliedschaftsrechte), the shareholder must refrain from acts that are contrary to the company’s interest as defined by the companies purpose and objectives in the articles of association. The duty of loyalty also encompasses the duty to take consideration to the interests of other shareholders. According to Koch, the

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424 Sandström, p. 182; Skog, p. 157.
425 See Jessica Östberg, Styrelseledamöters lojalitetsplikt - Särskilt om förbudet att utnyttja affärsmöjligheter (2016), p. 95 f. on the discussion concerning the limits for delegation of the board of directors’ duties.
426 See also Besher and Andersson, p. 283 with regard to the responsibility for the company’s organisation: The board of directors supervises the CEO who is responsible for the organisationen.
427 Hüffer/Koch AktG, § 53a para. 16.
428 Ibid, § 53a para. 17.
430 Rieckers in: ibid, § 17 para. 27. The interests of the other shareholders need to be related to the company and may not be of a private nature.
voting right is generally regarded as a selfless right. Other hold that its characterization needs to be determined in each single case depending on the content of the resolution. With regard to the exercise of self-serving rights (eigennützige Mitgliedschaftsrechte), the duty of loyalty is much more limited and only prohibits an arbitrary and inappropriate exercise of its rights, limiting the shareholder’s freedom only in extreme cases when it would otherwise jeopardize the company’s survival. The exercise of the dividend right is considered to be self-serving. The shareholders therefore do not have a duty to consider whether a distribution, for instance, has a negative effect on the company’s investment capability, as long as the existence of the company is not in danger.

The members of the management board have according to § 76 (1) AktG “direct responsibility for the management of the company” (VVaG: § 188 (1) VAG 2016, § 76 (1) AktG). This is interpreted as including the obligation to only take decisions that are in compliance with the company interest (Unternehmensinteresse). What is meant by “company interest” has been subject to debate for many decades. The prevailing view argues that the term “company interest” encompasses a plurality of interests, mainly those of its shareholders and employees, but also the expectations of the public towards the company to act as a “good corporate citizen”. Since 2009, this understanding is also reflected in the definition of Unternehmensinteresse in the German Corporate Governance Code, a soft-law code applicable to listed companies, which defines the term as “meaning that it considers the needs of the shareholders, the employees and other stakeholders, with the objective of sustainable value creation”. In the case of an insurance company, policyholders must be considered as an important stakeholder group whose interests form part of the company interest.

Where stakeholder interests conflict, the management board needs to take them into consideration and weigh them against each other. Even though the interests of the shareholders do not have priority, the company’s continuing existence and competitiveness are regarded as prime objectives lying in the interest of all stakeholder

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431 Hüffer/Koch AktG, § 53a para. 17.
432 Rieckers in: MHdGR AG, § 17 para. 6.
433 Rieckers in: ibid, § 17 para. 22.
434 Hüffer/Koch AktG, § 53c para. 17.
435 Ibid, § 53a para. 17; Rieckers in: MHdGR AG, § 17 para. 4 f.
436 Translation applied in Norton Rose Fullbright, German Stock Corporation Act (Aktiengesetz) English translation as at September 18, 2013.
438 German Corporate Governance Code as amended on 7 February 2017, section 4.1.1.
439 Hüffer/Koch AktG, § 76 para. 33; Mertens and Cahn in: KK-AktG vol. 2/1, § 76 para. 18; Kubis in: Semler/Peltzer/Kubis, Vorstand HB, § 1 para. 97.
The management board is therefore obliged to seek sufficient profitability. The management board has a wide discretion how it weighs diverging interests. It is, for instance, allowed to seek short-term or long-term profit maximisation (but it is not obliged to seek profit maximisation, merely profitability), to strive towards distributing a high dividend or towards retaining as much profit as possible in the company, as long as it pays sufficient attention to safeguarding the company’s competitiveness. The divergence between the majority opinion advocating a pluralistic concept and the opposing opinion in favour of a monistic shareholder interest is therefore not necessarily very wide. Many advocates of a monistic interpretation apply a moderate or “enlightened” shareholder value concept according to which the management board is primarily obliged to seek long-term shareholder value maximisation, but also needs to take the interests of other stakeholders into consideration in order to ensure their continuing cooperation or goodwill and is allowed to meet expectations of the public of a “good corporate citizen”. According to the majority opinion, the plurality of relevant interests has the consequence that the management board is not allowed to simply follow its shareholders’ wishes, even if it is a sole shareholder, or in the words of Mertens and Cahn: The management board is not trustee of the shareholder, but of the company. The pluralistic company interest concept also has the consequence that the management board of a German Aktiengesellschaft is considered to have a wide (but not unlimited) discretion to use company funds for charitable donations, to support social or cultural activities, even without any connection to the object of the company (Unternehmensgegenstand) as laid down in the articles of association. The management board is also allowed to apply higher social, environmental or employee protection standards than what is required by law, as long as this does not endanger the company’s continuing existence.

Also the supervisory board members are bound by the company interest. Their task is therefore not to represent the interests of the stakeholders that have elected them, such as the employees or the majority shareholder. Instead, they are obliged to act in the interest of the company. For (management or supervisory) board members who are also members of the management board of a parent company, this means that they have to observe the interests of the company they are representing: When acting as board

440 Hüffer/Koch AktG, § 76 para. 34; Mertens and Cahn in: KK-AktG vol. 2/1, § 76 paras. 19-22; Spindler in: MüKo AktG, § 76 para. 69.
441 Hüffer/Koch AktG, § 76 para. 34; Mertens and Cahn in: KK-AktG vol. 2/1, § 76 para. 22.
442 Mertens and Cahn: in: KK-AktG vol. 2/1, § 76 para. 21.
443 Fleischer in: Spindler/Stilz, Kommentar zum Aktiengesetz, vol Band 1 §§ 1 -149 (3rd edn 2015), § 76 para. 44.
444 Fleischer in: ibid, § 76 para. 38.
445 Mertens and Cahn in: KK-AktG vol. 2/1, § 76 para. 32.
446 Spindler in: MüKo AktG, § 76 para. 88 f.; Fleischer in: Spindler/Stilz, Kommentar zum Aktiengesetz, § 76 para. 45 f.
447 Hüffer/Koch AktG, § 116 para. 2.
448 BVerfGE 34, 103 (Abzugsverbot von Aufsichtsratsvergütungen), p. 103.
member of the parent company, its company interest is decisive, and when acting as board member of the subsidiary, they are obliged to act solely in the interest of the subsidiary.449

The prevailing view does not recognize a “group interest”, that would allow group undertakings to take decisions in conflict with their individual company interest to promote the well-being of other group undertaking or the group as a whole.450 This does not mean, however, that the fact that a company belongs to a group could not affect the interest of the company, but there is no group interest that supersedes each individual company’s interest. A consequence of the pluralistic concept is that the interests of a subsidiary are not equal to its shareholder’s interests.

4.1.4.2 Swedish law

Also Swedish law requires the board of directors and the CEO to observe the company’s interest in their management, even though the term company interest (bolagets intresse) has been removed from the ABL in 1975. According to the preparatory works, the removal was not supposed to lead to any legal change, however, since breaches against the company interest were deemed to coincide with breaches against the general provision (generalklausulen).451

The definition of company interest differs, however, considerable from the predominant one in German law. In the context of the Corporate Social Responsibility debate, a discussion about the inclusion of other values in the notion of company interest has arisen,452 but the prevailing view is still that the company interest is equal to the shareholders’ common interests.453 For Dotevall, it is obvious that a company cannot have interests of its own.454 When more than half of the company’s share capital has been consumed, the creditors’ interests become relevant instead of the shareholders’.455

That the company interest is a monistic interest is supported by a judgment of the Högsta Domstolen (Supreme Court) concerning a housing cooperation (bostadsrättsförening).456 The cooperation had been founded by a construction company and its owners and entered into a contract with the construction company on the construction of a residential building with condominiums to be sold to future members

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450 Hüffer/Koch AktG, § 76 para. 48, § 308 para. 16 with further references.
455 Dotevall, Skadeståndsansvar för styrelseledamot och verkställande direktör - En aktiebolagsrättslig studie i komparativ belysning, p. 361; Östberg, p. 81.
456 HD, NJA 2013 p. 117.
of the cooperation. The board of directors of the cooperation later agreed to changes in the construction contract that were favourable to its members - the construction company and its owners - without claiming a price reduction. The Supreme Court explicitly referred to legal doctrine concerning ABL and held that the board of directors only was obliged to take existing members’ interests, but not future members’ interests into consideration.\(^{457}\) It also stated that the inclusion of such interests would mean that an association would have an interest of its own, which would be difficult to define and therefore should not be relevant for potential liability claims against a director.\(^{458}\)

What exactly the shareholders’ common interests are, is not entirely clear, however, since shareholders may have diverging interests, or they may have not expressed their view on a particular question. In that case, management must follow the hypothetical interest of the shareholders.\(^{459}\) The hypothetical interest is, however, equally difficult to determine, and, as it seems, depends on the context. \(\text{Stattin}\) discusses the concept in the context of the management’s right or obligation to refuse to execute a decision of the general meeting and comes to the conclusion that such a right exists if the execution would be harmful to the company.\(^{460}\) Consequently, he uses the term in the sense that the company’s interest is to avoid harmful decisions. Broader concepts of “company interest” require decisions to safeguard the company’s economic stability or its development potential or to take various stakeholder interests into consideration\(^{461}\) - which \(\text{Stattin}\) regards as too vague to serve as guiding principle for the management that might be tempted to put its own personal interests above the company’s interest.\(^{462}\)

According to another view, the company interest is equal to its purpose,\(^{463}\) which for almost all companies is to make a profit.\(^{464}\) This view can be based on chapter 3 § 3 ABL laying down a presumption that the company’s purpose is to generate profit for the shareholders, unless a different purpose is stated in the articles of association.

The profit purpose can be set aside on a case-by-case basis if all shareholders are in agreement,\(^{465}\) according to the so-called “SAS principle”.\(^{466}\) The profit purpose is

\(^{457}\) Ibid, para. 19 f.
\(^{458}\) Ibid, para. 21.
\(^{459}\) Dotevall, Skadeståndsansvar för styrelseledamot och verkställande direktör - En aktiebolagsrättslig studie i komparativ belysning, p. 143; \(\text{Stattin}\), p. 214; Östberg, p. 68.
\(^{460}\) \(\text{Stattin}\), p. 218 f.
\(^{462}\) \(\text{Stattin}\), p. 219.
\(^{463}\) Ohlson, p. 110.
\(^{466}\) Sandström, p. 20 (SAS is an abbreviation for “samtliga aktieägares samtycke” – English: “consent by all owners”).
interpreted as an objective to maximise the value of the company’s equity, in an “adequate” long-term perspective (unless the shareholders have decided on a different time horizon, of course), which needs to be determined by the board of directors. It is important to note that the profit purpose is not set aside automatically just because a company’s profits may not be distributed to its shareholders, but need to be allocated to others. This concerns life insurance undertakings that are operated on a mutual basis.

For life insurance companies, chapter 3 § 3 ABL does not apply. Instead chapter 11 § 3 section 2 FRL 2016 requires the shareholders to lay down in the articles of association how the general meeting may dispose over the company’s profit. According to § 16, life insurance companies are only allowed to distribute dividend to the shareholders if this is explicitly stated in the articles of association. If this is not the case, profits must be distributed as bonuses to the policyholders to the extent they are allocated to the free equity and are not necessary to compensate losses (§§ 17, 18). For insurance mutuals, chapter 12 § 11 no. 14 FRL 2016 corresponds to chapter 11 § 16. From the preparatory works, it can be derived that the purpose of an insurance mutual is deemed to be the promotion of the member’s common interest that the mutual’s business is operated in a way that is advantageous for them as policyholders, which may, but does not have to, coincide with profit maximisation. In the absence of an explicit different purpose in the articles of association or a decision by the general meeting, it can therefore be assumed that the profit purpose also applies to insurance mutuals.

The importance of the shareholders’ preferences and the profit purpose laid down in the ABL leads to the question whether the board of directors and the CEO are allowed to take other stakeholders’ interests at all into consideration in their management decisions. According to Skog,

“[…] the general meeting, board of directors and CEO, within the framework of the company’s operation, must consider and invest in every possible “interest” as long as the present value of the investment is positive. On the other hand, the law does not allow the governing bodies to disregard the profit purpose to the benefit of other stakeholders.”

Thus, in dubio, a decision needs to be measured against its consequences for the company to generate profit. Skog’s interpretation of the profit purpose does not hinder the management to go beyond legal requirements and offer employees, for example, better working conditions or to voluntarily comply with stricter environmental standards,

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467 Bergström and Samuelsson, p. 36; Ola Åhman, Behörighet och befogenhet i aktiebolagsrätten (1997), p. 689, who interprets the profit purpose as maximisation of the return on investment, which may take the form of an increased value or profit distribution.
468 Östberg, p. 69.
471 The general meeting of the insurance mutual Skandia Liv has adopted such a resolution, instructing the board of directors among other to conduct the mutual’s business in such a way to promote a long-term value maximisation for the insured, Ägarinstruktion för Livförsäkringsbolaget Skandia, ömsesidigt, 4 March 2017, p. 4.
473 Bergström and Samuelsson, Aktiebolagets grundproblem, pp. 34, 265.
as long as the “present value of the investment is positive”. He rejects a proposal made in the course of the Corporate Responsibility discussion to oblige the management to consider other stakeholder interests and stresses that it is the legislator’s role to adopt laws setting those standards by which companies have to abide, for instance on environmental issues. According to Dotevall, the profit purpose does not prohibit that consideration of other stakeholder interests is taken, but he considers it to be too inconcrete to give legally relevant guidance to the management other than with regard to obvious breaches. Bergström and Samuelsson argue against the inclusion of other interests that it would increase the management’s power to the detriment of the shareholders’ possibility of controlling the management. They even see a risk that an amendment of the articles of association to the effect that the environmental protection shall prevail over profit maximisation constitutes a breach against the rules on value transfer. Östberg seems to be more sympathetic to the inclusion of other stakeholder’s interests de lege ferenda, but also states that de lege lata, such interests may only be taken into consideration to the extent they are in compliance with the profit purpose.

She raises the example of a board of directors that has to take a decision on moving the company’s production to China in order to reduce costs. If the board rejected this proposal because the closure of the company’s factory in Sweden would have negative consequences for the employees and the municipality where it is located, this would probably be in conflict with the profit purpose. Östberg suggests that the board could try to argue that the decision not to close the factory could create goodwill that in the long-term will increase sales, but considers this argumentation to be risky. She argues that an increase in goodwill or badwill may justify decisions on issues where the society today expects companies to act responsibly, even without any corresponding legal obligation, for instance when investing into environmentally friendly production methods or when taking measures against child labour.

4.2 The economic rationale behind limited liability

The purpose of this book is to study the tension between the calculation of the group Solvency Capital Requirement on the basis of consolidated accounts and the company law reality. The most prominent feature of company law conflicting with a consolidated view is the limitation of liability granted to shareholders. Most national jurisdictions and,

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475 Beate Sjäfjell et al., Shareholder primacy: the main barrier to sustainable companies, in: Beate Sjäfjell and Benjamin J. Richardson (eds), Company Law and Sustainability (2015), pp. 79 – 147, who advocate as a redefined societal purpose of the company the creation of “sustainable value within the planetary boundaries”, p. 146.
478 Bergström and Samuelsson, Aktiebolagets grundproblem, p. 268.
479 Ibid, p. 266.
480 Östberg, p. 71.
482 Ibid, p. 71 f.
in any event, all EU member states offer at least one company form with limited liability for its owners.\textsuperscript{483} Armour/Hansmann/Kraakman identify five common legal characteristics of business corporations: Legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership.\textsuperscript{484} They call limited liability “a nearly universal feature of the corporate form”, even if it does not have a very long history in all jurisdictions, including English law, where it was introduced for Joint Stock Companies as late as 1855.\textsuperscript{485} The demand for companies with limited liability increased with the industrialization in the 19th century, for instance with the formation of railroad companies. However, there are examples of limited liability companies already before that, for instance Italian banks established during the Renaissance and in the 17th century. English, Dutch and North German trading companies engaged in overseas trade were granted limited liability by state concessions\textsuperscript{486} (for instance the East India Company).

For the economic rationale behind the limitation of shareholder liability to its investment, the following arguments are brought forward:

- Limited liability facilitates the division of labour by enabling investors without specialized knowledge to invest in companies that can employ specialists lacking the necessary capital to run a business;\textsuperscript{487}
- If shareholders’ liability was not limited, they would have to spend more on monitoring management in order to reduce agency costs because management mistakes would not only put their investment at risk, but their entire wealth;\textsuperscript{488}
- With their liability being limited, shareholders do not need to monitor other shareholders as closely as they would without limited liability, because it is irrelevant for a shareholder’s risk exposure whether the other shareholders are rich or poor;\textsuperscript{489}
- Connected to this is the advantage that the shareholders’ identity and financial situation does not influence the valuation of the company and therefore reduces the cost of purchasing shares;\textsuperscript{490}

\textsuperscript{483} See Opinion of Advocate General Trstenjak delivered on 2 June 2010, Case C-81/09 (Idryma Typou), para. 34.
\textsuperscript{485} Ibid, p. 9.
\textsuperscript{488} Cf. Easterbrook and Fischer, p. 94 f.
\textsuperscript{490} Easterbrook and Fischer, p. 96; Halpern, Trebilcock and Turnbull, p. 130.
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- Limited liability facilitates shares’ fungibility, which in turn incentivizes managers to act efficiently in order to prevent that dissatisfied shareholders sell their shares at a low price to a new shareholder who installs a new management;\textsuperscript{491}
- Limited liability allows investors to diversify efficiently. Without limited liability, any investment in a company would put the entire wealth of the investor at risk, which would weaken the willingness to invest into several companies;\textsuperscript{492}
- Without limited liability, companies (and their owners) would be more reluctant to invest into riskful projects such as developing new technology because they would put their shareholders’ entire wealth at risk if the project fails.\textsuperscript{493}

Closely connected to limited liability is the legal personality granted to limited liability companies. With regard to English common law, it has been claimed that limited liability necessarily followed from legal personality,\textsuperscript{494} a statement that is not valid for civil law countries that for a long time have known company forms combining legal personality with unlimited personal liability of their members, so-called partnerships (\textit{Offene Handelsgesellschaften} in German law, \textit{handelsbolag} i svensk rätt).

Legal personality enables companies to enter into contracts without binding their shareholders, which facilitates the engagement of individuals to in joint projects.\textsuperscript{495} The (economic) function of legal personality is “the demarcation of a pool of assets that are distinct from other assets owned, singly or jointly, by the firm’s owners”. According to this view, “these assets are conceived as belonging to the firm, rather than the firm’s owners”, thus making them unavailable to the owner’s creditors.\textsuperscript{496} While legal personality according to this economic-functionalist approach is supposed to protect the assets of the company from claims of the shareholders’ creditors, limited liability protects the shareholder’s assets from the claims of the company’s creditors.\textsuperscript{498}

Nevertheless, even though it is generally accepted nowadays, the concept of limited liability had been met with some reluctance, particularly with regard to two\textsuperscript{499} questions: First, should limited liability companies need to have several shareholders or should it be permissible that one person holds all shares? This question was based on the idea that a company is an association involving \textit{several} shareholders. Why should one person be

\textsuperscript{491} Easterbrook and Fischer, p. 95.
\textsuperscript{492} Ibid, p. 97.
\textsuperscript{493} Ibid, p. 97; Halpern, Trebilcock and Turnbull, p. 144, who emphasize the moral-hazard problem connected to this argument.
\textsuperscript{494} Davies and Worthington, p. 32, para. 2-9.
\textsuperscript{495} Armour, Hansmann and Kraakmann, p. 6.
\textsuperscript{496} Ibid, p. 6.
\textsuperscript{498} Armour, Hansmann and Kraakmann, p. 9 f.
\textsuperscript{499} A third concern relates to the question whether limited liability should apply to all liabilities notwithstanding their origin – contractual or tort – or whether liabilities in tort need to be exempted. This discussion is taken up later.
given the privilege to limit his liability he would otherwise have as a sole businessperson? And if one person should be allowed to hold all shares, the following second question is whether this should apply only to natural or even to legal persons. This question reflects the concern that companies could evade liability and harm creditors by creating subsidiaries, for instance by letting a subsidiary fall into insolvency or by placing group interest or the shareholder company’s interest above the subsidiary’s interest and thereby harming the subsidiary’s creditors.\textsuperscript{500}

According to Moberg, the second question has not been discussed in Sweden, where it was considered evident at least since the beginning 20\textsuperscript{th} century that legal persons were allowed to own shares.\textsuperscript{501}

From a law and economics perspective, it has been argued that the advantages of legal personality and limited liability for facilitating the financing of businesses work in the same way concerning group structures, because creditors only have to keep track of the ventures of the group company they are contracting with.\textsuperscript{502} In other words, they do not need spend time and money to monitor the activities of other group companies.\textsuperscript{503} Others argue that limited liability is efficient only with regard to companies with many shareholders, whereas unlimited liability would be most efficient for small, tightly held corporations because limited liability creates a moral hazard to shift risks to creditors without compensation.\textsuperscript{504}

Most, if not all, industrialized states nowadays allow legal persons to be shareholders in limited liability companies and many states allow limited liability companies to have only one shareholder.

The English Limited Liability Act 1855 required limited liability companies to have at least 25 shareholders, with their amount being reduced to seven already in 1856.\textsuperscript{505} In its famous decision \textit{Salomon v. Salomon} from 1897, the House of Lords held this requirement to be purely formal, thus in effect allowing companies with one single member, the other six merely being trustees.\textsuperscript{506}

Since 1976, Swedish law has allowed the formation of sole-shareholder companies (\textit{aktiebolag}) by Swedish legal and natural persons, with the novelty being at the time that also trusts (\textit{stiftelser}) and non-profit associations (\textit{ideella föreningar}) were allowed to found companies.\textsuperscript{507} Already before that, Swedish law did not require a company to be dissolved on the grounds that all shares were held by the same shareholder.

\textsuperscript{500} See Davies and Worthington, p. 229, pointing out that such actions nevertheless harm the parent undertaking’s shareholders most and therefore are not good arguments against limited liability within groups.
\textsuperscript{502} Armour, Hansmann and Kraakmann, p. 10.
\textsuperscript{504} Halpern, Trebilcock and Turnbull, p. 147 f.
\textsuperscript{505} Davies and Worthington, p. 5.
\textsuperscript{506} Ibid, p. 5
\textsuperscript{507} Prop. 1975:103 p. 293.
German law has allowed the formation of sole shareholder private limited liability companies (Gesellschaft mit beschränkter Haftung) since 1980\textsuperscript{508} and of stock corporations since 1994.\textsuperscript{509} Prior to the 1994 reform, five founders were formally required, but it was accepted that four of these merely acted as trustees of the fifth and transferred their shares to the same soon after the foundation.\textsuperscript{510} Both natural and legal persons are accepted as shareholders.

With the 12\textsuperscript{th} Company Law Directive\textsuperscript{511} from 1989, the European Community required member states to allow the creation of sole-shareholder private limited companies\textsuperscript{512}, in the EU terminology called “single-member company” (Article 2 (1) Directive 2009/102/EC). The objective was to give individual entrepreneurs the possibility to conduct business in a legal form involving limitation of liability. The European legislator was discontent with the fact that the national legislations differed considerably in their attitude towards single-member companies, with some member states such as Germany allowing single membership for both natural and legal persons, while others required several members, or did not allow wholly-owned private limited liability companies to be sole shareholder in such a company.\textsuperscript{513} The initial directive proposal did not allow limited liability companies to have a legal entity as sole shareholder, reflecting the reluctance towards chains of companies by some member states.\textsuperscript{514} Due to the fierce resistance of mainly Germany, this proposal was not upheld and chains of limited companies were allowed.\textsuperscript{515} However, Article 2 (2) allows member states to lay down special provisions or penalties for cases where a natural person is the sole shareholder (member) or a single-member company or other legal entity is sole shareholder in a private limited liability company. This gives member states for example the possibility to extend liability to the assets of a limited liability company that is the sole shareholder of a private limited liability company. According to recital 5 of the preamble to the directive, however, this possibility shall apply only in “specific cases”.\textsuperscript{516}

With regard to public limited liability companies in the EU-terminology, encompassing German Aktiengesellschaften and Swedish publika aktiebolag, there is no EU legislation requiring member states to allow sole shareholdings. To the contrary, the Second Company Law Directive explicitly allowed member states to require several

\begin{footnotes}
\footnotetext{508}{Roth in: Günther H. Roth and Holger Altmeppen, GmbHG (8\textsuperscript{th} edn 2015), § 1 para. 20.}
\footnotetext{509}{Hüffer/Koch AktG, § 2 para. 1.}
\footnotetext{511}{Twelfth Council Company Law Directive 89/667/EEC on single-member private limited-liability companies, replaced by Directive 2009/102/EC in the area of company law on single-member private limited liability companies.}
\footnotetext{512}{Please note that the corresponding national company forms falling under the directive are not eligible company forms for insurance undertakings.}
\footnotetext{513}{Vanessa Edwards, EC Company Law (1999), p. 219.}
\footnotetext{514}{Ibid, p. 224.}
\footnotetext{515}{Ibid, p. 225.}
\footnotetext{516}{Recital 5 to the Preamble of Directive 2009/102/EC.}
\end{footnotes}
shareholders and merely prohibits member states from putting companies into automatic liquidation on the grounds that there is only one shareholder left. However, most EU member states nowadays seem to allow single-shareholder public limited liability companies.

But even where more than one shareholder is required, this usually does not prevent the formation of practically wholly-owned subsidiaries, because other group companies or natural persons connected to the main shareholder will often be chosen to hold single shares in order to comply with the formal requirements.

As we have seen, limited liability nowadays is a commonly accepted feature of corporations, including the use of limited liability companies for the creation of groups, but its history is not as long as one may have expected. It is important to note, however, that the Solvency II Directive restricts insurance undertakings to specified forms of associations, particularly public stock corporations and mutuals.

4.3 Is limited liability a principle of EU company law?

Against this background, the question arises whether limited liability is a principle of law, in the sense that limited liability for shareholders constitutes an overarching general norm against which written legislation needs to be measured.

In the *Idryma Typou* case, the European Court of Justice was confronted with this question with regard to EU law. The case concerns a preliminary ruling on the interpretation of the First Company Law Directive on the question whether a certain national provision breaches against the directive. The national provision allowed a member state to impose fines on a shareholder of a limited liability company for wrongdoing by the company. The First Company Law Directive harmonizes provisions concerning companies limited by shares or otherwise having limited liability with regard to disclosure, validity of obligations, and nullity, but does not contain any explicit rules on the limitation of liability as such. The Court held that

“Although the third recital in the preamble to the First Directive implies that a principle exists that only companies are required to pay, out of their assets, company debts to third parties, that directive does not prescribe a

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518 The statement is based on the analysis of 14 country reports at www.lexmundi.com/lexmundi/Guides_To_Doing_Business.asp.
519 See Annex III of the Solvency II Directive. Ireland and Great Britain also allow incorporated companies limited by guarantee or unlimited the conduct of insurance business.
521 ECJ, Judgment of 21 October 2010, Case C-81/09 (Idryma Typou).
uniform concept of companies limited by shares or otherwise having limited liability that is based on such principle. [...] It follows that the First Directive does not prescribe what a company limited by shares or otherwise having limited liability must be, but merely lays down rules which must be applied to certain types of companies [...]” 523

The Court rebutted the argument put forward by Advocate General Trstenjak that the fact that all member states recognize limited liability for companies with share capital indicates that such a principle exists in EU law. 524 The Court further contended that even if according to the law of most member states, shareholders are not liable for a company’s debts, it cannot be concluded from this that “ [...] this is a general principle of company law applicable in all circumstances and without exception.” 525

It follows from the decision that absent harmonization, member states have the right to define the content of what limited liability exactly means, and when the corporate veil may be pierced. 526 Since a principle of limited liability is not recognized in EU law, EU measures defining (or restricting) limited liability only need to comply with higher ranking EU law (particularly the fundamental freedoms granted in the Charter of Fundamental Rights).

The law of an individual member state could, of course, recognize limited liability as a principle forming part of their respective national laws, 527 which would mean that national legislation has to comply with such principle, but not legislation of EU origin. 528

4.4 Limited liability in German and Swedish law

After having addressed limited liability from an economic and an EU law perspective, its treatment in German and Swedish law shall be addressed in the following. Of particular

523 Case C-81/09 (Idryma Typou), paras. 40 f.
524 See Opinion of Advocate General Trstenjak delivered on 2 June 2010, Case C-81/09 (Idryma Typou), paras. 33 f.
525 Case C-81/09 (Idryma Typou), para. 42. The Court then went on to examine the compatibility of the national rules in question with the freedom of establishment and the free movement of capital. The national rules in question allowed Greek authorities to impose a fine jointly and severally on a company holding a licence to operate a television station and on such shareholders holding at least 2.5 % of the capital in the company for breaches against certain rules of professional conduct for journalists. The Court held that the Greek rules in question infringed both freedoms because they restricted them unproportionately by not being suitable to achieve the aim of securing compliance with the rules of professional conduct and by going beyond what is necessary to attain the objective, paras. 47 – 70.
528 For the purposes of this study, the complicated relationship between national constitutional law and EU law can be left aside.
interest are the exceptions to limited liability, i.e. the (more or less extraordinary) circumstances when parent undertakings are liable for their subsidiary’s debts, since the enterprise approach applied by Solvency II in those cases in fact corresponds to the company law reality.

Another interesting exception exists in Portuguese law where a parent undertaking having its seat in Portugal is jointly and severally liable for its Portuguese subsidiary’s debts if it holds all shares (Articles 490, 501 Código das Sociedades Comerciais).

As mentioned earlier, insurance undertakings are limited to certain legal forms, i.e. försäkringsaktiebolag, ömsesidiga försäkringsbolag och försäkringsföreningar in Sweden, and Aktiengesellschaften and Versicherungsvereine auf Gegenseitigkeit (VVaG) in Germany.

In a group context, the most relevant legal forms for insurance undertakings as subsidiaries are försäkringsaktiebolag and Aktiengesellschaften. These have in common that their basic capital is divided into shares and that, after the company’s registration, their shareholders generally are only liable for the company’s debt with the share capital they hold. If a shareholder has paid in its shares in full, it does not have any company law obligation to inject further capital into the company or to compensate the company’s creditors for any failed payments by the company. This specific feature characterizes corporations in general in contrast to partnerships which – depending on their precise legal form – need to have at least one associate that is personally liable for the company’s debts.

Consequently, a corporation is liable for its debts only with its own assets. For Aktiengesellschaften, this is laid down in § 1 (1) AktG and for försäkringsaktiebolag in chapter 11 § 1 FRL 2016, chapter 1 § 3 ABL. For German insurance mutuals (VVaG), the corresponding norm is § 175 VAG 2016. According to § 179 VAG 2016, the articles of association of a VVaG have to stipulate whether members pay their contributions in advance or retroactively and if payment in advance is stipulated, whether it may demand extra payments in order to cover policyholder’s claims. The members’ contributions in larger mutuals usually takes the form of insurance premiums, and extra payments are often excluded, in which case the situation for members in this respect is equal to the one of shareholders in an Aktiengesellschaft.

For Swedish insurance mutuals, chapter 12 § 2 FRL 2016 states that members are not liable for the mutuals debts, but enables non-life insurance mutuals to insert such a liability for members who are not consumers.

530 Wilm in: Handbuch des Versicherungsaufsichtsrechts, § 20 para. 91. An example of a VVaG with a possibility to demand extra payments is HUK-COBURG Haftpflicht-Unterstützungs-Kasse kraftfahrender Beamter Deutschlands a. G. (as of 2015-11-01)
4.4.1 Exceptions to limited liability in German law

When a shareholder of a German Aktiengesellschaft has fully paid in his shares, it may be liable for a subsidiary’s debts only on the basis of certain obligatory law instruments, enterprise contracts, or possibly on the basis of the widely debated “qualified de facto group”.

4.4.1.1 Obligatory law instruments: Letters of comfort, parental guarantees etc.

In group contexts, parent undertakings sometimes issue letters of comfort for a subsidiary. Letters of comfort may take different forms and have different names, such as “letter of comfort”, “letter of support”, “letter of awareness” or “parental guarantee” (Patronatserklärung). Depending on how they are formulated and on the circumstances behind their issuance, they may express a mere, legally non-binding intention or lead to a legal obligation on the part of the issuer, i.e. they may be a “guarantee” in the legal sense. In this context, only legally binding parental guarantees are of interest.

In the insurance industry, the motivation behind a guarantee may be that the parent undertaking wants to ensure that a newly started subsidiary will be sufficiently capitalized during the first years as its business grows, without having to inject the required capital immediately. In that case, the guarantee will usually be designed in such a way that only the subsidiary is entitled to enforce it. Another situation where parental guarantees sometimes are issued concerns reinsurance subsidiaries – often subsidiaries located outside the EU, for instance in Bermuda. Since a cautious selection of reinsurers is part of a prudent risk management of primary insurers, it may be difficult for reinsurance subsidiaries with low ratings to write business if they cannot provide a guarantee of their parent company with a better rating. In that case, primary insurers may demand a parental guarantee that can be invoked directly against the parent undertaking.

Parental guarantees are often limited to a certain maximum amount and limited in time. Their enforcement may also be subject to certain preconditions, for example that losses have arisen or that the subsidiary did not pay a creditor’s claim. A parental guarantee only constitutes a real exception to the limitation of liability if it is unlimited and encompasses all creditors of the subsidiary. Guarantees of this sort seem to be rather exceptional. Limited guarantees constitute (potential) financial obligations that are related to a subsidiary’s financial situation, but do not set aside the limitation of liability.

For a German subsidiary, an alternative to a guarantee are partly paid-in shares. The outstanding share capital can be called by the subsidiary when needed.

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531 In German law, the obligatory Organisationsfonds has – at least partly – a corresponding function.
4.4.1.2 Domination and profit and loss transfer agreements

As explained above, German corporate law contains specific rules on the relationship between affiliated companies. One part of this corporate group law deals with so-called enterprise agreements between two companies. For the present study, the following enterprise agreements are of interest: domination agreements, also called control agreements (Beherrschungsvertrag) and profit and loss transfer agreements (Gewinnabführungsvertrag, Ergebnisabführungsvertrag), which often occur in a combined form as domination and profit and loss transfer agreements (Beherrschungs- und Ergebnisabführungsvertrag).

A domination agreement is concluded between two undertakings and gives one party, usually the majority or sole shareholder, the right to dominate the other party, usually its subsidiary. 532 The domination right allows the dominating party to give binding instructions to the dominated party, which the management of the dominated party is obliged to follow (§ 308 AktG). Only if an instruction clearly (offensichtlich) does not serve the interests of the dominating party or any of its related undertakings, the management board may refuse to follow an instruction. The general meetings of all parties to an enterprise agreement need to approve its conclusion with a ¾ majority, unless the articles of association require a larger majority (§ 293 (1) AktG). In order to be valid, the agreement needs to be registered in the company register of all parties to the agreement (§ 294 (2) AktG). 533 If the dominated party has other shareholders, the enterprise agreement must provide for an adequate financial compensation to be paid to these external shareholders (§ 304 AktG).

Insurance undertakings also need BaFin approval before entering into a domination agreement (§ 12 (1) VAG 2016). Approval may only be granted if the dominating undertaking is contractually obliged to refrain from instructions that may have negative consequences for the dominated party’s policyholders or its ability to fulfil its obligations arising out of the insurance policies, or that are incompatible with regulatory principles. 534 Consequently, the instruction right is limited to a certain extent if the dominated entity is an insurance undertaking. If the dominated subsidiary is a life insurance or health insurance undertaking offering with profit insurance products, policyholders could get harmed if an instruction would lead to a reduction of the capital yield 535. The dominating parent is therefore obliged to refrain from such instructions.

532 The parties to an enterprise agreement do not need to be parent and subsidiary undertakings or even related to each other, although this is almost always the case.
533 Hüffer/Koch AktG, § 294 para. 18.
534 Präve in: Prölss/Dreher VAG, § 9 paras. 71, 76; Wilm in: Handbuch des Versicherungsaufsichtsrechts, para. 43.
535 The exact details of how the capital yields and the participation of the policyholders are calculated are laid down in Mindestzuführungsverordnung from 2008, which has been significantly changed in 2014 by the Lebensversicherungsreformgesetz. For the purposes of this work, it suffices to note that policyholders are entitled to 90 % of the capital yield generated during a financial year.
According to § 291 (3) AktG, the rules on repayment of capital and on a required proportional share in the dividends otherwise limiting the transfer of assets to a shareholder do not apply. As a consequence, a dominated company may be instructed to transfer assets to the dominating company.

A mandatory feature of a domination agreement is the dominating company’s obligation to compensate the dominated company for any annual net loss occurring during the duration of the domination agreement (§ 302 (1) sentence 1 AktG). This obligation is a compensation for the relaxation of the capital maintenance rules and is intended to protect the dominated company and its creditors. To avoid a net loss on the annual profit and loss statement, the dominated company may only use such amount from the profit reserves that has been transferred to the reserves during the duration of the agreement in order, but not amounts that had been transferred to the profit reserves before (§ 302 (1) sentence 2 AktG). Also this provision protects the dominated company and its creditors.

For tax reasons, domination agreements are often combined with profit and loss transfer agreements, which oblige the dominated company to transfer its entire annual profit to the benefitting (dominating) party (§ 291 (1) AktG). The latter is in return obliged to compensate the dominated company for any annual net losses (as in the case of a separate domination agreement). In order to be recognized as a fiscal unit by the tax authorities, the parties must have concluded a domination and profit and loss transfer agreement for a period of at least five years. According to BaFin’s practice, approval is often refused if the duration exceeds five years, so that domination agreements with insurance undertakings usually have a duration of exactly five years. BaFin also disapproves contract clauses according to which the agreement is automatically renewed in case of non-termination.

Domination agreements (also in combination with profit and loss transfer agreements) have the effect that the dominating shareholder assumes management responsibility for its subsidiary, in so far as it exercises its instruction right. In return for this right, it needs to compensate any annual losses in the subsidiary, even if it does not exercise its instruction right. If the domination agreement is combined with a profit transfer agreement, the entire result of the subsidiary is automatically transferred to the dominating entity. The agreement thus tightens the bond between the contracting parties, but the parties remain nevertheless legally distinct. In order to be approved by BaFin, the obligation to transfer the profit to the dominating party must be explicitly limited in

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536 Considering the compensation obligation connected with a domination agreement, it is remarkable that BaFin recommends parent undertakings to consider concluding such agreements with its subsidiaries in preparation of Solvency II in order to be able to fulfil the obligation to a group-wide internal audit function, BaFin, Vorbereitung auf Solvency II: Interne Kontrollen und interne Revision, 2014-07-09, para. 15.


538 Altmeppen in: Müko AktG, § 291 para. 54.

539 Critical to this practice: Wilm in: Handbuch des Versicherungsaufsichtsrechts, § 19 para. 48.

540 Another more far-reaching measure would be an “integration” (Eingliederung) of a subsidiary into a parent undertaking according to § 319 AktG. Since this measure according to the author’s knowledge lacks practical relevance in the insurance industry, it is left aside here.
order to prevent that the profit transfer affects the dominated undertaking’s solvency or the profit participation of its policyholders, where applicable.\(^{541}\)

From a solvency perspective, a domination and profit and loss transfer agreement may be recognized as ancillary own funds at solo level of the dominated undertaking.

4.4.1.3 Piercing the corporate veil

Since the shareholder’s limitation of liability is an important feature of corporations, exceptions to it are limited to exceptional cases. In English terminology, it is referred to as “piercing the corporate veil”, if a shareholder becomes liable for a company’s debts towards the company’s creditors.

German law does not have any written law on veil piercing. Case law of the Federal Court of Justice (Bundesgerichtshof - BGH) only exists for limited liability companies (Gesellschaft mit beschränkter Haftung - GmbH) and has changed over the years.\(^{542}\) Based on earlier case law, principles were developed for identifying a so-called “qualified de facto group” (qualifiziert-faktischer Konzern) in which the parent undertaking was obliged to compensate the GmbH-subsidiary for disadvantages induced by it. However, in its Trihotel-decision from 2007, the BGH has given up the concept of a qualified de facto group in a case involving a subsidiary in the form of a GmbH.

In its decision, the BGH based the subsidiary’s claim against its parent undertaking for damages on § 826 BGB (Civil Code) – a general civil law provision on liability for wilful immoral damage.\(^{543}\) The decision concerns the so-called “Existenzvernichtungshaftung” which stipulates liability for economically destructive actions by a shareholder leading to the company’s bankruptcy (or worsening its situation if it is already insolvent) and disregarding the creditors’ preferential rights in the company’s assets. If the shareholder withdraws assets from the company that the latter needs for fulfilling its obligations without being given any compensation and the shareholder is aware of these circumstances, it is according to this decision liable towards the company, but not towards its creditors – consequently, the case does not concern veil piercing in the original sense that the shareholder becomes directly liable towards a creditor of the subsidiary, but rather a certain group of cases where the shareholder disloyally causes the subsidiary’s insolvency and therefore becomes liable towards the subsidiary.

With regard to Aktiengesellschaften, it is debated among scholars on which legal grounds a similar liability shall be based, with some authors claiming that the concept of the qualified de facto group only has been given up for GmbHs and that it is still applicable with regard to Aktiengesellschaften.\(^{544}\)

An important difference between GmbHs and Aktiengesellschaften in this respect is that GmbH-shareholders holding a majority of voting rights are entitled to give binding instructions to the managing

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\(^{541}\) Wilm in: Handbuch des Versicherungsaufsichtsrechts, § 19 para. 45.

\(^{542}\) For an account of the BGH jurisdiction, see Habersack in: Volker Emmerich, Mathias Habersack and Jan Schürmbrand (eds), Aktien- und GmbH-Konzernrecht, (8th edn 2016), § 317 Anh. Para. 2.

\(^{543}\) BGHZ 173, 246 (Trihotel).

director, limited only by the obligations not to cause the subsidiary’s insolvency and to respect the capital maintenance rules in § 30 GmbHG (Limited Liability Companies Act) protecting assets covering the company’s share capital from being transferred to the shareholders. If the subsidiary is an Aktiengesellschaft, the legal position of the majority or sole shareholder is different: Without a domination agreement, a controlling shareholder may only induce a subsidiary to enter into transactions or to take or omit any actions or measures that are detrimental to the subsidiary, if it receives compensation for the disadvantage (§ 311 AktG). If the shareholder does not grant compensation, it is liable for compensation of any damages incurred by the subsidiary (§ 317 AktG). A disadvantage is any reduction of or concrete risk for the company’s assets compared to the situation if the action or omission had not taken place.

A qualified de facto group needs to fulfil the following prerequisites:

- Dependency of an undertaking from its shareholder;
- Lack of reasonable consideration when the shareholder induces the undertaking to a disadvantageous action (or omission), and
- Impossibility of compensation due to the nature of the action.

In a qualified de facto group, the parent undertaking (notwithstanding whether it is sole or majority shareholder) systematically submits the subsidiary to its influence in such a way that the statutory compensation system in §§ 311 ff. AktG fails, or in such a way that compensation for each single case of detrimental influence is impossible because they are not sufficiently documented. But also single actions with unpredictable consequences for the subsidiary, according to Vetter, may lead to a loss compensation obligation, such as the removal of important business functions or the sale of an important business unit in the interest of the shareholder.

The legal consequence of a qualified de facto group is the analogous application of § 302 AktG, i.e. the parent undertaking needs to cover the annual loss of the subsidiary in the same way as if it had a domination agreement with the subsidiary. A situation where this might be relevant is if it has caused its subsidiary to restructure in such a way that its ability to exist on a stand-alone-basis is jeopardized. According to Krieger, in these cases the compensation obligation arises only when the company ceases to be part of the group. An advantage compared to the jurisdiction developed in the Trihotel decision with regard to GmbHs is that it is not necessary that the influence of the shareholder causes or risks to cause the subsidiary’s insolvency.

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546 It is not required that a parent-subsidiary relationship exists, Krieger in: MHdGR AG, § 70 para. 143.
547 Krieger in: ibid, § 70 para. 143 f.
548 It is not required that a parent-subsidiary relationship exists, Krieger in: ibid, § 70 para. 143 f.
549 Müller in: Spindler/Stilz AktG, Vor § 311 para. 27: “Im hier interessierenden Zusammenhang geht es lediglich um die Frage, ob die Einflussnahme des herrschenden Unternehmens eine solche Dichte erreicht, dass das Ausgleichssystem der §§ 311 ff. versagt.” See chapter 9.2.1.4 on the compensation system.
550 Krieger in: Schmidt/Lutter AktG Münch, § 317 para. 47.
553 Habersack in: Aktien- und Konzernrecht, § 317 Anh para. 5a.
Apart from that, in a qualified de facto group, minority shareholders are also entitled to receive a compensation (as if a domination agreement existed). They also have the right to claim from the company to refrain from any concrete measures that would lead to a qualified de facto group and to restore the situation before such a measure has been taken.553

The supervisory and management board members of the controlled company may be liable to the company if they let the controlling shareholder exercise such influence on the company. Also liability of the controlling shareholder’s board members may arise.554

Whether the parent undertaking may be liable towards the subsidiary’s creditors, is also debated. According to one view, this is the case, if the subsidiary does not have any assets.555 Following the Trihotel-decision, most authors do not see any room for applying the concept of a de facto group any longer.556 The advocates of this opinion reject the analogous application of § 302 AktG and base liability claims on § 317 instead. Vetter applies the principles of the qualified de facto group, but prefers to speak of a “qualified inducement of disadvantages” (qualifizierte Nachteilszufügung) and advocates a widening of the scope of § 317 to apply this norm on such interferences.557 According to this view, the subsidiary’s claim against the parent undertaking amounts to the restoration of the subsidiary’s equity to its size before the interference.558 If the subsidiary cannot fulfil its creditors’ claims, but there are no insolvency proceedings ongoing, the subsidiary’s creditors are entitled to exercise the subsidiary’s claim against the parent undertaking according to §§ 317 (4), 309 (4). Altmeppen does not see any necessity for any analogies or for the analogous application of § 826 BGB as in the Trihotel decision. He considers the existing norms in §§ 311 ff., especially § 317 AktG to be sufficient.559 According to this view, the cases discussed under the concept of the qualified de facto group can be solved by applying § 317. If it is in exceptional cases difficult to determine an adequate compensation for the disadvantage induced, damages can be estimated.560

To sum up, undue influence by the parent undertaking according to German law leads to compensation or liability claims of the subsidiary for a disadvantageous influence by the parent undertaking and according to some commentators in the case of a qualified de facto group to the obligation to compensate the annual losses of the subsidiary. Whether and when this may lead to direct claims by the subsidiary’s creditors, is debated.

554 Krieger in: ibid, § 70 para. 152; Müller in: Spindler/Stilz AktG, Vor § 311 para. 30.
556 Hüffer/Koch AktG, § 1 para. 29.
557 Vetter in: Schmidt/Lutter AktG, § 317 paras. 49 and 56.
558 Ibid, § 317 para. 62.
560 Altmeppen in: ibid, § 317 Anh para. 18.
4.4.2 Exceptions to limited liability in Swedish law

In Swedish law, exceptions to limited liability may be based on obligatory law instruments, and in the context of veil piercing.

4.4.2.1 Obligatory law instruments: letters of comfort, parental guarantees etc.

As in German law, obligatory law instruments may have the effect that a parent undertaking becomes liable for a Swedish subsidiary’s debts, thus limiting or entirely setting aside the limitation of liability otherwise granted to shareholders of a försäkringsaktiebolag in chapter 11 § 1 FRL 2016 in connection with chapter 1 § 3 ABL. In Swedish doctrine, such instruments are called stödbrev (letters of support). As in German law, their legal status depends on their wording, ranging from non-binding declarations to legally binding guarantees. The discussion in Swedish law and the limited case law available is generally concerned under which circumstances and on which grounds the parent may be liable for damages to a third party that relied on a letter of support.\(^{561}\) If the instrument constitutes a parental guarantee in a narrow sense, third parties may, of course, invoke the guarantee against the parent undertaking.

4.4.2.3 Domination agreements

Swedish law does not know domination agreements in the German sense. There is no need for such agreements because the general meeting has overall competence and may give binding instructions to the company provided that the rules on capital maintenance are complied with.

Sometimes shareholders enter into contracts with a company giving them certain decision or instruction rights. In contrast to German law, these contracts are not connected with an obligation to compensate an annual loss.

4.4.2.4 Piercing the corporate veil

Also in Sweden, veil piercing (ansvarsgenombrott) is not regulated in legislation but has been developed by case law. From the handful of Swedish cases,\(^{562}\) the following relevant circumstances have been identified:\(^{563}\)

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- Dependency: The company is dependent on a dominant shareholder in such a way that it exclusively serves its shareholders without having any independent business or assets of its own.
- Undercapitalization: The company’s assets have been obviously insufficient (from the start) in relation to its business and the risks it would take.
- Impropriety: The shareholder has acted dishonestly or illoyal or has misused the corporate form of the company to pursue its own interests.
- Good faith: The debtor must have been unaware of the circumstances that constitute the grounds for veil piercing.
- Ramberg also names causality: There must have been a causal link between the creditor’s losses and the improper disregard of its interests.\(^{564}\)

Not all requirements need to be fulfilled cumulatively, and there seems to be some disagreement as to which requirements always need to be fulfilled. According to Ramberg, impropriety, undercapitalization and good faith are necessary requirements, whereas dependency is considered by some as neither required nor sufficient.\(^{565}\) According to Moberg’s understanding of the case law, undercapitalization is not a necessary requirement, but a strong indicator for a subsidiary’s dependency and the shareholder’s illoyalty.\(^{566}\) Johansson stresses the illoyal misuse of a subsidiary to its creditor’s detriment as the central requirement for piercing the veil.\(^{567}\)

The legal consequence in those few cases where the veil was pierced was the dominant shareholder’s liability for the company’s debts, i.e. direct liability towards the company’s creditors.

Given the exceptional character of veil piercing in Sweden,\(^{568}\) it is hard to imagine a situation where these prerequisites would ever be fulfilled in an insurance group, in particular where the company in question is an insurance undertaking that needs to be licensed by the insurance regulator before starting business.

\(^{564}\) Ramberg, p. 182.
\(^{565}\) See ibid, pp. 181-182.
\(^{566}\) Moberg, pp. 80 -81.
\(^{568}\) Johansson stresses that Swedish courts are very reluctant to pierce the veil: ibid, p. 250.
5 Perspectives on groups in other legal disciplines

After having addressed limited liability and its exceptions from a company law perspective in the previous chapter, now a broader perspective on the concept of limited liability or the group as a phenomenon shall be taken. To find out whether limited liability is a feature of overriding importance or one that is limited to just company law and not supported in other areas of law, this chapter presents an overview of how groups of companies are treated by other legal disciplines. Depending of the result, the consolidation requirement in Solvency II would be an odd exception to an otherwise widely respected feature, or just one area of law among many where company borders within a group are ignored.

Generally, two different approaches to groups of undertakings can be distinguished: The first approach treats groups of undertakings as if they were one single entity, hereinafter called “the enterprise approach”569 or “economic entity approach”. The other approach focuses on the fact that all companies belonging to a group are separate entities. This approach is based on the limited liability that company law generally provides for shareholders and is called the “legal entity approach”570 hereinafter.

5.1 The treatment of groups by the Court of Justice of the European Union

In an interesting study, Engsig Sørensen has analysed the case law of the ECJ with regard to the Court’s attitude towards groups of companies: When does it apply an enterprise approach and when does it apply a legal entity approach?571

His findings depend on the area of law in question. Engsig Sørensen finds that the legal entity approach is the rule and the enterprise approach the exception in the case law of the ECJ. He identifies two groups of cases where the Court applies an enterprise approach:

- “when the aim of Union law is to regulate market behaviour”, or

569 The term “enterprise approach” is used by Engsig Sørensen in Karsten Engsig Sørensen, Groups of companies in the case law of the Court of Justice of the European Union, Nordic & European Company Law LSN Research Paper Series, 2015.
570 Engsig Sørensen applies the term “entity approach”, ibid. The term ”legal entity approach” has been used specifically in the literature on insurance regulation and is therefore used in this study, cf. Hato Schmeiser and Caroline Siegel, Regulating Insurance Groups: A Comparison of Risk-Based Solvency Models, 1 Journal of Financial Perspectives (2013), pp. 119-131.
571 Engsig Sørensen, p. 1 f.
• when a group of companies appears to be a single undertaking to third parties, particularly in agency situations, or where the group structure is used to abuse Union law. The argumentation used in these cases bears some resemblance to the justifications for piercing the corporate veil.572

Probably the most prominent area of law where the Court applies the enterprise approach is competition law, which therefore shall be presented in more depth than the other areas of law that are described entirely on the basis of Engsig Sørensen’s findings.

5.1.1 Competition law

With regard to European competition law, the Court clearly applies an enterprise approach.573 For the assessment of the compatibility of a merger with EU competition law, the enterprise approach is explicitly prescribed in Article 5 (4) Merger Regulation574, which requires the calculation of the turnover of the entire group to which the respective party belongs. In the assessment of a breach of Article 101 TFEU on anti-competitive agreements between undertakings, the Court uses an enterprise approach in two ways: The first is by excluding groups of companies from the scope of Article 101 TFEU, so that group companies are allowed to enter into agreements with each other that restrict competition, for instance on pricing or on the division of markets.575 The second is by imposing liability for other group companies’ breaches of competition law. In the latter case, the economic entity approach may work in two ways to the parent undertaking’s disadvantage: First, by imposing liability for a subsidiary’s wrongdoings, and second, by calculating the fine on the basis on the value of the sales of the economic entity, regardless of company boundaries, thus increasing the basis for setting the fine compared to a situation where only the sales of the legal person actively involved in a cartel would be taken into consideration.576

It is this second group of cases, which is particularly interesting here, because it in practice leads to veil piercing by imposing responsibility on an entity, usually the parent undertaking, for another legal person’s breaches of competition law. The Court emphasizes that EC competition law “is based on the principle of the personal

572 Ibid, pp. 19-20. On the prerequisites for piercing the corporate veil in German and Swedish law, see chapters 4.4.1.3 and 4.4.2.4
573 Engsig Sørensen, pp. 3-7.
575 ECJ, Case C-73/95 P (Viho Europe B.V. v Commission), Judgment of 24 October 1996, paras. 17-18. According to Odudo and Bailey, it is not the economic enterprise approach as such that renders Article 101 inapplicable between group undertakings, but the impossibility of the subsidiary to enter into an agreement (to be distinguished from a contract) with its parent undertaking, when the latter can use hierarchical power to determine the subsidiary’s actions, Okeoghene Odudo and David Bailey, The Single Economic Entity Doctrine in EU Competition Law, 51 Common Market Law Review (2014), pp. 1721-1758, at 1738 – 1740.
responsibility of the economic entity which has committed the infringement"\textsuperscript{577}, but does not consider this to be in conflict with the economic enterprise approach. The Court bases the economic entity approach on the term “undertaking” applied in Article 101 and 102 TFEU. “Undertaking” is interpreted by the Court as designating “an economic unit even if in law that economic unit consists of several natural or legal persons”.\textsuperscript{578} It is noteworthy that the term “undertaking” is also used in the Solvency II Directive.

In competition law, a parent undertaking is considered to form a single economic unit with its wholly-owned or nearly wholly-owned subsidiary “if the subsidiary does not decide independently upon its own conduct on the market, but carries out, in all material respects, the instructions given to it by its parent company”.\textsuperscript{579} A single economic unit requires the actual exercise of control, but the direct or indirect holding of the entire share capital is sufficient to establish a rebuttable presumption that control is in fact exercised.\textsuperscript{580} The Court does not consider this to be in conflict with the concept of limited liability if the parent undertaking has decisive influence on the subsidiary, even if it did not participate directly in the infringement.\textsuperscript{581} In the \textit{Stora Kopparbergs} Case, the Court held that if the parent undertaking was in a position to exercise decisive influence, there is no need to establish whether it actually did exercise its power, and pointed out that the parent undertaking had the possibility to rebut the presumption by providing evidence that its subsidiary “[…] determined its commercial policy largely on its own and had its own board of directors with external representatives.”\textsuperscript{582} The Court held the presumption to be a proportionate means to combat infringements against competition law and to avoid repetition of infringements, also in the light of general principles of European law such as the presumption of innocence and the principle that penalties should be applied solely to the offender.\textsuperscript{583}

\textit{Engsig Sørensen} argues that the presumption is very difficult to rebut for a parent undertaking even if the board of directors of the subsidiary consists of external representatives: Not only does the parent undertaking have to prove that it did not exercise formal control, for instance through decisions taken by the general meeting, but also that it refrained from exercising informal control, “for example by means of personal contacts between the companies”.\textsuperscript{584} Mere non-exercise of control is not sufficient either, because it is necessary to show that the subsidiary acted “with complete autonomy” on

\textsuperscript{577} ECJ, Case C-97/08 P (Akzo Nobel), Judgment of 10 September 2009, para. 77.
\textsuperscript{578} ECJ, Case C-501/11 P (Schindler Holding), Judgment of 18 July 2013, para. 103, with references to the Akzo Nobel Case and Case 521/09 (Elf Aquitaine).
\textsuperscript{579} Case C-97/08 P (Akzo Nobel), para. 58 with references to earlier case law.
\textsuperscript{580} Case C-97/08 P (Akzo Nobel), para. 63.
\textsuperscript{581} Case C-97/08 P (Akzo Nobel), para. 77.
\textsuperscript{582} ECJ, Case C-286/98 P (Stora Kopparbergs Bergslags AB v. Commission), judgment of 16 november 2000, para. 80.
\textsuperscript{583} Engsig Sørensen, p. 5.
the market.\textsuperscript{585} In a case pending before the General Court at the time of writing, the Court will have the possibility to clarify whether the presumption can be rebutted on the grounds that the parent undertaking is a financial investor abstaining from the exercise of control other than in high-level, non-operational matters.\textsuperscript{586} According to Wahl, if future case law finds that abstention to exercise control does not lead to a rebuttal of the presumption, it is effectively irrebuttable and the presumption would become a legal rule of responsibility based on the possibility of decisive influence.\textsuperscript{587}

Interestingly, in the \textit{Stora Kopparbergs Case}, the Court even held the parent undertaking responsible for competition law breaches committed by a subsidiary before it had been acquired by the parent undertaking, because the parent undertaking “could not have been unaware of the anti-competitive conduct” of the newly-acquired subsidiary, because another one of its subsidiaries also participated in the cartel.\textsuperscript{588} Here, the knowledge of the latter subsidiary is imputed upon the parent undertaking – no evidence whatsoever is referred to according to which representatives of the parent undertaking had actual knowledge – and because of the subsidiary’s knowledge, the parent undertaking was held responsible for the acquired subsidiary’s competition law breaches dating back to periods prior to the acquisition. The Court emphasized that the parent had to take measures to stop the continuation of the infringement.\textsuperscript{589} This may indicate that a parent could avoid fines by stopping anti-competitive conduct of a newly acquired subsidiary.

The enterprise approach applied by the Court has the advantage that parent undertakings may not adopt a “laisser-faire approach”, where they close their eyes upon a subsidiary’s anti-competitive conduct, and thanks to the reversal of the burden of proof, a parent undertaking approving or actively supporting its subsidiary’s infringements does not escape responsibility. One could also justify the enterprise approach with the argument that it holds the person responsible that has economically benefitted from the infringement.\textsuperscript{590} A disadvantage is that it forces parent undertakings in principle to exercise close control over its subsidiaries if they want to be sure to avoid responsibility, thus imposing a governance style where they make full use of their powers and to leave as little power as possible to external persons that are more difficult to control (for instance by leaving seats to external board representatives). As the \textit{Schindler Holding Case} shows, if such control measures – for instance in form of a compliance program

\textsuperscript{585} Odudo and Bailey, p. 1751 with reference to the Elf Acquitaine case.
\textsuperscript{586} Case T-419/14 (Goldman Sachs Group Inc. v. Commission) - pending. Cf. Odudo and Bailey, p. 1752.
\textsuperscript{588} Case C-286/98 (Stora Kopparbergs), para. 82 f.
\textsuperscript{589} Case C-286/98 (Stora Kopparbergs), para. 83.
\textsuperscript{590} Odudo and Bailey, p. 1753.
with regular audits – nevertheless fail, the parent undertaking still risks to be held responsible for its subsidiary’s infringements.591

5.1.1.1 German and Swedish competition law

With regard to Swedish competition law, the Market Court (Marknadsdomstolen) held in a judgement from 2001 in a case concerning the Swedish telecom operator Telia’s responsibility for competition law infringements by one of its wholly-owned subsidiaries that the enterprise approach as developed by the ECJ is applicable in Swedish law as well.592

In German competition law, the legal entity approach has been upheld until very recently, holding only the infringing subsidiary responsible for competition law breaches, but not its parent undertakings – unless it was directly involved in the breach and thus itself infringed competition law. This enabled groups to escape responsibility entirely by restructuring the group before a fine had been imposed: If the subsidiary that was subject to investigations by the competition authority ceased to exist, for instance following a merger with another surviving subsidiary, it could no longer be held responsible. The German legislator has reacted to this by amending the German Competition Act to the effect that since June 2017, the enterprise approach also applies to German competition law.593 Escaping responsibility by restructuring should therefore not be possible anymore, but the amendment goes beyond that. The only difference to EU competition law is that there will be no presumption for a parent undertaking’s actual influence, but the practical difference to EU law will probably be very small because according to the legislative proposal, knowledge based on common experience (“Erfahrungssätze”) may be used by a judge together with other evidence to prove the exercise of actual influence.594

5.1.2 Public procurement law

In the area of European public procurement law, Engsig Sørensen analysed three cases, where the relationship between group companies was an issue. Two concerned the question whether a tenderer that wants to rely on the capacities of a group company for fulfilling minimum requirements in the public procurement contract needs to provide evidence that these capacities are in fact available, or whether it suffices to be part of a group. In those cases, the Court ruled that the procuring authority was entitled to demand

591 Case C-501/11 P (Schindler Holding Ltd. et al. v Commission and Council), judgment of 18 July 2013, para. 114. Similar to the outcome in the Stora Kopparbergs Case, Schindler Holding was also held liable for the participation in the cartel by a company it acquired while the cartel was operative.
593 Neuntes Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen vom 1 Juni 2017.
594 Gesetzentwurf der Bundesregierung, Entwurf eines Neunten Gesetzes zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen, Bundesratsdrucksache 606/16, 14 October 2016, p. 100.
evidence that the resources were in fact available to the tenderer, thus following a legal entity approach.\footnote{Engsig Sørensen, p. 7, citing Case C-5/97 (Ballast Nedam Groep NV), para. 12, and Case C-176/98 (Holst Italia SpA).}

The other case concerned the question whether national law may exclude companies belonging to the same group from submitting tenders based on the presumption that group companies do no compete with each other so that their tenders have not been generated under competitive circumstances. The Court found such an unrebuttable presumption to be disproportionate and pointed out that control between undertakings is not sufficient to automatically exclude group companies because controlled undertakings may enjoy “a certain autonomy in the conduct of their commercial policy and their economic activities”.\footnote{Ibid, p. 8, citing Case C-538/07 (Assitur Srl), paras. 31 and 32.} The Court held that the national contracting authorities had to examine whether a relationship of control between two tenderers has influenced the content of the tenders if they want to exclude a tenderer. \textit{Engsig Sørensen} considers the Court to be somewhat open to an economic enterprise approach, albeit much less so than in the case of competition law.\footnote{Ibid, p. 9.}

5.1.3 Labour Law

\textit{Engsig Sørensen}'s analysis of the Court’s case law in labour law issues finds that the Court follows a legal entity approach, where companies belonging to the same group are not considered to be the same employer, so that the Transfer of Undertakings Directive\footnote{Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.} is applicable also for intra-group transfers of employees. Also in cases concerning the consultation obligation of the Collective Redundancies Directive\footnote{Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies.}, a legal entity approach is taken.\footnote{Engsig Sørensen, pp. 9-12.} In these cases, the refusal of the enterprise approach leads to a better protection of employees, which was the objective of the directives in question.

5.1.4 Other areas of law

\textit{Engsig Sørensen} further analyses cases from the following areas of law: commercial agency law, tax (VAT) law, procedural law, insolvency law and patent law. He finds that the Court applies a legal entity approach in all cases, with the following exceptions:

- In Case C-260/95 (\textit{DFDS}), the Court held that a subsidiary incorporated in the UK that was acting as an agent for its Danish parent company constituted a “fixed
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establishment” of its parent company with the result that the parent undertaking had to pay VAT in the UK on the services sold on its behalf by its English subsidiary in the same way as if it had sold the services itself.601

• In a case concerning tax avoidance within the meaning of the Sixth VAT Directive, Case C-425/06 (Part Service), the Court refers to the group connection between two companies as one of several indicators that transactions involving these group members constituted abuse of European VAT rules.602

• In Case C-218/86 (SAR Schotte GmbH), the Court had to decide on the question concerning the jurisdiction of the German courts in a civil law claim against a French company that was a subsidiary to a German company. The Court held that the German parent company constituted a branch of its French subsidiary because the parent company had acted on behalf of the subsidiary and acted as its representative when negotiating a contract with the claimants. The Court based the enterprise approach on the fact that the companies shared the same management, used the same brand and that they had created the appearance towards third parties that the parent undertaking was an establishment of the subsidiary.603

5.2 Corporate Groups in Insolvency Law

Insolvency law is an area of law that has been subject to EU legislation only to a very limited extent with regard to procedural matters, particularly on the question of which court shall have jurisdiction over insolvency proceedings in cross-border cases. It is thus in large parts still national law. Insolvency law in Sweden, Germany and most other EU states, applies a legal entity perspective. Whether a legal person604 is insolvent, is determined on the basis of the legal entity’s financial situation, largely disregarding its relationship to other group companies.

German law knows three alternative grounds for opening insolvency procedures: the legal person’s actual inability to pay its debts (Zahlungsunfähigkeit, § 17 Insolvency Statute), the inherent risk that the legal person will become unable to pay its debts (drohende Zahlungsunfähigkeit, § 18 Insolvency Statute) and the legal person’s liabilities surpassing the value of the assets on its balance sheet provided that it seems more likely than not that it will not be able to continue its business in the future (Überschuldung, § 19 Insolvency Statute). For insurance undertakings, a lex specialis in § 311 VAG 2016 limits the insolvency grounds to actual inability of paying debts and

603 Ibid, p. 15.
604 Of course, insolvency law also regulates bankruptcy of natural persons. However, the presentation is limited to legal persons, with particular regard to insurance undertakings and group affiliations.
the liabilities surpassing the assets. Another diverging procedural feature is that only the supervisory authority may apply for the opening of insolvency procedures with the management of the insurance company being obliged to report to the supervisory authority if a ground for insolvency exists (§ 312 VAG 2016).

In Swedish law, bankruptcy procedures may be opened if a legal person is not able to pay its debts and this inability is not merely temporary (obestånd, chapter 1 § 2 Bankruptcy Act). An alternative to a bankruptcy procedure which is not open to insurance undertakings, however, is a reconstruction procedure according to the Company Reorganisation Act.

In both jurisdictions, each insolvent entity forms its own bankruptcy estate, where its assets are distributed among the creditors, depending on their rank. Intra-group transactions may lead to claims by one group company against its insolvent affiliate. Intra-group claims are not consolidated and are, in general, treated like any other claim by third parties, with the exception that loans granted by a parent undertaking to a subsidiary are subordinated by law according to German Insolvency Statute (§ 39 (1) no. 5 Insolvenzordnung), a provision that is applied also on many other constellations of intra-group claims. Swedish law does not know any general subordination of shareholder loans.

U.S. courts have in a number of cases involving two or more bankrupt affiliated corporations applied so-called substantive consolidation where the corporations are treated as if they were a single corporation, so that all their assets and liabilities are merged into one single bankruptcy estate against which all creditors of allowed claims need to lodge their claims. Nevertheless, substantive consolidation is also in U.S. law the exception to the rule that each legal person has its own bankruptcy estate. Examples where substantive consolidation has been applied concern group companies whose economic affairs have been entangled in such a way that it would have been impossible or at least very costly to disentangle them and where creditors dealt with the entities as if they were a single economic unit, an argumentation which reminds of the veil piercing doctrine. Substantive consolidation seems to be possible in some EU member states.

With the recast of the Insolvency Regulation, which is not applicable to insolvency proceedings involving insurance undertakings (Article 1 (2) (a)), a new chapter on insolvency proceedings concerning groups of companies has been inserted, requiring courts and insolvency practitioners to cooperate when insolvency proceedings are

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607 On http://uk.practicallaw.com/resources/global-guides/internationalinsolvency-guide, the results of a questionnaire sent out in 2015 to business lawyers in a number of European and non-European states on the respective states insolvency law are published. Among the EU member state laws presented in the guide, Finnish, French, Dutch and Polish insolvency laws are reported to allow for substantive consolidation in certain cases.
initiated concerning two or more companies belonging to the same (vertical) group. The regulation also provides for the possibility to appoint a group coordinator to facilitate coordination of the insolvency proceedings. To the coordinator’s tasks belong the proposal of a group coordination plan with recommended measures to achieve an integrated approach to the insolvency proceedings, including the settlement of intra-group disputes, and to act as a mediator in disputes between two or more insolvency practitioners (Article 72 EU Insolvency Regulation). It is important to note that the Regulation does not provide for procedural consolidation where all insolvency proceedings would be concentrated at the same court and a common insolvency administrator would be appointed. The EU Insurance Regulation can therefore be seen as a confirmation of the legal entity approach in insolvency law.

The legal entity approach applied in Swedish and German insolvency law, i.e. the limitation of the shareholder’s liability, has the effect that the assets of a parent undertaking whose subsidiary is insolvent, are unavailable for the subsidiary’s creditors. The insolvency laws of both jurisdictions only give the possibility of reaching assets owned by a solvent parent company if the insolvency administrator can successfully contest a transfer of assets from the subsidiary to the parent undertaking, by applying the general rules on contesting transactions. Grounds for contesting such transfers include wilful disadvantage of creditors, gratitious benefits, and payments that have been effectuated at a time when the debtor was already illiquid. The limitation of liability granted by company law is thus respected and upheld in insolvency law.

The critique rendered against limitation of liability within corporate groups was fuelled during the financial crisis by the use of taxpayer money to save credit institutions. The EU has responded to this in 2014 with the Banking Resolution and Restoration Directive (“BRRD”), providing tools for member states to restore failing credit institutions. According to recital 5 of the preamble, the directive seeks to establish a regime where “shareholders bear losses first and creditors bear losses after shareholders”. The directive envisages resolution measures outside insolvency proceedings, giving the competent resolution authority the power to sell parts of the credit institution’s business to a third party, to transfer assets, liabilities and shares to a so-called bridge institution, to transfer assets to an asset management vehicle and to write down liabilities (“bail-in”). The aim that shareholders bear losses first can be achieved by capital reductions, canceling shares, dilution of shareholders by capital increases, or

608 The Regulation does not hinder member states from legislating on procedural consolidation with regard to cases concerning groups where all insolvency proceedings take place in the same member state, cf. Stephan Madaus, Insolvency proceedings for corporate groups under the new Insolvency Regulation, International Insolvency Law Review (2015), pp. 235-247, at p. 237.
609 See chapter 4 Swedish Bankruptcy Act and chapter 3 German Insolvency Statute for the various grounds and their prerequisites.
610 Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.
transfer of shares to bailed-in creditors. However, the directive respects limited shareholder liability because it does not impose any liability on shareholders to provide additional capital, but merely tries to make sure that shareholders do not profit from resolution mechanisms at the expense of others. The worst that can happen is that the shareholders will be deprived of their shares, which economically has the same effect for them as if the credit institution would have gone into bankruptcy.

The BRRD, which is not applicable to insurance undertakings, therefore does not serve as an example of a changing attitude towards limited liability in insolvency or near-insolvency situations.

To conclude, insolvency law in Sweden and Germany as well as the EU Insolvency Regulation respect the company law concepts of limited liability and follows a legal entity approach.

5.3 Corporate Groups in Environmental and Tort Law

The arguments in favour of limited liability are less compelling with regard to involuntary creditors compared to voluntary (contractual) creditors, who have actively chosen to enter into a contractual relationship with a company.611

While competition law has already been dealt with above in the context of the ECJ’s jurisdiction, here environmental law and tort law in general shall be shortly addressed, well aware of the fact that these areas of law belong to public law and private law respectively and thus concern different kinds of creditors (the state in the case of environmental law and natural or legal persons in the case of tort law).

In general, limited liability is upheld in both Swedish and German tort and environmental law. The Environmental Liability Directive requires member states to hold operators of certain activities liable to remedy environmental damage caused by that activity according to the “polluter pays principle”, with operator being defined as

“[…] natural or legal, private or public person who operates or controls the occupational activity or, where this is provided for in national legislation, to whom decisive economic power over the technical functioning of such an activity has been delegated, including the holder of a permit or authorisation for such an activity or the person registering or notifying such an activity” (Article 2 (6)).

The Swedish preparatory works to the implementation of the directive in the Environmental Code (Miljöbalken) take up the question of whether a parent undertaking can be considered to be an operator. The legal or natural person who operates or controls the polluting business is considered the polluter, however it is not sufficient that someone

611 See Armour, Hansmann and Kraakmann, p. 11; Easterbrook and Fischer, p. 111; see also chapter 5.5.
has control over a polluter, i.e. it is not sufficient that a parent undertaking holds all shares in the polluter, but it needs to have control over the actual activities that have caused the pollution. The preparatory works give the following example for when a parent undertaking may be deemed to be an operator: Parent company and subsidiary share the same facilities, and the subsidiary’s activities are entirely dependent upon resources provided by the parent undertaking. In a case from 2013, the Land and Environment Court of Appeal (Mark- och miljööverdomstolen) held a parent undertaking responsible for water pollution caused by a subsidiary prior to its liquidation because the parent undertaking had given capital contributions to its prior subsidiary that enabled the subsidiary to continue the loss-bearing business that caused the pollution. Case law from the ECJ or the German Courts on this aspect of the definition of operator does not yet exist. Bergkamp notes that the Environmental Liability Directive does not provide for a general liability of non-polluting parent undertakings and argues that treating a parent undertaking as operator even if it does not exercise direct control over the operations of the polluter might contravene the Directive’s objectives because it would incentivize parent undertakings to discontinue corporate environmental auditing programs because this could be interpreted as indicating control. The author sees, however, a possibility that current developments in corporate group and supply chain liability may influence the interpretation of the Directive in future court decisions.

Particularly English courts have dealt with a number of cases where parent undertakings have been sued for damages for human rights violations or environmental damage caused by or attributed to their foreign subsidiaries. In the widely-noticed decision in Cape plc from 2012, the Court of Appeal in London held that a British parent company had a duty of care towards the employees of its South African subsidiary that had manufactured asbestos products several decades ago. This duty of care arose out of the parent undertaking’s practice of submitting its subsidiaries to parent company direction in certain areas, for instance by giving instructions to its subsidiary concerning the product mix. Other circumstances the Court took into consideration was the parent undertaking’s employment of a chief chemist and medical advisor who was engaged in research on asbestosis and in health and safety-related activities also for the South-African subsidiary and therefore had superior knowledge and expertise in this field.

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612 Prop. 2006/07:95, Ett utvidgat miljöansvar, p. 57 f.
613 Ibid, p. 57 f.
614 Mark- och Miljööverdomstolen, MÖD 2013:28, p. 5.
616 Ibid, p. 189.
618 Chandler v Cape plc, paras. 73 and 75.
619 Ibid, paras. 75-78.
This judgment has the potential for paving the way for a relatively wide liability in tort for subsidiaries, but in 2018, the Court of Appeal denied jurisdiction by majority decision with one judge dissenting in two cases where Shell was sued by Nigerian citizens and a Nigerian community for harm suffered due to land contamination by oil spills and sabotage from oil pipelines and infrastructure operated by Shell’s Nigerian subsidiary. The assenting judges denied a duty of care by Shell towards Nigerians living in the vicinity of the pipeline because in their view, the claimants had not demonstrated that Shell controlled the operations of its Nigerian subsidiary.620

There are undeniably some cautious developments towards an increased parent undertaking responsibility in the field of human rights, environmental and supply chain liability that have been driven by activist organisations, but as the Shell jurisdiction case shows, it remains difficult to hold a parent undertaking responsible for torts committed by its subsidiaries. At present, limited liability continues to be respected in tort law.

5.4 Corporate Groups in Tax Law

As a general rule, both Sweden and Germany tax the income of the separate legal entities belonging to a group. However, group affiliation may have an influence on the tax burden of a legal entity.

In Sweden, a very limited form of enterprise approach is applied in corporate tax law. According to the expert commission encharged by the Swedish government to develop a proposal for a new corporate tax system, an important principle of the current corporate tax system is that the overall tax burden shall be the same notwithstanding whether business is conducted within a group of companies or within a single entity, because tax issues shall not incentivize one or the other form of organisation.621 This is achieved by allowing so-called koncernbidrag (“group contribution”) to be rendered from group companies to other group companies as a means for setting off the results between group companies according to chapter 35 Income Tax Act (Inkomstskattelag). The legal entity rendering the group contribution may deduct it from its taxable income while it increases the receiving entity’s taxable income, provided that a number of perquisites are fulfilled, such as taxability in Sweden and a minimum shareholding of 90 %.622 The basis for taxation, however, continues to be the profit calculated at company level, so that profits generated through intra-group transactions are not eliminated, merely moved to another group company.623 With regard to subsidiaries that are not subject to taxation in Sweden, chapter 35a Income Tax Act allows under certain circumstances Swedish parent

620 Court of Appeal (Civil Division), 14 February 2018, Okpapi and other v Royal Dutch Shell plc, paras. 127 and 205.
undertakings to deduct losses incurred by liquidated foreign subsidiaries from their taxable income. This group deduction (koncernavdrag) was inserted following a decision of the Supreme Administrative Court (Regeringsrätten, since 2010: Högsta förvaltningsdomstolen) from 2009, where the court held that the limitation of the group contribution rules to Swedish tax subjects in some aspects violated the freedom of establishment guaranteed by EU law. Chapter 40 Income Tax Act also allows tax subjects to carry forward losses, i.e. to set off profits with losses from previous taxation periods.

The above-mentioned expert group mentions the Netherlands, Denmark and France as states allowing for corporate taxation based on consolidated results. These states thus seem to apply or at least provide the opportunity to make use of an enterprise approach.

Germany generally applies a legal entity system. In contrast to the Swedish tax system, group contributions or group deductions are in principle not allowed. Instead, Germany allows legal entities to carry forward losses. This, however, only applies to losses incurred by the same legal entity. Only when a körperschaftsteuerliche Organschaft exists, the profit or loss of a subsidiary is aggregated to the taxable income of the the parent according to § 14 Corporate Income Tax Act (Körperschaftsteuergesetz). This presupposes among other, the existence of a domination and profit and loss transfer agreement with a duration of at least 5 years, whereby the parent undertaking is obliged to compensate the subsidiary for any annual losses that arise during the existence of the agreement.

The national corporate tax systems will however, at least in part, be affected if the EU Commission succeeds with its Common Consolidated Corporate Tax Base project. In October 2016, the Commission re-launched two directive proposals for a corporate taxation based on common rules for the calculation of taxable income as a first step and the consolidation of taxable profits and losses within a group as a second step. The proposals are supposed to eliminate current possibilities of tax avoidance by profit-shifting between member states while at the same time providing for a more business-friendly tax system by reducing administration costs for businesses. If the proposals are adopted, the system will be mandatory for the largest multinationals and optional for other businesses. Consolidation in this context means that the taxable income will consist of the net loss or profit of all group companies in the EU. The company’s taxable profits

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624 RÅ 2009 ref. 13–15.
628 Ibid.
PERSPECTIVES ON GROUPS IN OTHER LEGAL DISCIPLINES

will then be apportioned between the member states based on factors like the location of its assets, number of employees and sales in each member state. Each member state taxes the portion of profits attributed to it.

The Commission had already launched a similar proposal in 2011 upon which the member states could not agree. If the re-launch is successful, this will mean that at least for the largest corporate groups, an enterprise approach will be applied with regard to corporate taxation.

We can conclude that the legal entity approach is still prevailing in corporate income tax law, albeit modified in certain cases by features taking group affiliation into consideration, and with a few EU member states already applying an enterprise approach. A further move towards the enterprise approach can be observed with the Commission’s proposal.

5.5 Proposals for different approaches to parent company liability

Even though limited liability has become a well-established feature of company law, its application in group contexts is still (or again) met with criticism by some groups of legal scholars. Modifications to it had also been the subject of a legislative proposal by the Commission in the 1970s and 1980s.

Antunes criticizes both the entity and the enterprise approach as too rigid and formalistic, stressing either the diversity of the group and neglecting its unity, or vice versa. He proposes that control and liability should be connected in such way that a parent undertaking should be liable for its subsidiary’ debts if the liability in question has arisen from a business decision exercised under the control of the parent undertaking. If the decision has been taken autonomously, the parent undertaking should not be liable. The decisive question should therefore not be whether the parent undertaking was in a legal or practical position to exercise control, but whether it has actually done so, because corporate groups in most cases cannot be categorized as centralized or decentralized, but usually are somewhere in-between. Since creditors usually have no or very limited insight into the decision processes within a group, the burden of proof should be reversed according to this proposal.

A similar approach is defended by Strasser and Blumberg, who advocate the general application of a theory of enterprise analysis in all areas of law, according to which

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629 José Engrácia Antunes, Liability of Corporate Groups - Autonomy and Control in Parent-Subsidiary Relationships in US, German and EU Law (1994), p. 492. His criticism also encompasses also the German corporate group law, which he treats as a third "dualistic" approach with its differentiation between contractual and de facto groups, pp. 483-488.
630 Ibid, p. 495.
631 Ibid, p. 495.
“separate corporations under common control are presumptively operating one business enterprise and should be thought as such”, which would in most cases result in a parent undertaking’s inability to invoke limited liability. Parent undertakings – as opposed to investor shareholders – should in general be fully liable for their subsidiaries in order to reflect the economic reality of the corporate group. According to this line of thought, the possibility of invoking limited liability does not fit for modern corporate groups, because its economic justification only applies to investor shareholders, but not to parent undertakings that have the possibility to fully control and integrate their subsidiary’s business. Full liability by the parent undertaking would also eliminate incentives to use group structures to evade legal policies, such as in environmental, tax or bankruptcy law. The proponents of this view share a profound scepticism against corporate groups, especially large multi-national groups, and can, of course, point to numerous examples where group structures have been misused.

Teubner suggests that joint and several liability should be applied if and to the extent that the relevant decision-making process (“der haftungsmä ßig relevante Handlungszusammenhang”) has been centralized. This does not lead to a liability of the parent undertaking, if it has not been involved in the action in question. Instead, a single group undertaking could remain liable solely or jointly with those parts of the group, where the process has been centralized. Liability would not be based on legal relationships between group undertakings, but would follow the factual organisation of the group, so that units that are combined in profit centers, for instance, would be liable for their actions.

Others take a different approach and want to restrain the possibility of parent undertakings to invoke limited liability in respect of involuntary creditors, primarily in tort cases, because this group of creditors does not have any possibility to adjust for the financial situation of the creditor before being injured. They argue that the economic justification for a limitation of liability does not hold with respect to tortfeasors and advocate a pro-rata liability of shareholders in proportion to the size of their shareholding for tort claims against companies. Another analysis suggests that limited liability is the most efficient solution for widely-held large corporations, and unlimited liability most efficient with regard to tightly-held small corporations.

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632 Examples of exceptions are certain cases of contractual liability.
638 Ibid, at p. 1932 f.
639 Halpern, Trebilcock and Turnbull, p. 147 f.
The Commission presented in 1974 and 1975 in two steps its first draft for a proposal for a Ninth Company Law Directive containing a legal regime for group regulation. According to this first draft, parent undertakings would have been liable for their subsidiaries’ debts. This liability would have been direct towards the subsidiary’s creditors, unlimited but subsidiary, i.e. it could only be invoked after the creditor’s written demand towards the subsidiary has not been satisfied. Only in exceptional circumstances, the parent undertaking would have been able to escape liability. In later drafts, it was made easier to avoid liability and the draft from 1984 had strong resemblance to the German group company law. The draft proposal was revised in 1977 and 1984, but met little support and the Commission therefore never proceeded to launch an official legislative proposal. Instead, the Commission has several times announced more limited legislative actions in the field of group company law, for instance in a Communication from 2003 the presentation of a directive proposal “in the medium term” on the possibility for a group management on the basis of a coordinated group policy, or in its Company Law Action Plan from 2012 the presentation of an initiative on the recognition of the concept of “group interest” for 2014. To my knowledge, no such legislative procedures have been initiated so far.

5.6 Groups from an accounting perspective

Financial reports about corporate groups have emerged in the United States from the 1880s, initially as internal reports to meet the parent company’s owners’ information needs. From 1901 on, more and more US groups published their group reports, at first on a voluntary basis. With more and more companies establishing subsidiaries, shareholders saw a need for information about the performance of the group as a whole, eliminating the group results from intra-group transactions.

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640 Antunes, p. 286.
647 European Commission, Communication from the Commission to the the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, 12 December 2012, p. 14 f.
Sweden required parent undertakings to prepare a kind of group report in the ABL 1944, with a right to choose between setting up a group balance sheet or a more limited group report. Their legal purpose was to limit the distribution of dividends by the parent company to the group’s annual profit (and its own profit). This specific Swedish purpose was a reaction to the spectacular insolvency of the Kreuger group in 1932. However, until the ABL 1975, there was no obligation to present the group financial statements to the shareholders or the public – it sufficed that the board of directors and the auditor had access to them. Even in the preparatory works for the ABL 1975, it was emphasized that the main function of group reporting was to limit the distribution of profits to those reported in the the consolidated financial statements. The provision of information to other stakeholders such as employees or creditors seemed to be nothing but a positive side-effect. The explicit limitation of the distributable profit on the basis of the group reporting was abolished with the ABL 2005. This had the effect that all parent undertakings were subjected to the same rules in this respect, because small groups were already since 1996 not required to prepare consolidated financial statements and therefore were not subject to the limitation of distributable profits. In the preparatory works, it was also argued that other European states measure the distributable profit only on the basis of the parent company’s annual accounts and not on the basis of consolidated accounts and that the Swedish prudence principle still requires the consideration of the group’s economic situation when determining the size of a dividend.

Therewith, Swedish law is now aligned in this respect to the corresponding legislation in other industrialized states, where group financial statements have the function of providing information. Küting also mentions their function as documentation and decision instruments and points out that group financial statements nowadays are much more important for stakeholders than financial statements at company level, for instance when taking decisions on investments or loans.

At EU level, the Seventh Directive from 1983 required member states to oblige groups exceeding certain indicators to set up consolidated accounts from 1990 on. While

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651 Prop. 1975:103, Regeringens proposition med förslag till ny aktiebolagslag m. m., p. 280.
654 See Sandström, p. 53 on the Kreuger insolvency.
655 Prop. 1975:103, Regeringens proposition med förslag till ny aktiebolagslag m. m., p. 280. An obligation to present a group balance sheet and group profit and loss statement to the general meeting, was introduced in 1975 (chapter 9 § 5 ABL 1975).
656 Cf. Ibid, pp. 283, 286.
657 Prop. 2004/05:85, Ny aktiebolagslag, p. 933 f.
658 Ibid, p. 933 f. See also chapter 9.3.1.2.1.
659 Karlheinz Küting, Philipp Grau and Christoph Seel, Grundlagen der Konzernrechnungslegung - Eine Einführungsvorlesung, 22 Beihefter zu DSIR (2010), p. 35-61, at p. 43.
most OECD member states, such as the U.S., Canada, the United Kingdom, Germany, Japan, Italy and the Nordic countries, already required group reporting, the OECD identified in 1987 several states that did not yet, or only in exceptional cases, namely Greece, Luxembourg, Portugal, Turkey, and Switzerland.661

Group financial accounts are based on an enterprise approach, i.e. the group is treated as if it was a single economic entity.662 For IFRS accounts, this is laid down in IFRS 27.4:

“Consolidated financial statements are the financial statements of a group presented as those of a single economic entity”.

A corresponding provision can be found in § 297 (3) HGB which is applicable for groups that need to prepare group financial statements according to German GAAP. Swedish law, on the other hand, seems to be lacking an explicit corresponding provision. Chapter 7 Accounting Act (Årsredovisningslagen) and chapter 7 Insurance Accounting Act (Försäkringsårsredovisningslagen) imply, however, that the same principle applies in Swedish law.

Group accounts are prepared by consolidating the parent company’s financial statements with the financial statements of the legal persons included in the group financial account, usually by way of line-by-line consolidation while eliminating intra-group transactions, because the fictitious economic entity would not be able to transact with itself.664

The conceptional background of the different consolidation methods is shortly described in chapter 8.4.

As a conclusion, we can note that in group accounting, the enterprise approach is applied, but the legal role attributed to consolidated accounts is limited to provide information about the financial situation of the group, i.e. there are no legal sanctions or direct consequences connected with the consolidated accounts. This needs to be distinguished from the “indirect” legal significance attributed to group accounts: As an important source of information, various actors take them into consideration in their business or administrative decisions, or agree with another party about contractual consequences connected with the group accounts, such as the right to demand premature repayment of a loan, or the size of bonus payments to managers.

661 OECD, Consolidation Policies in OECD Countries. Report by the Working Group on Accounting Standards, 1987, p. 7. The authors of the report noted that major Swiss groups prepared and published consolidated accounts on a voluntary basis and that a legislative proposal had been made to make group reporting obligatory.


663 The debate, whether consideration at equity is a consolidation or a valuation method, does not need to be discussed here.

664 For a more detailed description of the process of preparing consolidated financial statements, see Küting, Grau and Seel, pp. 39 f. IFRS 27.22 – 27.36 also contain rules on the consolidation process.
5.7 Conclusions

Most legal areas uphold the legal boundaries between companies. Accounting law and competition law are the areas of law where an enterprise approach is applied in the most consistent way, albeit with a very different impact. In competition law, it works both in favour of groups, but also to a parent undertaking’s disadvantage, whereas the group reporting requirement in accounting law merely serves information purposes. Trends towards the enterprise approach can be observed particularly in tax law – to the advantage of groups –, and to some extent in environmental law – to the disadvantage of parent undertakings. When liability is imposed on a parent undertaking for a subsidiary’s wrongdoings, this is often motivated with some kind of interference by the parent undertaking.

Limited liability is not an overarching principle of EU law, and there are important exceptions to it, but it is still upheld in most legal areas, most importantly in company and insolvency law.
6 On risk and solvency

The rationale behind the capital requirement for insurance undertakings at solo level is easily explained: An additional buffer protects policyholders from the risk that technical reserves prove to be insufficient or that other unexpected losses occur.

Whether a group capital requirement is necessary, is less obvious. As has been mentioned in chapter 3.9.4, it was introduced in order to prevent harm to policyholders through so-called double gearing, i.e. the use of own funds in an insurance subsidiary to cover the solvency margin of both the insurance undertaking and its parent undertaking.

Both the solo and the group Solvency Capital Requirement aim at increasing policyholder protection from the risk that an insurance undertaking becomes unable to fulfil its obligations. A good starting point is therefore to look both into the risks faced by insurance undertakings and into the causes why insurance undertakings have failed in the past. Of particular interest in the course of this study are, of course, group-related risks and and in how far group related issues played a role in actual failures.

Before risks materialize, they constitute potential threats to the financial situation of an insurance undertaking. Risks can be managed by reducing the likelihood of their materialization or by taking measures to reduce the impact if they materialize: The probability of a large fire causing an underwriting loss can be reduced if the insurance undertaking requires the policyholder to take measures to prevent fire from spreading, for instance by installing fire doors or a sprinkler system. The exclusion of insurance compensation for damages resulting from terrorist attacks in insurance policies for large industries cannot hinder terrorist attacks, but it reduces the financial risks for the insurance undertaking connected with insuring policyholders particularly exposed to terror risk. The impact of a sudden fall in stock prices can be managed by limiting investment in shares.

By requiring a risk-adequate capitalization, Solvency II incentivizes insurers to reduce the impact of the materialization of risks.

6.1 Risks faced by the insurance industry

Insurance undertakings belonging to an insurance group are subject to a variety of different types of risks. Some risks are inherently connected with their specific business, others are of a more general nature. In the context of this thesis, a distinction between risks that are independent of any group affiliation and group-related risks seems appropriate, with the first being described in a very concise way only.
6.1.1 Risks faced by insurance undertakings irrespective of group affiliation

Irrespective of any group affiliation, all insurance undertakings are subject to risks that are closely or inherently connected with their insurance business, and to risks that do not have their origin in the insurance business.\textsuperscript{665}

Underwriting risk belongs, of course, to the first category. In short, it concerns the risk that the technical reserves are insufficient to cover the obligations towards the insurer’s policyholders. Since technical reserves are the result of actuarial calculations, significant differences between the assumptions underlying the calculations and the actual outcome may lead to a need to increase the reserves. These assumptions may concern the loss frequency, the cost development of insured risks, policyholder behaviour, demographic developments, and connected to all of this, the sufficiency of insurance premiums.

Insurance undertakings need large amounts of assets to cover the technical reserves. They are therefore subject to investment risk, i.e. the risk that the value of their assets diminishes, for instance due to a drop of share prices, changes of interest rates, currency exchange rates, or the default of obligors such as reinsurers or issuers of securities.

In addition, the financial situation of an insurer may be harmed by a number of other circumstances, for instance IT failures, criminal acts such as fraudulent behaviour by the insured or others, non-compliance with legal obligations leading to fines or liability claims, or with public expectations, both of which involves reputational risks.

6.1.2 Group-related risks

For the risks described above, it is irrelevant whether the insurance undertaking is part of a group or not. Being part of an insurance group is connected with both risks and opportunities, which are supposed to be reflected – to the extent possible – in the group Solvency Capital Requirement.

To the opportunities belong access to specialist expertise within the group, the possibility to use a common trademark with “higher visibility” on the market, cross-selling opportunities, access to capital and more favourable financing conditions, as well as lower costs by sharing certain functions with other group companies, such as sales, marketing, claims handling, accounting, legal services, compliance, or the actuarial function. Diversification effects are probably most important for the parent undertaking, but may have a positive effect for insurance subsidiaries as well, as they may have a

\textsuperscript{665} See also chapters 8.1.2 and 8.1.2.1 for a more detailed description of the treatment of risks in the context of the calculation of solvency capital requirement.
stabilising impact on the parent undertaking with a positive effect on financing costs and therewith on the parent’s ability to support the subsidiary.

The other side of the coin are specific risks that are connected with being part of a group, usually called “contagion risk”. If one group company gets into some form of difficulty, this may spread to its related undertakings with a negative impact on their financial stability. The reasons for a possible contagion vary and may be of a legal, financial or commercial nature.

6.1.2.1 Commercial contagion risk

The commercial contagion risk consists of the risk that problems in one group undertaking negatively affect the reputation of other group companies, only because they belong to the same group.

An example could be a life insurance company that rewards its most successful insurance agents not only with inadequately luxurious incentive voyages, but even hires prostitutes for the parties held during such get-togethers. If this became known to the public, it would likely produce a scandal that might affect even other group companies, especially if they are acting under the same trademark. Even if the other insurance undertakings of the group have nothing to do with it, they might (at least for a while) suffer a reduction in new business and higher cancellation numbers than usual, particularly if they provide consumer insurance.

This reputational contagion risk is very difficult to quantify and it might often be overestimated. The example above has been inspired by a scandal revealed in 2011 concerning the sales organisation of a life insurer belonging to the German Ergo group which received a lot of media attention. At group level, the consolidated total premium income increased with 1.0 % during 2011 compared to 2010, and decreased with 8.4 % in 2012. How much of the decrease is attributable to the sex scandal can only be speculated about. In the annual group report 2012, a 6.1 % decrease is explained to be the result of the divestment of insurance portfolios, and the remainder is attributed to the low interest-rate environment that negatively affected the attractiveness of life insurance policies and led to a drop in the sale of single-premium policies. The lack of a more tangible effect on the premium income can be explained with the long-term character of life insurance policies making it more difficult for customers to change their insurer, but it does not seem as if the scandal had a negative effect on the non-life insurance business of the Ergo group either.

Another example would be the insolvency of a life insurance company which would probably have a similar effect on other group companies, even if there are no financial relations to the failing company, because many customers (especially consumers) do not differentiate between different group companies, at least not if the companies are active

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666 ‘Interner Bericht zum Sex-Skandal der Hamburg Mannheimer "We love Hamburg Mannheimer“’, Sueddeutsche.de (29 august 2012).
on the same geographical market, use the same trademark and have the same target group.

6.1.2.2 Legal contagion risks

Legal contagion risks arise from transactions between group undertakings. Often, they are connected with transactions concerning the financing of a group undertaking. To this group of risks belong different forms of security provided by one group undertaking for a legal obligation of another group undertaking.

- **Guarantees and collateral**

A common form are guarantees granted by the parent undertaking on behalf of a subsidiary, for instance parental guarantees issued by the parent undertaking of an insurance undertaking that are enforceable by policyholders if the subsidiary fails to pay claims. Another example is a guarantee by the parent for a bond issued by a subsidiary. Joint and several liability with a subsidiary is also mentioned as a legal contagion risk, but is probably less common in insurance groups.

Collateral provided either by the parent for a loan taken by a subsidiary (downstream financing) or the other way round by a subsidiary for a loan taken by the parent (upstream financing) are other examples.

- **Cash pooling**

Cash pooling within a group is also connected with a contagion risk. In a so-called “physical cash pooling” system, the group companies belonging to the pool transfer liquidity to a bank account held by a group company, usually the parent. The pool members withdraw funds from the pool to meet their own payment obligations, for instance claims payments or payment of salaries. Depending on the amount of funds paid in and funds taken out, the group companies either have a claim or a debt against the members of the pool. The advantage of a cash pool is that it reduces the need for and therefore also the cost of external financing, because the pool members can use each other’s liquidity surpluses and thereby grant short-term loans to each other.

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671 This kind of guarantee is common when bonds are issued through separate financing vehicles. An example is a bond issued in 2014 by PZU Finance AB (publ), a company incorporated in Sweden and wholly-owned subsidiary of the Polish insurance company (and guarantor) Powszechny Zakład Ubezpieczeń S.A.. Information based on the prospectus available at http://www.ise.ie/debt_documents/Prospectus%20-%20Standalone_df1c190b-9360-4abf-ae55-78b7b4d3f3b8.PDF (accessed 2016-04-29 at 15:03).
672 Siemon and Frind, p. 4.
In a so-called “notional cash pool”, the pool members have separate bank accounts that together form a cash pool in the sense that interests payable by a pool member on a negative balance and interests payable by the bank on a positive balance are calculated on a consolidated basis, having a positive effect from a group perspective on the interest costs.\(^{675}\) While the pool members of a notional pool do not transfer funds to a bank account belonging to another entity, they usually are required to issue guarantees towards the bank for debts of the other pool members.\(^{676}\)

The design of a cash pool is very much influenced by the company law provisions applicable to the pool members,\(^{677}\) limiting for instance the amount transferable to the pool, or obliging them to constantly monitor the creditworthiness of the other pool members\(^{678}\). Common for both types of pools is that if a pool member becomes insolvent and cannot pay back its debts to the pool, this affects the other pool members negatively, of course. Examples of groups that use some form of cash pooling are the Swedish If group\(^{679}\) and German Allianz group\(^{680}\).

- **Cross default provisions in loan agreements**

Another legal risk connected with financing transactions stems from so-called “cross default” provisions in loan agreements between a parent undertaking and an external lender. Such a provision gives the lender the right to prematurely terminate the loan agreement and demand repayment if a borrower’s subsidiary fails to fulfil any of its financial obligations (towards any third party) when due. The opposite situation is also possible, i.e. a termination right in a loan agreement between a company and a lender if the company’s parent undertaking falls insolvent.\(^{681}\)

- **Group-internal reinsurance arrangement**

Another legal risk arises if the insurance undertakings of a group have reinsured each other.

Reinsurance has a risk-mitigating effect insofar as a portion of the claims risk is borne by the reinsurer.\(^{682}\) However, since the insurance undertaking stays responsible towards its policyholders, it bears a counterparty risk if the reinsurer is unable to fulfil its obligations.

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675 Schürnbrand in: MüKo AktG, § 188 para. 19.
677 Concerning the compatibility with the German rules on capital increases, see, for instance, Herrler in: Spindler/Stütz AktG, § 27 paras. 303 – 316, concerning the applicability of § 311 AktG on cash-pools, see Habersack in: Aktien- und Konzernrecht, § 311, para. 48.
678 Krieger in: MHdGR AG, § 70 para. 64.
679 If Skadeförsäkring AB (publ), Årsredovisning 2014, p. 17.
681 Siemon and Frind, p. 6.
682 See also chapter 8.1.2.3.
In groups with both primary and reinsurance undertakings, it is common that there are many intra-groups reinsurance contracts, for instance by giving the group reinsurer a preferential position or by obliging it to assume certain risks. But even insurance undertakings belonging to groups without a reinsurer may cede business to each other (so-called “indirect insurance”).

Some groups “institutionalize” group-internal reinsurance, for instance by creating reinsurance pools in which the group’s insurance undertakings participate and to which they cede a portion of their business. Depending on the exact formation, such pools may constitute (unregistered) partnerships (Swedish: *enkla bolag* / German: *Gesellschaften bürgerlichen Rechts*). The main difference between such a pool solution (again depending on how exactly it is formed) and an ordinary bilateral reinsurance contract is that the pool members have to inject more funds if the premiums paid do not suffice to cover all claims (at least when the pool is liquidated), whereas the cedant’s obligation in a bilateral contract is limited to paying the predetermined premium. If a pool member becomes insolvent and the funds attributable to the pool do not suffice to cover all reinsurance claims (including possible claims of the insolvent pool member), the remaining pool members have to pay their agreed proportional share of the required funds.

- **Domination and profit and loss transfer agreements**

Where a German parent undertaking has a domination and profit and loss transfer agreement with a subsidiary, it is obliged to compensate the annual loss of the subsidiary. This constitutes, of course, a contagion risk for the parent undertaking if the subsidiary gets in financial difficulties. As mentioned above, such agreements are quite common in the German insurance industry.

- **Pension arrangements**

Depending on the functioning of the respective national occupational pension system, group-internal pension arrangements may pose a risk, i.e. if one group undertaking takes over or guarantees the pension promises granted by other group undertakings to their employees. To my knowledge, such arrangements occur in Germany, but are not common in Sweden.

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683 See the example of Hannover Re and the primary insurers of the Talanx group: Hannover Re, Annual Report 2015, p. 225.
684 See, for example, Länsförsäkringsgruppen, Årsöversikt 2015, p. 21.
685 On the legal nature of “enkla bolag” and the relationship among partners, see Herbert Jacobson, Enkla bolag i civilrätten - en splittrad företeelse (2015), pp. 17 – 44.
686 See chapter 4.4.1.2
687 This risk is mentioned in: The Supervision of Financial Conglomerates, The Tripartite Group of bank, securities and insurance regulators, July 1995, para. 52.
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6.1.2.3 Financial contagion risks

Whether a distinction between legal and financial contagion risks is appropriate can be debated, of course, because financial risk (as probably most risk) often is connected with circumstances of a legal nature, and the realisation of a legal risk usually has a negative impact on a company’s financial condition. In other words: Law regulates financial risk by allowing or forbidding certain behaviour, but it also gives parties relatively large freedom to distribute financial risk by contract – for instance by allowing parties to agree on fixed or floating interest in bond terms.

Angerer identifies three types of risk connected with a participation in an insurance undertaking: Investment risk, profitability risk and liability risk. The investment risk is the risk that the capital invested in the participation is lost because the insurance undertaking’s entire equity is consumed by losses. In other words, investment risk is the risk that a subsidiary becomes insolvent. Since a participation in another insurance undertaking is eligible as own funds of the participating insurance undertaking, an insolvency (or need to write down the value of the participation) is at the same time connected with a loss of own funds at parent undertaking level, i.e. there is a direct connection between the parent undertaking’s solvency ratio and the well-being of its insurance subsidiaries. This phenomenon is referred to as “double gearing”. Profitability risk means the risk that the participation will not be able to distribute a dividend. The liability risk is the risk that the parent undertaking will be legally or morally liable to support the participation. Such a “moral obligation” could be imposed by public opinion, requiring the majority shareholder to support a failing subsidiary to save workplaces.

6.2 Actual causes for insurance failures

Several studies have been undertaken to examine the actual causes for insurance failures and/or near misses. Even though the methodology, time horizon and study objects differ, these studies have reached quite similar results.

6.2.1 Causes identified in the Müller and Sharma Reports

With regard to EU insurers, the Müller Report from 1997 and the Sharma Report from 2002 deserve particular attention because they have influenced the Solvency II rules.

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In these reports, the results of two studies undertaken by working groups of the Conference of Insurance Supervisory Services of the Members States of the European Union at the request of the European Commission were examined.\textsuperscript{692}

In the Müller Report, supervisory authorities of all EEA states were asked to state the causes for financial difficulties experienced by insurance undertakings under their supervision. For the Sharma Report, a similar exercise was undertaken covering the period between 1996 and 2001 to obtain an update of the Müller Report. In order to be able to identify causal chains, in addition to information derived from two surveys on actual failures and near misses in the insurance sector, 21 detailed case studies were discussed by the working group.

Actual failures comprised all undertakings that had undergone specific curative measures (restoration plan, short-term finance scheme, withdrawal of authorization, or safeguard measures) following for instance a breach of the solvency margin, a shortage of technical provisions or the failure to cover them with safe and liquid assets.\textsuperscript{693} Near misses comprised cases where the minimum capital amount was not breached, but the supervisor felt a need for intervention or special measures.\textsuperscript{694}

The rating agency Standard & Poor’s describes in a publication from 2013 its view on the causes of insurance failures, being defined as “[…] company defaults, liquidations, or regulatory takeovers or "near miss" situations where these would have occurred if the company had not received external support.”\textsuperscript{695} It covers insurance failures anywhere in the world from the 1980s onward that have influenced the agency’s rating methodology.

Another study examines the causes behind involuntary market exits of Canadian property and casualty insurers during the period of 1960 to 2005.\textsuperscript{697} Since it does not comprise insurers that recovered from financial difficulties, it has a narrower approach than the Müller and Sharma Reports.

The Müller Report observed the following types of difficulties experienced by distressed insurance undertakings:\textsuperscript{698}

\begin{itemize}
  \item CEIOPS did not yet exist at the time.
  \item See Sharma Report, Annex C.
  \item Sharma Report, section 3.3.3.
  \item While S&P usually categorizes default as a failure to pay debt obligations, it also classifies insurance undertakings as being in default if the regulator take supervisory action against it due to its financial situation. The rating "R" awarded in these cases is equivalent to "D" (default”); Standard & Poor's Rating Services, What May Cause Insurance Companies To Fail--And How This Influences Our Criteria, Ratings Direct (June 13th, 2013), p. 5.
  \item Ibid, p. 3.
  \item Müller Report, Annex 1, section 3.2.1 with regard to non-life insurance and section 3.3.1 with regard to life insurance.
\end{itemize}
ON RISK AND SOLVENCY

<table>
<thead>
<tr>
<th>Non-life insurance</th>
<th>Life insurance</th>
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<tbody>
<tr>
<td>Failure to meet solvency ratio and minimum guarantee fund requirements</td>
<td>Failure to comply with reserved asset requirements</td>
</tr>
<tr>
<td>Substantial losses during start-up phase</td>
<td>Failure to meet solvency ratio and minimum guarantee fund requirements</td>
</tr>
<tr>
<td>Failure to comply with reserved asset requirements</td>
<td>Substantial losses during start-up phase</td>
</tr>
<tr>
<td>Steady deteriorating results</td>
<td>Losses from non-insurance business</td>
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<tr>
<td>Inappropriate capital structure</td>
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<tr>
<td>Steady decline in own funds</td>
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<tr>
<td>High balance sheet losses</td>
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<tr>
<td>Insolvency and bankruptcy</td>
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The most frequent causes of difficulty according to the report were:699

<table>
<thead>
<tr>
<th>Non-life insurance</th>
<th>Life insurance</th>
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<tbody>
<tr>
<td>Inappropriate underwriting policy</td>
<td>Excessive transaction and administration costs</td>
</tr>
<tr>
<td>Poor management</td>
<td>Under-pricing in connection with an inappropriate underwriting policy</td>
</tr>
<tr>
<td>Inadequate investment policy (e.g. over-reliance on real estate assets, whose value slumps following the collapse of national property markets; losses on equity interests – including in affiliates – as a result of contagion)</td>
<td>Inadequate investment policy</td>
</tr>
<tr>
<td>Insufficient provisions for unsettled claims, in order to keep the solvency ratio low</td>
<td>Criminal enterprise</td>
</tr>
<tr>
<td>Lack of an appropriate reinsurance policy (quality of the assignee) and of an effective reinsurance system providing sufficient protection</td>
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<tr>
<td>General under-capitalisation with regard to underwritten risk</td>
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<td>High losses due to rapid growth</td>
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<tr>
<td>Poor risk performance</td>
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<td>Criminal enterprise</td>
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<tr>
<td>Double gearing</td>
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699 Müller Report, Annex 1 section 3.2.2 with regard to non-life insurance and section 3.3.2 with regard to life insurance.
The differences in the number of observed types and causes of difficulty between life
and non-life insurance can be explained partly with the low number of failures of life
insurers, partly with the then existing rules on the valuation of technical reserves
applicable to life insurance reducing the risk of under-valuation of liabilities.\textsuperscript{700}

The rating agency Standard & Poor’s also lists under-pricing and poor liquidity
management among the key factors present at insurance failures. Other key factors
according to S&P are:

- A high tolerance for investment risk
- Management and governance issues
- Difficulties related to rapid growth and/or expansion into non-core activities
- Sovereign-related risks.\textsuperscript{701}

A general observation made in both studies is that there is never only one reason why an
insurance undertaking gets into financial difficulties, but rather a combination of reasons
or a chain of causes. Internal causes, such as management problems or problems with
shareholders were usually identified as the underlying cause.\textsuperscript{702} The study on involuntary
market exits of Canadian property and casualty insurers observed strategic choices and
risk appetites to be “at the root of all causes of insolvency” having caused market exit in
61 \% of all cases analysed.\textsuperscript{703}

Also the insolvency of Swedish credit insurer försäkringsaktiebolaget Njord in 1990
was caused mainly by management mistakes. The expert commission encharged by the
government to review the rules for credit insurance in the light of the insolvency states
that the immediate reasons for the bankruptcy were insufficient reinsurance and the
termination of loans granted to Njord once the company’s difficulties became public.\textsuperscript{704}

Beside the insufficient reinsurance cover, Finansinspektionen identified a number of
failures by Njord’s management foregoing the insolvency, including inappropriate risk
assessment routines leading to the acceptance of too high risks and cumulation of risks,
and communication failures once problems were known to the management.\textsuperscript{705} Njord
had several shareholders, and none of them was willing to inject capital to save it from
insolvency.\textsuperscript{706}

The business model and risk exposure of credit insurance differs considerably from other types of
insurance since the risk exposure of credit insurers reminds more of that of banks than of property and
casualty or life insurers. However, the difficulties experienced by Njord are not specifically related to
the specific risks related to credit insurance.

\textsuperscript{700} See Müller Report, Annex 1, section 3.1.
\textsuperscript{701} Standard & Poor’s Rating Services, p. 3.
\textsuperscript{702} Sharma Report, section 1.3.1; Müller Report, Annex 1, sections 3.2.2, 4.
\textsuperscript{703} Leadbetter and Dibra, p. 482.
67 f.
\textsuperscript{705} Ibid, p. 69.
\textsuperscript{706} Ibid, pp. 57 – 58; 68.
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The causal chains examined in the Sharma Report, revealed that inappropriate risk decisions due to either poor or inexperienced management or an inappropriate business strategy set at group level were the underlying cause for all failures or near misses in its case studies.  

The Working Group developed a risk map illustrating the interconnection between various risks, distinguishing between underlying causes and trigger causes resulting in failed process and/or problematic risk decisions affecting the financial situation of an insurance undertaking (figure 6.2.1 no. 1):

![risk map](figure621.png)

6.2.2 On group-related causes

Group-related causes are not explicitly mentioned in the Working Group’s risk-map. From the case studies commented in the report can be derived, however, that group risks

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707 Sharma Report, section 4.5.  
708 Sharma Report, Figure 3.3.
concern mostly management risk. The Working Group condensed the 21 cases into twelve types of situations, five of which are or may be group-related, namely:

- Group management influenced an insurance subsidiary to make inappropriate strategic investments, setting the group’s strategy above the insurance undertaking’s interests;\(^{709}\)
- A parent undertaking with non-insurance focus sets an inappropriate policy because of an insufficient understanding of the insurance business (inadequate underwriting systems, asset management without a sufficient understanding of the regulatory requirements);\(^{710}\)
- A large insurer that has grown through mergers and acquisitions faces merger integration issues, namely due to the diversity of business, structures and cultures in the organisation making centralised control difficult.\(^{711}\) This situation type has a group dimension insofar as acquisitions often concern companies which become subsidiaries before being merged with a group company. However, the merger issues described in this type are not specifically group-related, but rather presuppose merger-related problems within one insurance entity.
- Problems in the cross-border management of an insurance group, vaguely described as a “poor management attitude centrally which affected the conduct of operations in more than one member state”\(^{712}\) and could be noticed by aggressive pricing, aggressive marketing and pursuit of market share in one case and in the other case failure to recruit sufficiently qualified personnel for a subsidiary that was supposed to sell insurance in the parent undertaking’s country.
- An insurer outsources key functions either without communication of the supervisory or commercial requirements to be met or without adequate monitoring of the service provider.\(^{713}\) This type of situation may arise in a group context if key functions are outsourced to a related undertaking, but are similarly possible if they are outsourced to an external service provider.

It seems as if the typical group-related contagion risks did not play a significant role in the cases forming the object of the study.

6.2.3 A few examples of failures or near-failures

The largest near-failure so far in the insurance sector was the imminent collapse of the AIG group in September 2008 during the global financial crisis, only prevented by a 180

\(^{709}\) Sharma Report, section 4.4.1.  
\(^{710}\) Sharma Report, section 4.4.2.  
\(^{711}\) Sharma Report, section 4.4.4.  
\(^{712}\) Sharma Report, section 4.4.5.  
\(^{713}\) Sharma Report, section 4.4.12.
billion USD bailout by the U.S. government to prevent a cascade of collapses throughout the financial system. The most important reason for the near-failure was a liquidity crisis caused by the enormous sale of complex credit default swaps by a non-insurance subsidiary that were guaranteed by the group’s parent undertaking, the AIG Holding. Contributing factors were the securities-lending activities and investment in mortgage-backed securities,\(^714\) which had lost significantly in value in 2007 and 2008. Even though the group’s insurance subsidiaries had more than enough capital to cover the payment obligations and collateral demands by obligors, due to regulatory restrictions, these assets could not be transferred to the holding or to the distressed affiliate.\(^715\) An Inquiry Committee concluded in its report to the U.S. government that the sale of credit default swaps without initial collateral, hedges or setting aside of capital constituted a profound failure in risk management practices.\(^716\) The sale of credit default swaps was largely deregulated, and the U.S. supervisory authority lacked the capabilities and insight into AIG’s complex non-insurance business activities to effectively exercise supervision.\(^717\)

The near-collapse of the AIG group was clearly caused by non-insurance activities and, as it seems, did not have a significant negative impact on the group’s insurance subsidiaries.\(^718\) These seem to have remained stable throughout the crisis, and the government bailout was not motivated with concerns for the policyholders, but for the stability of the financial system.

Another example was the near-failure of German life insurer Mannheimer Lebensversicherung AG in 2003 that suffered severe difficulties when the value of its share portfolio dropped significantly and it became unable to cover its technical reserves with assets.\(^719\) Its financial situation also threatened its parent undertaking that would have been unable to fulfil its contractual obligation to compensate its subsidiary’s losses.\(^720\) The focus of regulatory (and the insurance industry’s) attention, however, did not lie on this contagion risk, but on the possible consequences for Mannheimer Leben’s policyholders and the public’s confidence in the life insurance sector. An industry-internal solution was found with life insurance undertaking Protektor taking over Mannheimer Leben’s life insurance portfolio and managing the policies until they were transferred to another life insurer in 2017. Protektor had been founded as a voluntary


\(^{716}\) Ibid, p. 352.

\(^{717}\) Ibid, p. 352.

\(^{718}\) This aspect has been frequently stressed by the financial industry, see for instance The Geneva Association, The credit crisis and the insurance industry – 10 frequently asked questions, in: Anatomy of the credit crisis – An insurance reader from The Geneva Association, The Geneva Reports – Risk and Insurance Research No 3, January 2010, p. 63 f.


rescue company by the German life insurance industry in 2002 and now manages the obligatory guarantee fund for life insurance companies.\footnote{Http://www.protektor-ag.de/en/about-us.} Mannheimer Leben has so far remained the only life insurance undertaking whose portfolio was taken over by Protektor or the guarantee fund.

Swedish Finansinspektionen had to deal with a small life insurance undertaking, Aspis Liv, that belonged to a Greek group that was ultimately owned by an individual who in 2009 was accused of forgery by Greek authorities.\footnote{Finansinspektionens beslut; Förverkande av Aspis Livs Försäkringsaktiebolags koncession, 26 November 2009, p. 4.} Finansinspektionen decided to withdraw Aspis Liv’s authorization when it discovered that a considerable part of the company’s assets were pledged and unaccessible to the company, with the consequence that Aspis Liv failed to comply with the regulatory capital requirements. Finansinspektionen further motivated its decision with detrimental group-internal transactions and contractual relations to the benefit of related undertakings, breaches against the rules on value transfers, poor risk management and control, and the management’s failure to act in the company’s interest.\footnote{Ibid, pp. 5-16.}

A recent case of an insurance insolvency concerns the Danish non-life insurer Alpha Forsikring A/S. Alpha exhibited a solvency ratio of 217 % in its 2016 Solvency and Financial Condition Report,\footnote{Alpha Group, Solvency and Financial Conditions Report (SFCR), p. 34.} but the Danish Insurance Supervisory Authority discovered during an inspection that the insurance provisions for certain lines of worker’s compensation insurance were insufficient and ordered Alpha in February 2018 to strengthen its reserves.\footnote{Finanstilsynet, Summary of the orders issued by the Danish Financial Supervisory Authority to Alpha Insurance A/S (28 February 2018).} In March 2018, Alpha did not meet its MCR any longer and the supervisory authority ordered it to cease writing new business, also taking into consideration that one of Alpha’s main reinsurers was having difficulties.\footnote{Finanstilsynet, Summary of The Danish Financial Supervisory Authority’s order to Alpha Insurance A/S to cease writing new business (5 March 2018).} In May 2018, Alpha was declared bankrupt.\footnote{Finanstilsynet, Alpha Insurance A/S declared bankrupt (8/31 May 2018).}

6.3 A few remarks on the options available in a situation of financial distress

In both Sweden and Germany, it rarely happens that insurance undertakings fall insolvent and are subjected to bankruptcy or insolvency proceedings. If the shareholders are not
willing or able to invest further capital into the insurance undertaking, the following resolution measures\(^{728}\) are the most common:

- It is sent into “run-off“, which means that it stops writing new business, either entirely or partly with regard to a particular line of business or product. Depending on the situation, a run-off may be conducted through a formal liquidation procedure or not.
- The whole or parts of the insurance portfolio are transferred to another insurance undertaking.

These measures can, of course, also be taken if there is no acute difficulty, but simply because the management and shareholders are dissatisfied with the profitability of a certain business, and, of course, they may be, and often are, combined with capital injections by the shareholders.

In Germany, during the last years, several large life insurance companies have started run-off proceedings with regard to their traditional life insurance portfolios as a response to the persisting low-interest environment.\(^{729}\)

Articles 267 to 296 Solvency II Directive deal with reorganisation measures and winding-up procedures, taking up the corresponding provisions from the repealed Insurance Reorganisation Directive.

According to the definition in Article 268 (1) (c) Solvency II Directive, “reorganisation measures“ are measures that are “intended to preserve or restore the financial situation of an insurance undertaking and which affect pre-existing rights of parties other than the insurance undertaking itself“. § 314 (1) VAG 2016 empowers BaFin to take a number of measures if insolvency proceedings shall be avoided in the best interest of the insured even though the insurer in the long-term will not be able to meets its obligations: Among other measures, the supervisory authority may prohibit the insurer from temporarily effecting any payments, such as paying insurance compensations, distributing profits or buying back life insurance policies. In addition to that, § 314 (2) VAG 2016 allows BaFin to reduce a life insurer’s obligations from life insurance policies.

Winding-up proceedings are in Article 268 (1) (d) Solvency II Directive defined as

"[…] collective proceedings involving the realisation of the assets of an insurance undertaking and the distribution of the proceeds among the creditors, shareholders or members as appropriate, which necessarily involve any intervention by the competent authorities, including where the collective proceedings are terminated by a composition or analogous

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\(^{728}\) EIOPA, EC Consulation on a possible recovery and resolution framework for financial institutions other than banks - EIOPA response, 5 December 2012, para. 13.

\(^{729}\) See, for instance: Generali, Press Release of 2017-09-28: Generali accelerates the implementation of its strategic plan for excellence and long-term value creation in Germany; ERGO Group AG, Press Release of 2016-06-01: ERGO investiert 1 Milliarde Euro und macht sich fit für den digitalen Wandel.
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measure, whether or not they are founded on insolvency or are voluntary or compulsory”.

Based on recital 5 of the Insurance Reorganisation Directive, the German legislator interpreted this provision with regard to German law as encompassing only insolvency proceedings, but not voluntary or compulsory liquidation procedures.730

Reorganisation measures and winding-up proceedings falling under the Directive need to be decided upon by the competent authorities of the home member state (which do not necessarily need to be the supervisory authority, but may also be a competent court, for example)731 and must be automatically recognized by the authorities in all other member states (Articles 269 (5) and 273 (2) Solvency II Directive).

As mentioned above, a run-off may be combined with a liquidation. Under certain circumstances, a liquidation procedure is compulsory.732 In the context of this study, the most relevant reason for a compulsory liquidation of a German insurance undertaking is the supervisory authority’s decision to revoke the licence.733 If the licence of a Swedish insurer is revoked, chapter 11 § 45 and chapter 12 § 74 FRL 2016 requires the Swedish Companies Registration Office (Bolagsverket) to open liquidation proceedings.

A liquidation procedure aims at the settlement of the insurer’s debts and distribution of an eventual surplus to the shareholders and results in the company’s termination and deletion from the company register. Both voluntary and compulsory liquidation proceedings seem to be very rare, however, both in Germany and Sweden.735

730 Deutscher Bundestag, Gesetzentwurf der Bundesregierung: Entwurf eines Gesetzes zur Umsetzung aufsichtsrechtlicher Bestimmungen zur Sanierung und Liquidation von Versicherungsunternehmen und Kreditinstituten, (02 October 2003), p. 19. Presumably, sentence 2 of the recital is meant: „Winding-up proceedings which, without being founded on insolvency, involve for the payment of insurance claims a priority order in accordance with Article 10 should also be included in the scope of this Directive."
731 Recital 119 Solvency II Directive.
732 For Swedish aktiebolag, the reasons for compulsory liquidation are laid down in chapter 25 ABL. For German Aktiengesellschaften, § 262 AktG applies.
733 §§ 304 (6), 203 (1) VAG 2016 with regard to insurance mutuals. For Versicherungsaktiengesellschaften, the revocation of the licence is considered a ground for dissolution according to § 262 (2) AktG, leading to liquidation according to § 264 (1) AktG, unless insolvency proceedings are initiated.
734 Swedish law applies the term upplösning (English: "dissolution") for the result of the liquidation procedure (chapter 25 § 41 ABL), whereas German law applies the term Auflösung ("dissolution") for the event triggering the liquidation procedure and calls the termination for Schluß der Abwicklung ("completion of the liquidation").
735 A search in Finansinspektionens company register conducted on 2017-06-12 revealed three insurance undertakings labelled „i likvidation”, plus nine presumably very small local insurers, mostly livestock and property insurers. A corresponding search for the label „i.L.” in BaFin’s register revealed one life insurer and two pension funds in liquidation.
PART III

THE SOLVENCY II REGULATORY REGIME
7 Overview of the Solvency II regulatory regime

In this chapter, an overview of the Solvency II regulatory regime with a focus on group regulation is given after a short presentation of the objectives of the Directive (chapter 7.1) and principles-based regulation and the proportionality principle as basic features of Solvency II (chapters 7.2 and 7.3).

The provisions on group supervision have been criticized by the Swedish Council of Legislation as being unclear and incoherent. In an attempt to shed some light on these complicated provisions, I have chosen to dedicate these provisions more attention than what most other authors have done, with a particular focus on group structures that can be observed in Sweden and Germany. The structure of the analysis follows largely the structure in the Solvency II Directive, i.e. it starts with the definition of insurance groups (chapter 7.4) before moving on to the application and scope of group supervision (chapter 7.5). Chapter 7.6 provides an overview of the elements of group supervision. Chapter 7.7 deals with the question which group undertakings are responsible for compliance with the regulatory group requirements.

7.1 Objectives of the Solvency II Directive

The objectives of the Solvency II Directive are laid down explicitly in the directive. Article 27 bears the heading “Main objective of supervision” and obliges member states to provide supervisory authorities with the necessary means, capacity and mandate “to achieve the main objective of supervision, namely the protection of policy holders and beneficiaries”. Similarly, recital 16 of the Solvency II Directive states the adequate protection of policy holders and beneficiaries as the main objective of the Solvency II legal regime. Article 27 does not specify a certain level of protection, whereas recital 16 and recital 98 (on group supervision) both speak of an “adequate” level. Similarly, recital 82 on the need for harmonization speaks of a “suitable” level. Recital 141 speaks of a “high” level of policy holder and beneficiary protection, albeit in the context of CEIOPS’ advice on enhanced group supervision and capital management. What is clear is that the objective cannot be the highest thinkable degree of policyholder protection, because that would mean, for instance, that insurance undertakings would not be allowed to invest in any assets involving a market risk, which is clearly not the legislator’s intention, and

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736 Lagrådet, p. 3 f. See also chapter 1.3.
would not necessarily be in the policyholders’ interests because it would have a negative impact on premium levels.

As a second objective, recital 16 mentions financial stability and fair and stable markets “[…] which should also be taken into account but should not undermine the main objective”. Article 28 further requires member states to ensure that their supervisory authorities consider the impact of their decisions on the stability of the financial systems in the EU, and to take into account the potential pro-cyclical effects of their actions. The prevention of pro-cyclicality during times of distressed financial markets and the stability of the financial markets therefore can be explicitly derived as objectives from the binding norms of directive, whereas “fair and stable markets” are only mentioned in the recitals. According to Wandt and Sehrbrock, “fair and stable markets” therefore cannot constitute autonomous objectives, because this would violate the European law principle that essential elements need to be laid down in the legal act itself.\footnote{Manfred Wandt and David Sehrbrock, Regelungsziele der Solvency II-Rahmenrichtlinie, 100 Zeitschrift für die gesamte Versicherungswissenschaft (2011), pp. 193-206, p. 198; Wandt and Sehrbrock, Solvency II – Rechtsrahmen und Rechtsetzung, p. 24.} This would apply not only to the main but also to secondary objectives.\footnote{Manfred Wandt and David Sehrbrock, Gedanken zu den Solvency II-Richtlinienzielen und ihre Bedeutung für das VAG, in: Ulrich Burgard (ed), Festschrift für Uwe H Schneider zum 70 Geburtstag (2011), p. 1401.} According to this view, the promotion of fair and stable markets is therefore not a goal that supervisory authorities may pursue independently, but merely a factor that needs to be taken into account in the course of a teleological interpretation of Solvency II provisions.\footnote{Ibid.} Recital 65 of the Omnibus II directive names the following objectives:

“[…] improving the functioning of the internal market by means of ensuring a high, effective and consistent level of prudential regulation and supervision, protecting policyholders and beneficiaries and thereby businesses and consumers, protecting the integrity, efficiency and orderly functioning of financial markets, maintaining the stability of the financial system, and strengthening international supervisory coordination […]”

Since the Omnibus II directive amends the Solvency II Directive to reflect the establishment of EIOPA, the abovementioned objectives can only be understood as a summary of the objectives of the Solvency II regime as a whole. However, the abovementioned hierarchy between policyholder protection as the main objective and financial market stability as secondary objective remains intact.
7.2 Principles-based regulation

Solvency II has often been referred to as a principles-based regulatory regime. The directive itself does not contain any explicit reference to a principles-based regulatory approach. Article 30 (3), however, contains a provision which could be understood as a reference to principles-based regulation. The provision requires the supervisory authorities to determine whether insurance undertakings comply with “the prudential principles laid down in this Directive”.

Principles-based financial regulation is usually contrasted with rules-based regulation. Even though there is no exact definition, the main distinction is that rules-based regulation is mainly based on detailed rules that exactly prescribe what regulated undertakings need to do whereas principles-based regulation builds on more general principles. Principles-based regulation is generally characterized by undefined, vague requirements using terms like “adequate”, “reasonable” or “sufficient”, which need to be interpreted by the addressees.

A principles-based regulatory system places a higher degree of responsibility to insurance undertakings than a rules-based system where regulated entities have to follow detailed rules. It offers greater flexibility and leaves less room for circumvention of rules.

Black contends that detailed rules and principles-based regulation do not necessarily exclude each other. Even though the UK’s Financial Supervisory Authority (FSA) had issued large amount of written rules, its regulatory style was still principles-based because the rules were based on principles and interpreted in the light of the principles. The principles should be formulated in a way that the intention behind them becomes visible, so that they can be applied in such a way as to achieve the desired outcome. Rules-based systems, to the contrary, are characterized by an exhaustive set of rules to be followed by regulated entities and by narrowly defined competences of the supervisory authorities, where the focus lies on following the rules and not on achieving a desired outcome. Black distinguishes between formal and substantive

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742 In 2012, the FSA was split up into the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The FSA’s role as insurance supervisory authority has been taken over by the PRA.


744 See Black, Hopper and Band, pp. 192, 195.

745 Wandt, p. 8.

746 Black, p. 3.
principles-based regulation. The above mentioned legislative technique is a feature of formal principles-based regulation. Substantive principles-based regulation refers to the supervisor’s approach to regulation.\textsuperscript{747} It is characterized by repeated interchange between the regulator and regulated entities, where “[…] disputes over the application of principles are resolved not through detailed linguistic (legal) interpretive approaches but though purposive interpretations and consequentialist reasoning”.\textsuperscript{748}

\textit{Black} points out that when regulated entities do not get guidance by the regulator, a principles-based system will only work if regulators do not enforce sanctions for every minor infraction, because this would mean that undertakings bear the risk of misinterpreting the principles.\textsuperscript{749} The focus on principles also leads to a shift of responsibility for compliant behaviour to the regulated undertakings, because it gives undertakings greater discretion than detailed rules.\textsuperscript{750}

With regard to the Solvency II requirements on a governance system, \textit{Marcelli} expresses concern that principles-based rules may be interpreted wrongly. Insurance undertakings could interpret them in a way that leads to either non- or overcompliance. Overcompliance would lead to an unnecessary burden on insurance undertakings.\textsuperscript{751}

According to \textit{Eilert}, when insurance undertakings apply vague legal terms, they may have a margin of appreciation which only allows for a limited control by the supervisory authority.\textsuperscript{752} He advocates the analogous application of a theory developed by the German Federal Administrative Court on the scope of the judicial reviewability of administrative decisions by courts. Far from always does the Court acknowledge such a non-reviewable freedom of discretion, which explains why \textit{Eilert} does not contend that insurance undertakings always have a freedom of discretion when applying vague legal terms. To apply German procedural law principles is certainly an interesting proposal, but in the end, the question of a non-reviewable margin of appreciation for the benefit of insurance undertakings will have to be solved by EU law.\textsuperscript{753}

\textit{Eilert} seems to have a formal understanding of principles-based regulation, because he contends that it is necessary to determine for each provision whether it is a principle or a rule. He defines a principle as a norm with undefined legal terms which gives undertakings a margin of appreciation.\textsuperscript{754} Furthermore, for each area within Solvency II (such as asset management, own funds or remuneration), it should be determined

\textsuperscript{747} Ibid, p. 3.  
\textsuperscript{748} Ibid, p. 6.  
\textsuperscript{749} Ibid, p. 7.  
\textsuperscript{750} Ibid, p. 8.  
\textsuperscript{751} Riccarda Marcelli, Das Governance-System in der Versicherungsgruppe nach Solvency II - Grenzen der Umsetzung versicherungsaufsichtsrechtlicher Vorgaben und ihre Auflösung (2015), pp. 50 - 52.  
\textsuperscript{752} Hergen Eilert, Anmerkungen zur Debatte über prinzipienbasiertes Aufsichtsrecht, besonders zum aufsichtsrechtlichen Prinzipienbegriff, 101 Zeitschrift für die gesamte Versicherungswissenschaft (2012), pp. 621-628, at p. 624.  
\textsuperscript{753} See Dreher, Solvenzanforderungen in der Versicherungsaufsicht nach Solvency II und künftigem VAG, p. 411.  
\textsuperscript{754} Eilert, p. 624.
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whether principles-based or rules-based or a combination of the two is more suitable.\textsuperscript{755} According to this view, consequently, only where principles-based regulation is considered superior, a margin of appreciation in the application of vague legal terms is justified. Unsurprisingly, \textit{Eilert} did not expect Solvency II to be predominantly principles-based, because the delegated acts and technical standards would not leave much room for discretion.\textsuperscript{756}

Whether Solvency II is principles-based in a substantive sense understood by \textit{Black}, depends to a large extent on the attitude of supervisory authorities and of insurance undertakings towards the application of principles. Certainly, insurance undertakings in the EU feel insecure with vague principles and often demand detailed rules.\textsuperscript{757} This insecurity, however, is at least partly based on the fear that supervisory authorities will not be cooperative and will not acknowledge a freedom of discretion. Most of the time, supervisory authorities do not need to apply sanctions against insurance undertakings in case of disputes over the interpretation of norms because regulated entities often choose to give in and do as the regulator wants. This is, however, not necessarily a sign of a trust of insurance undertakings in the regulator’s willingness to an open discussion. Often, insurance undertakings simply do not want to get a formal decision and therefore follow the regulator’s demands after a discussion.

Taking into consideration that the Solvency II framework contains a large amount of detailed rules at level 2, it is hard to claim that Solvency II is substantially principles-based.\textsuperscript{758} It is striking that the EU Commission only speaks of a principles-based directive which is complemented by detailed implementing measures.\textsuperscript{759} According to \textit{Wandt}, Solvency II is therefore in most parts formally principles-based without being substantively principles-based.\textsuperscript{760} Indeed, the Commission seems to focus mostly on the greater flexibility that the Lamfalussy-procedure gives, with general rules at level 1 and detailed rules at level 2. The flexibility in this case does not lie in a flexible application of the law, but in the greater flexibility of amending the level 2 rules compared to the time-consuming procedure which would have to apply to amend the directive. Already during the negotiation of the Omnibus II Directive, the rapporteur of the European Parliament saw a shift towards rules-based regulation as a consequence of the financial

\textsuperscript{755} Ibid, p. 628. He does not state whether such a categorization should fall into the responsibility of EIOPA or the national supervisory authorities and whether it should be justifiable by national courts.
\textsuperscript{756} Ibid.
\textsuperscript{757} According to Black, this behaviour can be observed in both principles-based and rules-based regulatory systems, Black, p. 8.
\textsuperscript{758} Falkman, Ramlagstiftning på försäkringsområdet - ett hot eller en möjlighet?, at p. 300; with regard to the solvency requirements, \textit{Dreher} speaks of a complete abandonment of a principles-based regulatory system, which he considered unsuitable for capital requirements anyway, Dreher, Solvenzanforderungen in der Versicherungsaufsicht nach Solvency II und künftigem VAGp. 391. See also van Hulle, Solvency II: Reasonable Expectations, p. 314.
\textsuperscript{759} http://ec.europa.eu/internal_market/insurance/solvency/future/index_en.htm.
\textsuperscript{760} Wandt, p. 15; similarly, Dreher and Lange, p. 829.
crisis and an increased demand for democratic accountability of the Solvency II system.\textsuperscript{761}

It is doubtful whether substantive principles-based regulation really would work with regard to harmonized legislation in the EU, because it involves a greater risk of a divergent application of principles than a rules-based approach, frustrating the goal of an EU-wide harmonization.\textsuperscript{762} Certainly, EIOPA has been given competence in Article 17 EIOPA Regulation to take action against national supervisory authorities that do not apply EU law correctly, which gives supervisors an incentive to consult with EIOPA before giving guidance to regulated entities. However, if response from EIOPA takes too long, there is a risk that national supervisors will apply a strict interpretation approach, rather than an outcome-based approach.\textsuperscript{763} Consequently, there is a danger that EIOPA’s existence changes the character of the dialogue between national supervisory authorities and insurance undertakings.

As a conclusion, the Solvency II legal regime as a whole is more rules-based than principles-based. Article 30 could be understood as an instruction to apply a supervisory style where principles are given higher weight than detailed rules. This would mean that level 2 rules, for instance, would have to be interpreted in the light of the principles and therefore could be deviated from if this would mean that the intended outcome could be achieved as well or better with a different solution. However, given the binding character of level 2 rules, it is difficult to imagine that supervisory authorities will apply such a regulatory attitude.

What are then examples for principles-based norms in the Solvency II Directive? In the literature, the following examples are mentioned:

- The prudent person principle\textsuperscript{764} in Article 132 relating to insurance undertaking’s asset management;
- The requirement laid down in Article 45 (2) according to which undertakings need to have processes in place to conduct the own risk and solvency assessment (ORSA), which are “proportionate to the nature, scale and complexity of the risks inherent in its business”\textsuperscript{765};
- A corresponding requirement concerning the system of government (Article 41 (2)).\textsuperscript{766}

\textsuperscript{761} Burkhard Balz, Lessons learnt from Solvency II more rules than principles, eurofi newsletter 31 March/1 April 2014, p. 20.
\textsuperscript{762} Black, Hopper and Band, p. 196.
\textsuperscript{763} See Gal, p. 345, with regard to possible discussions on the interpretation of EIOPA’s guidelines and recommendations.
\textsuperscript{764} Falkman, Ramlagstiftning på försäkringsområdet - ett hot eller en möjlighet?, p. 302.
\textsuperscript{765} Wandt, p. 21; Meinrad Dreher and Christoph Ballmaier, Die unternehmenseigene Risiko- und Solvabilitätsbeurteilung (ORSA) nach Solvency II und VAG 2012, 63 Versicherungsrecht (2012), pp. 129-143; p. 129.
\textsuperscript{766} See Falkman, Ramlagstiftning på försäkringsområdet - ett hot eller en möjlighet?, p. 302.
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- The possibility for supervisory authorities to impose a capital add-on if an internal model is “inappropriate or ineffective” (Article 37 (3))

7.3 The proportionality principle

Principles-based rules with undefined terms need to be distinguished from the principle of proportionality which is mentioned several times in the directive. Rules need to be interpreted in order to assess their content, whereas the proportionality principle is an interpretation rule itself to be applied to interpret other rules.

The proportionality principle is laid down in Article 29 (3) which obliges member states to ensure that “[…] the requirements laid down in this Directive are applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of an insurance or reinsurance undertaking”. Paragraph 4 of the same article requires the delegated acts and technical standards to take the proportionality principle into account, particularly to ensure that Solvency II is applied proportionately with regard to small undertakings. Article 34 (6) further requires supervisory powers to be exercised in a proportionate manner.

According to recitals 19 to 21 of the Directive, the proportionality principle shall be applied to ensure that compliance with Solvency II is not overly burdensome for small and medium-sized insurance undertakings, for insurance undertakings that specialize in specific types of products, services or customer segments and for insurance captives.

The special proportionality principle in the Solvency II Directive needs to be distinguished from the general principle of proportionality in EU law. Article 34 (6) implies that regulatory sanctions need to be proportionate with regard to the risk-profile, i.e. that the special proportionality principle applies to the consequences that apply if the requirements in a provision are fulfilled (in German: Verhältnismäßigkeit auf der Rechtsfolgenseite), which is typically also the main field of application of the general principle of proportionality. Article 29 (3) must be understood in such a way that also the requirements themselves need to be proportionate (in German: Verhältnismäßigkeit auf der Tatbestandsseite) with regard to the risk profile. Article 29 (4) makes clear that this also concerns level 2 measures.

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767 Lüttringhaus, p. 823.
The special proportionality principle has been described as giving concrete form to the general proportionality principle. However, if this is supposed to imply that the general principle is replaced by the special principle, it is doubtful whether this is possible. According to my view, general principles of law cannot be set aside by special rules. The special proportionality principle therefore applies in addition to the general principle. However, since the ECJ usually only declares Union acts as disproportionate if they are “manifestly inappropriate”, the probability that Solvency II provisions are held invalid because they breach the general principle of proportionality is rather small. The special proportionality principle must therefore be considered to be stricter than the general one.

7.4 Insurance groups and group supervision: Definition and terminology

Group supervision is regulated in Articles 212 to 266 Solvency II Directive. The scope of group supervision depends on the group structure and encompasses any or all of the following areas: Group solvency, the system of governance at group level, risk concentration, and intra-group transactions.

The definition of a group can be regarded as a first step of identifying undertakings playing a role in insurance group supervision. This role may take several forms: An undertaking may be subject to group supervision and therefore be obliged to fulfil group solvency and organizational requirements, it may need to be included in the calculation of group solvency, and/or it may belong to those undertakings whose transactions with the insurance undertakings in a group need to be reported to the group supervisor. Closely interrelated with the definition of groups is the classification of undertakings as parent undertaking, subsidiary, participation, participating undertaking, related undertaking, insurance holding company, mixed-activity insurance holding company, or mixed financial holding company. These classifications are also relevant for the determination of the scope of group supervision and for the calculation of group solvency.

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770 Wandt and Sehrbrock, Die Umsetzung des Verhältnismäßigkeitsgrundsatzes der Solvency-II-Richtlinie im VAG-Regierungsentwurf - Eine kritische Würdigung der §§ 290, 91 VAG-RegE mit alternativen Regelungsvorschlägen, p. 29; Dröse and Littmann, p. 346.
772 See Wandt, p. 19.
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7.4.1 Definition of insurance group

In contrast to the Insurance Group Directive, the Solvency II Directive contains a definition of the term “group” in Article 212 (1) (c). The Financial Conglomerates Directive also defines “group” in Article 2 (12). In order to align the definitions in the directives to each other with regard to mixed activity holding companies, the Insurance Group Directive, the Financial Conglomerates Directive and the Solvency II Directive have been amended by Directive 2011/89/EU. The group definition in the Solvency II Directive has not been affected by this, but even after the amendments, the group concept in the Financial Conglomerates Directive is not entirely identical with the definition in the Solvency II Directive.

Article 212 (1) (c) Solvency II Directive defines “group” as a group of undertakings with certain specified characteristics. Interestingly, the directive uses the term “group” instead of “insurance group” at this stage. This is consistent with regard to the definition of the term “group”, which is entirely independent of the term “insurance”, i.e. a group according to Article 212 (1) (c) does not need to comprise any insurance undertakings at all. A group without any insurance undertaking is, of course, not subject to any form of group supervision according to Solvency II and therefore irrelevant in the further context. Thus, the legislative technique applied in this part of the directive is to use a wide group definition and then to apply group supervision only on certain kinds of groups or undertakings in a group.

According to item (i) in the cited provision, a group consists of a participating undertaking, its subsidiaries and those entities in which it or its subsidiaries hold participations. In addition to that, the provision refers to Article 12 (1) Seventh Council Directive. The Seventh Directive has been repealed in July 2013 in accordance with Article 52 of Directive 2013/34/EU (hereinafter called “New Accounting Directive”). According to this provision, all references to the Seventh Directive shall be construed as references to Directive 2013/34/EU and shall be read in accordance with a correlation table attached to the directive as Annex VI. Article 212 (1) (c) (ii) of the Solvency II Directive broadens the group definition by including undertakings over which another undertaking exercises a dominant influence through centralized coordination.

The structure of this chapter follows largely the different situations identified in the directive that lead to a group relationship between two undertakings. However, to follow

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773 In contrast to the Insurance Group Directive, the Financial Conglomerates Directive has not been repealed by the Solvency II Directive.
this structure strictly would make it difficult to discuss certain problems that are connected with one or more of these situations. Therefore, the structure is combined with a problem-based approach. To start with, a standard group structure that is a part of almost any insurance group will be presented, followed by an analysis of the three holding classifications applied in Solvency II. Then, various aspects of the group definitions in the directive are analysed.

7.4.1.1 The standard case – vertical groups

Notwithstanding the differences in the group definitions in various legal areas, a shareholding structure where one company holds the majority of voting rights in another company is usually considered a group, provided the absence of any circumstances that may give another entity control. Such a vertical group structure can be regarded as the standard case and falls under Article 212 (1) (c) (i) Solvency II Directive, in connection with the definitions in Article 212 (1) (a) and Article 1 (1) (a) Seventh Directive (now: Article 22 (1) (a) New Accounting Directive).\textsuperscript{776}

Example of a group based on majority of voting rights (standard case)

![Diagram: A vertical group with a shareholder (parent undertaking) holding 60% of the voting rights in Undertaking A (Subsidiary), 100% in Undertaking B (Subsidiary), and 75% in Undertaking C (Subsidiary).]

Figure 7.4.1.1 no. 1

Most insurance groups have a structure where undertakings are related to each other by a majority holdings of voting rights, and often the ultimate parent undertaking, i.e. the

\textsuperscript{776} In the following presentation, the original provision in the Seventh Directive with its corresponding provision in the New Accounting Directive will be named once. Further references will be limited to the provision in the New Accounting Directive.
parent undertaking which is not itself subsidiary of a parent undertaking or a participation of another undertaking,\(^{777}\) is itself an insurance undertaking.

Examples are the Axa group in France, the HDI/Talanx group in Germany, both with an insurance mutual as ultimate parent, and the Italian Generali group\(^{778}\) with a stock corporation as ultimate parent. In Sweden, for instance, the insurance undertaking Folksam Skadeförsäkring AB is a subsidiary of the mutual insurance undertaking Folksam Sak as ultimate parent.\(^{779}\)

Most groups have a multi-layered structure, where subsidiaries in turn hold shareholdings in other subsidiaries. Since the definition of “subsidiary” in Article 13 (16) also encompasses indirect subsidiaries (subsidiaries of subsidiaries, but not subsidiaries of participations that are not subsidiaries), also groups with several layers fall under the group definition. A subsidiary of a mere participation is not part of the group.\(^{780}\) A group with a multi-layered structure could, for example, look like this:

**Example of a multi-layered group**

![Diagram of a multi-layered group]

Figure 7.4.1.1 no. 2

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\(^{777}\) See chapter 7.5.2.1 on the concept of “ultimate parent undertaking at Union level”. On the definition of “participation” see chapter 7.4.1.3.1.

\(^{778}\) The Generali group is also a financial conglomerate, see Joint Committee of the European Supervisory Authorities, List of Identified Financial Conglomerates 2017, 30 October 2017.

\(^{779}\) In the Nordic countries, however, many insurance undertakings do not have an insurance undertaking as ultimate parent undertaking. In many cases, the ultimate parent is a bank (for instance Handelsbanken as sole shareholder in Handelsbanken Liv Försäkring AB) or a holding (for example Sampo abp as sole shareholder of If Skadeförsäkring AB or the Danish holding mutual TryghedsGruppen smba as majority shareholder in Tryg Forsikring A/S which is active on the Swedish market under the brand name Moderna försäkringar).

\(^{780}\) Kraft, Gruppenaufsicht, p. 139 f.
7.4.1.2 Vertical group structures with holding companies as parent companies

If the parent undertaking in the standard examples above is not an insurance undertaking, it may be classified as an insurance holding company, a mixed-activity holding company or a mixed financial holding company. Whereas the two former classifications where already known from the Insurance Group Directive, the latter has been introduced into the Insurance Group Directive, the Financial Conglomerates Directive and the Solvency II Directive by way of amendment in 2011.

A first observation is that the definitions of all of the three holding forms require that an undertaking is a parent undertaking. “Parent undertaking” is defined in Article 13 (15) which refers to Article 1 Seventh Directive (Article 22 New Accounting Directive). The definition of parent undertaking will be analysed in detail in chapter 7.4.1.3. In this context, it suffices to note that a parent undertaking needs to have subsidiaries, whereas the holding of participations does not suffice to qualify as a parent undertaking. Consequently, an undertaking that only holds participations, but not subsidiaries, cannot qualify for any of the three holding forms provided for in the Solvency II Directive.

7.4.1.2.1 Mixed financial holding companies

The definition of ”mixed financial holding company” in Article 212 (1) (h) Solvency II Directive refers to the definition in Article 2 (15) Financial Conglomerates Directive. According to this definition, a mixed financial holding company is a parent undertaking, which together with its subsidiaries forms a financial conglomerate. Another prerequisite is that at least one of the subsidiaries must be a regulated entity with its registered office in the European Union. The mixed-financial holding company itself must not be a regulated entity. A “regulated entity” is defined in Article 2 (4) as “a credit institution, an insurance undertaking, a reinsurance undertaking, an investment firm, an asset management company or an alternative investment fund manager”. “Financial conglomerate” is defined in Article 2 (14), which can be summed up as a group where at least one company is active within the insurance sector (i.e. is either an insurance undertaking, a reinsurance undertaking or an insurance holding) and at least one company is an investment firm or active in the banking sector (i.e. is a credit institution or a financial institution). Furthermore, the group’s main activities must be either in the insurance, banking or investment sector (together the “financial sector”). In addition to that, the activities in the insurance sector and in the banking and investment sectors must be significant according to the requirements in Articles 3 (2) and (3) which lay down certain thresholds with regard to the portions of the different segments in the group balance sheets and with regard to the solvency requirements.

Consequently, a group where the parent undertaking is a mixed financial holding company could have the following structure:
As of 30 October 2017, there were 80 financial conglomerates with a parent company in the EU or the EEA. Six of them are supervised by the German supervisory authority BaFin and another seven by Swedish Finansinspektionen. The Swedish financial conglomerates are Avanza, Nordnet, Länsförsäkringar, SEB, Svenska Handelsbanken, Skandia and Swedbank. The Swedish insurance company “If” belongs to the Sampo group, a financial conglomerate supervised by the Finnish supervisory authority.

7.4.1.2.2 Insurance holding companies

An insurance holding company is defined in Article 212 (1) (f) Solvency II Directive as a company other than a mixed financial holding company whose main business is to acquire and hold participations in subsidiary undertakings, where those subsidiaries exclusively or mainly are insurance or reinsurance undertakings. At least one of the subsidiaries must be an insurance undertaking with its head office in the EU.

An example of a group where the ultimate parent undertaking is an insurance holding is the RSA group, with RSA Insurance Group (plc) as ultimate parent and the Danish insurer Codan and, until 2015, the Swedish insurer Trygg-Hansa among its subsidiaries. More common are group structures with intermediate insurance holding companies. If Skadeförsäkring Holding AB (publ), Axa Travel Holding AB, and a number of other insurance companies.

Notes:
781 Joint Committee of the European Supervisory Authorities,
782 RSA Insurance Group plc, Annual Accounts and Report 2017, p. 177. Effective 31 March 2015, Trygg-Hansa was merged with Codan and converted into a branch serving the Swedish market under the name Trygg-Hansa, see http://www.trygghansa.se/om-trygghansa/om-foretaget/pages/fusion.aspx (accessed 2018-04-29 at 14:02). As reasons for the merger, the company referred to an intended simplification of the group structure to increase effectivity and to the regulatory demands following the introduction of Solvency II.
S.A., and Talanx AG, the listed intermediate insurance holding of the German Talanx/HDI group, can serve as examples.

A group with an insurance holding company could be structured like this:

Example of a group with an insurance holding as parent undertaking

| Shareholder (parent undertaking + insurance holding company) | Undertaking A  
(Subsidiary + insurance undertaking) | Undertaking B  
(Subsidiary + insurance undertaking) | Undertaking C  
(Subsidiary + company outside the financial sector) |
<table>
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<tr>
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<tbody>
<tr>
<td>100 % of the voting rights</td>
<td>60 % of the voting rights</td>
<td>75 % of the voting rights</td>
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Figure 7.4.1.2.2 no. 1

7.4.1.2.3 Mixed-activity insurance holding companies

The third holding form defined in the Solvency II Directive is the mixed-activity insurance holding company. According to Article 212 (1) (g), such a holding company is a parent undertaking with at least one insurance or reinsurance undertaking among its subsidiaries, without being an insurance holding company or a mixed financial holding company.

Insurance holding companies and mixed-activity holding companies differ in two aspects. First, unlike an insurance holding company, a mixed-activity holding company does not need to be a holding company in a narrow sense at all, i.e. its main business may be something else than to hold participations. For instance, a manufacturing company with an insurance captive would be a mixed-activity insurance holding company. An example is the producer of lawn-mowers and construction equipment Husqvarna AB with its 100 %-subsidiary Husqvarna Försäkrings AB. Second, even if a mixed-activity holding company’s main business is to hold subsidiaries, it is not focused on having insurance or reinsurance undertakings as subsidiaries, whereas this is a requirement for insurance holding companies. Consequently, the insurance activities

can be expected to play a subordinated role compared to other activities in a group headed by a mixed-activity holding.

A doubtful case would be a holding company which has one insurance subsidiary and one or more other subsidiaries, where the insurance subsidiary contributes to the larger part of the parent undertaking’s consolidated balance sheet. Is such a holding an insurance holding or a mixed-activity insurance holding? The classification is relevant because subsidiaries of mixed-activity insurance holdings are only subject to a limited form of group supervision in contrast to subsidiaries of insurance holdings.  

The reason why such a group structure is not entirely clear is because the requirement in the insurance holding definition in Article 212 (1) (f) that the subsidiary undertakings shall be “exclusively or mainly insurance or reinsurance undertakings” can be interpreted in two different ways: in a formal way relating to the number of subsidiaries, or in a material sense, for instance by taking into account their respective contribution to the holding’s consolidated balance sheet.

**Example of a group structure with both insurance and non-insurance activity**

![Diagram showing a group structure with both insurance and non-insurance activity](image)

**Figure 7.4.1.2.3 no. 1**

Article 3 Financial Conglomerates Directive, however, refers for the question whether a group is mainly active in the financial sector to the ratio of these activities of the balance sheet (with a 40 % threshold).

For a formal understanding speaks the fact that the parent undertaking would also be classified as a mixed-activity holding company and not as an insurance holding company if it was not a holding undertaking in a narrow sense at all, i.e. if it was a manufacturing company with one large insurance subsidiary, because its main business would not be

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784 See chapter 7.6.1.
the acquisition and holding of participations. Against a formal interpretation speaks the circumvention risk, because parent undertakings could otherwise invest into many insignificant small subsidiaries or engage in other business activities in order to avoid being classified as an insurance holding. For this reason, not the number of subsidiaries should be decisive, but their size in relation to the whole group. Nevertheless, if the insurance activities contribute to about half of the group’s balance sheet, it is still doubtful whether the requirements for an insurance holding would be met. In those situations, the description of the activities in the holding’s articles of association could be taken into account as an additional indicator.

7.4.1.2.4 Which forms of associations may qualify as holdings?

A question concerning all three forms of holdings is, whether even associations that are not companies, may fall under the holding definitions, because all language versions I have consulted apply the term “company”, as in “insurance holding company”, “mixed-activity holding company” and “mixed financial holding company”. In the Swedish version, the term applied is bolag, in the German version Gesellschaft, in the French and Spanish texts société and sociedad, respectively.

Examples where this question would become relevant are a Swedish foundation (stiftelse) or an “economic association” (ekonomisk förening) as parent undertaking, because both of these are associations, but not companies. After a restructuring of the Skandia group in 2012, Skandia Liv, for instance, was for an interim period a 100 % subsidiary of Thulestiftelsen – a foundation founded in 2011 with the purpose of holding the shares in Skandia Liv until the life insurance undertaking was transformed from a limited company into a mutual in 2014.

It is striking that the legislator has chosen the term “company” in this context, whereas in most other contexts, the term “undertaking” is applied in the directive. “Undertaking” has a wider connotation than “company” and includes other forms of associations. However, according to the three holding definitions, holding companies are “undertakings” with certain characteristics, which speaks for a wide interpretation going beyond companies in a strict sense. The Swedish expert committee encharged with the examination of how Sweden should implement the Solvency II Directive, also considered that not only companies in a strict sense may qualify as holdings, and therefore proposed to use the wider term “försäkringsholdingföretag” (insurance

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786 Cf. ch. 1 § 5 Stifelselag (SFS 1994:1420), which presupposes that foundations may hold majority participations in other undertakings.
holding undertaking) in the Swedish implementation norms. The legislator has followed the recommendation in chapter 1 § 12 no. 6 FRL 2016, without discussing this aspect in the legislative proposal. According to Swedish law, it is therefore clear that foundations or economic associations can qualify as holdings in a Solvency II sense.

Notwithstanding whether an undertaking that is not a company falls under one of the three holding definitions in the Directive or not, it still forms a group together with its subsidiaries according to Article 212 (1) (c) (i) Solvency II Directive. However, whether it can be classified as a holding according to Solvency II is of importance for the scope of group supervision and the question whether the parent undertaking needs to be included in the calculation of the group SCR.

7.4.1.3 Article 212 (1) (c) (i) further decomposed

Both examples above constitute vertical groups that are based on control through the holding of a majority of voting rights, falling under Article 212 (1) (c) (i) Solvency II Directive.

The group definition in this provision is characterized by the application of terms that are defined in other paragraphs of Article 212: “Participating undertaking” in Article 212 (1) (a) which in turn apply terms that are defined elsewhere in the Solvency II Directive, namely “parent undertaking” in Article 13 (15), “subsidiary undertaking” in Article 13 (16) and “participation” in Article 13 (20) Solvency II Directive. Several of these definitions in turn refer to the New Accounting Directive. This system of cross-references makes the application of the rules rather cumbersome.

According to Article 212 (1) (a),

“‘participating undertaking’ means an undertaking which is either a parent undertaking or other undertaking which holds a participation, or an undertaking linked with another undertaking by a relationship as set out in Article 12 (1) of Directive 83/349/EEC” [now: Article 22 (7) New Accounting Directive].

The corresponding term is “related undertaking” defined in Article 212 (1) (b) as an undertaking which is either a subsidiary or a participation or an undertaking linked to another by a relationship as set out in Article 22 (7) of the New Accounting Directive.

7.4.1.3.1 Group based on participation

Since the definition of participating undertaking not only encompasses the holding of subsidiaries, but also of participations, a group according to Solvency II does not need
to consist of a parent undertaking and subsidiaries. Instead, even a shareholder holding only participations fulfills the group definition according to Article 212 (1) (c) (i) Solvency II Directive.

A “participation” is defined in Article 13 (20) Solvency II Directive as the ownership of 20% or more of the voting rights or capital of an undertaking. The ownership can be held directly or by a controlled undertaking, where “control” is defined in Article 13 (18) by reference to Article 1 Seventh Directive (now: Article 22 New Accounting Directive) “[…] or a similar relationship between any natural or legal person and an undertaking”. Consequently, a participation of a subsidiary is also a participation of the subsidiary’s parent undertaking.

Example of group based only on participation

![Diagram showing a shareholder and an undertaking connected by 25% of the voting rights](image)

Figure 7.4.1.3.1 no. 1

Figure 7.4.1.3.1 no. 1 shows a simple example of a group relationship based only on a participation. However, the shareholder would not be required to set up consolidated accounts in any EU member state, because according to the New Accounting Directive, only undertakings that are deemed to have control (based on the various definitions in Article 22 (1) and (2)) or, those fulfilling the conditions in Article 12 (1) Seventh Directive - now Article 22 (7) New Accounting Directive), where implemented into national law, are obliged to set up group accounts. Similarly, IAS 27, and since 1 January 2014, IFRS 10 defines a group as “a parent and its subsidiaries”, thus leaving out mere participations. With the inclusion of participations into the definition of a group, the Solvency II Directive thus applies an unusually extensive group concept. As we will see below, however, this does not mean that such a group would necessarily be subject to insurance group supervision.
7.4.1.3.2 Overview on the parent-subsidiary relationships acc. to Article 212 (1) (c) (i)

For the term “parent undertaking” and its counterpart “subsidiary undertaking”, the definitions in Article 13 (15) and (16) refer, inter alia, to the definitions in Article 22 (1) New Accounting Directive, according to which a parent undertaking is characterized by

(1) Having a majority of the voting rights in a subsidiary,\(^{789}\) or
(2) Having the right to appoint or remove a majority of the members of the administrative, management or supervisory body of the subsidiary and at the same time being a shareholder of the subsidiary,\(^{790}\) or
(3) Having a contractual right to exercise dominant influence over the subsidiary and at the same time being a shareholder or member of the subsidiary,\(^{791}\) or
(4) Being granted a right to exercise dominant influence as a shareholder or member over the subsidiary in the subsidiary’s articles of association,\(^{792}\) or
(5) A majority of the members of the administrative, management or supervisory body of a subsidiary being appointed solely as a result of the exercise of the parent undertaking’s voting rights as a shareholder,\(^{793}\) or
(6) Having sole control over the subsidiary, pursuant to an agreement with other shareholders.\(^{794}\)

The situations described in items (1) to (6) have in common that they require the parent undertaking to be a shareholder in the subsidiary. In the situations described in these items, a parent-subsidiary relationship is deemed to exist, either by virtue of the size of a shareholding or by a shareholding in combination with other legal or factual arrangements.

Article 212 (1) (a) (i) further refers to Article 22 (2) New Accounting Directive. According to this provision, a parent undertaking is characterized by

(7) Having the power to exercise or actually exercising dominant influence over the subsidiary,\(^{795}\) or
(8) Managing the parent undertaking and the subsidiary on a unified basis.\(^{796}\)

Article 22 (7) New Accounting Directive, to which both the definitions of “participating undertaking“ and of “group” in the Solvency II Directive refer, gives member states the

\(^{789}\) Article 22 (1) (a) New Accounting Directive.
\(^{790}\) Article 22 (1) (b) New Accounting Directive.
\(^{791}\) Article 22 (1) (c) New Accounting Directive.
\(^{792}\) Article 22 (1) (c) New Accounting Directive.
\(^{793}\) Article 22 (1) (d) (i) New Accounting Directive.
\(^{794}\) Article 22 (1) (d) (ii) New Accounting Directive.
\(^{795}\) Article 22 (2) (a) New Accounting Directive.
\(^{796}\) Article 22 (2) (b) New Accounting Directive.
possibility to require undertakings to set up consolidated accounts, even though they are not parent undertakings in the sense of the Directives, so-called “horizontal groups”\(^{797}\), which are not characterized by one undertaking having control over another. This applies to

(9) undertakings that are managed on a unified basis pursuant to a contract between those undertakings,\(^ {798}\) or
(10) undertakings that are managed on a unified basis pursuant to provisions in the articles of association of those undertakings,\(^ {799}\) or
(11) undertakings, whose administrative, management or supervisory bodies consist for the major part of the same persons.\(^ {800}\)

Items (7) to (10) are remnants of the influence of the German economic approach to the identification of parent-subsidiary relationship on the Seventh Directive. According to this approach, entities that are managed as if they were a single economic unit, have a parent-subsidiary relationship.\(^ {801}\) This approach needs to be contrasted to the common law “control” approach, according to which it is decisive whether legal power to control another undertaking exists.\(^ {802}\) The control approach is considered to be characterized by criteria that can be checked more easily than the establishment of a parent-subsidiary relationship according to the economic approach.\(^ {803}\)

For the purpose of determining whether an undertaking is obliged to set up consolidated accounts, the New Accounting Directive allows the member states not to apply the situation described in item (6) above, or to connect it with a holding of at least 20 % of the voting rights. Whether the relationships described in items (7) to (11) above are sufficient to require consolidated accounts to be set up, is left entirely to the discretion of the member states. Concerning dominant influence pursuant to a contract (item (3) above), Article 22 (1) (c) New Accounting Directive allows member states not to require any shareholding or membership of the parent undertaking in the subsidiary undertaking. However, in the context of Solvency II, the references to Articles 22 (1) and (7) cannot be understood as comprising the different national variations in the implementation of these norms, because this would lead to inconsistencies in the composition of a group. As already mentioned, Articles 22 (1) and (7) New Accounting Directive are not concerned with determining which undertakings form part of a group, but with determining on which grounds an undertaking is obliged to set up consolidated group

\(^{797}\) Edwards, p. 170.
\(^{798}\) Article 22 (7) (a) (i) New Accounting Directive.
\(^{799}\) Article 22 (7) (a) (ii) New Accounting Directive.
\(^{800}\) Article 22 (7) (b) New Accounting Directive.
\(^{801}\) Edwards, p. 161.
\(^{802}\) Ibid, p. 161.
\(^{803}\) Wiedmann in: Carsten Thomas Ebenroth et al. (eds), Handelsgesetzbuch, vol 1 (2nd edn 2008), § 290 para. 7.
accounts. For this purpose, differences in the national implementation norms are irrelevant, because it is (usually) clear which national law governs the question of whether an undertaking needs to set up group accounts. In contrast to this, problems could arise, for instance with regard to the supervision of intra-group transactions, if differences in national laws would lead to an incoherent definition of a group in the context of insurance group supervision. This would contradict the aim of a consistent application of the harmonized Solvency II rules. One could imagine the situation that an undertaking according to its national laws would be considered to be a parent undertaking in another member state, but not according to the national law of the “subsidiary”. The references to the New Accounting Directive therefore need to be understood as references to the text in the directive only, without having regard to how member states have exercised the options for implementation.

7.4.1.3.3 Factual control

A doubtful case with regard to the group definition concerns the treatment of shareholdings in an undertaking, where the participating undertaking holds less than 50% of the voting rights, but is the largest shareholder and usually holds more than 50% of the votes represented in the general meeting. With this factual voting majority, the shareholder has the possibility to elect the majority of the members of the administrative, management or supervisory board of the company. This could be considered as constituting dominant influence and therefore establish a parent-subsidiary relationship between the company and its shareholder. Factual control may be relevant when the shareholding concerns a listed company with a large number of individual shareholders of which a considerable part usually is not represented at general meetings.

The situation where a minority shareholder in practice has the absolute majority of the votes in an undertaking’s general meeting has been discussed under the term praktisk majoritet in Sweden, where such constellations apparently do not lead to a parent-/subsidiary relationship according neither to company nor accounting law. In Germany, the term Präsenzmehrheit is used. I will use the term “factual control”.

805 See for instance, Anne Rutberg and Rolf Skog, Det nya koncernbegreppet, Svensk skattetidning (zeteo) (1997), who take up factual control solely with regard to the group definition applied before 1996, but do not discuss it in the context of the new group definition. According to Skog, factual control is not sufficient to establish a group relation, Skog, Rodhes Aktiebolagsrätt, p. 259.
806 Morck in: Ingo Koller et al. (eds), HGB, (8th edn 2015), § 290 para. 2; Böcking/Gros/Schurbohm-Ebneth in: Detlev Joost and Lutz Strohn (eds), Handelsgesetzbuch, vol 1 (3rd edn 2014), § 290 para. 18.
807 The term “factual control” is used by Edwards, p. 168.
Example of a group based on factual control

<table>
<thead>
<tr>
<th>Shareholder (parent undertaking)</th>
<th>Shareholder (parent undertaking)</th>
</tr>
</thead>
<tbody>
<tr>
<td>45 % of the voting rights</td>
<td>45 % of the voting rights</td>
</tr>
<tr>
<td>Remaining Free Float</td>
<td></td>
</tr>
<tr>
<td>50 % of the voting rights</td>
<td></td>
</tr>
<tr>
<td>Undertaking A (Subsidiary)</td>
<td></td>
</tr>
<tr>
<td>6 of 10 members of the administrative board elected with parent undertaking’s votes</td>
<td></td>
</tr>
</tbody>
</table>

Figure 7.4.1.3.3 no. 1

Such a constellation could be regarded as a parent-subsidiary relationship according to the definition of parent undertaking in Article 13 (15) Solvency II Directive in connection with items (2), (5) or (7) in the list above. Another possibility is that it falls under the definition in Article 212 (2) Solvency II Directive.

According to item (2), an undertaking is a subsidiary of a shareholder that has the right to appoint or remove the majority of the members of its administrative, management or supervisory body (Article 22 (1) (b) New Accounting Directive). However, the requirement that the shareholder needs to have a “right” is usually not considered to be fulfilled in the case of factual control. Rather, a contractual right or an explicit right to this effect in the articles of association of the undertaking are required.

A contractual right could be granted in a shareholders’ agreement. National law limits the possibilities to give certain shareholders or third persons a right to appoint board members in the articles of association. According to chapter 8 § 47 ABL, not more than half of the members of the board of directors (styrelsemödellemarna) of a public limited company may be elected by other someone else than the general meeting. For private limited liability companies, no such limitation exists. For Swedish insurance companies that are operated on a mutual basis, at least one director must be appointed by the policyholders or an interest group with links to the policyholders and the majority of the directors must

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808 Cf. the examples provided by Edwards, ibid, p. 165. On the corresponding provision in chapter 1 § 11 ABL, see Sten Andersson, Svante Johansson and Rolf Skog, Aktiebolagslagen - en kommentar (Norstedts juridik 2013), commentary to Chapter 1, § 11. On the corresponding German provision: Böcking/Gros/Schurbohm-Ebneth in: Joost and Strohn (eds), § 290 para. 28; Morck in: Koller et al. (eds), § 290 para. 3.

809 However, a shareholder’s agreement with a right to appoint a majority of board members is in Sweden not automatically sufficient to establish control: Prop. 1995/96:10 del I, Års- och koncerredovisning, p. 107. Sceptical also: Skog, Rodhes Aktiebolagsrätt, p. 259.

810 Andersson, Johansson and Skog, commentary to chapter 3 § 1.
be independent from the shareholders (chapter 11 § 7 FRL). § 101 (2) AktG provides that the articles of association of a German stock corporation may give certain shareholders (but not third parties) the right to elect up to one third of those supervisory board members that are not employee representatives.

According to some commentators, the German provision corresponding to Article 22 (1) (b) New Accounting Directive, namely § 290 (2) point 2 HGB, does not have any practical relevance at all with regard to German stock corporations, so that the right to elect the majority of the supervisory board members of a German Aktiengesellschaft does not lead to a parent-subsidiary relationship according to this provision. The proponents of this view refer to the fact that the management board (Vorstand) of such companies enjoys a large degree of managerial freedom, so that the right to elect the majority of the members of the supervisory board (Aufsichtsrat) is not sufficient to establish control over a company.811 However, this argument cannot be applied on the provision in the New Accounting Directive, because it relies on the specific wording in § 290 (2) point 2 HGB, according to which the board in question must be the company organ that determines the company’s financial and business decisions (Finanz- und Geschäftspolitik) which is not fulfilled by the supervisory board of a German stock corporation.

According to item (5), if the majority of the members of the administrative, management or supervisory body of an undertaking have been appointed solely with the votes of a shareholder, it is a subsidiary of this shareholder. A further requirement is that this applies to the board members in office during the last financial year and the preceding year (Article 22 (1) (d) (i) New Accounting Directive).

The requirement that the board members must have been appointed solely with the votes of parent undertaking, may give rise to various interpretations.812 Does it harm, for instance, if other shareholders also have voted in favour of the board members? My understanding is that the parent undertaking must have voted with a number of votes that represented the majority of the votes present at the general meeting, so that the board members would have been appointed even if all other shareholders present at the meeting would have voted against them. It would not be sufficient if the shareholder had less than the majority of all votes present, but would nevertheless get “its” candidates appointed because other shareholders abstained from voting or voted in favour of the candidate.

The requirement that the majority of the board members have been elected with the parent undertaking’s vote, leads to certain group structures falling outside the parent-subsidiary definition. German companies with more than 2000 employees (including subsidiaries’ employees in Germany) are obliged to reserve half of the seats in the supervisory board for employee representatives. Unless the chairman of the supervisory board has the casting vote or his vote counts twice, for such companies, a parent-subsidiary relationship based on factual control according to this provision is impossible,


812 Edwards, p. 169.
because only half and not the majority of supervisory board members could have been elected with the votes of the largest shareholder. In that case, the undertaking would only have a group relationship according to Solvency II with its largest shareholder based on the holding of a participation.

Swedish law only prescribes the number of employee representatives on the board of directors, but allows companies to set the number of board representatives in such a way that the shareholder representatives have the majority. The only statutory limit is § 4 Board Representation Act, stating that the employee representatives may not have the majority. An equal number of employee and shareholder representatives is not prohibited. A Swedish company where half of the members of the board of directors are employee representatives therefore cannot fall under item (5) either.

Item (7) establishes a parent-subsidiary relationship if an undertaking “has the power to exercise, or actually exercises dominant influence or control over another undertaking”. The term “dominant influence” is not defined in the New Accounting Directive. It bears resemblance to § 290 (1) HGB, which defines undertakings that are able to exercise dominant influence (beherrschender Einfluss) over another undertaking as parent undertakings. § 290 (1) HGB was amended in 2009 in order to align it to the concept of control in International Accounting Standard 27. Both beherrschender Einfluss and control according to IAS 27 are defined as “[…] the power to govern the financial and operating policies of an entity so as to obtain benefits from its operations”, with the only difference that the German concept presupposes that this power is long-lasting and not merely temporary.

Factual control is usually considered to fall under § 290 (1) HGB, if it is not the result of a coincidental factual majority taking into account past attendance at general meetings, so that a parent-subsidiary relationship according to German law exists. Somewhat surprisingly, the reservations made for the application of the provision concerning the right to appoint or remove the majority of board members are not brought forward in this context. Rather, it is sufficient that the shareholder with the majority of voting rights has the possibility to take those decisions that fall within the general meeting’s competence. The factual possibility to elect the majority of supervisory board members is therefore sufficient to establish a parent-subsidiary relationship according to German accounting

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**Notes:**

813 §§ 1 (1), 7 (1) Codecision Act (Mitbestimmungsgesetz). On the consequences for the assessment of a parent/subsidiary relationship according to German accounting law, cf. Kraft and Link, p. 520 with further references; Merkt in: Adolf Baumbach and Klaus J. Hopt (eds), Handelsgesetzbuch, (38th edn 2018) § 290 para. 11.


815 Karlheinz Küting and Christoph Seel, Das neue deutsche Konzernbilanzrecht - Änderung der Konzerneurechnungslegung durch das Bilanzrechtsmodernisierungsgesetz (BilMoG), Beihefter zu DStR (2009), p. 37-59, at p. 38.


law, even though the supervisory board of a German stock corporation only has limited influence on the company’s business and even though the general meeting of a stock corporation has very limited competences to give binding orders concerning the company’s business decisions.\textsuperscript{818}

Admittedly, to treat factual control as dominant influence is consistent with the fact that the absolute majority of voting rights also is considered to lead to control, even though the majority shareholder’s most important instrument to exert influence is the supervisory board, which does not necessarily lead to comprehensive influence, as we have seen. With this argumentation, it seems likely that the factual majority in the general meeting of an undertaking also leads to dominant influence according to item 7 (Article 212 (1) (a) and (c) (i) Solvency II Directive together with Article 22 (2) (a) New Accounting Directive).

Even under IFRS, factual control may lead to a parent-subsidiary relationship according to IAS 27 and the IFRS 10.\textsuperscript{819} For this purpose, the application guidance to IFRS 10 lists a number of criteria and examples for the assessment of factual control. Based on these criteria, it seems unlikely that the assessment would lead to different results according to IFRS and Article 212 (2) of the Solvency II Directive.

For the purposes of group supervision, it is not very satisfying if the parent/subsidiary relationship based on factual control changed from year to year depending on the attendance of the other shareholders in the general meeting. One solution could be to exclude an undertaking from group supervision according to Article 214 (2) (c) Solvency II Directive, for instance because the factual majority has been the result of unexpected circumstances, such as the unexpected absence of another shareholder.

7.4.1.3.4 Contractual right to exercise a dominant influence

According to Edwards, the only situation that falls under the parent-subsidiary relationship defined in Article 22 (1) (c) New Accounting Directive (item 3) is where companies are connected with each other pursuant to a domination agreement according to German law.\textsuperscript{820}

7.4.1.3.5 Group relationship through management on a unified basis

As for “dominant influence”, the New Accounting Directive lacks a definition for “management on a unified basis”. Both concepts have their origin in German law.\textsuperscript{821} Management on a unified basis may lead to a parent-subsidiary relationship as described

\textsuperscript{818} The situation is different with regard to German limited liability companies (GmbH), where the general meeting is competent to give binding orders to the management even with regard to the day-to-day business.


\textsuperscript{820} Edwards, p. 166. Edwards refers to the corresponding provisions in the Seventh Directive.

\textsuperscript{821} Edwards, p. 170.
in item (8) above according to Article 22 (2) (b) New Accounting Directive) or to a horizontal group as described in items (9) and (10) above according to Article 22 (7) (a).

In both cases, the provisions are optional and do not need to be implemented with regard for group accounting purposes. Germany had implemented them with regard to the vertical relationship until it in 2009 switched to the concept of dominant influence. Management on a unified basis existed if the parent undertaking over a longer period of time exercised management functions for the entire group and coordinated all or parts of the operative and strategic business policies of the group companies. Often, management on a unified basis was considered to be applicable for groups with „economic unity“ (wirtschaftliche Einheit). The parent undertaking does not need to be a shareholder in the subsidiary.

There are no requirements concerning the manner in which management on a unified basis is established for a parent-subsidiary relationship. For horizontal groups, Article 22 (7) (a) requires the relationship to be based either on a contract between the undertakings or on a provision in the articles of association of the undertakings. Management on a unified basis and control are separate concepts, with control being the more comprehensive one. Therefore, it seems unlikely that management on a unified basis will play an important role for the definition of Solvency II groups.

7.4.1.3.6 Groups with identical management

Of more practical relevance is therefore the concept of groups based on identical boards according to Article 22 (7) (b) New Accounting Directive, which also deserve a closer examination.

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822 Morck in: Ingo Koller, Wulf-Henning Roth and Winfried Morck (eds), HGB, (6th edn 2007), § 290 para. 2 with further references.


824 Ibid, p. 530.
An example for the group structure shown in Figure 7.4.1.3.6 no. 1 are the German mutuals Alte Leipziger Lebensversicherung auf Gegenseitigkeit und Hallesche Krankenversicherung auf Gegenseitigkeit, whose management boards are composed of the same members.825 These mutuals do not necessarily fulfill the group definition in Article 212 (1) (c) (ii)826 because the requirement of strong and sustainable financial relationships does not seem to be met based on the information publicly available as of November 2013. In their group Solvency and Financial Conditions Report 2016, the mutuals state, however, that they share a common strategy and management.827

Other examples are the Swedish mutuals Folksam and AFA. Folksam ömsesidig sakförsäkring and Folksam ömsesidig livförsäkring have boards of directors (styrelse) which are composed differently, but they share a common CEO and management group (called “koncernledning” by Folksam).828 The three AFA insurance companies are limited companies which are operated on a mutual basis (“hybrid companies”829). As of 2017, less than the half of their boards of directors are composed identically, but they have an identical management group.830

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825 See the list of members of the management boards (Vorstände) of the mutual at https://www.alte-leipziger.de/unternehmen-al/ueberblick-al/management-konzern.htm; accessed on 2017-12-12 at 16:18. Another example is the Signal-Iduna group.
826 See below on this part of the group definition.
829 The term hybridbolag is applied in SOU 2012:64, Förstärkt Försäkringstagarskydd, Betänkande av livförsäkringsutredningen, p. 142. The report also contains a description of the conflict of interests that may arise between the shareholders, the policyholders and other stakeholders, pp. 142 - 145.
830 AFA försäkring årsredovsning 2017, p. 214 f.
It is quite obvious that with a literal reading of Article 22 (7) (b), an Aufsichtsrat of a German mutual or ifalls under the term “supervisory body”, and a Vorstand qualifies as the “management body”. One could argue that it does not suffice if the majority of the supervisory board consists of the same persons because the management board of a German mutual or insurance company is granted a considerable degree of managerial freedom and the supervisory board does not have the power to manage the undertaking – i.e. to apply an argumentation similar to the one used to explain why the right to elect the majority of the supervisory board members of a German stock corporation does not suffice to establish a parent-subsidiary relationship according to § 290 (2) HGB.831 However, to apply this argument with regard to the question whether a horizontal group exists, would require a restrictive reading of Article (22) (7) (b) New Accounting Directive. As already mentioned, this provision contains an option for member states to require horizontal groups to set up consolidated accounts, and therefore gives member states the option not to implement it or to specify the relevant body in the national implementation norm. Due to its optional character, the exact wording of the provision was not decisive to reach an agreement on its adoption and could be wide in order to catch many thinkable situations. The Solvency II Directive, on the other hand, refers to this provision notwithstanding whether it has been implemented into national law or not. This could justify that the body in question must be the company organ where most business decisions are taken.

Against this speaks that the European legislator has taken a very broad approach to the group definition by referring to all situations described in the New Accounting Directive that may lead to a consolidation requirement, without referring to the possible exemptions laid down in this directive. The Solvency II Directive even expands the group definition with the concept of centralized coordination and dominant and significant influence in the opinion of the supervisor. This speaks against a restrictive application of Article 22 (7) (b), so that not only the Vorstand, but even the Aufsichtsrat of a German mutual or stock corporation is encompassed. In consistence with this interpretation, the German legislator has defined a horizontal group in § 7 no. 15 VAG 2016 as a group of undertakings where the majority of the members of the management or supervisory bodies have been identical during the entire fiscal year and during the first 4 to 5 months of the ongoing fiscal year.

With their identical management boards, Alte Leipziger and Hallesche therefore form a horizontal group for Solvency II purposes and therefore are participating and related

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831 Another area, where it does not suffice if the majority of supervisory board members are identical, is German tax law. In order to form a fiscal unit for VAT taxation (umsatzsteuerliche Organschaft) in Germany, two entities need to be financially and organizationally integrated, which is not necessarily the case if only the supervisory board consists of representatives of the parent undertaking, cf. Umsatzsteuer-Anwendungserlass (UStAE) of 1 Oktober 2010 as amended as of 7 March 2013. The effect of a fiscal union is that the undertakings are treated as one tax subject.
undertakings with respect to each other by virtue of Article 212 (1) (a) Solvency II Directive.

For the Folksam mutuals, the starting point is a little bit different, because Sweden has a one board system and the mutuals’ board of directors do not consist of the same persons. In its annual report 2012, Folksam Liv described Folksam Sak and its subsidiaries as related undertakings because of an identical management.\(^{832}\) To regard these mutuals for Solvency II purposes as horizontal groups according to Article 22 (7) (b) presupposes that even key management positions below the board of directors are relevant. The Swedish expert committee on the implementation of Solvency II considered that this is not the case.\(^{833}\) The Swedish legislator followed its advice and introduced in chapter 1 § 16b no. 2 FRL 2016 a definition of “common management” (gemensam ledning) referring to the board of directors only, so that a horizontal group cannot be based on an identical CEO (verkställande direktör)\(^{834}\) or group of managers reporting to the CEO.

For the correctness of this transposition speaks that Swedish law gives the board of directors comprehensive executive rights. Unlike a German supervisory board, the board of directors may represent the mutual or insurance company towards third parties. The CEO is in charge of the day-to-day business of the association and is obliged to follow the board of directors’ instructions.\(^{835}\) In contrast to the German AktG, Swedish law does not reserve certain tasks exclusively for the CEO, but allows the board of directors to decide upon and to execute decisions falling into the CEO’s domain, as long as they do not deprive the CEO entirely from his competence and responsibility for the day-to-day management.\(^{836}\) The members of the management group reporting to the CEO are not even given any particular rights and function in Swedish company law, in fact they are not even mentioned in the ABL. The management group therefore cannot override the CEO in case of disagreement, i.e. if the CEO disagrees with the majority of the

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\(^{832}\) Folksam ömsesidig livförsäkring, Årsredovisning 2012, p. 93. In later reports, the Folksam Sak group is described as related without explicit reference to the management group, see Folksam ömsesidig livförsäkring, Årsredovisning 2017, p. 118.


\(^{834}\) Verkställande direktör or VD is translated as CEO (Chief Executive Officer) following the translation applied by Finansinspektionen, for instance in Finansinspektionen's regulations regarding smaller local Swedish non-life insurance companies' obligation to report date from the annual report; FFFS 2008:19, p. 3. Another possible translation would be “general manager” or “managing director”.


management group members, he alone is entitled to take a decision. The management group therefore merely has a consultative function in relation to the CEO.

An argument for the inclusion of a “management group” including the CEO, or at least the CEO, under the term “managing body” would have been that this group in practice leads the day-to-day business and takes many of the business decisions that have an impact on the risk situation of the insurance undertaking, even if the board of directors has the overall responsibility for the business. The Solvency II legal regime also acknowledges that the legal responsibility allocated to a certain company organ does not need to coincide with where management is exercised and applies the fit and proper requirements according to Article 42 (1) Solvency II Directive to “[…] all persons who effectively run the undertaking or have other key functions […]”. Not to include the CEO and the management group reporting to him, means to ignore the practical relevance of these persons for the companies’ business. Furthermore, according to Chapter 12 § 25 FRL 2016, the majority of the directors of a mutual insurance company are not allowed to be employed by the company or a company belonging to the same group. Consequently, at least for the majority, their board assignment is not their principal work activity (similar as for German supervisory board members). The members of the management group (including the CEO), to the contrary, usually work on a full-time basis for the insurance group, similar to the members of a German management board. In many larger Swedish corporations, a large part of the management tasks have been delegated from the board of directors to the CEO, so that the board of directors’ main responsibility shifts from an administrative towards a supervisory function. In such companies, the CEO has in practice the profoundest knowledge of the company, and the board of directors is dependent on the information provided by the CEO. According to chapter 8 § 7 ABL, the board of directors of a limited company is obliged to decide upon a written division of responsibilities between the board of directors and the CEO, which usually define which kind of transactions need the to be decided by the board of directors. Even though a corresponding obligation does not exist for Swedish insurance mutuals, it seems reasonable to assume that the board of directors of a mutual will set up similar rules. Similarly, the supervisory board of a German insurance company or insurance mutual is obliged to set up by-laws defining the kinds of transactions that need the approval of the supervisory board. Consequently, in practice, the tasks of a German supervisory board and management board and a Swedish board of directors and CEO of an insurance mutual have more similarities than one would expect at first glance, even

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837 Skog, Rodhes Aktiebolagsrätt, p. 158.
838 Ibid, p. 162.
839 Dotevall, Bolagsledningens skadeståndsansvar, p. 129. According to Moberg, the board of directors in such an association also has the task to support the CEO, for instance with regard to strategic decisions, Krister Moberg, Företaget och sekretessen - En rätts- och samhällsvetenskaplig studie av medinflytandeinformation och sekretess i företagen (1981), pp. 88-89.
though Sweden applies (a modified) one-tier board system and Germany a two-tier board system.

Against this background, it is questionable whether the Swedish transposition is fully in compliance with the objectives of the Solvency II Directive. This illustrates how different interpretations – in this case of the concept of “common management” – lead to differences in the level of supervision: Whereas German mutuals with identical management boards are obliged to calculate and comply with a group SCR, Swedish mutuals with identical “management groups” are not.

An example of a Swedish horizontal group calculating a group solvency ratio is the AFA group. The life and the health insurance company at the top of the group are both owned by Swedish Trade Union Confederation (Landsorganisationen) and the Confederation of Swedish Enterprise (Svenskt Näringsliv), holding 50% each. They share the same CEO, management group and three of the nine board members are identical, among them the chairperson and have a centralised risk management.

7.4.1.3.7 Can mutuals only be participating undertakings?

Another question with regard to the group definition in Article 212 (1) (c) (i) Solvency II Directive is whether mutuals only can be participating undertakings, or whether situations are imaginable where an insurance mutual is a participation or even a subsidiary.

Mutuals are explicitly mentioned in Article 212 (1) (c) (ii) only according to which a group based on strong and sustainable financial relationships may include “mutuals and mutual-type associations.” This does not mean, however, that mutuals are not encompassed by the other group definitions. From a teleological perspective, specifically in the context of the group definition for Solvency II purpose, it seems appropriate to let all associations fall under the term “undertaking”, including mutuals and non-profit organisations (Swedish: ideella föreningar), notwithstanding whether they are classified as companies or associations according to national law. Otherwise certain group structures risk to fall outside the group definition, and for instance, transactions between two mutuals with an identical management board (see Figure 7.4.1.3.6 no. 1) would not have to be reported to the group supervisor. These groups do not necessarily need to have strong and sustainable financial relationships required for groups through centralized coordination. Only if the group definition in Article 212 (1) (c) (i) encompasses mutuals, these undertakings may form a group in the sense of Solvency II according to Articles 212 (1) (c) (i) Solvency II Directive together with Article 22 (7) (b) New Accounting Directive. The Swedish expert committee suggested not to include an explicit reference to mutuals in the Swedish implementation norm, because mutuals are just one example of associations that might have strong and sustainable financial relationships. Although not discussed explicitly, this could be understood as if the committee members are of the opinion that mutuals are not limited to being part of

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840 Besher and Andersson, p. 278 (“ett svenskt särpräglat monistiskt system med två förvaltande bolagsorgan”).
841 AFA Försäkringsgruppen, Rapport om solvens och finansiell ställning (SFCR) 2016, pp. 12, 13, 81.
842 See chapter 7.4.1.4 for a more detailed analysis of “mutual” and “mutual-type association.
843 See chapter 7.4.1.4 on groups based on centralized coordination.
844 On Article 212 (2) which could also be applied on such group structures, see chapter 7.4.1.5.
groups based on centralized coordination. As a conclusion, mutuals are able to qualify as group members even according to Article 212 (1) (c) (1) Solvency II Directive.

For the situations described in items (1) to (8), however, it is much more likely that a mutual will qualify as a parent undertaking than as a subsidiary, because usually one single member or member representative does not have a voting majority in a mutual’s general meeting.

Nevertheless, the articles of association of some mutuals give certain organizations the right to appoint representatives for its members, thus giving these organizations control over a certain amount of votes at the general meeting. An example are the Folksam mutuals, where KF (Kooperativa Förbundet), an organization for consumer associations, has the right to appoint 22 of 75 respectively 80 member representatives, and the Swedish Confederation of Trade Unions (Landsorganisationen - LO) has the right to appoint 18 representatives.846 Does this mean that KF and LO hold participations in the sense of Solvency II in the Folksam mutuals? KF is an cooperative society (ekonomisk förening). LO is not registered in the company register. In its articles of association, it is called a förbund, which is not an autonomous form of association. Presumably, LO forms an ideell förening, a non-profit organization with legal personality.847 Based on the interpretation applied here, both organizations qualify as “undertakings” that are able to hold a participation. The definition of “participation” in Article 13 (20) Solvency II Directive requires “the ownership, direct or by way of control, of 20 % or more of the voting rights of an undertaking”.

In the Folksam case, LO and KF do not hold the voting rights themselves, but each may determine which persons together shall exercise more than 20 % of the voting rights. To argue that the organizations have “control” of the voting rights in a legal sense, is connected with considerable difficulties, because the definition of “control” in Article 12 (18) Solvency II Directive does not really fit. In the definition of “participation”, “control” is meant to include indirect holdings of voting rights, but this would presuppose that LO and KF control the individual member representatives appointed by them. Control between a natural person and an undertaking exists, if they are connected through a relationship which is similar to the situations described in Article 22 (1) New Accounting Directive. However, these situations can be applied to establish a control situation of a natural person over an undertaking, but not the other way round.

This result is somewhat unsatisfactory, because it would clearly constitute a participation, if the articles of association gave LO and KF the right to exercise the voting rights themselves. With the mere right to appoint natural persons that together exercise

846 See the articles of association of the Folksam mutuals: Folksam ömsesidig livsförsäkring, Bolagsordning, § 4; Folksam ömsesidig sakförsäkring, Bolagsordning, § 4. Apart from KF and LO, several other organizations have the right to appoint smaller numbers of member representatives.

more than 20% of the voting rights, it seems unlikely that KF’s and LO’s role in the Folksam mutual would constitute a relationship according to Article 212 (1) (c) (i). The same must be true if an organization was given the right to elect representatives for more than 50% of the voting rights in a mutual. Another solution could be the analogous application of Article 22 (1) (d) (ii) New Accounting Directive, where board members elected by a shareholder are considered to lead to the shareholder’s control over a company. Also here, we are dealing with natural persons who are taking their own decisions in a board meeting, but who may be inclined to take orders by the undertaking that has appointed them.

A solution could be to regard the relationship between these organisations and the Folksam mutuals as a significant influence in accordance with Article 212 (2) Solvency II Directive.848 In this context, it is important to note that a participation in an insurance undertaking does not automatically lead to the application of the entire scope of group supervision, but would be limited to the supervision of intra-group transactions in this case.

7.4.1.4 Horizontal groups based on centralized coordination (Article 212 (1) (c) (ii))

As mentioned above, the second paragraph in the group definition widens the group concept to undertakings that are linked with each other by “strong and sustainable financial relationships”, where one of the undertakings “effectively exercises, through centralized coordination, a dominant influence over the decisions, including financial decisions, of the other undertakings that are part of the group”. This part of the group definition does not have an equivalent in the Financial Conglomerates Directive. Its practical relevance is seems to be very limited849, especially taking into consideration the extension of the definitions of the terms “parent undertaking” and “participation” in Article 212 (2) Solvency II Directive.850 According to Erdélyi, this definition of this kind of horizontal group is a special provision for “[…] a special form of cooperation between insurance undertakings originating from France“ and aims at ensuring a level playing field for different types of insurance groups.851 Since she does not provide any source for this statement, this group definition is nevertheless discussed with a view to its eventual applicability to German or Swedish undertakings.

848 See chapter 7.4.1.5.
849 With regard to German insurance undertakings, Kraft does not see any practical relevance, Kraft, Gruppenaufsicht, p. 143.
850 See chapter 7.4.1.5 on the extended group definition.
851 Erdélyi, p. 82.
- On the concept of centralized coordination

The requirement of dominant influence through centralized coordination is a special form of control exercised by one undertaking over another. The provision states explicitly that management based on centralized coordination may include “mutual or mutual-type associations”.

The Solvency II Directive leaves open what is to be understood by “centralized coordination”. The term reminds of the term “group with centralized risk management”, for which Articles 236 to 243 contain special rules for the supervision of group solvency. With a centralized risk-management, a group goes beyond the obligatory rules on a group-wide risk management applying to all groups, and centralizes the risk management of its group companies at one group undertaking (usually the parent undertaking) and thereby replaces the risk management functions of the subsidiaries with a centralized risk management function.\(^{852}\) CEIOPS provides some examples for such legal constructs that could form the basis for the establishment of a centralized risk management, namely domination agreements (where allowed by national law) and outsourcing arrangements.\(^{853}\) This shows that a centralized risk management may, in principle (subject to eventual restrictions imposed by national law), be established for any kind of group, and that the term cannot serve for defining a particular form of group. Consequently, the two concepts must be considered as being entirely unrelated to each other.

In its advice to the European Commission concerning the assessment of group solvency from 2009, CEIOPS considered that centralized coordination would encompass the same situations covered by Article 22 (7) New Accounting Directive.\(^{854}\)

Similarities between the requirements for management on a unified basis (Article 22 (7) (a) New Accounting Directive) and centralized management can certainly be noted, since the difference between “management on a unified basis” and “centralized coordination” is rather blurry. However, from a systematic perspective, it would seem surprising if the two concepts were identical, because management on a unified basis is already encompassed by the definition in Article 212 (1) (c) (i), also concerning mutuals and mutual-type associations. With a literal reading, some significant differences can also be noted. Whereas centralized coordination requires that one undertaking exercises a dominant influence over the decisions of the other undertaking, the provision on management on a unified basis in Article 22 (7) is not concerned with control, but encompasses horizontal groups where it is not possible to identify a dominating undertaking. Another difference is that Article 22 (7) (a) requires management on a unified basis to be based on a contract or on provisions in the articles of associations of the undertakings concerned. Dominance by centralized management, on the other hand, may not only be established on the basis of a contract, but also in other ways (“or otherwise”). Furthermore, “strong and sustainable financial relationships” between the undertakings are required. Finally, Article 212 (1) (c) (ii) provides that “the establishment and dissolution of such relationships for the purposes of this Title are subject to prior approval by the group supervisor”.

Taken altogether, these differences illustrate that for an assessment of a parent-subsidiary relationship based on centralized coordination, recourse cannot be taken to Article 22 (7) New Accounting Directive, but that an independent assessment based on the requirements stated in Article 212 (1) (c) (ii) is necessary.

\(^{852}\) CEIOPS, CEIOPS’ Advice for Level 2 Implementing Measures on Solvency II: Supervision of Group Solvency for Groups with Centralised Risk Management, 2010, para. 3.4. CEIOPS refers to the corresponding provision in the Seventh Directive.

\(^{853}\) Ibid, paras. 3.94 – 3.104.

\(^{854}\) CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09, October 2009, para. 3.24. CEIOPS refers of course to the corresponding norms in the Seventh Directive.
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One question in this context is how the requirement of supervisory approval needs to be understood. The wording as well as its position in a provision dealing with definitions suggest that supervisory approval is merely a prerequisite to become a group based on centralized coordination, and not that Article 212 constitutes the approval requirement itself. However, it does not seem as if the directive contains any corresponding approval requirement elsewhere.

A possible solution could be that national laws contain relevant approval requirements. Whereas Swedish law does not lay down any such approval requirements, an example could be § 12 (1) VAG 2016, according to which domination agreements with insurance undertakings – as in the past – need BaFin approval. If an insurance undertaking concluded such an agreement with a non-shareholder as dominant undertaking, this would presumably establish such a strong and sustainable financial relationship to qualify for dominant influence through centralized coordination: According to § 292 AktG, domination agreements need to be concluded for a period of at least five years, and give the dominating undertaking the right to give instructions with regard to the dominated undertaking’s business, with the latter’s management body being obliged to follow the instructions (§ 308 AktG). The dominating undertaking’s obligation to compensate any annual losses that the dominated undertaking suffers during the duration of the agreement (§ 302 (1) AktG), should be sufficient to establish the financial relationship required.

German mutuals (Versicherungsvereine auf Gegenseitigkeit) may not enter into such domination agreements as the dominated part since domination by a third party and the profit transfer collide with the idea of mutuality. In this context, it is necessary to point out that domination agreements usually are concluded between a majority shareholder and the dominated undertaking. A scenario where the dominating undertaking is neither a shareholder nor related to a shareholder, needs to be considered as rather exceptional. Usually, the parties therefore already form a group because the dominating shareholder has the majority of voting rights in the dominated subsidiary. A group structure based on a domination agreement in the absence of a shareholding could look like this:

855 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 397. In the proposal, it is pointed out that the provision is not relevant for relationships between two Swedish undertakings, but could be of relevance to assess the relationship between a Swedish and a non-Swedish undertaking.
856 Entwurf eines Zehnten Gesetz zur Änderung des Versicherungsaufsichtsgesetzes, Entwurf der Bundesregierung (February 2012).
857 The absence of any shareholding is required to distinguish this scenario from the situations covered by Article 22 (1) (c) of the New Accounting Directive. Following the argumentation developed above, the scenario would fall under Article 212 (1) (c) (i) of the Solvency II Directive in connection with Article 212 (1) (a) Solvency II Directive and Article 22 (1) (c) of the New Accounting Directive, if the dominating undertaking is a shareholder or member in the dominated undertaking, but not if no shareholding or membership exists.
858 The general meetings of both parties have to approve the conclusion of the agreement with a ¾ majority. In addition to that, those shareholders of the dominated undertaking that are not party to the agreement are entitled to receive an annual compensation. Obligor of the compensation payment is according to the prevailing opinion the dominating party, see Hüffer/Koch AktG, § 304 para. 4.
859 Präve in: Prölss/Dreher VAG, § 9 para. 73; Wilm in: Handbuch des Versicherungsaufsichtsrechts, § 19 para. 34.
An argument against this scenario qualifying for a group relationship based on centralized coordination is that the German draft does not require approval by the group supervisor, but by the solo supervisor of an insurance undertaking that wants to enter into a domination agreement. This leaves us with three possible interpretations. First, one could take the approval requirement literally in the sense that national or EU law somewhere else must require approval by the group supervisor, which would have the consequence that the likelihood that there will be any groups based on centralized coordination is relatively low. If no such approval requirement exists, groups based on centralized coordination would be possible only in theory. However, this does not mean that such arrangements in practice would be impossible – as in the example described above between a domination agreement between an insurance undertaking and a non-shareholder or a minority shareholder. Second, with an extensive interpretation, one could argue that it suffices if a solo supervisor has approved the arrangement. In that case, the example illustrated above would lead to a group based on centralized coordination. As a third possibility, Article 212 (1) (c) (ii) could even be understood – against a literal interpretation – as constituting an obligation to acquire prior approval for the establishment of such “strong and sustainable financial relationships“. Especially where the dominated undertaking is an insurance undertaking, it seems reasonable to require some form of supervisory approval, similar to the notification requirements in place for the proposed acquisition of significant shareholdings in insurance undertakings, because the effects of such an arrangement can be expected to be at least as serious as the acquisition of a majority shareholding. However, since the provision is included in a paragraph dealing with definitions, such a definition would not be compatible with the systematic structure of the directive. Mainly due to the requirement of group approval, it is very doubtful whether the definition for groups based on centralized coordination will gain any practical relevance in Sweden and Germany, even more so since it will probably be easier to establish a parent-subsidiary relationship based on Article 212 (2) in cases that might otherwise be considered groups based on centralized coordination.
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- Mutuals and mutual-type associations

Article 212 (1) (c) (ii) provides explicitly that mutuals or mutual-type associations may form a group based on centralized coordination. The directive does not define these two terms, but from recital 52 can be derived that such associations are characterized by having members rather than shareholders. Annex III of the directive lists which forms of associations in each member state may conduct insurance business may. This gives an indication for which kind of associations are mutuals or mutual-type. For Sweden, two forms of mutuals are listed: ömsesidiga försäkringsbolag (mutual insurance companies) and understödföreningar (friendly societies). For Germany, Versicherungsvereine auf Gegenseitigkeit are the only association form based on mutuality available for insurance undertakings. All types of associations are characterized by a cooperative idea, i.e. they are owned by their members, who have acquired membership by being policyholders. In fact, the German language version of Article 212 (1) (c) (ii) refers directly to "Versicherungsvereine auf Gegenseitigkeit oder diesen ähnliche Vereine".

Less clear is whether a Swedish life insurance company that is operated on a mutual basis falls under the category “mutual-type association”. Examples are Länsförsäkringar Liv försäkringsaktiebolag and AFA Trygghetsförsäkringsaktiebolag. This type of company is not allowed to distribute profits to its shareholders. Instead, profits may only be distributed to its policyholders. This is an important similarity to “ordinary” mutuals, which would justify to classify them as a “mutual-type associations”.

According to the German language version of Article 212, such a company form would not qualify as a mutual-type association, because a company is not a Verein. Not only in comparison with the English, but also with the Swedish language version (ömsesidiga företag eller liknande företag), the German version seems to apply a too narrow terminology. However, for the purpose of analyzing the definition of group undertakings, this question can be left open, because groups based on centralized coordination are not explicitly limited to mutual and mutual-type associations, but include all forms of associations.

The group definition based on centralized management seems to be inserted mainly in order to cover certain institutionalized forms of cooperation between mutuals that may fall outside the categories covered by Article 212 (1) (c) (i), even though mutuals qualify for this part of the group definition, as has been shown above.

861 See ibid, p. 317, on Swedish mutual associations. New understödföreningar are not allowed to be founded, however, and existing ones have to enter into liquidation until 2019, § 7 Lag (2010:2044) om införande av försäkringsrörelselagen (2010:2043). Why försäkringsföreningar (insurance associations) do not appear in Annex III is not quite clear.
862 Länsförsäkringar AB, Årsredovisning 2012, p. 20.
863 AFA försäkring årsredovisning 2017, p. 117.
864 See chapter 11 §§ 6, 7 and 10 FRL.
As we have seen above, however, mutuals may form part of a horizontal group as qualified by items (9) to (11).

7.4.1.5 Dominant and significant influence in the opinion of the supervisory authorities

As mentioned above, solely with respect to the title on group supervisions, Article 212 (2) further extends the definitions of “parent undertaking”, “subsidiary undertaking” and “participation”. According to this provision, an undertaking is also considered a parent undertaking if it, in the opinion of the supervisory authorities, exercises dominant influence over another undertaking. The dominated undertaking is in turn considered to be a subsidiary. Similarly, a participation also exists where, again in the opinion of the supervisory authorities, an undertaking may exercise significant influence over another undertaking. Interestingly, however, Article 212 (2) requires for undertakings with a significant influence, but not for those with a dominant influence, that they hold, directly or indirectly, voting rights or capital in the participation.

The Swedish expert committee expressed concerns about the consequences of a strict interpretation, which could lead to capital investments in listed companies in certain cases to be qualified as participations of insurance companies, which the committee considers unreasonable. The Swedish legislator considered it necessary that a parent-/subsidiary relationship can be determined solely on the basis of facts laid down in the law and therefore refrained from implementing Article 212 (2). As a consequence, Finansinspektionen does not have the possibility to treat undertakings as parent and subsidiary undertakings or as a participation. Whether this constitutes a correct transposition of the Directive, seems doubtful. For a uniform application of the Solvency II rules and a smooth cooperation among supervisory authorities, differences in the national implementation laws should, of course, be avoided.

Significant influence is not defined in the directive, but the term is used in the definition of “qualifying holding” in Article 13 (21). According to this provision, a qualifying holding means a direct or indirect holding of at least 10 % of the capital or the voting rights in an undertaking “or which makes it possible to exercise a significant influence over the management of that undertaking”. The wording implies that shareholdings of 10 % per se are considered or at least presumed to provide significant influence. This would be quite a far-reaching conclusion, though, because it would in effect replace the 20 %-threshold laid down in the definition of “participation” in Article 13 (20) with a 10 %-threshold. According to recital 75, the national supervisory authorities should be entitled to issue guidance as to when holdings below 10 % would be deemed to result in significant influence. However, it is important to note that the term “qualifying holdings” in the context of the Solvency II Directive is used in a different context, namely the notification requirements in the event of a proposed

865 SOU 2011:68 Rörelsereglering för försäkring och tjänstepension, Betänkande av Solvens II-utredningen, Del 1, p. 419.
866 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 398.
acquisition of a qualified holding in an insurance undertaking, whereas Article 212 (2) is extending the definition of “participation” for the purpose of defining group relationships. These concepts are related to each other, but are not identical. If diverging national guidance on “significant influence” would be conclusive, there is a risk that the qualification of an undertaking as a participation depends on where the assessment is done.867 Different interpretations do not pose any serious problems if their only consequence is that they trigger different starting points for a notification of an acquisition, but concerning the group composition, without a harmonized interpretation, there is a risk that the same relationship between two undertakings would be interpreted differently between two supervisory authorities, for instance a group supervisor and a sub-group supervisor.

Outside the Solvency II Directive, guidance cannot be found in any of the other directives in the field of financial regulatory law. However, “significant influence” is defined in International Accounting Standard 24 on related party disclosures as

“[...] the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies. Significant influence may be gained by share ownership, statute or agreement.”868

With effect as of 1 January 2014, the definition was moved to International Accounting Standard 28 (investments in associates and joint ventures) whereby the second sentence was deleted:

“Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.”869

The Standard continues with listing criteria for the assessment of significant influence:

“The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

867 Here, a parallel to the question concerning the irrelevance of member states’ differences in the implementation of the Seventh Directive for the purposes of Solvency II group assessment can be noted, see chapter 7.4.1.3.2
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(a) representation on the board of directors or equivalent governing body of the investee;

(b) participation in policy-making processes, including participation in decisions about dividends or other distributions;

(c) material transactions between the entity and its investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

To use this definition would have the advantage that the treatment in the consolidated accounts would be identical to the treatment according to Solvency II. According to EIOPA’s Guidelines on the treatment of related undertakings, supervisory authorities should use the same criteria as evidence for both significant and dominant influence, together with two additional ones: management on a unified basis and potential voting rights. The guidelines are based on advice issued by CEIOPS, that obviously took recourse to the criteria used in IFRS, but stressed that the concepts do not necessarily need to be identical. Consequently, a company might be deemed to exert significant (or dominant) influence according to Solvency II but not according to IFRS (or vice versa). In this context, it may be worth mentioning that the term “dominant influence” is not used in IFRS. In Article 2 (9) Financial Conglomerates Directive, it is used in the definition of “parent undertaking” in a similar way as in Article 212 (2) Solvency II Directive and in Article 22 (1) (c) New Accounting Directive.

As mentioned, Article 212 (2) leaves it to the supervisory authority to determine whether dominant or significant influence is deemed to apply. This supports CEIOPS’ opinion that absolute consistency with the group definitions in IFRS or the New Accounting Directive has not been expected by the legislator. Furthermore, a considerable degree of discretion is granted to the supervisory authorities in their assessment of the level of influence. The wording “in the opinion of the supervisory authority” even seems to imply that the decision of the supervisor is unjusticiable. However, this would violate the insurance undertakings’ right of access to justice.

As mentioned above, the (somewhat unrealistic) example of one insurance undertaking being dominated by a non-shareholder pursuant to a domination agreement, would probably not fall under any of the other aspects of the group definition. With the dominating party being able to determine in detail the policies and business decisions of the dominated undertaking, dominant influence according to Article 212 (2) is without

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870 EIOPA, Guidelines on treatment of related undertakings, including participations, 2 February 2015, para. 1.17.
871 See CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09, paras. 3.26 and 3.31.
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doubt given. These undertakings would therefore be considered to have a parentsubsidiary relationship.

The case of two Swedish mutuals sharing the same “managing group” could fall under the criterium “interchange of managerial personnel”.

- A doubtful case: Länsförsäkringar

An example of a group of undertakings where it is doubtful whether they constitute a group in the sense of Solvency II are Länsförsäkringar. Länsförsäkringar are 23 Swedish regional insurance mutuals that together own a service company, Länsförsäkringar AB, which in turn owns other companies, including several life insurance companies and a bank.872 Taken together, Länsförsäkringar belong to Sweden’s largest insurers. Whereas Länsförsäkringar AB and its subsidiaries form a financial conglomerate873 and a group in the sense of Article 212 (1) (a) (i) Solvency II Directive, the contractual and factual relationships between the regional insurance mutuals do not seem to give one single regional mutual dominant influence over any other mutual or over Länsförsäkringar AB. Rather, according to the information publicly available, it seems as if the regional mutuals together exercise a dominant influence based on a consortium agreement among each other.874 This is not covered by the wording of Article 212 (1) (c) (ii), which requires that one undertaking exercises a dominant influence.

Depending on the circumstances, some or all of the regional Länsförsäkringar mutuals might be considered to exercise at least significant influence over Länsförsäkringar AB, so that Länsförsäkringar AB would qualify as their participation, even though their respective shareholdings875 do not reach the 20%-threshold required for a participation according to the general definition in Article 13 (20) Solvency II Directive – however, since Sweden has not implemented Article 212 (2) Solvency II Directive, Finansinspektionen does not have this possibility. But even if this was the case and some of the regional mutuals were considered to exercise significant influence, this would only have the effect that each of these mutuals would form a group with Länsförsäkringar AB and its subsidiaries and participations, but not that all regional mutuals together with Länsförsäkringar AB would form a group.

The result that the regional Länsförsäkringar mutuals do not form a group according to Solvency II is a bit unexpected taking into consideration that the mutuals use a common logo and have divided the Swedish market into regions whereby eliminating effective competition between them. They also share a website platform from which users are directed to the respective mutual in their region. They even publish a group report covering the results of all regional mutuals and the Länsförsäkringar AB group.876 According to this report, the regional mutuals also have a common reinsurance pool, reinsuring each other’s businesses.877 Länsförsäkringar is not entirely unique with this structure. Another example are Dina Försäkringar, consisting of ten insurance mutuals that are active under the same brand and share a common service and reinsurance undertaking.

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872 Based on the structure described in Länsförsäkringsgruppen, Årsöversikt 2017, p. 52
873 Joint Committee of the European Supervisory Authorities, item 64.
874 According to the description of shareholder governance, the shareholders steer Länsförsäkringar AB through the general meeting, a shareholder consortium based on a consortium agreement, and representation in the board of directors, Länsförsäkringsgruppen, Årsöversikt 2017, p. 4 f.
875 In 2017, the shareholdings reached from 0.0 % to 9.8 %, ibid, p. 52.
876 Ibid, p. 42 f.
7.4.2 A few remarks on the group concept applied in Solvency II

As we have seen above, outside the usual obvious cases where undertakings are related to each other through majority shareholdings, the identification of group relationships according to Solvency II is far from simple. The terms relevant for the identification are known from other directives and from IFRS, or are used in a different context in the Solvency II Directive. This makes the application of the group definition in Solvency II complicated, even though in many cases, the same outcome can be expected. However, there are cases, as CEIOPS correctly pointed out, that are treated differently in Solvency II compared to other group definitions.

One complication results from the fact that the Solvency II Directive refers to concepts in the New Accounting Directive that is not concerned with defining the term “group”. The repealed Seventh Directive did not even use the term “group”, and the provisions that the Solvency II Directive refers to are supposed to identify those undertakings that are or may be obliged to set up consolidated accounts. For instance, as already mentioned, an undertaking does not need to set up consolidated accounts just because it holds a participation, whereas a shareholder and its participation form a group according to Solvency II.

Similarly, the optional character of several of the situations described in the New Accounting Directive may lead to groups according to Solvency II that do not need to set up group accounts. An example would be a horizontal group that consists only of an undertaking that is managed on a unified basis with another undertaking, where the relevant member states do not have exercised their right to implement Article 22 (7) (a) New Accounting Directive. Another example would be two mutuals where the management bodies consist of the same persons, as discussed above. These undertakings form a group in the sense of Solvency II according to Articles 212 (1) (c) (i) Solvency II Directive together with Article 22 (7) (b) New Accounting Directive. In contrast to that, the group definition in Article 212 (1) (c) (ii) is not fulfilled because the requirement of strong and sustainable financial relationships is not met. In the example of the two German mutuals Alte Leipziger and Hallesche, they form a group in the form of a Gegenseitigkeitskonzern (horizontal group) according to § 18 (2) AktG, but they do not need to consolidate each other in their group accounts, because Germany has chosen not to implement Article 22 (7) (b) New Accounting Directive.\footnote{879}

\footnote{See Böcking/Gros/Schurbohm-Ebneth in: Ebenroth/Boujong/Joost/Strohn, HGB, § 290, para. 1.\footnote{878} Alte Leipziger Lebensversicherung a.G. was in 2017 obliged to set up consolidated accounts because it held other subsidiaries, see the group structure in Alte Leipziger Lebensversicherung auf Gegenseitigkeit, Konzerngeschäftsbericht 2017, p. 2. Hallesche Krankenversicherung a.G. did hold any subsidiaries in 2017 and consequently, did not publish any consolidated accounts for that year, see Hallesche Krankenversicherung auf Gegenseitigkeit, Geschäftsbericht 2017, p. 65.}
- Is it a problem that the Solvency II group definition is not entirely identical with other group concepts?

Is it then a problem that the Solvency II group definition is not entirely identical with other group definitions? Already before Solvency II has added yet another group definition, many different group concepts existed. So, it is nothing new that the Solvency II group concept is not entirely identical with any other group definition.

For instance, the German AktG contains definitions of the terms “affiliated enterprises” (§ 15 AktG), “parent enterprises” and “subsidiaries” (§ 16 AktG), “controlled and controlling enterprises” (§ 17 AktG), and of “group” (Konzern) and “members of a group” (§ 18 AktG). Nevertheless, a group in the sense of the AktG is not necessarily identical with the scope of companies that need to be included in the consolidated accounts – even if one disregards the inclusion of participations in the consolidated accounts which do not fall under the group definition according to the AktG. Whether a company needs to set up consolidated accounts, is laid down in § 290 HGB, which implements Article 1 (1) Seventh Directive. If an undertaking is obliged to set up consolidated accounts according to § 290 HGB, and where these accounts need to be set up according to German GAAP, §§ 294 to 312 HGB determine which undertakings have to be consolidated and with which method. Only listed companies are obliged to apply IFRS for their consolidated accounts (§ 315e (1) HGB). The same applies to companies that have submitted an application to have their securities listed on an organized market (§ 315e (2) HGB). All other companies may choose to set up their consolidated accounts according to IFRS or according to German GAAP (§ 315e (3) HGB). Unconsolidated accounts always have to be set up according to German GAAP. Unlike Sweden, Germany does not prescribe the application of IFRS for insurance undertakings in general.

If the consolidated accounts are set up according to IFRS, the IFRS standards as endorsed by the European Commission determine which entities need to be consolidated and in which way, notably IFRS 10 replacing the corresponding provisions in IAS 27 (Consolidated Financial Statements) and SIC 12 (Consolidation – Special Purpose Vehicles).

Also Swedish law contains definitions of moderföretag/moderbolag, dotterföretag and koncern both in Chapter 1 § 11 ABL and in Chapter 1 § 4 Accounting Act, which correspond to Articles 1 (1), 2 (1) and 3 (1) Seventh Directive. As we have seen, factual control may lead to a parent-subsidiary relationship according to Solvency II. In this context, differences between Solvency II groups and national law can be observed. The Swedish legislator has chosen not to implement Article 22 (1) (d) (i) New Accounting Directive because it considered it too impractical that the assessment needs to be made...

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880 See Kraft and Link, for a comparison of the rules for the identification of the companies to be consolidated according to German GAAP and IFRS 10.
at the end of the financial year, i.e. retroactively.\textsuperscript{881} Prior to the implementation of the Seventh Directive, a practical majority could fall under the group definition contained in Chapter 1 § 5 ABL 1975.\textsuperscript{882} The preparatory works imply that this is not longer the case.\textsuperscript{883} Consequently, according to Swedish accounting and company law, there is no parent–subsidiary relationship between these undertakings.

Against the background that there are many different group definitions for different purposes, one could say that Solvency II uses its own group definition. The legislative technique used by referring to the (meanwhile repealed) Seventh Directive was probably chosen in order to create coherence between group definitions in different pieces of legislation. The result, however, can be criticized as overly complicated, also taking into account that the Solvency II Directive refers to provisions that member states are not obliged to implement. This increases the risk that some of the more complicated group definitions are applied differently at national level, which would be counterproductive to the aim to achieve a level playing field for insurance undertakings in Europe. When the result of such a legislative technique becomes too complicated, as in the present case, the legislator should therefore consider the possibility to insert stand-alone definitions instead.

\textit{- Some differences to IFRS}

According to the prevailing opinion, the provisions in Article 22 (1) (a) and (b) New Accounting Directive describe situations with an unrefutable presumption for a parent/subsidiary relationship, i.e. if an undertaking has the majority of the voting rights or the right to appoint the majority members of the administrative board, it is considered to have control, even though due to other circumstances, the parent cannot really exercise control.\textsuperscript{884} An example would be the case with a parent that has 51 \% of the voting rights in an undertaking whose articles of association prescribe a 75 \% majority for all decisions of the general meeting. Since the Solvency II Directive refers to the New Accounting Directive, the parent/subsidiary relationship must be irrefutable in those cases even for the purposes of determining the scope of an insurance group. In contrast to that, IFRS applies a non-formalistic approach. IFRS 10 requires a shareholder ("investor") to assess whether it has control over an undertaking, where circumstances such as a majority of voting rights can be rebutted.\textsuperscript{885}

\textsuperscript{881} Prop. 1995/96:10 del II, Års- och koncernredovisning, p. 112.
\textsuperscript{882} Ibid, p. 107.
\textsuperscript{883} Ibid, p. 112.
\textsuperscript{884} Edwards, p. 162 – 164; Küting and Seel, p. 39; on the corresponding German norms: Kraft and Link, p. 547; differently: von Keitz and Ewelt, p. 454.
\textsuperscript{885} Kraft and Link, p. 547.
OVERVIEW OF THE SOLVENCY II REGULATORY REGIME

- Insurance subsidiaries managed on the basis of mutuality principles

As mentioned above, Swedish law knows a hybrid between an insurance company and a mutual that is characterized by a prohibition to distribute profits to its shareholders. For the purposes of determining its membership in a group according to Solvency II, it is irrelevant whether the company may distribute profits to its shareholders or not, so that the question whether it forms a group with its shareholders needs to be assessed according to Article 212 Solvency II Directive. Equally, these companies and their shareholders may form a group according to the ABL and the Accounting Act, which is also presupposed in Chapter 11 § 7 FRL 2016, limiting the number of directors who may be employees or managers within the same group. The purpose of this limitation is to limit the influence of the shareholders on the insurance company. However, even if these “hybrid” insurance companies are part of a group, they are usually not consolidated in the group accounts of the parent undertakings, which is explained in the group report with the fact that they are managed according to principles of mutuality (ömsesidiga principer).

7.5 Application and scope of group supervision

This section analyses which companies are subject to group supervision, in other words: Which entities are encompassed by group supervision and which entity or entities are the adressees of group supervision, i.e. are responsible for complying with the rules on group supervision? The correlated issue “what” exactly is being supervised, is dealt with in the subsequent section.

Articles 213 to 217 Solvency II Directive determine at which level group supervision shall apply. These rules, with the exception of Article 214, have in common that they determine one or several group undertakings to which group supervision shall apply. What is meant exactly with “supervision at the level of the group”, is not entirely clear. Intuitively, one might expect that group supervision applies at the ultimate parent undertaking within the EU and that this undertaking is responsible for compliance with the provisions on group supervision. However, the rules on group supervision are more complex than that. The question of responsibility will be dealt with after an analysis of the situations provided for in Articles 213 to 217.

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886 See Chapter 11 §§ 6, 7, 10 FRL 2016.
7.5.1 The four situations described in Article 213 (2) Solvency II Directive

Article 213 (2) defines four situations, where member states shall ensure that group supervision “applies”.

7.5.1.1 Article 213 (2) (a) Solvency II Directive

According to Article 213 (2) (a), group supervision applies to “…insurance or reinsurance undertakings, which are a participating undertaking in at least one insurance undertaking, reinsurance undertaking, third-country insurance undertaking or third-country reinsurance undertaking […].”

From the definition of insurance undertaking in Article 13 (1) in connection with Article 14 can be derived that insurance undertakings (and reinsurance undertakings) need to have their head office in the European Union – otherwise they are third-country insurance undertakings. Consequently, the participating undertaking referred to in Article 213 (2) (a) needs to be an EU-insurer or reinsurer. Article 213 (2) (a) speaks of participating undertakings and not of parent undertakings, i.e. for group supervision to be applied according to this provision, it is not necessary that the related insurance undertakings are subsidiaries. It suffices that they are participations, i.e. the participating undertaking only needs to hold 20 % of the voting rights or otherwise have significant influence.

The situations described in Article 213 (2) (a) are illustrated below, with the entity to which group supervision applies being marked with a red frame:

889 The Swedish legislator chose not to use the terms “participating undertaking” (Swedish: företag med ägarintresse) because it could be confused with the term “ägarintresse”, Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 399 f. ”Ägarintresse” is defined in chapter 1 § 13 FRL as the holding of at least 20 % of the capital or the voting rights in an undertaking. Chapter 19 § 2 No. 1 FRL speaks instead of ”försäkringsföretag som är moderföretag till eller har ett ägarintresse i ätminstone ett försäkringsföretag, en EES-försäkringsgivare eller en försäkringsgivare från tredjeland” and no. 2 of ”försäkringsföretag som har en gemensam eller i huvudsak gemensam ledning med ett annat försäkringsföretag, en EES-försäkringsgivare eller en försäkringsgivare från tredjeland”. This approach had been criticised by Finansinspektionen and Svensk Försäkring. To use a different terminology may not only be problematic with regard to the consistent application throughout the EEA, but also also taking into account that the Delegated Regulation applies the term “företag med ägarintresse” in Articles 68, 171, 328 ff.
Supervision at the level of the group according to Article 213 (2) (a)

The scope of supervision in this case encompasses group solvency, risk concentration, corporate governance and intra-group transactions, i.e. all elements of group supervision.890

7.5.1.2 Article 213 (2) (b) Solvency II Directive

Article 213 (2) (b) requires member states to apply group supervision to

“[…] insurance or reinsurance undertakings, the parent undertaking of which is an insurance holding company or mixed financial holding company which has its head office in the Union […]”

This provision covers the situation where the ultimate parent undertaking is an insurance holding or a mixed financial holding, i.e. the ultimate holding company of a financial conglomerate, in the European Union. Concerning insurance undertakings outside the European Union, Article 214 (1) states that Article 213

“[…] shall not imply that the supervisory authorities are required to play a supervisory role in relation to the third-country insurance undertaking, the third-country reinsurance undertaking, the insurance holding company, the mixed financial holding company or the mixed-activity insurance holding company taken individually […]”.

890 Cf. Article 213 (2) (a) Solvency II Directive which refers to Articles 218 to 258.
The wording of this provision is not entirely clear. Is it supposed to give supervisory authorities an option whether they want to exercise group supervision over insurance undertakings outside the European Union? Or is it supposed to be understood as a mandatory exception? Most likely, the provision simply clarifies that these undertakings are not subject to some form of solo-supervision by supervisory authorities in the EU. Read together with Article 214 (2), the impression arises that insurance undertakings outside the EU are not per se considered to lie outside the scope of group insurance supervision. This provision specifies certain situations in which the group supervisor on a case-by-case basis may decide not to include an undertaking in the supervision of the group. This indicates that Article 214 (1) is supposed to be understood as an option rather than a mandatory non-inclusion of Non-EU-insurance undertakings. In Figure 7.5.1.2 no. 1 below, the relevant undertakings are therefore marked with a broken line.

In contrast to point (a), point (b) presupposes a parent/subsidiary relationship between the holding and the insurance undertaking because according to their definitions, insurance holding and mixed financial holding are characterized by having insurance subsidiaries and not merely participations.

Supervision at the level of the group according to Article 213 (2) (b)

The difference between the situations described in point (a) and point (b) is that group supervision applies to the ultimate participating undertaking, if it is an insurance undertaking itself, and to its insurance subsidiaries, if it is an insurance holding or mixed financial holding. The elements of supervision to be applied are the same as in point (a), i.e. group solvency, corporate governance, risk concentrations and intra-group transactions.
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7.5.1.3 Article 213 (2) (c) Solvency II Directive

According to Article 213 (2) (c), supervision at group level also applies to

“[…] insurance or reinsurance undertakings, the parent undertaking of which is an insurance holding company or a mixed financial holding company which has its head office in a third country or a third-country insurance or reinsurance undertaking, […].”

This situation differs from point (b) in so far as the parent undertaking has its head office outside the European Union. Point (c) specifies further that in this case, group supervision shall apply in accordance with Articles 260 to 263. According to these provisions, group supervision is not applied if the supervisory regime of the applicable third country is deemed equivalent to the Solvency II regulatory regime.

The competence for declaring equivalence lies with the European Commission. By June 2018, decisions on the equivalence according to Article 260 have been taken with regard to Switzerland and Bermuda, both being deemed to have fully equivalent group supervision systems (Article 3 Commission Delegated Decision (EU) 2015/1602 and Article 3 Commission Delegated Decision (EU) 2016/309).891

Supervision at the level of the group according to Article 213 (2) (c)

![Diagram of supervision at the level of the group according to Article 213 (2) (c)](image)

891 Other equivalence decisions have been taken with regard to Australia, Brazil, Canada, Japan, Mexico, and the United States of America, see the information on EIOPA’s website: https://eiopa.europa.eu/external-relations/equivalence/overview-of-equivalence-decisions. These decisions do not concern equivalence according to Article 260, though.
7.5.1.4 Article 213 (2) (d) Solvency II Directive

The fourth situation where group supervision applies, is laid down in Article 213 (2) (d). According to this provision, supervision at the level of the group shall apply to

“[…], insurance or reinsurance undertakings, the parent undertaking of which is a mixed-activity insurance holding company, […]”.

The provision further states that the scope of group supervision for this kind of undertakings is limited to the supervision of intra-group transactions according to Article 265.

Accordingly, the mixed-activity insurance holding itself is not subject to group supervision.

7.5.2 Which group undertakings are encompassed by group supervision?

After the preceding analysis, which has been based on a literal reading of Article 213 (2), it is necessary to specify further at which levels group supervision is supposed to apply, and whether only the undertakings identified in Article 213 (2) are subject to group supervision or even other undertakings.

Another question concerns the role of insurance holdings in group supervision, because, according to the provisions described above, group supervision does not apply
at the level of the insurance holding. As we will see, this does not mean, however, that insurance holdings are not given a role in group supervision. This question will be dealt with in chapter 7.5.2.4.

7.5.2.1 Group supervision at the level of the ultimate parent undertaking in the EU

Article 215 (1) limits the levels of group supervision by “cutting off” certain levels. According to its wording, the provision applies to participating insurance companies or insurance holdings referred to in Articles 213 (2) (a) and (b), which in turn are subsidiaries of another insurance undertaking or insurance holding company in the European Union. In that case, group supervision shall apply only at the level of the ultimate parent undertaking or insurance holding which has its head office in the Union. This is a major difference to the Solvency I regulatory system where the insurance group directive allowed supervisors to apply supplementary supervision to all participating insurance undertakings within a group. However, national supervisory authorities were called upon by CEIOPS to use this possibility restrictively.892

Supervision at the level of the ultimate parent insurance undertaking inside the EU (1)

A consequence of Article 215 (1) is that group supervision is not applied at the level of undertakings C, D and E in Figure 7.5.2.1 no. 1 above, although they fall under Article 213 (2) (b).

892 CEIOPS, Advice to the European Commission in the framework of the Solvency II project on sub-group supervision, diversification effects, cooperation with third countries and issues related to the MCR and SCR in a group context, 2006, para. 1.5.
Since the situations referred to in Article 213 (2) (a) and (b) only apply to insurance undertakings in the EU, it is implied that parent undertakings outside the EU are automatically excluded from group supervision according to Solvency II.

See chapter 7.5.2.3 on this situation.

For a group structure with various levels in- and outside the EU, Article 215 (1) has the effect that group supervision applies to the insurance undertaking that is not a direct or indirect subsidiary of an insurance undertaking or insurance holding inside the EU. This conclusion is based on the definition of “subsidiary undertaking” in Article 13 (16) which explicitly encompasses even indirect subsidiaries, so that an insurance undertaking may be a direct subsidiary of an undertaking within the EU and at the same time an indirect subsidiary of an undertaking outside the EU.

Supervision at the level of the ultimate parent insurance undertaking inside the EU (2)

Since Article 215 only refers to the situations in Article 213 (2) (a) and (b), but not to (c) and (d), the question arises whether it also may apply to groups with the ultimate parent undertaking outside the EU, i.e. whether “sub-group supervision at EU level” would apply.

The answer to that question depends on whether the four situations in Article 213 (2) exclude each other or whether an undertaking may fall under several situations simultaneously.

Figure 7.5.2.1 no. 3 shows a group where the different situations would apply to several of the group companies. Unless indicated to the contrary, all participations shall be 100%.
OVERVIEW OF THE SOLVENCY II REGULATORY REGIME

The ultimate parent undertaking A is a mixed-activity insurance holding in the EU. It holds 100% in an insurance holding B outside the EU, which in turn is parent of an insurance holding C in the EU with insurance subsidiaries D and E within the EU and a 35% indirect participation in insurance undertaking G.

![Diagram of group with several layers of parent undertakings]

Undertaking E is a participating undertaking in G and therefore falls under Article 213 (2) (a). Insurance holding C is parent undertaking of undertakings D and E. D and E therefore fall under Article 213 (2) (b). At the same time, D and E have an indirect parent undertaking in the form of insurance holding B outside the EU, which fits under Article 213 (2) (c), and an indirect (ultimate) parent undertaking in the form of mixed activity insurance holding A in the EU, falling under Article 213 (2) (d).

If only the ultimate parent undertaking would “count”, this would have the consequence that for a group with a mixed-activity insurance holding at the top, group supervision would be limited to the supervision of intra-group transaction. No group solvency would have to be calculated and the group would not have to establish any governance functions at group level, for instance a group-wide risk management. The example above may be not the most realistic example because it would require an ultimate parent undertaking where the insurance activities amount for less than half of its balance sheet, but that still has several insurance subsidiaries. But it illustrates that it would be inconsistent not to apply the largest possible scope of group supervision just because the ultimate parent undertaking happens to be a mixed-

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893 See chapter 7.4.1.2.3 on the definition of mixed-activity insurance holdings.
activity insurance holding, because otherwise (only) Article 213 (2) (c) would apply if the ultimate parent undertaking ceased to be the majority shareholder of insurance holding B (for instance after an IPO of B). If B instead would cease to be the majority shareholder of insurance holding C, only Article 213 (2) (b) would apply, even though the direct shareholding in D and E would remain unchanged.

The four situations in Article 213 (2) must be understood as not excluding each other – which corresponds to EIOPA’s understanding as expressed in the Guideline on Group Solvency. As a consequence, Article 215 may apply even to undertakings within a group where the ultimate parent undertaking has its seat outside the EU. In the example above, this means that Article 215 leads to group supervision at the level of insurance holding C. Insurance holding B outside the EU may have to be included in the group solvency calculations according to Article 262 (1), unless B is situated in a third country with equivalent group supervision. The fact that the ultimate parent is a mixed-activity insurance holding has the consequence that the reporting on intra-group transactions also needs to encompass transactions with A and its non-financial subsidiaries.

7.5.2.2 Sub-group supervision

As we have seen, group supervision is applied at the level of the ultimate parent undertaking at EU level. Some of the member states, however, wanted to keep the possibility to subject groups within their member states to group supervision, even if the ultimate parent company is located in another member state. This wish needs to be seen against the background that the group supervisor in charge of exercising group supervision according to Article 247 in many cases is the supervisory authority of the member state where the ultimate parent undertaking at group level has its head office. During the legislative process, a compromise was reached in the form of article 216, giving member states the option to apply group supervision on national sub-groups. If the national law allows for sub-group supervision, the supervisory authority is obliged to consult the group supervisor and the ultimate parent undertaking at Union level prior to deciding upon the exercise of sub-group supervision.

Member states making use of this possibility shall according to Article 217 (1) even provide for the possibility of including a sub-group in another member state into the sub-group supervision. This requires an agreement between the supervisory authorities of both parent undertakings at national level.

Article 217 (1) specifies that this leads to “group supervision at the level of a subgroup covering several Member States.” This raises the question whether such an agreement is also necessary if a sub-group stretches over several member states, if the subsidiaries in the other member states are not “ultimate parent undertakings at national

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894 Guidelines on group solvency, EIOPA-BoS-14/181EN, Guideline 4; see also Behrendt Jonsson in: Yvonne Gebert, Kay Uwe Erdmann and Heinrich R. Schrardin (eds), BeckOK VAG, (1st edn 2018), § 245 para. 19.
895 See chapter 7.5.2.3 on supervision of groups with parent undertakings outside the EU.
level”. In the light of Article 217 (1) (Sub 2), it does not seem as if the legislator’s intention was to preclude sub-group supervision to stretch over more than one member state. This provision states that the effect of an agreement between the member states is that sub-group supervision only shall be exercised at the top level of the sub-group. This implies that sub-group supervision may be exercised at several levels of a sub-group in the absence of such an agreement, and that sub-group supervision may apply to a sub-group stretching over several member states if Article 217 is not applicable.

Figure 7.5.2.2 no. 1 shows such an insurance group with subsidiaries and participations in four member states. Group supervision is applied at the level of insurance undertaking A with its head office in Member State 1 being the ultimate parent undertaking at EU level.

Sub-group supervision at national level

Assuming that Member State 3 has chosen not to implement Article 216, insurance holding B and its subsidiaries may not be subjected to sub-group supervision by the supervisory authority in Member State 3. If Member State 2 has implemented Article 216, its supervisory authority may apply sub-group supervision on insurance undertaking C. The sub-group relevant for the sub-group supervision (marked with a red frame), for instance group solvency requirements or group wide risk assessments and intra-group transactions, consists of C and its subsidiaries and participations, encompassing its participations or subsidiaries in Member States 1, 2 and 4. Insurance holding B’s participation in the insurance undertaking in Member State 2, on the other hand, does not form part of the sub-group, because it is not a participation or subsidiary of C.

Sub-group supervision may apply to all aspects of group supervision (group Solvency Capital Requirement, group-wide risk assessment, intra-group transactions) or can be limited by the sub-group supervisor to certain parts.
Even though Germany opposed the introduction subgroup supervision, §§ 248, 249 VAG 2016 make uses of this possibility. Also Sweden implemented the provisions on subgroup supervisions in chapter 19 §§ 74 ff. FRL 2016 with the argumentation that Finansinspektionen should not be deprived any supervision instruments. The legislative proposal mentions a scenario where a large international group has financial difficulties and the group supervisor is not able to dedicate sufficient resources to the supervision of the Swedish subgroup as a possible case for subgroup supervision. The Swedish expert committee on Solvency II acknowledged that sub-group supervision should generally not be necessary if Solvency II is applied consistently in all member states, but argued that Sweden should keep the possibility in case certain group supervisors do not do their job properly. Another argument put forward was the expectation that most member states will implement Article 216.

The expert committee mentioned explicitly the Trygg-Hansa group as a possible case for subgroup supervision: Since Trygg-Hansa would not have Finansinspektionen as group supervisor, sub-group supervision would give Finansinspektionen the possibility to discover capital transfers from the Swedish insurance companies to other group companies at an earlier stage. After Trygg-Hansa’s group internal merger onto Danish insurer Codan in 2014, this possibility does not exist anymore.

Indeed, there is a risk that sub-group supervision will be applied as a political instrument. In the example above, parent undertaking A and its group supervisor in Member State 1 might consider it as a sign of distrust if C was subjected to sub-group supervision by the supervisory authority in Member State 3. If Member State 1 also has implemented Article 216, it might threaten to subject a subsidiary belonging to a group with the ultimate parent in Member State 3 to sub-group supervision so that Member State 3 may reconsider sub-group supervision. However, if Member State 3 was a small member state, the deterrent effect of such threats will in many cases be non-existent simply because Member State 3’s supervisory authority might not be a supervisor over any international group, or if it is, these insurance groups do not need to have a sub-group in Member State 1. Sub-group supervision may therefore become a tool most valued by smaller member states that are worried that group supervisors in other member states might not take the interests of policyholders of smaller group companies into consideration.

It is therefore appropriate that Article 358 Delegated Regulation restricts sub-group supervision to situations where ”objective differences in the operations, the organsiation

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896 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 470.
897 Ibid, p. 470.
900 Ibid, p. 428. The report also names Skandia. After a restructuring started in 2012, the Skandia companies are, however, no longer subsidiaries of undertakings outside Sweden.
or the risk-profile between the subgroup and the group” justify an additional layer of supervision.

However, as the Swedish expert committee correctly pointed out, there are good reasons against this form of national sub-group supervision. The exercise of sub-group supervision causes additional work and expenses both for the sub-group supervisor and for the undertaking subjected to sub-group supervision. The idea behind group supervision is that each group shall have one strong group supervisor supported by a college of supervisors. This concept is not coherent with several levels of group supervision. Accordingly, sub-group supervision has been met with skepticism among insurance groups and insurance interest associations.

In exceptional cases, there may be good reasons to exercise an additional sub-group supervision within a group, but it seems anachronistic and incoherent with the spirit of the European Union that the trigger for sub-group supervision is connected to the member state in which such a sub-group is located. After all, national borders between member states are supposed to lose importance in a unified Europe. Sub-group supervision may make sense in respect of sub-groups that enjoy a considerable degree of independence from the rest of the group. Even though control in a formal sense exists in such cases because the ultimate parent undertaking directly or indirectly holds the majority of voting rights, factors like the existence of external shareholders or a listing on a regulated market may effectively limit the parent undertakings influence on the subsidiary. To subject the sub-group parent undertaking of such a group to sub-group supervision could make sense – notwithstanding whether it has its head office in the same member state as the ultimate parent undertaking at Union level or not. Consequently, it is unfortunate that sub-group supervision is connected to “nationality” and not to substantive factors that justify the implementation of sub-group supervision in certain situations.

De lege ferenda, Article 216 should be amended and allow for sub-group supervision if certain circumstances indicate that the parent undertaking cannot in practice exercise full control over the sub-group, disregarding in which member state the group undertakings are located. This could be the case if a considerable amount of shares in a subsidiary is held by third parties outside the group.

902 Response by Royal and Sun Alliance Insurance Group plc to CEIOPS-CP-01/06 and CEIOPS-CP-03/06, 2006-09-13.
904 Cf. Talanx, (Sub)Group Supervision according to the Solvency II directive proposal, 2008; Behrendt Jonsson in: BeckOK VAG, § 248 para. 1.
7.5.2.3 **Supervision of groups with the ultimate parent undertaking outside the EU**

As mentioned above, group supervision only needs to be exercised over groups with the ultimate parent undertaking outside the EU, if the third-country supervisory system is not considered equivalent to Solvency II group supervision. In case of equivalence, member states shall rely on the exercise of group supervision by the third-country supervisor (Article 261). In that case, only the provisions on cooperation between supervisors are applied *mutatis mutandis*, implying that supervisors are expected to enter into cooperation agreements with third country supervisors.\footnote{CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09, para. 3.100.} This possibility is also encouraged in Article 264.

The equivalent to Article 215 for groups with parent undertakings outside the EU is Article 263, according to which also for these groups, the verification of equivalence shall be done with regard to the state where the ultimate parent of the group has its head office. This ultimate parent needs to be a third-country insurance undertaking, a third-country insurance holding or a third-country mixed financial holding. However, if there is no equivalence at this level, another verification at a lower level outside the EU may be undertaken.

In case of non-equivalence, Articles 218 to 258 shall be applied *mutatis mutandis* “to the insurance and reinsurance undertakings” (Article 262 (1)).

As an alternative to the analogous application of Articles 218 to 258, Article 262 (2) allows supervisory authorities to determine other methods. In particular, they may demand the establishment of an intermediate insurance holding for the EU participations and apply group supervision on this undertaking.

It is not quite clear, which insurance and reinsurance undertakings are meant because the provision does not explicitly say “third-country” undertakings. Considering that a supervision at the level of a third-country undertaking would lead to an extraterritorial application, it seems reasonable that the provision means those insurance and reinsurance undertakings within the EU on which group supervision applies according to Article 213 (2) (c). As in other provisions of the directive, it remains unclear, which undertakings exactly are supposed to be the addressees of group supervision, i.e. which undertakings are responsible for the calculation of the group SCR, for compliance with the reporting requirement, the establishment of group governance processes and functions and for the coverage of the group SCR with own funds.

The picture gets even more confusing when taking into account the second paragraph of Article 262 (1), which states

> “The general principles and methods set out in Articles 218 to 258 shall apply at the level of the insurance holding company, mixed financial holding”
Again, it is unclear whether the holding companies are supposed to be within the EU or whether the ultimate parent holding companies outside the EU are meant. Whereas Article 263 uses the expression “third-country insurance holding company”, this could imply that the insurance holdings referred to in Article 262 are supposed to have their head office in the EU. On the other hand, the provision treats holdings and third-country undertakings equally. This again speaks for an interpretation in conjunction with Article 213 (2) (c) that holdings outside the EU with insurance undertakings in the EU as subsidiaries are meant.

The two paragraphs are consistent if they are understood in such a way that the second paragraph merely intends to express that the calculation of the group SCR and the reporting of intra-group transactions etc. needs to encompass all insurance undertakings and holdings world-wide and not just those within the EU. This interpretation is supported by Article 262 (1) (Sub 3), which states that “for the sole purpose of the group solvency calculation”, the parent undertaking (outside the EU) shall be treated the same way as an insurance undertaking or an insurance holding within the EU. It is not quite clear how this is supposed to be done in practice, because this presupposes that the insurance undertaking in the EU has access to the necessary information concerning the third-country parent undertaking.906

Interestingly, the case of group-supervision over insurance undertakings with third-country parent undertakings is not explicitly mentioned in Article 264 as an area that should be facilitated by cooperation agreements with third countries.

However, this does still not answer the question which EU insurance undertakings are addressees of the group supervision requirements (and therewith can be held responsible for any breaches). In its consultation paper on the assessment of group Solvency, CEIOPS mentions that the group solvency calculation will be done by the parent undertaking in the EU if the deduction and aggregation method is applied907, but remains silent on the basis for and the consequences of this assumption.

A similar question arises with regard to the role of insurance holdings (in the EU) in group supervision, which will be discussed in more detail in the following section.

7.5.2.4 The role of insurance holdings and mixed activity holdings in group supervision

Article 214 (1), excerpts of which have been cited above, does not only state that supervisory authorities do not need to play a supervisory role with respect to third-country insurance undertakings at an individual level, but also with respect to the three types of

906 This concern is also raised by Krämer in: Pröss/Dreher VAG, § 291 para. 6.
907 CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, para. 3.93.
holding companies “without prejudice to Article 257 as far as insurance holding companies or mixed financial holding companies are concerned.” According to Article 257, the fit-and-proper requirements laid down in Article 42 for members of the administrative boards for insurance undertakings also apply to insurance holdings908.

As noted above, insurance holding companies are not identified in Article 213 (2) as being entities to which group supervision applies. Recital 96 merely states that the Directive shall not imply that insurance holdings need to be supervised individually. Therefore, the purpose of the statement in Article 214 (1) is unclear – Does it mean that supervisory authorities are nevertheless allowed to exercise supervision over insurance holdings, or is its purpose merely to highlight that the fit and proper requirements apply to insurance holdings in any case, but that apart from that no “solo-supervision” is applied on insurance holdings? And what are the responsibilities of insurance holdings with regard to group supervision?

CEIOPS seems to have understood the provision in such a way that it gives member states an option to determine the scope of supervision on insurance holding companies.909 Germany shares this understanding and has inserted some elements of supervision that do not have a corresponding requirement in the Solvency II Directive, namely by prescribing in § 293 (1) VAG 2016 the analogous application of the fit and proper requirements for shareholders of insurance undertakings, of certain corporate governance requirements, of the provision on outsourcing, and certain notification requirements.910 Sweden has not enacted any provisions on insurance holding companies that go beyond the requirements in the Directive.

Article 215 (1) states that the rules on group supervision shall “apply only at the level of the ultimate […] insurance holding company” which has its head office in the EU. This can be made consistent with Article 213 (2) (b) if it is merely understood as a provision “cutting” off certain companies that would otherwise fall under Article 213 (2), and not as a provision that is supposed to widen the scope of Article 213 (2). The expression that group supervision is applied “at the level” of certain undertakings then would not necessarily mean that insurance holdings are the addressees of the provisions on group supervision.

908 To facilitate reading, the term “insurance holding” as applied in this section shall encompass even mixed financial holding companies, but not mixed-activity insurance holding companies, unless stated otherwise.
909 CEIOPS, Advice to the European Commission on aspects of the Framework Directive Proposal related to Insurance Groups; Measures to facilitate the effective supervision of groups, 2008, para. 74.
910 On the German provisions on the supervision of insurance holding companies and "other holding companies", i.e. holding companies whose principal business is the holding of participations in insurance or reinsurance undertakings or pension funds, that do not qualify as insurance holding companies according to the Solvency II Directive, see Schmid in: BeckOK VAG, § 293 paras. 1- 303.
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Supervision at the level of the ultimate parent holding inside the EU

Outside EU
- Parent undertaking insurance undertaking

Inside EU
- Parent undertaking insurance holding or mixed financial holding
- Insurance undertaking
- Reinsurance undertaking
- Subsidiary, Non-financial sector
- Third Country Insurance undertaking

Figure 7.5.2.4 no. 1

Figure 7.5.2.4 no. 1 shows that with this reading, the application of Article 213 (2) (b) on the ultimate parent holding inside the EU would have the consequence that the rules on group supervision apply on the insurance subsidiaries, but not on the insurance holding.

The Swedish wording of Article 215 (1), however, states that group supervision shall be applied “on” the holding, implying that only the holding is the addressee of the obligations in Articles 218 to 258.911:

The German (auf Ebene [...] der obersten Versicherungsholdinggesellschaft), Spanish (al nivel [...] de la sociedad cartera de seguros última) and French (au niveau [...] du société holding d’assurance mere supérieure) language versions are equally ambiguous as the English version.

Article 235 (1) provides that “the calculation of the solvency of the group is carried out at the level of the insurance holding company”, if insurance undertakings are subsidiaries of an insurance holding. Article 219 (1) requires group supervisors to ensure that the group solvency calculations are carried out at least annually, “by the participating insurance or reinsurance undertakings, by the insurance holding company or by the mixed financial holding company” and according to Article 219 (2), the insurance holding shall monitor group solvency on an ongoing basis.

911 Original wording: “Om det försäkrings- eller återförsäkringsföretag eller försäkringsholdingbolag med ägarintresse som avses i artikel 213.2 a och b är ett dotterföretag till ett annat försäkrings- eller återförsäkringsföretag eller försäkringsholdingbolag som har sitt huvudkontor inom gemenskapen ska artiklarna 218-258 tillämpas endast på det försäkrings- eller återförsäkringsföretag eller försäkringsholdingbolag som är moderföretag med huvudkontor inom gemenskapen.” (emphasis added).
Also in other provisions, the directive reveals an ambivalent attitude of the legislator towards insurance holding companies. On the one hand, the directive states that certain reporting requirements shall be carried out either by the holding company or by the insurance undertaking identified by the group supervisor (Article 245 (2) concerning the reporting of intra-group transactions and Article 219 (1) with regard to the calculation of the group SCR), whereas the group solvency and financial conditions report shall be submitted by the holding (Article 256 (1)). Also the group own risk and solvency assessment (ORSA) shall be undertaken (only) by the holding (Article 246 (4)). With regard to the system of governance at group level, Article 246 (1) requires somewhat dubiously that the respective requirements shall apply *mutatis mutandis* at the level of the group. Taking into account paragraph 4, a systematic interpretation indicates that it is indeed the holding company’s responsibility to establish a group-wide governance system. This is also the understanding of the Swedish expert committee.  

On the other hand, Article 218 (3) states that insurance and reinsurance undertakings in a group shall be required to ensure that eligible own funds are always available to cover the group SCR, but does not mention insurance holdings. Furthermore, according to Article 231 (1), it is not the insurance holding that may apply for permission to use a group internal model, but rather its related undertakings jointly with the holding. Prior to an amendment by the Omnibus II directive, only the related undertakings were entitled to submit the application.  

Article 258 (1) states that the group supervisor shall take measures against an insurance holding in case of non-compliance with the group solvency or governance requirements or if intra-group transactions jeopardize the financial position of the group and that solo-supervisors shall take measures against insurance undertakings in these situations, but leaves it to the member states to “determine the measures which may be taken by their supervisory authorities with respect to insurance holding companies”. Article 258 (2) requires member states to ensure that sanctions or measures may be imposed against insurance holdings which “infringe laws, regulations or administrative provisions enacted to implement this Title” while at the same time leaving it up to the member states to determine which measures may be taken against insurance holdings (however, coordinated through delegated acts).  

Consequently, even though group supervision according to Article 213 (2) is not formally applied to them, the Solvency II Directive nevertheless imposes certain obligations in connection with the supervision of group solvency on insurance holdings.

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7.6 Elements of group supervision

After having seen which entities are being supervised, it is time to get an overview on what is being supervised. As already mentioned, group supervision may encompass group solvency, risk concentration, risk management and internal control and/or intra-group transactions. The elements of group supervision depend on the group structure and, in case of sub-group supervision, on the decision of the sub-group supervisor.

7.6.1 Supervision of intra-group transactions

All forms of Solvency II group supervision encompass the supervision of intra-group transactions. Accordingly, this represents the minimum level of group supervision. The only possible exception concerns sub-groups where the sub-group supervisor according to Article 216 (2) Solvency II Directive may restrict sub-group supervision to one or several elements of group supervision, and consequently, may decide not to exercise supervision on intra-group transactions.

For insurance undertakings that are subsidiaries of mixed-activity insurance holding companies, group supervision is limited to intra-group transactions according to Articles 213 (2) (d) and 265. Article 265 in turn refers to Article 245 which in paragraph (2) states that insurance and reinsurance companies and insurance holdings shall be required to report regularly, at least annually, “to the group supervisor all significant intra-group transactions by insurance and reinsurance undertakings within a group”. Very significant transactions need to be reported as soon as practicable.

Article 245 (4) empowers the Commission to adopt delegated acts with respect to the definition and identification of significant intra-group transactions and on the reporting of intra-group transactions. While the Delegated Regulation does not specify how to identify “very” significant transactions, Article 377 (1) Delegated Regulation defines “significant” intra-group transactions as “transactions that materially influence the solvency or liquidity position of the group or of one of the undertakings involved in these transactions”. Article 377 (2) lists a number of items that undertakings shall consider, including investments, guarantees, loans, dividend payments, reinsurance operations, agreements to share costs, and property sales. The list contains a few more items than the corresponding list in Article 8 of the repealed Insurance Groups Directive, but it cannot be understood as implying a presumption that these items automatically are significant intra-group transactions. The requirement of a material influence on the solvency position is new compared to the situation pre-Solvency II.

Article 245 (3) Solvency II Directive requires the group supervisor, after consultation with the other supervisory authorities and the group, to identify the type of intra-group transactions that always need to be included in the reporting of the insurance and reinsurance undertakings of a particular group. This obligation is new in comparison to the Insurance Groups Directive and gives the group supervisor power to determine the scope of reporting and to align it to the size and structure of insurance groups. As the
Swedish expert group on the implementation of Solvency II pointed out, what very significant transactions are, depends on the group’s structure and other circumstances.  

The group definition discussed in chapter 7.4.1 becomes relevant in this respect, because the reporting requirement concerns all significant transactions between all insurance or reinsurance undertakings with their head offices in the EU and other group entities, notwithstanding whether the other entities are regulated entities or not. Article 245 (2) further extends the reporting requirement to transactions with natural persons with close links to an undertaking in the group, i.e. natural persons who have a participation in or control over a group undertaking (Article 13 (17)). Transactions solely among non-insurance undertakings do not need to be reported, which for instance also concerns transactions between an insurance holding and its non-insurance subsidiaries, even though the obligation to report intra-group transactions may apply to insurance holdings according to Article 245 (2).

Read together with Articles 213 to 216, it can be concluded that the entity obliged to report intra-group transactions must be the undertaking to which group supervision is applied.

7.6.2 Supervision of risk concentration

Groups need to report significant risk concentrations at group level to the group supervisor on a regular basis and at least annually (Article 244 Solvency II Directive). Article 376 (1) Delegated Regulation concretizes that risk concentrations are significant if they could threaten the group solvency or liquidity situation. A concentration of risk can be described as a risk that would hit the group at several instances if it realizes.

Examples could be the insolvency of a reinsurer with whom several group companies have reinsurance contracts, or the occurrence of an earth quake in a region where group companies have insured (or reinsured) many homeowners and businesses. Article 376 (2) lists the following exposures that may lead to risk concentrations:

“[...] (a) individual counterparties;

(b) groups of individual but interconnected counterparties, for example undertakings within the same corporate group;

(c) specific geographical areas or industry sectors;

(d) natural disasters or catastrophes”.

The group supervisor shall determine the type of risks and appropriate thresholds that a particular group shall report in all circumstances (Article 244 (3) Solvency II Directive), taking into consideration the factors laid down in Article 376 (3) Delegated Regulation,

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including the diversification of the investment portfolios and of the insurance activities within the group.

The risk concentration is subject to supervisory review. Article 244 (3) Solvency II Directive explicitly requires the group supervisor to monitor the contagion risk, “the risk of a conflict of interests, and the level or volume of risks”.

7.6.3 Supervision of group solvency

The rules on group solvency are laid down in Title III Chapter II of the Solvency II Directive. While the group Solvency Capital Requirements are dealt with in detail in chapter 8.2, here only a few short comments on the scope of the calculations shall be made.

The group solvency calculation needs to encompass the undertaking at whose level group supervision is applied and all of its related insurance and reinsurance undertakings (i.e. even undertakings that are merely participations, but not subsidiaries), including related undertakings outside the EU (Article 227 (1)).

If the group is headed by an insurance undertaking or insurance holding outside the EU without equivalent group supervision, even this parent undertaking may have to be included in the group solvency calculation (Article 262 (1)).

If the group solvency is calculated with the deduction and aggregation method and the third-country solvency regime is considered equivalent to the Solvency II requirements, member states may allow that the local solvency requirement and the own funds calculated according to the local solvency rules are applied. If the consolidation method is used, the question of equivalence is irrelevant because the third-country insurance undertaking needs to be included in the consolidated accounts like any other related insurance undertaking.914

The directive also deals with the treatment of related credit institutions, investment firms and financial institutions (Article 228) and insurance holdings. Both intermediate insurance holdings and insurance holdings at whose level group supervision applies are treated as if they were insurance undertakings for the purposes of calculating the group SCR (Articles 226 and 235).

It is important to note that the companies that need to be included in the calculation of the group solvency requirement and the own funds at group level, are not necessarily identical with the companies that are identified in Article 213 (2) as the undertakings on which group supervision applies, because neither insurance undertakings that are mere participations nor third-country insurance undertakings, for instance, are mentioned in Article 213 (2).

914 Cf. CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09, para. 3.92.

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7.6.4 Supervision of the system of governance

Both insurance undertakings and insurance groups are obliged to have a governance system that “provides for sound and prudent management of the business” (Article 41 (1) Solvency II Directive. Elements of the system of governance are a risk management system including the “own-risk and solvency assessment” (ORSA) and a risk management function, internal control proceedings including a compliance function, an internal audit function, and an actuarial function (Articles 44 - 48).

The rules on the system of governance also include fit and proper requirements for management personnel. Article 258 (1) Delegated Regulation further obliges insurance undertakings *inter alia* to ensure adequate qualifications of their personnel, to establish clear reporting lines, to establish adequate information systems, to maintain orderly records of the undertaking’s business organisation, to safeguard the security and confidentiality of information, and to adopt an adequate remuneration policy. The “system of governance” consequently encompasses a large variety of issues, a few of which will be shortly described in the following.

7.6.4.1 Fit and proper requirements

Article 42 Solvency II Directive requires insurance undertakings to ensure that persons “who effectively run the undertaking or have other key functions” are fit and proper. Fitness refers to these person’s professional qualifications, knowledge and experience and propriety to such persons’ good repute and integrity. This requirement is new insofar as it also applies to persons exercising key functions, i.e. key function holders and other employees working with key functions. According to Article 257, the fit and proper requirements apply *mutatis mutandis* to all persons effectively running an insurance holding or mixed financial holding company.

The appointment of relevant persons needs to be notified to the supervisory authority (Article 42 (2)). The notification requirement does not apply to employees who are working with key functions without being key function holders.915

If the supervisor does not longer consider a relevant person fit or proper, it may dimiss the person, or even recall an insurance undertaking’s licence. This competence is not explicitly mentioned in the Solvency II Directive, but mentioned in recital 99 to the Delegated Regulation and laid down in §§ 303, 304 VAG 2016 and chapter 17 § 11 FRL 2016.

The Technical Annex to EIOPA’s Guidelines on System of Governance contains a list with minimum information to be provided to the supervisory authority to enable it to exercise the fit and proper assessment, including extracts from the judicial record, university diplomas, relevant professional experience, information on supervisory sanctions against the person, bankruptcies, potential conflict of interests, and qualifying...

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ownerships in other companies. These requirements constitute *intra legem* concretizations of Article 42 (2).

For the identification of the required documents, Article 43 Solvency II Directive concerning the mutual recognition of certain documents in this context needs to be observed. Another question is, which persons fall under the fit and proper requirements. As mentioned, Article 42 speaks of persons “who effectively run the undertaking or have other key functions”.

Swedish law applies the fit and proper requirement to the members of the board of directors, the CEO, and their alternates, and to the persons carrying out the four key functions (chapter 10 §§ 4, 5 FRL 2016). It is doubtful whether this really covers all persons “who effectively run the undertaking”. The directive speaks in many provisions of the “administrative, management or supervisory body” (for example Articles 34 (2), 40, 41 (3) and 44 (5) (e) Solvency II Directive), and the preparatory works discuss the question when this should be “translated” into “board of directors only” and when into “board of directors and CEO”. The fact that the directive in Article 42 does not use the term, but rather speaks of “persons who effectively run the undertaking” indicates that these do not necessarily have to be identical with and restricted to directors. Therefore, the definition applied in EIOPA’s Guidelines on System of Governance, constitutes an *intra legem* concretization:

“[…’persons who effectively run the undertakings’ cover members of the administrative, management or supervisory body taking into account national law, as well as members of the senior management. The latter includes persons employed by the undertaking who are responsible for high level decision making and for implementing the strategies devised and the policies approved by the administrative, management or supervisory body”.

Even if Swedish company law allocates the responsibility for the day-to-day management and the implementation of decisions of the board of directors to the CEO, it does not seem far-fetched to assume that senior managers such as the Chief Financial Officer, or the managers responsible for asset management (chef Kapitalförvaltning), products (chef Produkt) and distribution (chef Marknad och försäljning) have delegated responsibility that could fall under EIOPA’s definition of “persons who effectively run the undertaking”. Whether other persons than the directors, the CEO and the persons holding those key functions mentioned in the directive could fall under the fit and proper requirements, has not even been discussed in the legislative proposal or the report of the expert group. German law has implemented Article 42 in § 24 VAG 2016 with a literal translation of the term (Personen, die das Unternehmen tatsächlich leiten). § 24 (2) concretizes that this includes besides

916 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, pp. 301 – 303. The transposition of the directive in this regard has been criticized by Andersson and Besher who argue that it disregards the competences bestowed upon the general manager by Swedish company law, Besher and Andersson, pp. 296 - 298.
917 Dreher has a different opinion. He discusses whether the notion of key function is limited to the four functions mentioned in the Solvency II Directive or could encompass other functions and argues that legal certainty requires a restrictive interpretation: Meinrad Dreher, Begriff und Inhaber der Schlüsselfunktionen nach Solvency II und VAG 2012, 63 Versicherungsrecht (2012), pp. 933-942, at p. 936.
918 Guidelines on System of Governance, EIOPA-BoS-14/253 EN para. 1.21.
919 The named positions are examples from the group of individuals presented on Folksam’s website as “Verkställande direktör och företagsledningsgrupp”, https://www.folksam.se/om-oss/om-folksam/sa-styrs-vd-och-företagsledning, accessed 2017-02-06 at 13:21. Interestingly, the persons holding the risk management, compliance, internal audit and actuarial functions are not mentioned on the website.
920 The expert group expected EIOPA to specify further which functions need to be considered “key functions”, SOU 2011:68 Rörelsereglering för försäkrings och tjänstepension, Betänkande av Solvens II-utredningen, Del 1, p. 297. However, with chapter 10 § 4 FRL enumerating the key functions, an extension of the fit and proper requirements to other functions would require a change of the provision.
Geschäftsführer such persons that are competent to take significant decisions. Geschäftsleiter are all persons who have statutory competence or competence awarded in the articles of association to manage the company and to represent it towards third parties. This includes the members of the board of directors as well as branch governors (Hauptbevollmächtigte), but not members of the supervisory board. According to the legislative proposal, however, the legislator considered supervisory board members to fall under the term “persons with key functions”. This interpretation has the background that “key function” has been translated with two different terms in the German language version of the directive: Schlüsselfunktion and Schlüsselaufgabe (similar to the Swedish language version where the terms nyckelfunktioner and centrala funktioner” and the Spanish version where the terms funciones clave and funciones fundamentales are applied). Such a distinction is not made in the English and French language versions. In any case, BaFin also applies fit and proper requirements on supervisory board members.

In a case decided by the Joint Board of Appeal of the European Supervisory Authorities concerning an appeal against EBA’s decision of non-intervention against the Finnish banking supervisory authority, the Board held that branch governors do not necessarily need to be key function holders and that EBA was entitled to rely on the Finnish supervisor’s assessment. But it also held that individuals running a significant branch may be key function holders in the sense of applicable EBA guidelines, thus making clear that the notion of key function holder is subject to criteria determined at EU level and not entirely at national level. Since EU banking law is very similar to Solvency II in this respect, the decision must be considered relevant also in an insurance context.

7.6.4.2 Risk management system

According to Article 44 (1), the risk management system that insurance undertakings need to have in place comprises

“[…] strategies, processes and reporting procedures necessary to identify, measure, monitor, managed and report, on a continuous basis the risks, at an individual and at an aggregated level, to which they are or could be exposed, and their interdependencies.”

Paragraph (2) requires that the system covers at least the following areas:

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921 Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur Modernisierung der Finanzaufsicht über Versicherungen, Bundestagsdrucksache 18/2956, 2014-10-22, 240. This has also been criticized by Dreher who holds that supervisory board members due to their inability to manage the undertaking are not key function holders and that fit and proper requirements applicable to them are based on company law requirements for financial services providers rather than on regulatory law, Dreher, Begriff und Inhaber der Schlüsselfunktionen nach Solvency II und VAG 2012, p. 938.

922 Dreher comes to the same conclusion as the Swedish legislator that both terms refer to the same functions, namely the four key functions belonging to the risk management system, Dreher, Begriff und Inhaber der Schlüsselfunktionen nach Solvency II und VAG 2012, p. 935.

923 See BaFin’s information on the fit and proper requirements for supervisory board members: BaFin, Merkblatt zur fachlichen Eignung und Zuverlässigkeit von Mitgliedern von Verwaltungs- oder Aufsichtsorganen gemäß VAG 2016-11-23.

924 Board of Appeal, 14 July 2014, SV Capital OÜ ./ European Banking Authority, paras. 38 and 39. The case was initiated by a company that was dissatisfied with the decision of EBA not to intervene with the Finnish banking supervisory authority that had decided not to remove two governors of the Estonian branch of Nordea on the grounds that they were not key function holders. The appellant claimed that the individuals in question were key function holders who did not fulfil the fit and proper requirements.

925 Ibid, para. 40.
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“(a) underwriting and reserving;
(b) asset-liability management;
(c) investment, in particular derivatives and similar commitments;
(d) liquidity and concentration risk management;
(e) operational risk management;
(f) reinsurance and other risk-mitigation techniques.”

EIOPA’s Guidelines on System of Governance point out that the administrative, management and supervisory board is ultimately responsible for the effectiveness of the risk management system.926 An important part of the risk management system is a decision on the risk appetite of the undertaking or group and the setting of risk tolerance limits. Since both need to be derived from the undertaking’s or group’s strategy, their determination (at least high level) is also a task of the board.927 Examples for risk tolerance limits are the limits for the maximum insurance sum for types of risks per insurance policy (for instance 20 million EUR in commercial fire insurance) or limits for the overall exposure to a certain type of risk (for instance limits for the possible maximum loss caused by floodings in the Swedish Dalälven region).

An effective risk management system needs effective processes for the assessment of risks both at undertaking and at group level, with automated risk assessment and observation of limits, where possible, but also qualitative analyses of other risks, for example compliance risks. This requires effective and documented coordination and reporting processes, as well as detailed risk management policies. The risk management system needs to be integrated into the decision-making processes of the undertaking (Article 44 (1) Solvency II Directive), which encompasses both concrete business decisions at working level and decisions at management level. For example, if underwriting an insurance policy would lead to a breach of an underwriting limit, the insurance undertaking needs to have a process in place to ensure that the policy is not accepted.

At board level, the risk position of the undertaking or group must be taken into consideration when taking business decisions, which requires regular reporting to the board.

926 Guidelines on System of Governance, EIOPA-BoS-14/253 EN, guideline 17.
927 See ibid, guideline 17.
7.6.4.3 The own-risk and solvency assessment

An important part of the risk management system is the own-risk and solvency assessment (ORSA) that needs to be undertaken by each insurance undertaking (Article 45 Solvency II Directive) as well as at group level (Article 246). The ORSA is a self-assessment that needs to be undertaken on an “ongoing basis” whenever the risk profile changes, but at least annually.\(^{928}\) According to Article 45 (4), it shall be “an integral part of the business strategy”. This means on the one hand, that the business strategy needs to be reflected in the ORSA,\(^{929}\) and on the other hand, that the results of the ORSA need to be taken into account in the undertaking’s capital management, business planning and its product development and design.\(^{930}\) Consequently, the business strategy and the ORSA interact.

The administrative, management or supervisory body of the undertaking or ultimate parent at EEA level must take an active role in steering the ORSA process and has to approve its results.\(^{931}\) These tasks are non-delegable duties. According to Article 45 (1), an ORSA comprises at least the following items:

”[[…] (a) the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking;

(b) the compliance, on a continuous basis, with the capital requirements […] and with the requirements regarding technical provisions […];

(c) the significance with which

the risk profile of the undertaking concerned deviates from the assumptions underlying the Solvency Capital Requirement […]”

According to guideline 7 of EIOPA’s Guidelines on the own-risk and solvency assessment, the overall solvency need must be assessed on the basis of stress tests of those material risks identified by the undertaking in the ORSA process. This sounds similar to a SCR calculation, but there are some important differences, mainly:

First, the ORSA has a longer time horizon than the SCR with its 1-year-perspective. EIOPA’s guidelines on the ORSA state somewhat vaguely that undertakings need to assess their overall solvency capital needs with a medium-term or long-term perspective, “as appropriate”.\(^ {932}\) BaFin has interpreted this as generally meaning three to five years.\(^ {933}\)

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\(^{928}\) Guidelines on own-risk and solvency assessment, EIOPA-BoS-14/259 EN, guideline 14; for Swedish law: chapter 10 § 12 FRL.

\(^{929}\) Dreher and Ballmaier, p. 137.


\(^{931}\) Ibid, guidelines 2, 4, 6.

\(^{932}\) Ibid, guideline 7.

\(^{933}\) BaFin, Auslegungsentscheidungen: ORSA, 2015-12-23; para. 89.
whereas the British Prudential Regulation Authority in a Supervisory Statement has expressed the expectation that non-life insurers falling under its supervision take the “total uncertainty and risk over the time horizon of the run-off of a firm’s obligations towards its policyholders” into consideration.\footnote{Prudential Regulation Authority, Solvency II; ORSA and the ultimate time horizon - non-life firms, June 2015; para. 1.5.}

Second, the ORSA shall reflect the actual risk profile of the undertaking, which may deviate from the assumptions in the standard formula. Undertakings that calculate the SCR with the standard formula therefore need to assess and document in how far their risk profile is sufficiently or insufficiently reflected in the standard formula.

If the ORSA reveals significant differences in the risk profiles, the insurance undertaking may have to take measures to closer align its SCR to its risk profile, for instance by changing its business model or applying a partial or full internal model.\footnote{EIOPA, Explanatory text on Guidelines on own risks and solvency assessment in: Consultation Paper on the proposal for Guidelines on system of governance and own risks and solvency assessment 2 June 2014, para. 2.54.}

Third, also risks that are not taken into consideration in the SCR need to be included in the calculation of the overall solvency capital need in the ORSA. This includes, for instance, reputational risk, or risks connected to changes in the fiscal or legal environment.\footnote{Ibid, paras. 2.21 and 2.38.} In the ORSA, the insurance undertaking also needs to identify unquantifiable risks and develop strategies how to manage them.

Fourth, companies may apply valuation methods or correlations in the ORSA that differ from those applied for SCR calculation purposes, provided they can demonstrate that these valuation methods are more adequate with regard to the company’s risk profile, business strategy and risk tolerance limits.\footnote{Guidelines on own-risk and solvency assessment, EIOPA-BoS-14/259 EN, guideline 9; EIOPA, Explanatory text on Guidelines on own risks and solvency assessment in: Consultation Paper on the proposal for Guidelines on system of governance and own risks and solvency assessment, para. 2.39.}

Fifth, companies may take business decisions into account that are not reflected in the SCR calculations, or they may use a higher confidence level, i.e. a lower probability for loss of own funds than the VaR of 99.5 % applied in the SCR calculation.\footnote{BaFin, Erläuterungen zu Leitlinien für die unternehmenseigene Solvabilitäts- und Risikobeurteilung, 2016-05-20, para. 2.55.}

The undertaking needs to ensure that the overall solvency capital needs can be met, also taking into account adverse scenarios, and, if necessary, needs to develop a strategy how to raise capital. It is important to note, that the overall solvency capital needs do not result in a recalculation of the SCR (Article 45 (7)), so that an undertaking (or a group) may have a (group) SCR ratio of more than 100 %, but nevertheless may need to raise capital, apply risk reduction mechanisms or reduce risk in order to cover the overall solvency capital needs identified in the ORSA. The results of each ORSA as well as

\footnote{Prudential Regulation Authority, Solvency II; ORSA and the ultimate time horizon - non-life firms, June 2015; para. 1.5.}
information on the ORSA process need to be reported to the supervisory authority, but in contrast to the solvency and financial conditions report, they do not need to be made public.

Despite the lack of a direct link between the ORSA and the SCR, Dreher and Ballmaier see a risk that supervisory authorities will automatically demand a capital add-on if the ORSA shows a significant difference between the risk-profile of the undertaking and the risk profile underlying the standard formula.

The ORSA has a two-fold function: It serves as an important instrument for the supervisory authority and for the management and supervisory body of the insurance undertaking in the management of the company, including strategic decisions, product development, capital and risk management. Regulatory law does not prescribe the methods how to conduct the ORSA or which calculation methods to apply, but rather sets up rules on the process and the use of the results. This is another major difference to the SCR calculation, where the standard formula is laid down in detail in the Delegated Regulation. It falls therefore in the responsibility of the insurance undertaking’s administrative, management and supervisory body that appropriate methods for the ORSA are applied. Another purpose of the ORSA is to force the board members to reflect upon the appropriateness of the SCR calculation and to prevent that the insurance undertaking is managed only with a view to compliance with the SCR.

Dreher and Ballmeier consider it peculiar from a legal perspective to require that the undertakings that are subject to supervision are obliged to question the standard formula because this is the original task of the supervisory authority.

For the supervisory authority, the ORSA is an important source of information. Article 36 (2) (a) Solvency II Directive expressly requires the supervisory authorities to review the ORSA and to demand remedies if they detect deficiencies, for instance in the insurance undertaking’s ability to withstand “possible events or future changes in economic conditions that could have adverse effects on the overall financial standing of the undertaking” (Article 36 (5)).

This raises the question whether the supervisory authority has competence to supervise the business strategy reflected in the ORSA (and consequently may demand changes to the business strategy). The definition of the business strategy is an original, non-delegable duty of the administrative, management or supervisory board of an insurance undertaking, and as a general rule, supervisory authorities do not have the right to prescribe a certain business strategy. Neither is it their duty to prevent an insurance undertaking from taking (in its view) inappropriate business decisions, as long as the

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939 According to Dreher and Ballmaier, p. 140, this obligation falls under the reporting obligations laid down in Article 35 (1) sentence 2a, (2) (a) (i) of the Solvency II Directive. The obligation to report the results of the ORSA is laid down in Article 46 (6).
940 Ibid, p. 137.
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Solvency is not endangered and policyholders not negatively affected. With the requirement to review the ORSA including the overall solvency capital needs and ability to fulfill these needs in the future, the business strategy becomes indirectly subject to supervisory review, because the capital management strategy, product strategy, financing strategy and risk appetite of the undertaking all form part of the overall business strategy. Dreher and Ballmaier therefore correctly observe that the business strategy is “resistant to supervision”, albeit not entirely free from supervision, so that the supervisory authority needs to conduct the review of the ORSA with great sensitivity and restraint, in order not to interfere with management competences.942

7.6.4.4 The system of governance: Some group aspects

The system of governance needs to be implemented both at solo and at group level. In the Guidelines on System of Governance, EIOPA describes how it considers that the risk management system needs to be implemented at group level, expressly advocating an enterprise perspective:

“The implementation of governance requirements at group level should be understood as having in place a robust governance system applied to one coherent economic entity (holistic view) comprising all entities that are part of the group.”943

“Entities that are part of the group” are not limited to insurance and reinsurance undertakings, but comprise all other entities.944 To include all group entities and not just insurance undertakings is justified because risks arise even from non-insurance activities and their realization may have a negative impact on the financial situation of the group. A “holistic view” in this context implies that the risk management and internal control systems need to be applied consistently throughout the group.945

Consistency is particularly important with regard to the limit system. If an insurance undertaking’s risk limits allow the underwriting of risks that would lead to a breach of limits at group level, there is prima facie a lack of consistency, unless the risk management system is applied in such a way that both risk limits must be observed during the underwriting process.

942 Ibid, p. 136. The authors use the term “aufsichtsresistent”.
943 Guidelines on System of Governance, EIOPA-BoS-14/253 EN para. 1.17.
944 Ibid, para. 1.19.
945 Ibid, para. 1.18.
7.7 On the responsibility of group undertakings for compliance with the group supervision requirements

As we have seen, the directive does not always clearly state which undertaking within a group is responsible for compliance with the group supervision requirements. In the following, the rules on the allocation of responsibilities with regard to group solvency are further analysed. Closely connected to this question are the measures and sanctions available in case of a breach of group supervision requirements.

7.7.1 Groups with a participating insurance undertaking as ultimate parent undertaking

As mentioned above, Article 218 (2) requires member states to oblige a participating insurance undertaking in the case of a group according to Article 213 (2) (a) to ensure that the group SCR is covered with own funds. Article 215 states that Articles 218 to 258 shall apply

“[…] only at the level of the ultimate parent insurance or reinsurance undertaking, insurance holding company or mixed financial holding company which has its head office in the Union”.

This must be understood as limiting the obligation to the participating insurance undertaking at the top of the group at EEA level, so that participating insurance undertakings at lower levels in the group are not addressees of the obligation to comply with the group SCR.946

The Swedish legislator, however, does not seem to share this understanding. The preparatory works state with regard to the obligation to undertake the group ORSA that

“A reasonable starting point is that it is the undertaking at the top of the group that shall undertake the measure. However, there may be cases where the group structure is complex and in those cases, it may be reasonable to deviate from this starting point. An example could be certain groups with an ultimate owner outside the EEA”[own translation].947

The participating insurance undertaking is also responsible for the group SCR calculation (Article 219 (1)), for monitoring group solvency on an ongoing basis (Article 219 (2)), for undertaking the group own risk and solvency assessment (ORSA) (Article 246) and for disclosing the annual report on the solvency and financial condition at the

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946 See also chapter 7.5.2.1 for a discussion of Article 215.
947 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 400, original wording: “En rimlig utgångspunkt är att det är företaget i toppen av gruppen som ska utföra åtgärden. Det kan emellertid finnas fall där gruppens struktur är komplex och då kan det vara befojat att frångå denna utgångspunkt. Som exempel kan nämnas vissa grupper med ett yttersta ägande utanför EES.”
level of the group (Article 256). With regard to the reports on risk concentration within
the group (Article 244 (2)) and the reporting of intra-group transactions (Article 245 (2)),
the wording differs from the foregoing provisions, pointing out not the participating
insurance undertaking, but the “insurance or reinsurance undertaking which is at the head
of the group”. This applies to the participating insurance undertaking at the top of the
group.

According to my understanding, the Solvency II Directive places the responsibility
to fulfil the regulatory requirements at group level entirely with the participating
insurance undertaking (or insurance undertakings in the case of a horizontal group) that
is the ultimate parent at EU level. Subsidiaries in this kind of group are not designated
any responsibility by the Directive.948

7.7.2 Groups with an insurance holding company as ultimate parent
undertaking

If the group is headed by an insurance holding company or mixed financial holding
company, this holding company is in principle responsible for all requirements at group
level except for the coverage of the group SCR with own funds. Instead, Article 218 (3)
imposes this obligation on the insurance undertakings in the group. According to the
wording of the provision, this comprises all insurance undertakings regardless of their
position in the group structure. The group supervisor may, however, determine an
insurance undertaking that shall be responsible for the calculation and the reporting
instead of the insurance holding.

Responsibilities in a group with an insurance
holding as parent undertaking

* = Responsible for

Group SCR calculation
Group ORSA
Risk concentration report
Report on the solvency and financial
condition at the level of the group
Reporting on intra-group transactions

Coverage of group SCR

* = Responsible for

Figure 7.7.2 no. 1

948 See also Krämer in: Prölls/Dreher VAG, § 246 para. 5.

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The requirement that all insurance undertakings have to ensure coverage of the group SCR raises questions, which can be illustrated with the fictitious group structure in Figure 7.7.2 no.1:

- The group SCR and the group solvency ratio is influenced by the financial situation and behaviour (underwriting of new business for example) of all companies included in the calculation. The management of insurance undertaking A1, for example, does not have any instruments to influence business decisions taken by insurance undertakings B1, B2, C1, or C2. Is A1 nevertheless responsible for any business decisions taken by other group companies outside its control?
- If insurance undertaking A2 breaches its solo SCR and as a consequence of this, also the group SCR is not covered by own funds any more, is it, for instance, insurance undertaking B1’s obligation to restore the group solvency, for instance by issuing a subordinated bond eligible as own funds, even though B1 itself is already generously funded?
- If B1 instead breached its solo SCR leading to a breach of the group SCR, could A1 (with 40 % external shareholders) be required by a supervisory authority to reduce its risk profile in order to lower the group SCR?

The answer to these questions depends on what is understood by being “required to ensure coverage of the group SCR with own funds”, which ultimately concerns the relationship between regulatory and company law. Therefore, here, only a few aspects shall be taken up. A strict obligation in the sense that the management of an insurance undertaking breaches against regulatory law as soon as the group SCR is not covered any more raises concerns if it also applies to deficits attributable to business decisions taken elsewhere in the group without any possibility for the management to influence these decisions. It would impose a kind of strict liability for compliance with the group SCR by all group undertakings notwithstanding to which extent they are able to influence coverage of the group SCR. The directive, at any rate, does not give insurance undertakings the corresponding control rights. Therefore, it would be disproportionate to hold insurance undertakings responsible for compliance with the group SCR regardless of their position in the group structure.

Also, the distinction made between groups with an insurance undertaking at the top and those with an insurance holding company as ultimate parent undertaking, speaks against such an interpretation. There are no valid reasons to differentiate between these two sorts of groups and to impose considerable higher obligations on insurance undertakings headed by a holding as opposed to groups with an insurance undertaking at the top. Article 218 (3) must therefore be explained against the background that the Solvency II legislator struggled with regard to the role given to insurance holding

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949 See chapters 10 and 11.2.5.
companies: On the one hand, they are explicitly not subjected to supervision at solo level, but on the other hand, their existence cannot be denied, and the Solvency II legislation therefore imposes certain duties on them with regard to group supervision, however, without treating them entirely equally with insurance undertakings – as would be the logical consequence.

From the Swedish preparatory works, it can be derived that the Swedish legislator understands the provision in such a way that only one insurance undertaking is responsible. However, this cannot be explicitly derived from chapter 19 § 16 FRL 2016 despite the legislator’s intention that the FRL should clearly state which undertaking is responsible.950

The first Swedish government proposal contained an explicit provision pointing out which insurance undertaking within the group was supposed to be responsible for compliance with all group supervision rules, namely the insurance undertaking at the top of the group, and in case there are more than one, the one with the largest balance sheet.951 This provision met critique during the consultation process, particularly from Länsförsäkringar AB, and was deleted in the next version.952 The main arguments brought forward against the provision were the following:

- It was unclear what was meant with “responsibility” - a “best-effort” requirement or being subject to regulatory sanctions for breaches even despite best efforts;953
- There is no corresponding provision in the Solvency II Directive;954
- None of the possible interpretations of the provision was suitable to specify the responsibility allocated to the undertakings;955
- Depending on its interpretation, the provision would have breached against company law because it would have given subsidiaries the possibility to steer its parent holding undertaking and sister companies.956

To determine one subsidiary to be responsible is problematic enough since there might not be a single insurance undertaking that has control rights comparable to those of a parent undertaking. In the Swedish preparatory works, similar concerns are raised: To impose responsibility on an insurance subsidiary of a holding company would require that the insurance undertaking could exercise control over its parent undertaking, which is not the case.957

The German legislator has chosen a different approach with § 246 (3) VAG 2016 which is applicable irrespective whether an insurance group is headed by an insurance holding or an insurance undertaking:

“All undertakings included in the group supervision are responsible for compliance with Part 5 of this act unless something different is laid down in this act.”[own translation] 958

This provision does not have a counterpart in the directive and is not commented in the preparatory works. According to Krämer, the only field of application of the provision is sub-group supervision

950 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 422.
951 Utkast till lagrådsremiss - Genomförande av Solvens 2-direktivet på försäkringsområdet, p. 302.
952 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 404 f.
955 Ibid, p. 10.
956 Ibid, p. 11.
957 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 422.
958 Original wording: “Für die Einhaltung der Anforderungen nach Teil 5 dieses Gesetzes sind alle der Gruppenaufsicht unterworfenen Unternehmen der Gruppe verantwortlich, sofern dieses Gesetz nichts anderes bestimmt.”
because he understands § 247 VAG as allocating exclusive responsibility on the ultimate parent undertaking.959 This understanding is based on a different understanding of Article 215 Solvency II Directive than the one applied here.

What exactly is meant with “responsible” in § 246 (3) VAG is not clear. The provision imposes a vague form of responsibility for the group requirements. The widest form of responsibility would be an obligation for the actual compliance with all group-related obligations, for instance coverage of the group SCR, notwithstanding the legal and factual possibility to remedy a situation. Such an interpretation would be too far-reaching, imposing responsibility for circumstances that are beyond the subsidiary’s control. In a circular on the governance requirements, BaFin interprets the provision as establishing a duty to cooperate (Mitwirkungspflicht) that does not set aside company law or capital market law requirements.960 This interpretation takes into account the company law reality and does not require impossible actions from subsidiaries. BaFin expresses the expectation that parent undertakings make appropriate use of their steering instruments (Einwirkungsmöglichkeiten).961 This implies that BaFin does not refer to injecting funds, but rather to the instruments available under company law to steer decisions of subsidiaries. However, from that it is just a short step to the expectation that parent undertakings need to apply their discretion in such a way that a subsidiary is supported unless forbidden by company law. The cooperation requirement imposed on other group undertakings could mean, for instance, that when a subsidiary needs to decide between two equally attractive business opportunities, it has to choose the one that is within the group’s risk tolerance limits rather than the one which would lead to a breach of these limits (constituting a breach against the risk management and internal control system required by Article 246).962 Or, if the subsidiary would like to underwrite a risk that would exceed the group’s limits for such risks (e.g. windstorm in Germany), it must refrain from this business if the parent undertaking promises to compensate it for any disadvantages due to the missed opportunity, i.e. the subsidiary’s management is not free to follow or not follow the parent undertaking’s order but must take a decision that is both compliant with company law and avoids a breach of the regulatory requirements of the group.963 The duty to cooperate thus encompasses the obligation to refrain from actions that would cause the breach of regulatory law applicable on the group, for instance a breach of the group SCR, or a breach against the group’s risk management and internal control system.

Similarly, Article 218 (3) Solvency II Directive could be understood as imposing on all related insurance undertakings not a strict duty to ensure that the group SCR is always covered, but rather a duty of loyalty or cooperation. Then, however, no insurance undertaking in a group headed by a holding would have an overall obligation to ensure compliance with the group SCR. The content of such a cooperation duty would depend on the relationship between company law and regulatory law which is discussed in chapter 10. It is is further discussed in chapter 11.2.5 as an expression of the “ultra posse nemo obligatur” principle.

959 Krämer in: Prößl/Dreher VAG, § 246 para. 5.
960 BaFin, Rundschreiben 2/2017 (VA) - Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen (MaGo), 25 January 2017, para. 23.
961 Ibid, para. 21: "Zu diesem Zweck hat das für die Erfüllung der Anforderungen auf Gruppenebene zuständige Unternehmen die vorhandenen Einwirkungsmöglichkeiten angemessen zu nutzen."
962 See also Behrendt Jonsson in: BeckOK VAG, § 246 para. 19.
963 With regard to banking supervision law, a comparable example has been discussed by van de Sande: Carsten van de Sande, Die Unternehmensgruppe im Banken- und Versicherungsaufsichtsrecht (1st edn 2003), p. 305 f.
Why insurance holdings are treated differently from participating insurance undertakings, is unclear. One aspect might be that insurance holdings are not subject to an individual supervision (except for fit and proper requirements) and do not need an authorization. The toughest sanction that can be applied against an insurance undertaking, namely the withdrawal of the insurance authorization, is unavailable against insurance holdings.

Under the supplementary supervision in Solvency I, insurance holdings did not have any obligations (apart from the fit and proper requirements with regard to their management) and were not subjected to any supervisory measures. The Financial Conglomerates Directive applies the same system as the Solvency II Directive with regard to its treatment of mixed financial holdings, i.e. it contains similar reporting requirements and provisions concerning measures against mixed financial holding, but states that only regulated entities (not encompassing mixed financial holdings) have to ensure that there are enough own funds in the conglomerate to cover the capital adequacy requirements. According to the preparatory works on the Swedish Financial Conglomerates Supervision Act implementing the Financial Conglomerates Directive, it should also be possible to impose regulatory sanctions against mixed financial holdings if the capital requirements are not met, because the holding usually steers the group’s activities. However, the act does not contain any provision that would give Finansinspektionen the right to take measures against the holding in such a case, and in the motives to the act, the failure to report is mentioned, but not undercapitalization as situations in which sanctions could be imposed. In contrast to that, § 21 (1) para. 2 of the German Act on the Supervision of Financial Conglomerates (Finanzkonglomerate-Aufsichtsgesetz) contains an explicit provision allowing BaFin to impose adequate supervisory measures against a mixed financial holdings if the capital requirements are not met, particularly to prohibit the distribution of dividends. In case of non-compliance with reporting requirements, BaFin may according to § 22 (1) prohibit the holding from exercising its voting rights in the general meetings of its subsidiaries.

### 7.7.3 Measures in case of non-compliance with the Solvency Capital Requirements

Closely connected with the question of responsibility for compliance with the group requirements are, of course, the measures that the responsible undertaking is or may be obliged to take in case of non-compliance, and when it can be subject to regulatory sanctions. Since the main interest of this study lies with the capital requirements, the overview is limited to the measures required or available in case of a breach of these. Regulatory sanctions for a failure to calculate the group SCR at all, for non-compliance with the group reporting and internal governance provisions are therefore not analysed.

It is important to note that a breach of neither the SCR nor the MCR needs to be connected with insolvency. A breach does not necessarily mean that the undertaking does not have own funds anymore at the time of the breach, but simply that its own funds would hypothetically be consumed if an event occurred that an undertaking with sufficient own funds would be able to survive. Concerning the

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964 Lag om särskild tillsyn över finansiella konglomerat.
965 Ds 2005:1, Finansiella konglomerat, del 1, p. 106.
966 Prop. 2005/06:45, Finansiella konglomerat, p. 171.
connection between insolvency and the actual loss of own funds at solo level, it is also important to note that a loss of own funds is not an insolvency ground in itself. This is because even though the Solvency II Directive contains a chapter on reorganization and winding-up of insurance undertakings, insolvency is still based on national law (Article 273). For German insurance undertakings, for instance, this means that insolvency is determined on the basis of German GAAP accounts and not IFRS accounts or the solvency balance sheet.

In the case of group own funds, the situation is different, because groups cannot become insolvent. A complete loss of own funds at group level will presumably in most cases be connected with the insolvency of one or more subsidiaries or of the parent undertaking, but it seems unlikely that all undertakings of a large group would fall insolvent.

7.7.3.1 Measures in case of breach of solo SCR

If the solo own funds fall below the SCR, insurance undertakings are according to Article 138 Solvency II Directive obliged to immediately inform the supervisory authority and to submit a recovery plan within two months. The plan must be approved by the supervisor. The supervisor may also require certain measures to be taken in order to restore coverage of the SCR within a time period of six months, which may be extended to nine months. Recovery can be achieved by raising capital or by lowering the SCR through a reduction in risk or a combination of both. In case of a significant breach or a breach of the MCR, the supervisory authority shall convene a meeting of the college of supervisor (Article 249 (2) (a)).

Supervisory action gets more severe when the minimum solvency capital requirement (MCR) is breached. If the MCR is no longer complied with, the undertaking needs to submit a short-term finance scheme to restore compliance with the MCR within three months (Article 139). The supervisor may also restrict or prohibit the free disposal of the assets of the insurance undertakings. In case of a breach of the SCR only, such a restriction may be imposed only in exceptional circumstances, if the supervisor expects the financial situation to further deteriorate (Article 138 (5)).

The corresponding competence in § 314 VAG 2016 concretizes the restriction in such way that a prohibition of the free disposal of assets may be ordered by the supervisory authority if the insurance undertaking’s inability to meet its obligations while avoiding insolvency proceedings in the best interest of the insured.

If the undertaking does not manage to restore the MCR within three months or if the supervisory authority considers the finance scheme to be “manifestly inadequate” or if the undertaking does not comply with an approved scheme, the authority shall withdraw the authorization (Article 144 (1) para. (2)).

7.7.3.2 Measures in case of breach of group SCR

Much of the above also applies to a breach of the group SCR, because Article 136 and Article 138 (1) to (4) Solvency II Directive apply mutatis mutandis according to Article
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218 (4). The undertaking in charge of monitoring group solvency (i.e. the ultimate participating insurance undertaking or insurance holding) is obliged to inform the supervisory authorities when the financial condition of the group deteriorates (Articles 218 (4), 136) or when the group SCR is no longer complied with or risks not being complied with in the following three months (Article 138 (1)). When the group SCR is no longer complied with, a group recovery plan for supervisory approval must be submitted and measures need to be taken to comply with the group SCR within a period of six months.

7.7.3.2.1 Particular measures and sanctions

Article 218 (4) Solvency II Directive only refers to Article 138 (1) to (4), but not to paragraph (5) that allows the supervisory authority to restrict or prohibit the free disposal of the assets of an insurance undertaking. Not to extend the reference to paragraph (5) is correct: Since a restriction of the free disposal of assets is a serious interference with an undertaking’s right to conduct business, its purpose must be to protect the interests of policyholders, for instance in a situation where insolvency is imminent, which is not the case if the solo SCR is still complied with despite a breach of the group SCR (for instance because the breach of the group SCR is caused by a breach of the solo SCR of another group undertaking). A breach of the group SCR therefore does not justify a restriction of the free disposal of assets.

Neither is it explicitly mentioned as a reason for withdrawing the authorization of an insurance undertaking. However, Article 144 (1) (c) allows supervisory authorities to withdraw an authorisation if “the undertaking concerned fails seriously in its obligations under the regulations to which it is subject”. The question is then, if it constitutes such a breach of regulatory law if the group recovery plan is not complied with and the group own funds remain insufficient to cover the group SCR. In other words, could non-compliance with the group SCR alone or in connection with non-compliance with a group recovery plan be a ground for withdrawing the authorization of an insurance undertaking at the top of the group, even though the solo SCR is fulfilled? The answer must be negative: Since withdrawal of the authorization is one of the strongest sanctions available, it requires a very high threshold of intervention. Non-compliance with the group SCR alone would not justify withdrawal of the authorization, as long as there is no significantly increased risk for the policyholders of the parent undertaking, because a withdrawal of the authorization would probably itself be connected with negative effects on the policyholders since the cost ratio would rise when no new business is written.

7.7.3.2.2 Competences of the group and solo supervisory authorities

From Article 258 (1) (a) Solvency II Directive can be derived that the competence for regulatory measures in case of non-compliance with group supervision requirements
against insurance holdings lies with the group supervisor. With regard to measures against insurance and reinsurance undertakings, the competence lies with the supervisory authorities (Article 258 (1) (b)). The plural indicates that not only measures from the participating insurance undertaking at the top of the group are meant, but indeed measures by related insurance undertakings, which also opens up for requiring measures both from holdings and insurance subsidiaries. This is also the understanding of the German legislator: § 287 (1) VAG 2016 expressly states that measures shall be required by both solo supervisors with regard to insurance undertakings and group supervisors with regard to insurance holding undertakings at the same time (gleichzeitig).

Baier suggests that § 287 (1) VAG 2016 (implementing Article 258 (1) (a) Solvency II Directive) merely has a declaratory nature since the solo supervisor already on the basis of the rules on solo supervision has corresponding competences.967 This comment seems to be based on an underlying understanding that measures against insurance subsidiaries are taken to preserve or restore solo solvency that also threatens compliance with the group SCR.

7.7.3.2.3 On the addressees of regulatory action

The legislative technique of referring in Article 218 to Article 138 Solvency II Directive leads to a lack of clarity with regard to the addressee of the obligations when the group is headed by an insurance holding: Which undertaking at group level is obliged to submit a recovery plan and from which undertaking may the supervisor require measures to restore group solvency if the recovery plan is insufficient or not implemented? Since the insurance holding probably has the best overview over the financial situation of the group and the possibilities to reduce risk exposure or to raise capital, it seems adequate that the holding is not only responsible for calculating the group SCR and conducting the group ORSA, but also for developing and submitting a recovery plan.

Article 258 (1) (a) Solvency II Directive require the group supervisor to adopt measures with respect to insurance holdings and the solo supervisors with regard to insurance undertakings when insurance undertakings do not comply with the group solvency requirements, or when group solvency is jeopardized, or when the intra-group transactions or the risk concentrations are a threat to the financial position of insurance undertakings.

The wording of this provision is not entirely clear as to whether measures against an insurance holding may be taken to restore group solvency since it is not the holding’s obligation to ensure compliance with the group SCR. This could lead to situations where the group SCR is not covered with own funds, but where there is no insurance undertaking in the group that could reasonably be required to remedy the undercapitalization. An example could be a group where all insurance subsidiaries are

967 Baier in: Brand and Baroch Castellvi (eds), VAG, § 287 para. 2.
sufficiently capitalized to fulfil their respective solo SCR, but the group SCR is not covered by own funds because the holding company’s indebtedness has increased.

Article 258 (2) further requires member states to impose effective sanctions or to adopt measures relating to insurance holding companies that infringe the rules on group supervision. Paragraph (3) empowers the Commission to adopt delegated acts for the coordination of enforcement measures. As of June 2018, the Commission has not made use of this delegation. Article 258 (2) implies that measures against an insurance holding shall only be taken if it breaches against any of its obligations, for instance if it fails to report intra-group transactions, but not for breaches that lie outside its responsibility.

The question is then, whether an insurance subsidiary of an ultimate insurance holding can be addressee of regulatory measures to restore group solvency? Systematically, it is inconsistent to take measures against a holding to comply with rules that other undertakings have to follow. On the other hand, insurance holdings clearly have been given an important role in the group solvency calculations, and group supervision would be more effective if measures could be taken against insurance holding undertakings, particularly if the reason for a breach of the group SCR lies with them. Without such a possibility, there is a risk that supervisory authorities do not have sufficient competences if the group SCR is not covered with own funds any longer. From Article 258 (1) can be derived that a breach of the group SCR is a severe breach of regulatory law that requires supervisory action, so that the obligation to ensure compliance with the group SCR forms part of the regulatory duties that could lead to supervisory action in case of non-compliance. A teleological interpretation therefore speaks for a possibility to require measures from the ultimate insurance holding in case of a breach of the group SCR in order to promote the efficiency of insurance supervision.

According to Krämer, § 287 (1) VAG 2016 (transposing Article 258 (1) Solvency II Directive) is only applicable if the measures envisaged in § 134 (1) to (4) (i.e. the obligation to set up a recovery plan and to restore group solvency within six months) have failed.

Sweden has transposed paragraph (2) by inserting chapter 19 § 64 (2) FRL 2016. The provision gives Finansinspektionen the right to require an insurance holding company to take measures to remedy non-compliance with any of the obligations imposed to it in FRL’s chapter on group supervision, EU regulations based on the Solvency II Directive or ordinances based on the FRL:

"Finansinspektionen may require an insurance holding company or a mixed financial holding undertaking to take corrective measures if the holding undertaking does not fulfill the requirements imposed on it according to the EU regulations that have been adopted on the basis of the Solvency II Directive, this chapter or rules that have been adopted on the basis of this chapter" (own translation; emphasis added).

968 Krämer in Prölss/Dreher VAG, § 287 para. 5.
969 Original wording: "Finansinspektionen får förelägga ett försäkringsholdingföretag eller ett blandat finansiellt holdingföretag att vidta åtgärder för att göra rättelse, om holdingföretaget inte uppfyller de krav som ställs på det enligt EU-förordningar som antagits med stöd av Solvens II-direktivet, detta kapitel eller föreskrifter som meddelats med stöd av detta kapitel.”
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Such an order may be combined with a penalty payment in case of non-compliance (chapter 18 § 27 FRL 2016). However, since the holding undertaking itself is not obliged to ensure that the group SCR is covered with own funds, it is very doubtful whether chapter 19 § 64 FRL 2016 could form the basis for regulatory measures against an insurance holding in the case of non-compliance with the group SCR. The provision could be applied for imposing an insurance holding to submit a recovery plan. Other provisions enabling Finansinspektionen to take measures against an insurance holding can be found in chapter 18 § 24 and chapter 19 § 64 (1) (concerning fit and proper requirements) and chapter 19 § 58 FRL 2016 (reporting requirements).

7.7.4 Comment and recommendations

The distinction between groups headed by participating insurance undertakings and those headed by insurance holdings leads to an unclear distribution of responsibility between holdings and their insurance subsidiaries, which also affects their enforceability. The first draft of the Swedish implementation legislation was sharply criticized by the Swedish Council of Legislation, particularly with regard to the chapter on group supervision.970 The preparatory works to the final proposal vaguely indicate that the Swedish legislator continues to struggle with the roles allocated to holdings and insurance undertakings in the context of group supervision.971 It cannot be blamed for it. The rules in the Directive on group supervision, both with regard to the levels at which group supervision is exercised, and concerning the responsibility for compliance group supervision are extremely complicated and incoherent.

It would have been less complex if the directive simply treated insurance holdings and participating insurance undertakings equally with regard to group supervision. Insurance holdings often have the best overview over the risk situation in the group and have decisive influence on the capital allocation in the group. The circumstance that insurance holdings may be subject to varying degrees of solo-supervision does not hinder an equal treatment with regard to group supervision. That effective sanctions can be taken also against holdings, show BaFin’s competences with regard to mixed financial holdings: The possibility to impose fines against a holding, to hinder it from exercising its voting rights or from deciding upon the distribution of dividends of its subsidiaries, or to declare its managers unfit to conduct the business of the holding, are strong sanctions. With the current rules, the role of insurance holdings in group supervision remains dubious and inconsistent. There is no good reason for differentiating between groups with a participating insurance undertaking at the top (subjecting only the participating insurance undertaking but not its insurance subsidiaries to group supervision), and groups with an insurance holding as ultimate parent undertaking (subjecting all of its insurance subsidiaries and, to a restricted extent, the holding itself to group supervision). Not to place any responsibility for coverage of the group SCR on

970 Lagrådet, pp. 31-52.
971 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, pp. 405-409, 421 f.
the insurance holding, may have the consequence that the supervisory authorities do not have sufficient power to force groups to restore group solvency. Similarly, the cooperation requirement derived from Article 218 (3) Solvency II Directive should be applicable even when an insurance group is headed by an insurance undertaking, since the parent undertaking is in a comparable situation as an insurance holding concerning its possibilities to ensure compliance with the group solvency requirements. This result can be achieved by applying the cooperation duty by analogy.

With respect to the aim of reaching supervisory convergence and a level playing field for insurance undertakings throughout the EU, it is not very optimal if the interpretation of Directive provisions leads to results that are relatively far away from their wording (restrictive teleological interpretation in the case of Article 218 (3) with regard to the content of the obligation and application by analogy to groups headed by insurance undertakings). This increases the risk that the national implementation norms, and therewith also the application of the Solvency II Directive, will differ considerably between member states.

De lege ferenda, the Solvency II Directive should therefore be amended in such a way that insurance holding undertakings are treated equally with insurance undertakings with regard to group supervision, i.e. the responsibility for covering the group SCR should lie with the insurance holding instead of with its insurance subsidiaries and insurance subsidiaries should be imposed an explicit duty of cooperation with regard to compliance of the rules on group supervision. The Commission should also make use of the delegation in Article 258 (3) and adopt rules on the coordination of measures in case of a breach of the group SCR.
8 Solvency Capital Requirements

Pillar I of the Solvency II regulatory regime deals with the quantitative requirements. To this belong the solo Solvency Capital Requirement (solo SCR), the solo Minimum Capital Requirement (MCR) and the group Solvency Capital Requirement (group SCR) in the case of group solvency supervision.

8.1 Capital requirements at solo level

Since the group Solvency Capital Requirement cannot be understood without having an understanding of the solo SCR, this chapter starts with a description of the concepts behind and methods for calculating the capital requirements and their coverage at solo level.

8.1.1 The solvency balance sheet

The starting point for the calculation of the solo SCR is the so-called solvency balance sheet, i.e. a balance sheet of the insurance undertaking where the assets and liabilities are valued in accordance with Article 75 Solvency II Directive. If the group SCR is calculated according to the consolidation method, a consolidated solvency balance sheet needs to be set up based on the same valuation principles.

 Compared to other parts of the directive with more detailed provisions, Article 75 is surprisingly general. It requires assets and liabilities to be valued at the amount for which they could be transferred in an arms’-length-transaction and leaves the details to regulation in delegated acts and regulatory technical standards. Only with regard to the valuation of technical provisions, the directive contains more detailed rules in Articles 76 to 86.

 The idea behind the solvency balance sheet is that it is supposed to show the market value of the assets and liabilities. Liabilities, such as technical provisions shall not be inflated by overly prudent assumptions and assets shall not be over- or undervalued in the solvency balance sheet. This is consistent with the fair value concept generally applied by IFRS. Accordingly, Article 9 Delegated Regulation states that assets and liabilities shall be valued in accordance with IFRS, unless otherwise stated. Where quoted market prices exist, assets and liabilities other than technical provisions shall be

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valued in accordance with these (“mark-to-market valuation”; Article 10 (2)). If there are no quoted market prices for the asset or liability in question, quoted prices for similar markets with adjustments shall be used. If a valuation cannot be made according to these two methods, alternative valuation methods shall be applied, based on market input and undertaking-specific inputs. One such alternative valuation is a “mark-to-model” approach, i.e. a valuation based on financial or actuarial models.

Even though generally the same valuation methods as in IFRS are supposed to be applied for the solvency balance sheet, there are differences, also called “prudential filters”. These “filters” are applied, for example, when the legislator has doubts whether assets can be liquidated at the value in the IFRS accounts. If an insurance undertaking or a holding prepares IFRS accounts, it consequently has to make some adjustments to prepare the solvency balance sheet.

The most important difference concerns the technical provisions, forming the central part of the liability side of an insurer’s balance sheet. The valuation of the technical provisions has been a major issue of discussion during the Solvency II project. Especially the long-debated treatment of long-term guarantees in life insurance contracts lied behind the delay in the application of the Solvency II Directive. The treatment of technical provisions differs considerably from their valuation according to IFRS, at least partly due to the fact that the IFRS have not been written with the insurance industry in mind. Since the current IFRS standard 4 on insurance contracts, issued in 2004, has been considered insufficient with many accounting issues concerning insurance contracts being unaddressed, the International Accounting Standards Board started an insurance contracts project with the objective of developing a new standard to improve comparability and transparency. The new standard IFRS 17 has been issued in 2017 and is currently undergoing the EU endorsement procedure. Even though the new standard will lead to an approximation between the IFRS and Solvency II valuation of technical provisions, some differences will remain.

But even outside the area of technical provisions, there are differences between IFRS and Solvency II, for instance concerning the valuation of intangible assets. Article 12

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973 On the valuation of such assets and liabilities, see also EIOPA, Guidelines on recognition and valuation of assets and liabilities other than technical provisions, EIOPA-BoS-15/113 EN, 2 February 2015.
977 See PwC, Laying the foundations for the future of insurance reporting (2012), p. 14, featuring a table with a comparison between the proposed IFRS standard and Solvency II; Laura Barella and Alice Boreman, General insurance: The wide-ranging implications of IFRS 17, The Actuary (8 June 2017).
978 In 2012, intangibles assets amounted to between 1 and 9 % of the consolidated assets of some of the major European insurance groups (Allianz, Axa, Generali, RSA, Talanx). The percentage may vary depending on whether deferred acquisition costs are included in the intangible items.
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point 1 Delegated Regulation prescribes that goodwill needs to be valued at zero for Solvency II purposes. In contrast to its treatment according to IFRS, goodwill is therefore not regarded as an asset for solvency purposes. Goodwill is the difference between the acquisition costs for a shareholding and the aggregated fair value of the acquired company’s assets minus its liabilities (and other shareholders’ interests in the company, if less than 100% are acquired),\(^979\) i.e. goodwill arises if a buyer of an undertaking pays more than the fair value of the equity of the undertaking. According to IFRS 3, goodwill is recognized as an asset without amortization, but subjected to regular impairment tests.\(^980\)

For other intangible assets, such as intellectual property rights or customer lists, IAS 38 requires to evaluate first whether the item can be recognized for IFRS purposes, and if this is the case, allows to choose between two valuation options: Valuation at cost with amortization, or revaluation, where the fair value of the intangible asset needs to be determined every year. The application of the revaluation model requires that there is an active market for the intangible asset. Carbon dioxide emission rights are an example for such assets. For most intangible assets, however, there are no active markets.\(^981\) On the solvency balance sheet, such intangible assets have to be valued with zero, unless the insurance undertaking can demonstrate that a higher value is consistent with the prices that can be achieved at an active market for this or similar intangible assets. In other words, the valuation rule in the Delegated Regulation follows the IFRS revaluation model. An undertaking that has followed the cost model for an intangible asset in its IFRS accounts will have to switch to the revaluation model in its solvency balance sheet, if possible, or value the item at zero.

Other items on the asset side, where differences to the valuation according to IFRS exist, concern investment property, property (real estate), plant and equipment, where IFRS allows to choose between valuation at cost\(^982\) or at fair value based on revaluation, and where Solvency II does not accept valuation at cost.\(^983\) Also for deferred tax assets, i.e. tax amounts that will be recoverable in the future, employee benefits, inventories, leases, and holdings in related undertakings, the valuation methods differ.\(^984\)

With respect to the liability side, differences between Solvency II and IFRS concern contingent liabilities (Swedish: *eventualförbindelser*).\(^985\)) Contingent liabilities are either

\(^{979}\) Wiley IFRS 2016: Chapter 15 (“Business Combinations”).

\(^{980}\) Ibid.

\(^{981}\) EIOPA, Draft proposal for Level 3 Implementing Technical Standards on Valuation of Assets and Liabilities other than Technical Provisions, pre-consultation draft (unpublished), para. 42.

\(^{982}\) Valuation at cost means that the asset is valued with the consideration given in exchange for an asset.


\(^{984}\) See EIOPA, Guidelines on recognition and valuation of assets and liabilities other than technical provisions, guideline 9.

\(^{985}\) Related terms are "*latenta skulder*" och "*villkorade skulder*", which are "*eventualförbindelser*" in the sense of IAS 37, if they do not meet the requirements for liabilities that provisions have to be set up for.
possible liabilities arising from past events, where it depends on the outcome of uncertain future events outside the undertaking’s control, whether they will materialize, or present liabilities arising from past events, where it is more likely than not that payments will not have to be made.⁹⁸⁶ Contingent liabilities are not recognized in IFRS and therefore not shown as a liability in IFRS accounts. In contrast to that, with regard to liabilities whose existence is certain, but where uncertainty concerning the amount or timing exists, IFRS requires provisions to be set up on the liability side of the balance sheet, because it is probable, i.e. more likely than not, that they will lead to “an outflow of resources” (IAS 37.13). Whereas IFRS only requires disclosure of certain contingent liabilities in the notes, the estimated cash-flow needed to settle material contingent liabilities needs to be taken up as a liability in the solvency balance sheet, discounted at the risk-free interest rate (Article 11 Delegated Regulation).

For the consolidated solvency balance sheet, the valuation principles are the same as for solo solvency balance sheets. With regard to the consolidation methods, it suffices to note here that the solvency balance sheet differs in some respects from IFRS. The consolidation methods will be discussed in more detail below. Furthermore, since the group definition in Solvency II is not entirely consistent with IFRS, a consolidated IFRS balance sheet and a solvency balance sheet do not always cover exactly the same group of companies.⁹⁸⁷

It is important to note that Solvency II does not expect member states to prescribe that the annual accounts of insurance undertakings and insurance holdings need to be set up in accordance with IFRS. In Germany, insurance undertakings and holdings that are not listed on a regulated market need to continue to set up their annual accounts according to German GAAP and may choose between IFRS and German GAAP for their consolidated accounts. Only listed companies need to set up their accounts according to IFRS. German GAAP has traditionally been characterized by the principle of prudence, but with the accounting reform of 2009, fair value valuation for certain types of assets was introduced. German GAAP thereby has come closer to IFRS, but the principle of prudence still has importance. Since 2008, Finansinspektionen has recommended Swedish insurance undertakings and insurance holdings to apply IFRS for the preparation of their accounts, with some national modifications, however.⁹⁸⁸

We can conclude that notwithstanding whether insurance undertakings and holdings set up their accounts according to local GAAP or IFRS, they will need to make adjustments to prepare the solvency balance sheet.

⁹⁸⁶ Wiley IFRS 2016: Chapter 18 (“Current Liabilities, Provisions, Contingencies, and Events after the Reporting Period”).
⁹⁸⁷ CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09, para. 3.2.
⁹⁸⁸ FFFS 2008:26, Chapter 1, Allmänna Råd 1, repealed with effect of 1 January 2016. Chapter 2 FFFS 2015:12 contains a general recommendation to prepare annual accounts in accordance with IFRS. For group accounts, the application of IFRS is required by chapter 7 § 2.
8.1.2 Minimum and solvency capital requirements at solo level

Insurance undertakings need to comply with two levels of solvency capital requirements, the Solvency Capital Requirement (SCR or solo SCR) and the Minimum Capital Requirement (MCR). Compliance means that the insurance undertakings must have eligible own funds covering at least the solo SCR and the MCR.

At group level, only a group SCR needs to be complied with. A group MCR does not exist, but the sum of the MCRs of the group undertakings forms a floor for the group SCR.

The solo SCR shall ensure that an insurance undertaking has enough financial resources to fulfil its payment obligations towards the insured even if unexpected losses occur. It corresponds to the value at risk (VaR) calibrated at 99.5 % over a period of 12 months, i.e. the amount of capital that, with a confidence level of 99.5 %, will be needed to cover losses within the next 12 months that may result from quantifiable risks that the insurance undertaking is exposed to (Article 101 (3) Solvency II Directive).

Article 129 provides that the MCR is calibrated at a value at risk of 85 % over a one-year-period and may not be lower than 25 % of the SCR and not higher than 45 % of the SCR. However, there are fixed minimum amounts for non-life (between 2.5 million EUR and 3.7 million EUR depending on the classes of insurance written), life (3.7 million EUR) and reinsurance undertakings (3.6 million EUR). For captive reinsurance undertakings, the floor is 1.2 million EUR. The MCR must be covered with so-called “basic own funds” (see below 2.1.3.1).

An insurance undertaking is exposed to a number of risks that need to be taken into account for the determination of the SCR. Some of the risks affect the liability side of the balance sheet, i.e. are connected with unexpected obligations. This concerns the non-life underwriting risk, life underwriting risk and health underwriting risks and, to some extent, operational risks. Underwriting risks in non-life insurance include the risk that the claims frequency and amounts of losses are higher than expected and calculated with, so that the premiums and the reserves (technical provisions) will be insufficient (premium and reserve risk), and the risk that one or several natural disasters are not sufficiently reflected in the technical provisions and therefore cause unforeseen losses (catastrophe risk).

For example, a non-life insurance undertaking could be adversely affected if its policyholders cause more car accidents than expected, or if more winter storms than expected cause damage to the policyholders’ insured property.

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989 For a more detailed description of the risks that need to be taken into consideration for the calculation of the SCR, see Marcel Butzke, Sven Ludwig and Claudius Vievers, Die Standardformel nach Solvency II, in: Christoph Bennemann, Lutz Oechlenberg and Gerhard Stahl (eds), Handbuch Solvency II - Von der Standardformel zum Internen Modell, vom Governance-System zu den MaRisk VA (2011), pp. 46 – 55. An overview is also presented in: Maria Heep-Altiner et al., Internes Holdingmodell nach Solvency II (2011), pp. 10 – 11; de Weert, pp. 102 - 105.
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In life insurance, changes in the mortality rate may lead to higher liabilities by the life insurer, for instance because a decrease in the mortality rate could lead to longer pension payments (longevity risk). An increase in mortality, on the other hand, would affect the technical provisions for traditional life insurance policies negatively because more insurance payments will have to be made if more policyholders than expected pass away during the duration of their life insurance policy. Another underwriting risk in life insurance is the lapse risk, i.e. the risk that more policyholders than expected cancel their policy during the policy’s duration.990

Market risks are most likely to affect the asset side of the balance sheet. This comprises, inter alia, changes in the market prices of securities and real estate as well as changes in interest rates and currency rates. All of these may lead to an increase or decrease in value of the insurer’s assets.

Operational risk encompasses risk of losses arising from inadequate internal processes, external risks, legal risks and risks relating to mistakes by individual people or failure of operative systems.991 Examples could be IT failures, fraud committed by employees or hackers, accounting errors992 or an epidemic among the employees leading to delays in claims handling with negative impact on new business.

The various risks that need to be taken into consideration are specified in Articles 104 to 107 of the Solvency II Directive. The modular approach to the calculation of the SCR is usually illustrated as follows:993

990 See de Weert, p. 101, on the underwriting risks in life insurance.
991 CEIOPS, Advice to the European Commission in the Framework of the Solvency II Project on Pillar I issues - further advice, 2007, para. 5.70.
992 de Weert, p. 88.
Depending on the structure of an insurer’s insurance and asset portfolio, risks may cumulate or mitigate each other, which is taken into consideration in the calculation of the SCR.

Article 101 (3) specifies that only unexpected losses from the existing insurance business shall be taken into account. This makes sense because for the existing business, expected losses are already shown as liabilities in the technical provisions. The limitation to unexpected losses does not exist for new business expected to be written during the next twelve months. New business also needs to be taken into account, because it will generate premium income and expenses during the 12-month-period, even though it is not reflected in the solvency balance sheet at the beginning of the period. In other words, the expected losses from the new insurance business and the unexpected losses from both the existing and the new business have in common that they are not shown on the solvency balance sheet as liabilities.

An insurance undertaking with a solvency ratio of 100 % (i.e. having just enough own funds to cover the SCR), would need all own funds to cover the losses, if the (unexpected) risks provided for in the SCR materialized. The technical provisions (including their risk margin) would still be covered with assets, so that the insurance undertakings would still be able to pay policyholders’ claims, or, as CEIOPS put it, that the portfolio could still be transferred to another insurer who takes over the failed insurer’s obligations towards policyholders.994

994 CEIOPS, Advice to the European Commission in the Framework of the Solvency II Project on Pillar I issues - further advice, para. 2.21.
Figure 8.1.2 no. 2 shows the interrelation between solvency balance sheet positions and the Solvency Capital Requirement. The SCR and the Minimum Capital Requirement (MCR) need to be covered with own funds. As described in more detail in chapter 8.3.1, own funds correspond to the excess of assets over liabilities (comparable to shareholder’s equity), subordinated liabilities and certain so-called ancillary own funds. While not all own funds are on the balance sheet, the main portion is and can be compared with a company’s equity on its “ordinary” balance sheet. Even disregarding off-balance sheet own funds, one needs to bear in mind, however, that the own funds are calculated on the basis of the solvency balance sheet. Own funds are thus not entirely equivalent to shareholders’ equity in IFRS accounts.

The calculation of the SCR requires a projection of the solvency balance sheet twelve months into the future, to reflect the new insurance business to be written under the upcoming year, and a simulation, during which the balance sheet is submitted to certain stress factors, such as increases in interest rates, a rise or fall of stock prices, a rise or fall of the mortality rate. In a very simplified form, this can be illustrated as follows:

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995 Based on the illustration in paragraph 2.3 in CEIOPS’s consultation paper, ibid.
996 The kinds of assets and risks named in the illustration are not meant to be exhaustive. Operational risk is not mentioned because a capital requirement for the operational risk is added only after the simulations, see Article 103 (b) of the Solvency II Directive.
In general, one can expect that the effect of the stress test on the asset side will be that the value of assets after twelve months decreases in comparison to the beginning of the twelve months period (Figure 8.1.2 no. 3). Similarly, the liabilities will normally increase after being stressed (Figure 8.1.2 no. 4).

To put it very simple, one can say that the insurance undertaking is undercapitalized if the stressed liabilities exceed the stressed assets (Outcome 1 in Figure 8.1.2 no. 5) and it is just sufficiently capitalized, if the liabilities and the assets are in balance (Outcome 2).
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If the assets exceed the liabilities, the undertaking has more own funds than required (Outcome 2).

If the stress level corresponds to the confidence level of 99.5 %, the solvency ratio is 100 % in Outcome 2, i.e. the SCR is equal to the amount of the own funds at the beginning of the period.

In case of overcapitalization (Outcome 3), the SCR corresponds to the own funds in the beginning of the period minus the own funds (excess own funds) at the end of the period, the latter of which need to be discounted at the risk-free interest rate (see Figure 8.1.2 no. 6).\(^99^7\)

\(^99^7\) Cf. the formulas in Heep-Altiner et al., p. 229.
In case of undercapitalization, the SCR corresponds to the own funds at the beginning of the period plus the deficit, discounted at the risk-free interest rate. When an insurance undertaking in such a situation raises capital to close the gap, it will of course need to consider which kind of assets the additional capital shall be invested in, because this will in turn influence the SCR.

As we have seen, the SCR is calculated on the basis of a stressed solvency balance sheet. For the stress test, two methods are available: The standard formula (for solo and group SCR) and the use of an internal model.

8.1.2.1 The standard formula

The directive contains general provisions on the standard formula in Articles 103 to 111, in particular on the risks it needs to cover as a minimum requirement, and leaves the parameters to be used in the formula to be regulated at level 2 by the Commission. Accordingly, for users of the standard formula, the Commission determines which stress on their assets and liabilities insurance undertakings and groups needs to be able to cope with. This also means that the Commission implicitly determines those scenarios for which the own funds do not need to be sufficient. Users of the standard formula consequently need to be able to survive a pre-determined set of scenarios.

In roughly 140 articles plus annexes, Chapter V of the Delegated Regulation lays down the parameters and assumptions to be applied, as well as rules on the possibility to replace parameters with undertaking-specific parameters and rules on when insurance undertakings may apply the simplified calculation methods laid down in subsection 6.
Due to the complexity of the calculation methods, only a very brief description of the
standard formula can be given.

The standard formula consists of the non-life, life and health underwriting risk
modules, each with several sub-modules, a market risk module with sub-modules for
interest rate risk, equity risk, property risk, spread risk, concentration risk and currency
risk, a counterparty default risk module, an intangible risk module and an operational
risk module.

To give an example from the non-life underwriting risk module: The windstorm risk sub-module refers
to windstorm risk factors for certain regions, allocating for example risk factors of 0.09 % to Sweden
and Germany and 3.19 % to the French overseas department of Martinique, reflecting the higher risk of
tropical storms in the Caribbean. Applying these factors, undertakings then need to calculate the impact
of two different scenarios on the basic own funds, scenario A involving a sequence of two windstorms,
where a region is first hit by a windstorm leading to an instantaneous loss equal to 80 % of the specified
windstorm loss in this region and then hit by another storm leading to a loss equal to 40 %. In scenario
B the respective losses are 100 % and 20 % For each region, the capital requirement shall be equal to the
higher of the losses in basic own funds in scenarios A and B (Article 121 (2) Delegated Regulation). A
table in Annex V determines correlation coefficients for windstorm risk in the regions. For Sweden, the
correlation factor with Denmark and Norway is 0.5 and 0.0 for all other regions, meaning that
undertakings need to calculate with a 50 % probability that a windstorm hitting Sweden, also hits
Denmark or Norway. Applying these correlation factors, the capital requirement for windstorm risk for
all regions is then calculated. Similar calculation methods are laid down for hail, flood and earthquake
risk.

For man-made risks, the standard formula contains sub-formulas to calculate the capital
requirements for motor vehicle liability risk, marine risk (involving platform explosions
and tanker collisions), aviation risk, fire risk, liability risk and credit and surety risk.

The life underwriting risk module consists of sub-modules for the mortality, longevity,
disability-morbidity, life-expense, revision, laps and life catastrophe risks. For instance,
the mortality risk submodule requires undertakings to calculate the effect on the basic
own funds of an assumed permanent increase of 15 % in the mortality rates (Article 137
(1)). Concerning the longevity risk, the standard formula is based on the assumption that
the life expectancy of the insured rises with 20 % (Article 138 (1)). The correlation
coefficient for mortality and longevity is -0.25, reflecting that an increase in the mortality
rate leads to a decrease in the longevity risk and vice versa.

The health risk module consists of sub-modules concerned with premium, reserve
and lapse risks related to health insurance and a health catastrophe risk sub-module.

Concerning market risk, the standard formula requires undertakings for instance to
hold own funds to be prepared for a 22 % decrease in the value of strategic equity
investments in related undertakings listed in regulated markets in EEA and OECD
member states (Article 169 (1) (a)). For investments in such equities, provided that they
are not of a strategic nature or not in related undertakings, the capital requirement
corresponds to the effect on the basic own funds of a decrease in value of the sum of
39 % and the so-called “symmetric adjustment” (Article 169 (1) (b)). The symmetric adjustment may have a value between -10 % and +10 % and depends on the development of an equity index built by EIOPA for that purpose. In March 2018, the adjustment amounted to -0.88 %.\footnote{EIOPA Symmetric adjustment equity capital charge, March 2018.} The SCR based on the standard formula corresponds to the sum of the capital requirements of the various modules, whereby correlations between the modules have to be taken into account.

According to Article 101 (5) Solvency II Directive, insurance undertakings shall also take risk-mitigation techniques into account. The Delegated Regulation specifies under which circumstances and how risk-mitigation techniques decrease the SCR. Articles 208 to 215 explicitly mention reinsurance contracts, special purpose vehicles, financial instruments and collateral arrangements\footnote{A collateral arrangement is an arrangement where (usually) cash or financial instruments are rendered as a security.}. These arrangements may reduce the SCR or increase the available own funds, provided they meet the qualifications laid down in the Regulation.

\subsection*{8.1.2.2 Internal models}

Instead of the standard formula, insurance undertakings and holdings may apply an internal model to calculate the solo or group SCR. Internal models need to be approved by the solo or group supervisor, as the case may be (Article 112 (1) for internal models at solo level and Article 231 (1) for group internal models). Articles 120 to 125 contain requirements that a model needs to fulfill in order to be approved, among others concerning statistical quality standards. Once approval has been given, the undertaking is only allowed to revert to the standard formula with supervisory approval (Article 117).

Internal models may be full or partial models. Partial models are combined with the standard formula and may be applied to the modelling of the operational risk, to replace one or more of the risk-modules of the standard formula or to calculate the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes. In addition to that, they may be applied to the whole business or to one or more major business units (Article 112 (2)). A partial group model does not need to be applied to all subsidiaries (Article 343 (5) (iii) Delegated Regulation). Approval of a partial model requires that the SCR calculated with an internal model reflects the risk profile more appropriately than the SCR calculated with the standard formula (Article 113 (1) (b)).

Article 121 (8) Solvency II Directive allows insurance undertakings to take account of future management actions. These are decisions that are expected to be taken in certain situations, for instance concerning changes in the underwriting policies or concerning financial support for a subsidiary in need. The management actions need to be laid down in predetermined management rules. Internal models may also take into account
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diversifications effects if these can be adequately measured (Article 121 (5)). Diversification effects are dependencies between certain circumstances with a risk-mitigating effect.

For a transport insurer, an economic crisis could lead to a lower premium income due to a reduced import and export activity. If the same group had another undertaking active in motor insurance with an important portfolio in fleet insurance, a decrease in transports would lead to fewer accidents and therewith fewer insurance claims. Another example would be two group undertakings in the same territory where one would profit from an increase of interest rates whereas the other undertaking would make a loss.  

From Article 121 (1) can be implied that internal models need to generate a distribution curve. There are various ways how such a distribution curve can be generated. A common one seems to be a stochastic approach applying a so-called Monte Carlo simulation.

In this approach, the impact of thousands or even millions of different scenarios on the solvency balance sheet is simulated. The outcome consists of an equal amount of different post-simulation solvency balance sheets. In most of these balance sheets, the assets will exceed the liabilities, but in some, this will not be the case (scenarios no. 4 and no. 300 in the Figure 8.1.2.2 no. 1 below).

Results of each scenario

![Figure 8.1.2.2 no. 1](image)

As long as all of the 99.5 % best scenarios have positive results, i.e. the own funds at the end of the period suffice to cover the simulated losses, the company or group is in compliance with the SCR.

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1001 Cf. the description of the various methods with regard to internal models for banks by de Weert, pp. 83-88.
Distribution of results

Percentage of Scenarios With Positive/Negative Results

Negative result = company/group’s own funds did not suffice to cover the losses ≈ liabilities exceed assets

Positive result = company/group still has own funds at the end of the 12 month period ≈ assets exceed or are equal to

At least 99.5% of the scenarios need to have a positive result
Not more than 0.5% of the scenarios may have a negative result

Figure 8.1.2.2 no. 2

On the basis of the data in Figure 8.1.2.2 no. 1, a distribution curve can be generated, showing the distribution of the own funds after simulation.

Distribution curve

Figure 8.1.2.2 no. 3

If in the example in Figure 8.1.2.2 no. 3 above\textsuperscript{1002}, the probability for a solvency balance sheet with more liabilities than assets is equal to 0.5 %, the undertaking’s own funds at

\textsuperscript{1002} Based on Heep-Altiner et al., p. 66. See also de Weert, p. 85.
the beginning of the 12-month period cover exactly its SCR.\textsuperscript{1003} In other words, if 100,000 scenarios are applied, those 499 scenarios with the worst results can be disregarded, because they have a statistical probability of less than 0.5%. In the remaining 99,501 scenarios, the own funds of the undertaking must be sufficient to cover the losses at the end of the period. This presupposes, of course, that the scenarios applied have a sufficiently high quality.

It is also important to understand that with such a model, it is impossible to say beforehand, which scenarios an undertaking needs to be able to cope with. For undertaking A, for instance, a certain scenario might belong to the worst 0.5%, and therefore, it could become insolvent if this scenario became true, whereas undertaking B would survive this scenario, but might get insolvent in another scenario that A would survive.

During the approval process for internal models, insurance undertakings will have to show that the internal model is used not only for calculating capital requirements, but also that it is an important tool in the undertakings or groups risk management process. For instance, the effects of important business decisions on the solvency capital need to be simulated before a decision is taken. This requirement is referred to as the “use-test” (Article 120).

\subsection*{8.1.2.3 On the impact of reinsurance on the SCR}

Insurance undertakings have several reasons to reinsure their insurance policies. Reinsurance reduces an insurer’s claims risk because it passes on a portion of the risk to the reinsurer and thereby also achieves a smoothing effect on its profit and loss statement.\textsuperscript{1004} The risk reduction also has the effect that the insurer increases its capacity to write insurance business, by being able to increase volume or to write types or sizes of risk that it would not be able to cover without reinsurance.\textsuperscript{1005} This effect can be achieved because reinsurance has a positive effect on the solvency capital requirement, i.e. the insurance undertaking needs less own funds compared to a situation without reinsurance.

In the following, a short overview over the most important forms of reinsurance are given, leaving out the complex area of finite risk deals (financial reinsurance) which - depending on their exact structure - may have a predominant financing function (often with the reinsurer financing a newly started insurance undertaking) and lack a sufficient risk transfer. In that case, they are treated as a loan rather than reinsurance for accounting purposes.

\textsuperscript{1003} In this example, again, the fact that the undertaking may have off-balance sheet ancillary own funds is disregarded.
\textsuperscript{1004} Colin Edelman QC and Andrew Burns, The Law of Reinsurance (2\textsuperscript{nd} edn 2013), para. 1.09.
\textsuperscript{1005} Ibid, para. 1.10.
Reinsurance contracts are divided into two pairs of categories: facultative v. treaty, and proportional v. non-proportional reinsurance. Treaty or obligatory reinsurance means reinsurance cover for a specified portfolio of insurance policies, for instance all personal accident insurance policies. A treaty reinsurance contract defines the classes of risks to be encompassed as well as their features (e.g. their terms and conditions, premiums and maximum insurance sum) and covers all insurance policies falling under the definition, including those that are underwritten or renewed during an agreed period in the future (usually twelve months). All insurance policies falling under the definition are automatically reinsured, i.e. the reinsurer does not have the right to refuse payment from the reinsurance contract. For the insurance undertaking, treaty reinsurance has the advantage that it does not have to negotiate reinsurance for every single insurance policy, thus reducing administrative costs, and that it can rely on having reinsurance cover when accepting a risk.

Facultative reinsurance means reinsurance cover for a particular insurance policy. It has to be bought separately for each policy and, of course, the reinsurer has the right not to accept the risk. An insurance undertaking may buy facultative reinsurance for a risk that is not covered by treaty reinsurance, for instance because it is too large or falls into a class of insurance not covered by treaty protection, or in order to be able to accept a risk that it would otherwise not be able to accept according to its underwriting guidelines. There is also a hybrid form called facultative obligatory reinsurance or open cover, giving the reinsured the option to cede certain risks to the reinsurer.

Both facultative and treaty reinsurance can be proportional or non-proportional. Proportional reinsurance means that the reinsurer receives a certain proportion of the premium (less commission to cover for the insurer’s acquisition and servicing costs) for the reinsured policy or policies and bears a corresponding amount of the losses.

An example could be a 30 % quota share treaty where the reinsurer pays 30 % of the claims arising out of the reinsured portfolio and receives 30 % of the premium less commission (which may be as high as 40 %). In the example, the reinsured thus keeps a retention of 70 % on the portfolio. In a surplus treaty - somewhat simplified - a fixed amount is kept as the insurer’s retention and only risks larger than the retention are reinsured with a quota corresponding to how much the risk (expressed for instance as

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1006 The terminology varies. The English literature consulted uses the term "treaty reinsurance" whereas Swiss Re applies the term "obligatory reinsurance" and speaks of both facultative and obligatory reinsurance treaties. For the terminology used by Swiss Re, see Christoph Bugmann, Swiss Re, Proportional and non-proportional reinsurance, 1997, p. 6. In the following, the English terminology is used.
1007 Edelman QC and Burns, para. 1.50.
1009 Edelman QC and Burns, para. 1.71.
1010 Cave, p. 17.
1011 Edelman QC and Burns, para. 1.51.
1012 See the example in Cave, p. 17. It is important to note that quota share reinsurance treaties also concern a maximum risk covered by the reinsurer, see Bugmann, p. 8.
1013 See Bugmann, p. 8.
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sum insured or probable maximum loss)\textsuperscript{1014} exceeds the retention.\textsuperscript{1015} If the retention is 100,000 EUR (sum insured), all insurance policies with a sum insured below 100,000 EUR are not reinsured. If, for instance, an insurance policy with an insurance sum of 150,000 EUR is reinsured with a quota of 66.7% under the surplus reinsurance treaty, the reinsurer receives 66.7% of the premiums (less commission) and bears 66.7% of the losses under the policy.\textsuperscript{1016}

Non-proportional reinsurance (also called “excess of loss”)\textsuperscript{1017} works in such a way that the reinsurer assumes liability only for losses that exceed a predetermined limit.

An example would be a facultative non-proportional reinsurance contract with a retention of two million EUR. If a loss of 1.9 million EUR occurs, the insurer does not receive any payment out of the reinsurance contract. If a loss of 15 million EUR occurs, the reinsurer has to pay 13 million EUR to the reinsured (provided that the maximum limit in the reinsurance contract is higher than 15 million EUR). Other forms are so-called “stop loss” reinsurance contracts, where the reinsurer covers losses on a portfolio above a predetermined loss ratio, for instance an annual loss ratio of 110% (losses divided with net premium income).\textsuperscript{1018}

Insurance undertakings usually combine several forms of reinsurance in a reinsurance program with the aim of limiting fluctuations in the results. Reinsurers in turn purchase reinsurance cover, so-called “retrocession”.

In order to work properly, reinsurance requires that the terms and conditions of the insurance policies covered by the reinsurance contract are incorporated into the latter, so that the reinsurer’s liability runs parallel to the insurer’s, i.e. that a loss under an insurance policy also constitutes a loss under the reinsurance contract.\textsuperscript{1019}

Since the reinsurance contract does not affect the insurance undertaking’s obligations towards its policyholders, the insurance undertaking bears a counterparty risk if the reinsurer falls insolvent. Insurers therefore need to carefully select their reinsurers. Reinsurance undertakings registered in a member state of the EU also fall under the Solvency II Directive, including the authorization requirements. Also primary insurance undertakings may be licenced to write reinsurance, but they are in that case not licenced as reinsurers but as primary insurers with the authorization to write direct and/or indirect insurance in particular insurance classes.

In a primary insurer’s solvency balance sheet, already existing reinsurance recoverables are shown as reinsurance assets, but the future cash flows from reinsurance contracts are also taken into consideration in the calculation of the technical reserves (see

\textsuperscript{1014} Cave, p. 40.
\textsuperscript{1016} Cf the example in Bugmann, p. 11.
\textsuperscript{1017} Munich Reinsurance America, p. 22.
\textsuperscript{1018} So-called “excess of loss cover”. Another form is an “aggregate excess of loss” cover, see Edelman QC and Burns, paras. 1.66 – 1.70.
\textsuperscript{1019} So-called “back-to-back cover”. For proportional reinsurance, there is a presumption of back-to-back cover in English law, whereas non-proportional reinsurance requires an incorporation clause, see ibid para. 3.28. Often, reinsurance contracts also contain “follow the settlement” clauses, “precluding the reinsurer from requiring the reinsured to prove that it was in fact liable under the original policy”, ibid, para. 4.47.
Article 41 Delegated Regulation). Under certain circumstances, even future cash-flows are recognized from reinsurance contracts that are not yet in existence, but are intended to replace existing reinsurance contracts.\footnote{EIOPA, Guidelines on the valuation of technical provisions, 2 February 2015, Guideline 78.} However, Article 42 (4) Delegated Regulation requires insurers to adjust reinsurance recoverables for the counterparty default risk, with a quota of at least 50 % “[…] unless there is a reliable basis for another assessment”. With a careful selection of reinsurers, however, insurers should be able to significantly lower the adjustment ratio.

Thus, reinsurance has a mitigating effect on an insurer’s SCR, because the technical provisions both in the opening Solvency II balance sheet and in the projected stressed balance sheet are lower compared to a situation without reinsurance. If the insurer applies the standard formula, reinsurance contracts are recognized as risk-mitigating factors in the non-life, life and health insurance underwriting risk modules (see Article 208 (1) Delegated Regulation) and in the counterparty credit risk module (see Article 196), provided the requirements set up in the Regulation are met. For instance, the reinsurer must comply with its own SCR, or, in case of a reinsurer outside the EEA, be subject to a solvency regime deemed equivalent to Solvency II.

8.1.3 Own funds

Insurance undertakings and holdings must have enough own funds to cover the Solvency Capital Requirements. The Solvency II Directive distinguishes between two types of own funds: basic own funds and ancillary own funds.

8.1.3.1 Basic own funds

Basic own funds are the excess of assets over liabilities, as valued in the solvency balance sheet, reduced by the amount of own shares held by the undertaking, plus certain subordinated liabilities (Article 88 Solvency II Directive). Article 91 also mentions accumulated profits which have not been made available for distribution to policyholders and beneficiaries. If these accumulated profits according to national law do not have to be considered as insurance liabilities, they also classify as own funds (so-called surplus funds, överskottsmedel in Swedish and Überschussfond in German) provided they fulfill the requirements set out in Article 94 (1), mainly permanent availability and subordination. Otherwise, they have to be shown as a liability on the solvency balance sheet. If they are recognized as own funds, they belong to the basic own funds.\footnote{Cf. Article 69 (a) (iv) Delegated Regulation, which lists surplus funds among basic own funds.}

According to the Swedish expert committee for the implementation of Solvency II, the provision is relevant for the consolidation reserve (konsolideringsfond) in Swedish life insurance mutuals and life insurance companies that are operated on a mutual basis, i.e.
that are not allowed to distribute dividends to their shareholders.\textsuperscript{1022} The expert committee recommended to insert an explicit provision in the FRL to this effect.\textsuperscript{1023} The Swedish legislator, however, did not see a need for an explicit provision. According to the preparatory works, the consolidation fund is considered a basic own fund item.\textsuperscript{1024} For German insurance companies, § 93 VAG 2016 states that the part of the provision for rebates (\textit{Rückstellung für Beitragsrückerstattung}) that may be used to cover losses and does not represent any credited bonus amounts, shall be eligible as own funds. This concerns German life insurance undertakings, undertakings conducting substitutive health insurance\textsuperscript{1025} and those that offer accident insurance with premium refunds.

8.1.3.2 Ancillary own funds

Ancillary own funds are defined as “other than basic own funds which can be called up to absorb losses” (Article 89 (1)). Paragraph 1 then lists three sorts of items funds that may qualify as ancillary own funds:

1. uncalled unpaid share capital
2. letters of credit and guarantees
3. other legally binding commitments received by the insurance undertaking.

For mutual or mutual-type associations with variable contributions, a fourth category is mentioned:

4. “[…] any future claims that the association may have against its members by way of a call for supplementary contribution, within the following 12 months”.

Given the wording of Article 89 (1) and the broadness of the third category, the list needs to be understood as being exhaustive. Ancillary own funds have in common that they are off-balance sheet items.\textsuperscript{1026} Uncalled unpaid share capital arises if the issued shares of a company are not fully paid in. Whereas the ABL does not allow partly paid-in shares, these are relatively common among German insurance undertakings, because § 36a AktG only requires shares to be paid in by 25 % of their nominal amount plus premium. Shareholders holding partly paid-in shares need to pay in the remaining amount as soon

\textsuperscript{1022} SOU 2011:68 Rörelsereglering för försäkring och tjänstepension, Betänkande av Solvens II-utredningen, Del 1, p. 148.
\textsuperscript{1023} Ibid.
\textsuperscript{1024} Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, pp. 248 f.
\textsuperscript{1025} Substitutive health insurance is such health insurance that is suitable as a full or partial substitute for statutory health insurance, § 146 VAG 2016. Substitutive health insurance needs to be operated in accordance with the principles for life insurance.
\textsuperscript{1026} Lu Wang, The Implications of Solvency II on Insurance Undertakings (2013), p. 3.
as the management of the company demands payment. § 182 (4) sentence 1 AktG in principle does not allow corporations to increase their share capital as long as not all issued shares are fully paid in. According to sentence 2, however, insurance companies are allowed to increase their capital even if there are shares that have only partly been paid-in. The only legal requirement is that the articles of association of the undertaking provide for this possibility. The rationale behind the exception is that insurance undertakings in general do not need to have the entire share capital as liquid capital, but often only need it for regulatory purposes. Unpaid share capital needs to be deducted from the issued share capital on the IFRS balance sheet, i.e. it is not recognized as equity.\textsuperscript{1027} As long as the company has not requested its shareholders to pay in outstanding share capital (“uncalled share capital”), it is no allowed to show it as a receivable on the asset side either.\textsuperscript{1028}

Article 90 requires the amounts of ancillary own funds to be approved by the supervisor according to criteria such as the ability of the item to absorb losses in the insurance undertaking, the ability and willingness of the counterparty to pay and the recoverability of the own funds. The criteria are further specified in Articles 62 - 67 Delegated Regulation.

### 8.1.3.3 Tiering

Both basic own funds and ancillary own funds are classified into three tiers, with tier 1 items having the highest and tier 3 the lowest quality. According to Article 98 Solvency II Directive, quantitative limits for tier 2 and tier 3 own funds shall apply in order to ensure that the SCR is covered with not less than one third tier 1 own funds and not more than one third of tier 3 own funds. For the MCR, the limit must require more than 50 % to be covered by tier 1 own funds. Tier 3 own funds are not eligible to cover the MCR. Article 99 empowers the Commission to adopt delegated acts laying down the quantitative limits, which it has made use of with Article 82 Delegated Regulation. In this provision, stricter limits are set, requiring at least 40 % of the SCR with tier 1 own funds and not more than 15 % with tier 3 own funds. At least 80 % of the MCR need to be covered with tier 1 own funds.

The Swedish and the German wordings of Article 98 leave some doubt as to whether the provision allows for different limits,\textsuperscript{1029} which may explain why §§ 94, 95 VAG 2016 formulates the same limits as

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\textsuperscript{1027} Wiley IFRS 2016: , chapter 16, p. 373.
\textsuperscript{1028} Until the accounting reform of 2009, in the course of which § 272 (1) HGB was amended by the Bilanzrechtsmodernisierungsgesetz, German GAAP recognized uncalled capital as an asset, see Merkt in: Baumbach/Hopt, HGB, § 272 para. 2.
\textsuperscript{1029} The first sentence of Article 98 (1) of the Swedish version has the following wording: "I fråga om efterlevnanden av solvenskapitalkravet ska följande gränsvärden gäller för de medräkningsbara beloppen av posterna på nivå 2 och 3." The German version of Article 98 (2) lacks an expression corresponding to "as a minimum" in the English version: "[...] Diese Begrenzungen müssen sicherstellen, dass der Anteil der “Tier-1-
provided in the Directive, without opening for stricter limits at level 2. The Swedish expert committee noted that the Commission has proposed stricter limits, but did not comment on whether it regards this as being covered by the delegation norm. In chapter 7 § 11 FRL 2016, also the Swedish legislator has laid down the same limits as in the Directive. The English, Spanish and French versions of Article 98 on the other hand make relatively clear that the Commission is not hindered from setting stricter limits. From a socio-political perspective, one may question whether it is appropriate to implement stricter standards at level 2 without first having a few years of experience with the limits set in the directive, also considering that insurance undertakings had to start their preparations for Solvency II before the level 2 provisions are in place. Against this can be argued that with the delay of the implementation of Solvency II and, above all, the transitional provisions in Article 308b (9) and (19) introduced by the Omnibus II Directive, the insurance industry has enough time to accommodate to the stricter limits. These transitional provisions allow own-fund items to continue to count as tier 1 or tier 2 for a transitional period of 10 years after implementation of Solvency II, provided they were issued before 2016 and on 31 December 2015 were eligible to cover the available solvency margin according to the Solvency I rules.

Article 93 Solvency II Directive lists criteria that have to be taken into account for a correct classification. According to Article 94 in connection with Article 93, only basic own fund items that fulfill the criteria of permanent availability and subordination qualify as tier 1. Permanent availability means that the item is readily available, or can be called up on demand to fully absorb losses, both in a situation where the insurance undertaking is continuing business and where it is being wound up. Subordination refers to items that need to be repaid to creditors and means that repayment may be refused until all other obligations, including insurance obligations have been met. Permanent availability may be problematic if the own fund consists of a receivable against another party (for instance a shareholder) and thus first has to be called up by the undertaking, or if it is a subordinated liability that may or needs to be repaid to the creditor in the nearer future. Subordinated liabilities, also called hybrid capital, often consist of subordinated bonds which form an important financing source for insurance undertakings.

Article 71 Delegated Regulation specifies the features tier 1 own funds need to have. Corresponding provision for tier 2 items can be found in Articles 73 (basic tier 2) and 75 (ancillary tier 2) and for tier 3 in Articles 77 (basic tier 3) and 78 (ancillary tier 3). For all three tiers (and therefore for all own funds) applies that they may not include features

Bestandteile” an den anrechnungsfähigen Basiseigenmitteln über der Hälfte des Gesamtbetrags der anrechnungsfähigen Basiseigenmittel liegt.”

1030 SOU 2011:68 Rörelsereglering för försäkring och tjänstepension, Betänkande av Solvens II-utredningen, Del 1, p. 269.

1031 Article 98 (1) and (2) of the English version has the following wording: “1. As far as the compliance with the Solvency Capital Requirement is concerned, the eligible amounts of Tier 2 and Tier 3 items shall be subject to quantitative limits. Those limits shall be such as to ensure that at least the following conditions are met […]

2. As far as compliance with the Minimum Capital Requirement is concerned, the amount of basic own-fund items eligible to cover the Minimum Capital Requirement which are classified in Tier 2 shall be subject to quantitative limits. Those limits shall be such as to ensure, as a minimum, that the proportion of Tier 1 items in the eligible own basic own funds is higher than one half of the total amount of eligible basic own funds.”

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that may cause or accelerate the insolvency of the insurance undertaking, that they need to rank below the claims of all policyholders, beneficiaries and non-subordinated creditors and that they may not be repaid or redeemed if the undertaking is in breach of its SCR or if the repayment would lead to non-compliance with the SCR. These criteria are particularly relevant for subordinated liabilities which need to be designed in such a way that the creditors may not apply for insolvency if the insurance undertaking fails to pay the interest rates, for example, if they are supposed to qualify as own funds.

Article 69 Delegated Regulation lists certain items that are “deemed to possess these characteristics” provided they fulfil the specifications laid down in Article 71: Paid-in share capital, paid-in members’ contributions in the case of mutuals, surplus funds qualifying as own funds, paid-in preference shares, the share premium accounts relating to paid-in shares and preference shares, paid-in subordinated liabilities, and a reconciliation reserve.

The reconciliation reserve is not mentioned in the Solvency II Directive and is defined in Article 70 Delegated Regulation as an amount equalling the excess of assets over liabilities reduced by a number of positions, such as own shares, foreseeable dividends, own fund items, participations in financial and credit institutions and so-called restricted own funds exceeding the “notional Solvency Capital Requirement” for ring-fenced funds. The reconciliation reserve therefore constitutes a residual amount of basic own funds.

It is not entirely clear whether “deemed to possess the characteristics” is meant to mean a rebuttable or a non-rebuttable presumption.

To the criteria listed in Article 71 that tier 1 items need to fulfil, belong in general the following:

- Only basic own funds qualify.
- Immediate availability required.
- Ranks below all other claims, or, in the case of subordinated liabilities, at least below tier 2 capital.
- In case of non-compliance with the Solvency Capital Requirement, the nominal or principal amount is written down or it is automatically reverted into paid-in share capital.
- Undated, i.e. there is no particular date when the own fund item needs to be paid back to the persons who have paid in the fund.
- The item is only repayable at the option of the insurance undertaking subject to prior approval.
- The earliest possible date for repayment lies at least five years after the issuance.
- There may be no incentives to repay, which excludes subordinated liabilities with step-up interest, i.e. mechanisms where the obligor is obliged to pay a higher interest rate after a certain number of years.
• The undertaking is entitled to cancel distributions (i.e. the payment of dividends or interest) if it does not comply with the SCR or the distribution would lead to non-compliance with the SCR.
• Distributions may only be paid out of distributable items and insurance undertakings may not be obliged to make distributions.

Many of the criteria are obviously concerned with subordinated liabilities and my impression is that it will be difficult in the future for insurance undertakings to successfully raise subordinated capital that will classify as tier 1.1032

For basic tier 2 own funds, the criteria listed in Article 73 are, of course, a bit less strict. For instance, tier 2 items do not need to be undated. Instead, it suffices if they have an original maturity of at least 10 years. They may also include limited incentives to repay or redeem the item before the maturity date, provided that these incentives do not occur before 10 years after issuance.

The list of possible basic tier 2 own funds in Article 72 lists the same items as the list for tier 1 items, with the exception of surplus funds and the reconciliation reserve, and with the exception that shares and members’ contributions do not need to have been paid in. Whereas ancillary own funds cannot qualify as tier 1, Article 74 lists ancillary own fund items that qualify as tier 2, if they will comply with the features laid down for tier 1 items after they will have been called up and paid in. Ancillary own funds that do not qualify as tier 2, are automatically classified as tier 3 (Article 78).

The list over basic tier 3 items in Article 76 comprises subordinated mutual member accounts, preference shares and the related share premium account, and subordinated liabilities. They have to fulfil the criteria laid down in Article 77, among others a maturity of at least five years. When the insurance undertaking is in breach of the MCR or a distribution (for instance interest payments to holders of a subordinated bond) would lead to a breach, the item must provide for a deferral of the distribution. Other items not appearing in any of the three lists of items only qualify as own funds if they comply with the criteria for tier 1, tier 2 or tier 3 items and if they have been approved by the supervisory authority (Article 79). Net deferred tax assets classify as tier 3 without having to comply with the criteria laid down in Article 77.

Article 97 (1) Solvency II Directive asks the Commission to adopt delegated acts “[…] laying down a list of own-fund items […] deemed to fulfil the criteria, set out in Article 94, which contains for each own-fund item a precise description of the features which determined its classification”. This wording leaves the reader with the impression that the Commission was supposed to clearly determine how certain items have to be classified and to motivate for each listed item why it was sorted into tier 1, tier 2 or tier 3. If it was the legislator’s intention that the Delegated Acts should be applied as a reference

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1032 Subordinated debt that has been issued before 2016 can be recognized as tier 1 until 2026 on the basis of transitional rules, even if it does not meet all requirements for tier 1 subordinated debt (“grandfathering”).
list where supervisors and insurance undertakings easily could look up whether a certain item falls under tier 1, 2 or 3, however, the Delegated Regulation does not meet these expectations. Rather, supervisors and insurers have to check for each item whether it has the required features. Obviously, the task of classifying own funds is considerably more complicated than it seems at a first sight.

The notion of own funds is complex because it combines an economic balance sheet definition with legal aspects. On the one hand, basic own funds are calculated on the basis of the balance sheets as the difference between assets and liabilities, but on the other hand, many legal features determine whether they fall under tier 1, 2, or 3. Ancillary own funds, to the contrary, are not defined by balance sheet positions but by legal characteristics.

8.2 The group Solvency Capital Requirement

As mentioned above, insurance groups need to fulfil a group Solvency Capital Requirement (group SCR), whereas the obligation to cover a Minimum Capital Requirement (MCR) with own funds only exists at solo, but not at group level.

8.2.1 The two methods for calculating the group SCR

The Solvency II Directive allows for two alternative methods to calculate the group Solvency Capital Requirement: The accounting-consolidation based method according to Article 230, or the deduction and aggregation method according to Article 233. According to Article 220 (2), normally, the consolidation method shall be used, whereas the deduction and aggregation method is reserved for exceptional cases where the consolidation method is inappropriate, upon decision of the group supervisor that is required to take a number of criteria laid down in Article 328 (1) Delegated Regulation into consideration.

A situation where the D&A method usually is approved by Finansinspektionen as group supervisor is with regard to a subsidiary that is a life insurance undertaking that is operated on a mutual basis, i.e. a life insurance undertaking that is not allowed to distribute profits to its shareholders. BaFin mentions the possibility to apply for the D&A method for the group solvency calculation of horizontal groups, but points out that it generally supports a wide application of the consolidation method.

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1033 See, for instance, Finansinspektionen, FI Dnr 15-9677, Beslut att ge Länsförsäkringar AB tillstånd att inkludera Länsförsäkringar Liv Försäkringsaktiebolag med sammanläggnings- och avräkningsmetoden, 21 December 2015; Finansinspektionen, FI Dnr 15-15845, Beslut att ge Folksam ömsesidig livförsäkring tillstånd att inkludera KPA Livförsäkring med sammanläggnings- och avräkningsmetoden, 21 December 2015; Finansinspektionen, FI Dnr 16-7761, Beslut att ge SEB Life and Pension Holding AB tillstånd att inkludera Gamla Livförsäkringsaktiebolaget SEB Trygg Liv med sammanläggnings- och avräkningsmetoden, 9 June 2016. KPA Livförsäkring is a partly-owned subsidiary; the other hybrid insurers are wholly-owned.

With the deduction and aggregation method, the group SCR is simply calculated as the sum of the SCR of the parent undertaking and the proportional share of the SCR of the related insurance undertakings (Article 233 (3) Solvency II Directive). The same applies to the group own funds.

### Deduction and aggregation method

<table>
<thead>
<tr>
<th>Insurance undertaking</th>
<th>SCR solo: 100</th>
<th>OF solo: 120</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ultimate parent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subsidiary 1</td>
<td>SCR solo: 100</td>
<td>OF solo: 300</td>
</tr>
<tr>
<td>Subsidiary 2</td>
<td>SCR solo: 300</td>
<td>OF solo: 500</td>
</tr>
<tr>
<td>Subsidiary 3</td>
<td>SCR solo: 100</td>
<td>OF solo: 150</td>
</tr>
<tr>
<td>Subsidiary 4</td>
<td>SCR solo: 100</td>
<td>OF solo: 120</td>
</tr>
<tr>
<td>Subsidiary 5</td>
<td>SCR solo: 100</td>
<td>OF solo: 140</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>100 %</th>
<th>60 %</th>
<th>30 %</th>
<th>100 %</th>
<th>100 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group SCR</td>
<td>= 100 + 100 + 60%*300 + 30%*100 + 100 + 100 = 610</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group Own funds</td>
<td>= 120 + 300 + 60%*500 + 30%*150 + 120 + 140 = 745</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 8.2.1 no. 1

The example for the application of the deduction and aggregation method in Figure 8.2.1 no. 1 presupposes that there are no intra-group transactions between the undertakings, since these have to be eliminated even when calculating the own funds according to this method.\(^\text{1035}\)

For the consolidation method, Article 230 (1) refers to the rules for the calculation of the solo SCR in Articles 100 to 127. In principle, what has been said above on the solo SCR, consequently also applies to the group SCR, with the difference that the calculation is based on a consolidated solvency balance sheet where all intra-group transactions have been eliminated. Accordingly, also the group SCR shall reflect a confidence level of 99.5 %, i.e. only with a probability of 0.5 %, the group’s entire own funds will be consumed after a 12 months period. According to Article 230 (2), the group SCR may not be lower than the sum of the MCR of the parent undertaking and the “proportional share” of the MCR of the related undertakings. For the calculation of the “proportional share”, it is arguably necessary to apply the same consolidation method as applied in the consolidated accounts in order to achieve coherency. The sum of the MCRs of the group undertakings thus forms a floor for the group SCR.

The calculation of the group Solvency Capital Requirement (SCR) presupposes that the assets and liabilities of all relevant group undertakings in the consolidated solvency

\(^{1035}\) Butzke, Ludwig and Vievers, p. 58.
balance sheet are considered in an appropriate way. This does not only require rules on an appropriate valuation of assets and liabilities – which lie outside the scope of this study – but also on how to take group undertakings into account. An equally important question is how group undertakings’ own funds count for covering the group SCR. The consolidation methods are discussed in the following chapter.

An important difference between the deduction and aggregation method and the consolidation method is that diversification effects between the group undertakings only are recognized with the consolidation method. These lower the group SCR compared to the sum of the solo SCRs. The group solvency calculated on the basis of the deduction and aggregation method are therefore usually lower compared to a calculation based on the consolidation method.\textsuperscript{1036}

8.2.2 Solvency II rules dealing with consolidation

Recital 101 of the Solvency II Directive refers to the “consolidated Solvency Capital Requirement for a group” which should take into account the global diversification of risks for a proper risk assessment.

However, from this one can only infer that and not how consolidation shall be done for the purposes of calculating the group solvency requirement. In the section on group solvency, the directive gets a bit more specific. Article 221 (1) deals with this issue, and since the provision gives rise to several questions, its complete wording is provided here:

\begin{quote}
\textit{“Article 221}

\textbf{Inclusion of proportional share}

1. The calculation of the group solvency shall take account of the proportional share held by the participating undertaking in its related undertakings.

For the purposes of the first subparagraph, the proportional share shall comprise either of the following:

(a) where method 1 is used, the percentages used for the establishment of the consolidated accounts; or

(b) where method 2 is used, the proportion of the subscribed capital that is held, directly or indirectly, by the participating undertaking.
\end{quote}

However, regardless of the method used, where the related undertaking is a subsidiary undertaking and does not have sufficient eligible own funds to cover its Solvency Capital Requirement, the total solvency deficit of the subsidiary shall be taken into account.

Where in the opinion of the supervisory authorities, the responsibility of the parent undertaking owning a share of the capital is strictly limited to that share of the capital, the group supervisor may nevertheless allow for the solvency deficit of the subsidiary undertaking to be taken into account on a proportional basis.”

According to the first sentence, the proportional size of the shareholding is considered important. Another observation is that the treatment of related undertakings is dependent on the method used for calculating the group SCR: Where the accounting-consolidation based method (method 1 according to the heading of Article 230 and the preferred method of consolidation in the context of the Solvency II regime) is used, the same percentages shall be used as for the establishment of the consolidated accounts. If the deduction and aggregation method (method 2 according to the heading of Article 233) is used, the proportion of the capital share held in the related undertaking shall be used.

What is meant by “consolidated accounts” is not explicitly defined in the directive, but in a different context, namely the definition of “large risks” in Article 13 (27), the directive refers to “consolidated accounts within the meaning of Directive 83/349/EEC” (Seventh Directive). As mentioned above, the Seventh Directive has been repealed in July 2013 by the New Accounting Directive. Pursuant to Article 52, all references to the Seventh Directive are considered to refer to the New Accounting Directive. The directive determines inter alia which companies need to set up consolidated financial statements and reports and contains a number of requirements that consolidated financial statements have to comply with. Whereas the Seventh Directive – like the Solvency II Directive – used the term “consolidated accounts”, the New Accounting Directive instead applies the terms “consolidated financial statements”. A fundamental change in meaning is obviously not connected with this change in terminology. There are no indications that the meaning of the term “consolidated accounts” in the Solvency II Directive is not supposed to be consistent with the usage in other EU legislation and with the normal usage of the term, so that one can conclude that the consolidated financial statements are meant. These comprise the consolidated balance sheet, consolidated profit-and-loss accounts and notes to the financial statements.1037

Article 221 (1) requires users of the consolidation method to use the same proportional share that is used for the establishment of their consolidated accounts. Article 24 (2) New Accounting Directive requires full consolidation, i.e. 100 % of the

assets and liabilities (after elimination of intra-group items) need to be taken into account. Where a subsidiary has shareholders outside the group, Article 24 (4) requires that “the amount attributable to those shares shall be shown separately in the consolidated balance sheet as non-controlling interests”. For joint ventures, Article 26 allows member states to allow or require proportional consolidation. For associated undertakings, Article 27 (1) requires consolidation at equity. Over associated associations, a shareholder exercises significant, but non-controlling influence, which is presumed with a shareholding of at least 20% (Article 2 (13)).

For consolidated accounts prepared according to IFRS, IFRS 10 requires full consolidation of subsidiaries. Consequently, when the consolidation method is used for the calculation of the group SCR, subsidiaries need to be fully consolidated, notwithstanding whether the group’s shareholding in the subsidiary amounts to 50% plus one share or to 100%.

Returning to Article 221 (1) with this result in mind, some further observations can be made. Article 221 (1) seems to contain a contradiction: On the one hand, it requires groups to take the percentage of shareholdings into account, while on the other hand requiring users of the consolidation method to fully consolidate all subsidiaries, i.e. even subsidiaries with minority shareholders. Full consolidation of a partly owned subsidiary, however, does not really take into account the proportional share held in this subsidiary. In the IFRS accounts, it is somewhat taken into account by the requirement to show the non-controlling interests separately.

8.2.2.1 Consolidation of insurance subsidiaries

The interpretation applied above according to which subsidiaries need to be fully consolidated, is confirmed by Article 335 (1) Delegated Regulation which contains specific consolidation rules. Subparagraph (a) requires full consolidation of all insurance and reinsurance undertakings, third-country insurance or reinsurance undertakings, insuring holding companies, mixed financial holding companies and ancillary services undertakings which are subsidiaries of the parent undertaking that needs to calculate the group SCR.

8.2.2.2 Consolidation of partly-owned subsidiaries with a solvency deficit

The next interesting observation is that the above-mentioned principles shall only apply if the partly owned subsidiary is sufficiently capitalized. If it is not sufficiently capitalized, i.e. if it does not have enough own funds to cover its solo SCR, Article 221 (1) Solvency II Directive requires the ultimate parent undertaking to take the total solvency deficit into account. This implies a change only for companies using the deduction and aggregation method, whereas companies using the consolidation method
already apply full consolidation of subsidiaries and therewith implicitly take the total solvency deficit into account.

The last paragraph of Article 221 (1) then gives groups an opportunity to “escape” this calculation method: If the group supervisor is of the opinion that the ultimate parent undertaking’s “responsibility” is “strictly limited” to its share of capital in the undercapitalized related company, it may allow that the solvency deficit is taken into account on a proportional basis. For users of the deduction and aggregation method, this opens an opportunity to return to the same calculation method used where the related undertaking is not in deficit. For the users of the consolidation method, it is an exception from the requirement of full consolidation. The provision is explicitly applicable regardless of the calculation method, but it is not entirely clear, how the solvency deficit of an undertaking shall be taken into account on a proportional basis when the consolidation method is applied. Guideline 10 in EIOPA’s Guidelines on group solvency uses the same expression as the directive: “[…] the own funds and the solvency capital requirement of the subsidiary should be calculated on a proportional basis instead of applying a full consolidation”.1038 While this could be understood as a reference to proportional consolidation, EIOPA explains in its comments to the guideline, that the subsidiary shall not be consolidated at all, but treated as a participation, with the result that diversification effects between the subsidiary and the rest of the group are not recognized any longer.1039

Guideline 10 also states that this opportunity shall not be applicable to users of a group internal model if the relevant undertaking is included in the model.1040 It seems doubtful whether this is an intra legem interpretation of Article 221 (1) because it is unclear on which grounds users of group internal models should be treated differently in this respect from users of the standard formula.

The guideline also contains a list of criteria which need to be fulfilled cumulatively in order to be eligible for proportional consideration according to Article 221 (1):

”[…] (a) no profit and loss transfer agreement and no guarantees, net worth maintenance agreements or other agreements of the parent undertaking or any other related undertaking providing financial support are in place;

(b) the investment in the subsidiary is not considered as a strategic investment for the parent undertaking;

(c) the parent undertaking does not benefit of any advantage from its participation in the subsidiary, where such advantage could take the form

1038 Guidelines on group solvency, EIOPA-BoS-14/181EN, guideline 10 para. 1.29.
1039 Ibid, guideline 10 para. 2.26a.
1040 Ibid, guideline 10 para. 1.25.
of intra-group transactions such as loans, reinsurance agreements or service agreements;

(d) the subsidiary is not a core component of the group's business model, in particular regarding product offering, client base, underwriting, distribution, investment strategy and management; furthermore it is not operating under the same name or brand, and there are no interlocking responsibilities at the level of the group senior management;

(e) a written agreement between the parent undertaking and the subsidiary explicitly limits the support of the parent undertaking in case of a solvency deficit to the parent undertaking’s share in the capital of that subsidiary. In addition, the subsidiary should have a strategy in place to resolve the solvency deficit, such as guarantees from minority shareholders.”

The burden of proof lies with the ultimate parent undertaking.

Criterium (a), i.e. absence of guarantees, is legitimate because such guarantees constitute legal obligations of the parent undertaking to the effect that the parent’s legal responsibility is not strictly limited to its shareholding, as required in Article 221 (1). Concerning the way of providing evidence of the non-existence of such agreements, it should suffice if the parent undertaking’s management board declares that no such obligations exist, possibly accompanied by a statement by the company’s auditors that they do not have any knowledge of any obligations of this kind. Such obligations would have to be disclosed in the parent undertaking’s annual accounts, anyway, if they existed already at the end of the preceding financial year.

The other criteria are connected to circumstances that do not lead to a legal obligation of the parent undertaking to support a subsidiary in distress. These circumstances may raise expectations that the parent undertaking will support the subsidiary even without a legal obligation, which in turn may put pressure on the parent to actually do so. That Article 221 (1) not only concerns a strict limitation of legal liability, but also covers situations that may put so much pressure on the parent undertaking that it is effectively forced to support the subsidiary, is a legitimate *intra-legem* interpretation, because the proportional consideration as an exception to full consolidation leads to a better group solvency ratio which would be misleading if a part of the own funds would have to be used to fill the gap of the subsidiary.

Another question is whether the criteria listed in the guideline are suitable to identify whether the parent’s responsibility is strictly limited or not. When interpreting the Article 221 (1), it is important to note that proportional consideration is the exception to the requirement of full consolidation of subsidiaries with a SCR deficit. Despite the

exceptional character, it is reasonable to assume that the legislator nevertheless intended the provision to be applicable in practice and not only in theory. If the requirements in the guideline for proving limitation of liability are set so high that it is almost impossible to fulfil them, the guidelines would be at least extra legem, if not contra legem.\textsuperscript{1042}

Concerning criterium (b), non-strategic investment, it is not clear how "strategic" in this context needs to be understood. The Solvency II Directive uses the term "strategic nature" of investments, without defining them. The Delegated Regulation also uses the term "strategic nature" and lists a few criteria in Article 171 for when an equity investment can be considered strategic, so that a "milder" stress is applied on the equity according to the standard formula. Since this covers even subsidiaries, the criteria may help also in identifying strategic and non-strategic subsidiaries. The criteria to be taken into consideration are

"[...] (i) the existence of a clear decisive strategy to continue holding the participation for long period;

(ii) the consistency of the strategy referred to in point (a)\textsuperscript{1043} with the main policies guiding or limiting the actions of the undertaking;

(iii) the participating undertaking's ability to continue holding the participation in the related undertaking;

(iv) the existence of a durable link;

(v) where the insurance or reinsurance participating company is part of a group, the consistency of such strategy with the main policies guiding or limiting the actions of the group."

The term “durable link” stems from Article 17 Fourth Company Law Directive (now Article 2 (2) New Accounting Directive). It does not seem as if it is used consistently, and had therefore been identified as one of the reasons leading to an inconsistent application of the Financial Conglomerates Directive.\textsuperscript{1044}

However, the starting points in the two situations – equity investment and insurance subsidiary – are different: With regard to the equity investment, the assumption is that it is non-strategic, and the participating undertaking needs to prove the strategic nature in order to be eligible to apply more favourable stress factors. With regard to an insurance subsidiary, the starting point will most often be that the subsidiary is a strategic

\textsuperscript{1042} The interpretation rule applied here is one aspect to safeguard the "effet utile" of EU law in the ECJ’s jurisdiction: Riesenhuber in: Europäische Methodenlehre, § 11 para. 42a.
\textsuperscript{1043} The reference to (a) in the wording of Article 171 (b) (ii) seems to be a mistake, as it should most probably read (ii).
participation, and the parent undertaking will have to prove that this not the case (anymore), for instance by providing documentation that it plans to sell or liquidate the distressed subsidiary. To withhold a parent undertaking the possibility laid down in the directive to resort to proportional consideration because a partly-owned subsidiary in distress is a strategic participation, would be disproportionate at least when the subsidiary in question is small.

Criterium (c) – absence of benefits of any advantage in the participation – must be understood in such a way that benefits that are the result of a “normal” coordination within a group do not preclude that the criterium may be fulfilled. It would be disproportionate, if any service agreement or reinsurance agreement on arms-length-terms between the distressed subsidiary and another group entity hindered the proportional consideration of the subsidiary, just because the agreement in some way constitutes a benefit for the parent undertaking. The rationale behind the criterium is not entirely obvious. Probably it was considered inappropriate if the parent undertaking continues to profit from any advantages connected to the subsidiary if it does not want to cover the entire solvency deficit in its group SCR.

Criterium (d) contains several subcriteria:

(i) The subsidiary may not be a “core component of the group’s business model”;

(ii) It “is not operating under the same name or brand”;

(iii) and ”there are no interlocking responsibilities at the level of the group senior management”.

That the subsidiary may not be a core component of the business model is related to the strategic character of the participation, in so far as a non-strategic participation cannot be a core component of a business model. What is a ”core” component compared to a peripheral is not entirely clear, especially if the group’s business model rests on several legs, for instance life insurance, non-life insurance and reinsurance, or differentiates between different customer groups, for instance retail customers and industrial customers. Does it depend on the size of a subsidiary (in relation to the group’s size) whether it is a core component or is it decisive that it belongs to a segment that is defined as important in the business strategy? Partly-owned subsidiaries are not very common in the insurance industry, but there are examples. Insurance undertakings operating with bankassurance (i.e. selling insurance to bank customers by using the bank’s distribution channels) are examples of insurance undertakings that may have several shareholders, one in the insurance sector and one (or more) in the banking sector. Since guideline 10 aims at providing criteria for when a parent undertaking’s liability is strictly limited to its shareholding, the criteria in guideline 10 may not go farther than what is necessary to establish such conviction. The question needs to be when a partly-owned subsidiary is
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central to the group to such an extent that the public may have legitimate expectations – as opposed to a mere hope that is usually placed on the majority owner – that the parent undertaking will inject own funds into the subsidiary. These expectations need to be strong in such a sense that their disappointment would have severe negative consequences for the group, for instance in the form of difficulties in raising finance in the future or in a massive reduction of new business. For this reason, the factors mentioned in the guideline that the subsidiary is not a core component "in particular regarding product offering, client base, underwriting, distribution, investment strategy and management” must be interpreted narrowly.

Probably more important for the public’s expectations is the use of the same brand or name as the parent undertaking or another group undertaking. Especially retail customers often do not distinguish between different legal entities if they are using similar names. Corporate customers will probably be less likely to confuse subsidiaries or to expect a parent to support a subsidiary just because it uses the same brand, especially if the subsidiary is only partly-owned. The use of the same brand should therefore not be an absolute hindrance to applying proportional consideration.

"Interlocking responsibilities at the level of senior management” is another criterium that hinders proportional consideration. The wording is not quite clear neither in the English, Swedish1045, German1046 nor French1047 versions. Probably, the provision means that the senior management of the subsidiary must consist of other individuals than the senior management of the parent undertaking. Here again, it is not clear whether all management members must be different, so that already an overlap with one person is supposed to lead to non-fulfilment of the criterium, or whether it suffices if the majority is different.

The last criterium (e) requires a written agreement between the parent undertaking and the subsidiary that ”explicitly limits the support of the parent undertaking in case of a solvency deficit to the parent undertaking’s share in the capital of that subsidiary”. Such an agreement actually widens the parent’s responsibility rather than limiting it, because the starting point is that the parent undertaking does not have any obligation at all to support a subsidiary in distress. If the parent undertaking and the subsidiary enter into such an agreement, the parent undertaking therefore promises more than what it is legally obliged to, but at the same time binds itself not to give more support than promised. It is doubtful that parent undertakings and subsidiaries ever enter into such agreements. For the subsidiary, such an agreement is attractive on the one hand, because it gives certainty that a SCR deficit will at least partly be remedied by the parent undertaking, but it is negative in such sense that the parent undertaking binds itself not to provide more support, even if this would be commercially desirable. For the parent

1045 “[…] det finns inga samverkande ansvar på gruppnivå för ledande befattningshavare”.
1046 “[…] es bestehen keine Zuständigkeitsüberschneidungen auf Ebene der Geschäftsleitung der Gruppe”.
1047 “[…] la filiale […] n'a pas de responsabilités conjointes au niveau de la direction supérieure du groupe”.

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undertaking, such an agreement would probably only be acceptable if it is combined with a number of conditions, such as financial limits and a limited duration, which risk that the agreement will be deemed insufficient to fulfil the criterium. Also, it is not clear whether a subsidiary that fulfils all the other criteria will have to be fully consolidated if the parent undertaking does not provide any support at all. One could imagine that the parent undertaking plans to take in another investor who is willing to inject the necessary capital rather than injecting capital itself, and therefore would be reluctant to enter into a support agreement. Critierium (e) further expects the subsidiary to have a strategy in place how to remedy the solvency deficit, for instance through guarantees by minority shareholders. This criterium is formulated less strict than the other ones (“should have a strategy”), which indicates that it may be deviated from.

Taken together, the criteria are unnecessarily burdensome for the parent undertaking. There is a considerable risk that parent undertakings are deprived of the possibility to use proportional consideration provided in Article 221 (2) Solvency II Directive, even though their legal responsibility is actually limited to their capital share in the subsidiary.

Even though EIOPA’s attempt to limit the applicability of proportional consideration are in parts at least extra legem, it is understandable. Article 221 fits poorly into the concept of the calculation of the group SCR and it is inconsistent to require or allow groups to change the way a subsidiary is taken into consideration just because the subsidiary’s SCR is no longer covered with own funds. In those cases where a group may switch from full consolidation to proportional consideration, the group SCR will decrease and the group solvency ratio increases compared to continued full consolidation. Unless the group solvency ratio also is in distress, this will in turn result in an increase of distributable means to the benefit of the parent undertaking’s shareholders.

8.2.2.3 Consolidation of jointly controlled undertakings

According to Article 335 (1) (c) Delegated Regulation, undertakings that are managed by a group undertaking together with another undertaking outside the group need to be consolidated proportionally, provided that the liability of the managing undertakings is limited to the share of the capital they hold. This corresponds to Article 26 New Accounting Directive and applies to jointly controlled operations. With proportional consolidation, a percentage of the participation’s assets and liabilities corresponding to the group undertaking’s share in the participation is included in the consolidated accounts. IAS 31 allowed undertakings to choose between proportional or equity consolidation of a jointly controlled operation. However, the new standard IFRS 11 has eliminated this option in favour of equity consolidation. According to the EU’s
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regulation endorsing IFRS 11, the amended standard must be applied for accounting periods beginning on 1 January 2016 or later.\textsuperscript{1048}

8.2.2.4 Consolidation of special purpose vehicles

Those special purpose vehicles that are not excluded from the scope of the group solvency calculation need to be consolidated in full (Article 335 (b) Delegated Regulation).

8.2.2.5 Treatment of credit institutions etc.

Article 335 (1) (e) Delegated Regulation provides that holdings in credit institutions, investment firms and financial institutions and a few other types of entities\textsuperscript{1049} that have to comply with sectoral capital requirement rules, shall be taken into consideration with the proportional share of their own funds as calculated by the respective applicable sectoral rules. Correspondingly, a proportional share of the capital requirements of such undertakings is added to the group SCR (Article 336 (c) Delegated Regulation). This applies to related undertakings, notwithstanding whether they are participations or subsidiaries.

Consequently, subsidiaries that have to fulfil capital requirements according to other sectoral rules are treated differently from insurance subsidiaries, because they are considered only proportionally. Furthermore, no distinction is made between such subsidiaries that fulfil their capital requirements and those that have a capital deficit, since Article 221 (1) only applies to subsidiaries that do not meet the SCR, but not to those that do not meet capital requirements in other financial sectors.

The treatment of related undertakings falling under other sectoral rules means in fact that such undertakings do not need to be consolidated, which constitutes another divergence from IFRS group accounting. IFRS requires either full consolidation in the case of subsidiaries, or consideration at equity in the case of participations. The European insurance industry lobby organization CEA (now: Insurance Europe) advocated a closer alignment to group accounting by allowing group accounts based on national GAAP in certain cases to form the basis for the group SCR calculations, and criticized the treatment of e.g. banks as leading to “a completely different balance sheet and a huge administrative burden [… not] reflective of the way risk management of the group is undertaken”.\textsuperscript{1050}


\textsuperscript{1049} Namely alternative investment fund managers, UCITS management companies, institutions for occupational retirement provision, and non-regulated undertakings carrying out financial activities.

\textsuperscript{1050} CEA, Position Paper - Essential adjustments for the success of Solvency II for groups, 28 October 2011, p. 3.
8.2.2.6 Consolidation of other related undertakings

Other related undertakings need to be taken into account with the “adjusted equity method” defined in Article 13 (3) Delegated Regulation as a value based on an undertaking’s share in the excess of assets over liabilities of the related undertaking. In contrast to full or proportional consolidation, the related undertaking is not consolidated with all its different balance sheet positions, but with one value, i.e. with the result of a calculation exercise, that is shown as an asset on the consolidated balance sheet. The adjusted equity method corresponds roughly to the equity method according to IFRS with an important difference: IAS 28 para. 10 prescribes an initial valuation at cost which is during the following years increased or reduced with the undertaking’s share in the profit or loss. In contrast to that, Article 13 (4) Delegated Regulation requires undertakings to calculate the excess of assets over liabilities based on the fair-value valuation principles laid down in Articles 75 to 85 of the Solvency II Directive. Paragraph 5, however, allows equity valuation according to IFRS for non-insurance undertakings if valuation of individual assets and liabilities in accordance with the Solvency II Directive is not practicable.

Especially where other related undertakings are subsidiaries, their treatment in the consolidated solvency balance sheet differs from IFRS accounting, because IFRS requires full consolidation of subsidiaries.

8.2.2.7 Treatment of insolvent subsidiaries and subsidiaries in run-off and liquidation

The Solvency II legislation does not explicitly state how insolvent subsidiaries or subsidiaries in run-off are treated for the purpose of calculating group solvency.

If a subsidiary goes into run off, it stops writing new insurance business and merely administers the existing insurance policies. Especially in the case of life insurance, run-off proceedings usually take many decades, but also for non-life insurance, the settlement of all claims will usually take years or even decades. If a run-off is not combined with liquidation proceedings, the insurance undertaking keeps its licence and needs to be treated like any other insurance undertaking for Solvency II purposes, i.e. its needs to meet its solo SCR and is fully consolidated for group solvency purposes.

When an insurance undertakings is insolvent or in liquidation proceedings, it is not clear whether it needs to be consolidated or not. Neither the Solvency II Directive, nor the Delegated Regulation take up this question explicitly, and as far as I have seen, it is not dealt with in any level 2 measures, guidelines or consultation papers, either.

It is surprising that this is not openly discussed, but may be explained by the fact that Solvency II is supposed to prevent insurance failures, so that insolvency and liquidation proceedings are undesired outcomes that stakeholders are reluctant to take up.
The relevant question is whether an insolvent subsidiary or a subsidiary in liquidation proceedings still is a subsidiary in the sense of Article 13 (16) Solvency II Directive. Since the most common parent/subsidiary relationship is based on the majority of voting rights held by the parent undertaking (Article 22 (1) (a) New Accounting Directive), this situation shall be analysed here. Until the insolvency or liquidation proceedings are completed, the parent undertaking continues to be majority shareholder, so that the number of voting rights held by the parent stays the same. The question is then, whether it is important that the voting rights do not confer the same rights anymore.

For proponents of a formal interpretation, it is irrelevant whether the voting rights confer control or not.\textsuperscript{1051} The opposite view holds that the majority of voting rights must be connected with the right to take significant decisions.\textsuperscript{1052}

IFRS 10 requires a substantive interpretation because control is the decisive factor. The majority of voting rights is presumed to confer control, but this presumption is rebutted when this voting majority is not connected with sufficient power to take decisions concerning the company.\textsuperscript{1053} Such a situation exists when a liquidator or administrator has the right to exercise such decisions,\textsuperscript{1054} because the general meeting’s competences during insolvency proceedings are extremely limited.\textsuperscript{1055} For German law, § 296 (1) no. 1 HGB states explicitly that a subsidiary does not need to be consolidated if the parent undertaking is significantly and permanently restricted in exercising control over the subsidiary, which is considered to be the case when the subsidiary is subjected to insolvency proceedings.\textsuperscript{1056} With regard to subsidiaries in liquidation, there are different views on when the parent undertaking is allowed to deconsolidate the subsidiary.\textsuperscript{1057} § 296 (1) no. 1 HGB corresponds to Article 23 (9) (c) no. 1 New Accounting Directive, which is, however, not referred to in the Solvency II Directive. Under the assumption that control is the decisive criterion for establishing a parent/subsidiary relationship also in the context of the New Accounting Directive,\textsuperscript{1058} a substantive interpretation would also have to be applied in a Solvency II context.

This means that the same argumentation needs to be applied with regard to the definition of parent/subsidiary according to Article 212 (1) (a) Solvency II Directive and

\textsuperscript{1051} With regard to the corresponding provision in § 290 (2) no. 1 HGB, Böcking/Gros/Schurbohm-Ebnet seem to be proponents of this view: in: Ebenroth/Boujong/Joost/Strohn, HGB, § 290 para. 16.
\textsuperscript{1052} Merkt in: Baumbach/Hopt, HGB, § 290 para. 10.
\textsuperscript{1053} Wiley IFRS 2016: , chapter 14, p. 266.
\textsuperscript{1054} IFRS 10, Appendix B, Application Guidance B. 37.
\textsuperscript{1055} With regard to German law: Koch claims that the prevailing view nowadays holds that the general meeting does not have any competences anymore during insolvency proceedings, Hüffer/Koch AktG, § 264 para. 10.
\textsuperscript{1056} Merkt in: Baumbach/Hopt, HGB § 296 para. 2; Jakob in: Martin Häublein and Roland Hoffmann-Theinert (eds), BeckOK HGB, (20th edn 2018-04-15), § 296 para. 6.
\textsuperscript{1057} Winkeljohann/Deubert in: Bernd Grottel et al., Beck’scher Bilanz-Kommentar (10th edn 2016), § 296 para. 11.
Article 22 (1) (a) New Accounting Directive, according to which the majority of voting rights leads to a parent/subsidiary relationship. Consequently, if insolvency proceedings over an insurance undertaking are started, it is not considered a subsidiary any longer because the majority shareholder has lost control: All important decisions are taken by the insolvency administrator. Therefore, the insolvent subsidiary does not belong to the Solvency II insurance group anymore and is no longer taken into consideration when calculating the group SCR.

If a stock corporation is liquidated on a voluntary basis, the general meeting’s competences remain largely the same as before, but it is not allowed to take any decisions that are contrary to the purpose of the liquidation.\footnote{With regard to German law: Hüffer/Koch AktG, § 264 para. 16; with regard to Swedish law: Skog, Rodhes Aktiebolagsrätt, p. 271 f.} This includes a prohibition to distribute assets to the shareholders before the company’s debts towards its known creditors have been settled.\footnote{§ 272 (1) AktG stipulates that assets may not be distributed before a one-year period after the notice to creditors has been published. For Swedish law: Sandström, p. 397.} The company in liquidation is represented by the liquidator, who is appointed by the general meeting in the case of a voluntary liquidation.\footnote{Chapter 25 § 3 no. 5, § 7 ABL; § 265 (2) AktG. According to German law, the board of directors are the liquidators unless the general meeting appoints someone else. In Sweden, a director or someone with dominant influence over the company may only be appointed as liquidator if there are good reasons, Skog, Rodhes Aktiebolagsrätt, p. 271.} Also the liquidator’s competences are limited by the purpose of the liquidation, so that the liquidator is not allowed to take measures that would lead to a continuation of the company’s business for a longer period than necessary.\footnote{Ibid, p. 271; § 268 (1) AktG.} However, this restriction is not interpreted strictly, so that a liquidator may continue the business for a transition period if this is may increase the proceeds from the liquidation.\footnote{Hüffer/Koch AktG, § 268 (1) AktG.} The general meeting may decide to discontinue the liquidation and to resume the company’s business.

Since the general meeting’s competences remain largely the same and the liquidation can be discontinued by the general meeting, the parent/subsidiary relationship according to Article 212 (1) (a) Solvency II Directive must probably be considered to remain intact at least in the case of a voluntary liquidation, so that it continues to be included in the Solvency II group balance sheet. This result may be different if the liquidation is compulsory, for instance because the subsidiary’s licence has been revoked, since the general meeting’s competences in this case are more limited.

Even when the shareholder still has control over an insurance subsidiary in liquidation, it is necessary on a case-by-case basis to consider making use of the possibility to exclude a group undertaking from group supervision according to Article 214 (2) Solvency II Directive, either because the subsidiary in liquidation is of negligible interest according to point (b), or because its inclusion would be inappropriate...
or misleading according to point (c). Since the liquidation procedure has the effect that the subsidiary is not allowed to distribute any dividend or transfer any assets to its parent undertaking until all debts have been settled – which may take many years in the case of an insurance undertaking –, its own funds must be considered to be unavailable at group level and are therefore only eligible up to its diversified SCR. However, this is not misleading, because – to the contrary – thanks to the “haircut”, no false impression is raised that the subsidiary’s own funds could be used somewhere else in the group. An aspect that may speak for an exclusion (or the application of the deduction and aggregation method instead of consolidation) could be if the subsidiary contributes to significant diversification effects. Another important aspect is whether the parent undertaking may be liable for the subsidiary’s debts or not: In case of an unlimited liability, it would be misleading not to include the subsidiary in liquidation.

If the subsidiary’s own funds do not meet its SCR, and the parent undertaking has decided not to inject additional own funds, it may be inappropriate to take the subsidiary in liquidation into consideration, for the following reason: If the lack of own funds at the level of the subsidiary also leads to a lack of own funds to meet the group SCR, the parent undertaking may try to raise own funds elsewhere in the group, for instance by exercising pressure on other group undertakings to change their risk profile, reduce costs or raise subordinated capital (or by taking these measures itself) that is not going to be injected into the subsidiary anyway. This would be an undesired and inappropriate effect that could be prevented if the subsidiary is not taken into consideration in the group solvency balance sheet.

8.2.3 The eligibility of own funds at group level

The requirement to cover a group SCR with own funds is connected with a decision whether a group undertaking’s own funds shall be fully eligible at group level or not. This is relevant for all groups, notwithstanding whether they calculate the group SCR with the consolidation method according to the standard formula or with an internal group model, or with the deduction and aggregation method.

8.2.3.1 Overview on the legal rules on the eligibility

Articles 222 and 223 Solvency II Directive address the eligibility of own funds at group level, but are – as many other provisions in the directive – rather difficult to understand. They expressly concern the elimination of the double use of own funds (Article 222) and of own funds that are the result of reciprocal financing within the group (Article 223). An example of reciprocal financing covered by Article 223 would be a situation where a subsidiary holds a financial instrument issued by its parent undertaking that is eligible for the parent as own funds at solo level.
Article 222 Solvency II Directive has the somewhat misleading heading “Elimination of double use of eligible own funds” since only paragraph (1) actually deals with double gearing. It requires own funds that are financed by own funds in another group entity to be excluded from the own funds at group level. This concerns the own funds of a subsidiary represented in its book value on the balance sheet of the parent undertaking. Paragraph (1) therewith fulfils the objective of the group SCR to force groups to have a sufficient capital basis without relying several times on the same own funds. When the consolidation method is applied, double gearing among fully consolidated undertakings should be eliminated already when setting up the consolidated Solvency II balance sheet,\textsuperscript{1064} so that the provision is relevant mainly when the deduction and aggregation method is used.

Article 222 (2) states that surplus funds in the sense of Article 91 (2) in a related life insurance undertaking only are eligible insofar as they are eligible for covering the SCR of the related undertaking. This concerns own funds consisting of accumulated profits that have not been made available yet for distribution to the policyholders, but that are in principle “ear-marked” for them. With regard to German life insurance undertakings, this concerns the provision for rebates (Rückstellung für Beitragsrückerstattung) insofar as it counts as own funds at solo-level. For Swedish life insurance mutuals and life insurers operated on a mutual basis, it is applicable on the konsolideringsfond (consolidation reserve),\textsuperscript{1065} constituting the largest equity item on such an insurer’s balance sheet.

Article 222 (2) also deals with another form of internal financing: With regard to not paid-up capital, the legislator differentiates between such capital that has been subscribed by the group undertakings and capital that has been subscribed by others. The first category is not recognized as own funds at group level at all, which can be explained with the fact that this capital constitutes potential obligations within the group which would need to be mutually eliminated as intra-group transactions during the consolidation process once the capital is called up. The latter is recognized “in so far as it is eligible for covering the Solvency Capital Requirement of the related undertaking”. Its recognition is consistent, because in this case, there is no corresponding potential payment obligation within the group. The limitation for the recognition refers to the fact that unpaid share capital constitutes ancillary own tier 2 funds which only may cover a part of the SCR.

In addition to that, Article 223 (3) contains a general provision stating that own funds eligible for the Solvency Capital Requirement of a related insurance or reinsurance undertaking that, in the opinion of the group supervisor, cannot be made effectively available to cover the SCR of the participating insurance undertaking, may be included.

\textsuperscript{1064} SOU 2011:68 Rörelsereglering för försäkring och tjänstepension, Betänkande av Solvens II-utredningen, Del 1, p. 441.
\textsuperscript{1065} Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 266.
“only in so far as they are eligible for covering the Solvency Capital Requirement of the related undertaking”. This norm needs to be read together with paragraph 4, which states that the sum of the own funds referred to in paragraphs 2 and 3 count at group level up to an amount corresponding to the solo SCR for the related undertaking. Unavailable own funds are therefore ineligible to the extent they exceed the solo SCR.

With Article 330 Delegated Regulation, the Commission has made use of its delegated power in Article 234 Solvency II Directive to “adopt delegated acts in accordance with Article 301a specifying the technical principles and methods set out in Articles 220 to 229”.

Article 330 (1) and (2) lay down criteria to be taken into account by the group supervisor when assessing whether own-fund items in a related undertaking cannot be made effectively available at group level and how to assess the amount of unavailable own funds.

Paragraph (3) contains a list of own-funds items that are assumed to be unavailable, namely:

ancillary own funds;

preference shares, subordinated mutual members account and subordinated liabilities; and

an amount equal to the value of net deferred tax assets.

For these own-fund items, the assumption can be rebutted.

Paragraph (4) contains a list of own-fund items that cannot considered to be effectively available at group level, namely:

minority interests in insurance undertakings;

minority interests in subsidiary ancillary undertakings; and

certain restricted own fund items in ring-fenced funds.

In contrast to those items that are assumed to be unavailable, there is no possibility to demonstrate that the ineligibility of items considered unavailable leads to inappropriate results.

Paragraph (5) deals with the question how many of the own-funds unavailable at group level may be taken into consideration for covering the group SCR, or, in other words, at which level the unavailable own funds are subjected to a so-called “haircut”. Paragraph (6) determines how the contribution to the group SCR shall be calculated.

According to paragraph (5), own-fund items that cannot effectively be made available to cover the group SCR, shall be included “up to the contribution of [the related undertaking] to the group Solvency Capital Requirement”.

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At level 3, EIOPA has addressed the eligibility of own funds at group level in guidelines 13 to 17 of its Guidelines on group solvency. Guideline 13 in practice relieves the ultimate parent undertaking from assessing the availability of own funds of participations that are not subsidiaries when the own-fund items of these participations do not “materially affect the amount of group own funds or the group solvency”.

Guideline 14 deals with the treatment of minority interests, guideline 15 with ring-fenced funds and “matching-adjustment portfolios” and guideline 16 describes the process how non-eligible own funds should be deducted. Guideline 17 lays down the process how the group supervisor of a cross-border group should discuss the availability of own funds with the other supervisory authorities within the college of supervisors.

8.2.3.2 On the availability of own funds

Article 222 (3) Solvency II Directive is the central norm in the directive concerning the eligibility of own funds at group level with regard to those own funds that are not explicitly mentioned in Article 330 (1) and (2) and Article 223. It lays down “availability” as the central criterion for the question whether and up to which amount own funds are eligible at group level or not, however, without specifying what “availability” exactly means.

8.2.3.2.1 Non-available own funds only of related or also of parent undertakings?

Article 222 (3) speaks of the availability of

“[…] own funds eligible for the Solvency Capital Requirement of a related insurance or reinsurance undertaking […] to cover the Solvency Capital Requirement of the participating insurance or reinsurance undertaking for which the group solvency is calculated […]”.

This wording is remarkable in two respects: First, it refers only to own funds of related undertakings and not of the ultimate parent undertaking that is calculating the group SCR. As already mentioned, the term “related undertaking” according to the definition in Article 212 (1) (b) Solvency II Directive encompasses subsidiaries, undertakings in which a participation is held, and certain undertakings in certain forms of horizontal groups, but not the parent undertaking.

Second, the availability must be assessed with regard to cover the parent’s solo SCR, and not the group Solvency Capital Requirement. This indicates that the relevant question is whether the own fund item can be transferred to the ultimate parent undertaking, but not whether it can be transferred to any other group undertaking. A literal interpretation of Article 222 (3) comes to the conclusion that it is unimportant
whether an own-fund item can be downstreamed from the ultimate parent undertaking to its subsidiaries.

According to the provisions in the Directive, own funds of the parent undertaking only need to be eliminated in the following cases:

- The value of any asset which represents the financing of own funds eligible for the Solvency Capital Requirement of one of its related insurance or reinsurance undertakings, i.e. double gearing (Article 222 (1));
- Subscribed but not paid-up capital which represents a potential obligation on the part of a related insurance or reinsurance undertaking (Article 222 (2) (ii));
- Own funds arising out of reciprocal financing between the participating insurance or reinsurance undertaking and a related undertaking (Article 223).

This is at first glance consistent with Article 330 Delegated Regulation which according to its heading also only concerns the eligibility of own funds of related undertakings, but not of the ultimate parent undertaking. Paragraph (1) equally only requires an availability assessment with regard to own funds of related undertakings only. The wording of paragraph 4 with regard to the unrebuttable assumption of non-availability of certain ring-fenced funds, is unclear, however. It declares so-called “restricted own-fund items” in ring-fenced funds unavailable at group level, without specifying whether this refers to restricted own-fund items in related undertakings only, or also to those in the ultimate parent undertaking. This concerns own funds in ring-fenced funds that can only be used to cover losses on a defined portion of the insurance undertaking’s insurance contracts, or in respect of certain policyholders or beneficiaries, or arising from particular risks or liabilities (Article 80 Delegated Regulation).

Ring-fenced funds are funds that may only be used to absorb losses arising in a specific part of the undertaking, for instance within a specific insurance portfolio. They are therewith “earmarked” for a specific purpose or on behalf of a certain group of policyholders or beneficiaries within the undertaking. For ring-fenced funds, Article 81b Delegated Regulation requires the calculation of a notional SCR. Guideline 15 in EIOPA’s Guideline on group solvency implies that also ring-fenced funds within parent undertakings may be restricted up to their notional SCR. Funds that may be used to absorb losses wherever they arise within an undertaking are not ring-fenced, even if they may not be transferred to the shareholders or to other group undertakings.

So is it really so that only own funds of related undertakings may be ineligible at group level, but not those from the ultimate parent undertaking?

The Swedish expert committee that was encharged by the Swedish government with analysing how to implement the Solvency II Directive into national law, seems to have understood the provision in such a way that even the parent’s own funds may be unavailable at group level:

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1066 Guidelines on group solvency, EIOPA-BoS-14/181EN, para. 1.44.
“For the group solvency calculation, it is important to assess if an item is transferable and can be used to cover losses in other group undertakings as well. If an item only can be used to cover losses in a single undertaking, the own fund item may only be used to cover that undertaking’s solvency capital requirement adjusted for any eventual surpluses may not be used to cover the solvency capital requirements of the other group undertakings. In that case, a deduction shall be made from the group-based own fund items” [own translation].

However, with regard to the consolidation reserve (constituting restricted surplus funds), the Committee suggested a wording which would only restrict the eligibility of own funds covering the consolidation reserve of related life insurance undertakings, but not those of a parent life insurance undertaking. Sweden has implemented Article 222 in chapter 13 § 6 FFFS 2015:8. The provision follows the directive’s wording and thereby also only restricts the eligibility of non-available own fund items of related group undertakings. § 7 specifies that the undertaking’s share in the group SCR forms the limit for the eligibility and thereby applies a wording that reminds more of Article 330 (5) Delegated Regulation than of Article 222 (4) Solvency II Directive.

The corresponding German provisions in § 254 (4) and (5) VAG 2016 also apply the wording of the Solvency II Directive, i.e. they restrict only the eligibility of non-available own funds of related undertakings up to the SCR of the respective undertaking.

Also guideline 16 in the Guideline on group solvency speaks of “related undertakings” only. The availability of own funds at group level has been subject of comprehensive advice by CEIOPS, which, however, leaves an incoherent impression. In the more general part, its advice could be understood as if the “haircut” requirement applies also to the parent undertaking:

“3.137. In order to assess the group solvency, it is necessary to determine the amount of group own funds which are eligible for covering the group SCR; that assessment needs in particular to take consideration of the availability of the own funds of each entity within the scope of group solvency, but also of the tiers limits laid out in the directive.

1067 SOU 2011:68 Rörelsereglering för försäkring och tjänstepension, Betänkande av Solvens II-utredningen, Del 1, p. 441. The syntax mistake has been taken over from the original: “I gruppsolvensberäkningen är det viktigt att fastställa om en post är överförbar och kan användas för att täcka förluster även för andra företag i gruppen. Om en post endast kan användas för att täcka förluster i ett enskilt företag får den kapitalbasposten endast täcka det företagets solvenskapitalkrav justerad för eventuella överskott får inte användas för att täcka solvenskapitalkraven för övriga företag i gruppen utan ett avdrag ska göras från den gruppbaserade kapitalbasen.”

1068 Ibid, p. 440: “Följande poster i den gruppbaserade kapitalbasen får endast täcka solvenskapitalkraven för det företag där de uppkommit 1. konsolideringsfond eller andra överskottsmedel i ett anknutet livförsäkringsföretag efter godkännande av Finansinspektionen eller annan ansvarig tillsynsmyndighet, […]”.

1069 Guidelines on group solvency, EIOPA-BoS-14/181EN, para. 1.46.
3.138. For the aim of that paper, the available group own funds are the group own funds after adjustment for availability of excess solo own funds, and eligible own funds are obtained after having applied tiers limits to available group own funds.”

However, when the consultation paper gets more specific, it uses the wording of the directive, speaking of “related undertakings” whose own funds may be unavailable for covering the group SCR of the participating undertaking.

Against this clear wording, an interpretation that would extend the need to restrict the eligibility of unavailable own funds held by the parent undertaking would exceed the limits of interpretation.

Here, all language versions consulted have the same meaning, applying terms with a clear definition in the directive itself. This situation differs from those where the different language versions cannot be reconciled and therefore require an interpretation by applying other interpretation methods. Even if it is sometimes pointed out that a literal interpretation of EU law is insufficient by itself and always has to be complemented by other interpretation methods, the clear wording of a norm constitutes the limit between interpretation and development of the law (Rechtsfortbildung). In the Wendelboe Case, the ECJ confirmed its textual interpretation with systemic and teleological arguments, thereby enhancing the legitimacy of the decision, without explicitly stating that such a confirmation is necessary. Even if the ECJ is known for its creativity, I am not aware of any cases where it has interpreted norms of a technical character against their clear wording.

It seems inconsistent with the purpose of group solvency to only take the availability of own funds in related undertakings into consideration, but not from the ultimate parent undertaking setting up the group solvency accounts. As a consequence, there is a risk that own funds are fully eligible to cover the group SCR only because they constitute own funds of the ultimate parent undertaking and not those of a subsidiary. The restriction of the eligibility of own funds can be justified with the need to correct a potentially wrong impression of financial stability that could arise if all own funds were allowed to cover the group SCR even if they cannot be made available somewhere else in the group. To automatically consider all own funds (with a few exceptions) of the ultimate parent undertaking as available within the group, may have the consequence that group own funds are suitable to safeguard the coverage of the solo SCR of the parent undertaking, but may not be used to strengthen the capital basis of its subsidiaries.

The wording of Article 222 Solvency II Directive is quite similar to the one used in sections C2 and C3 of Annex 1 of the Insurance Group Directive for the calculation of

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1070 CEIOPS, CEIOPS’ Advice for Level 2 Implementing Measures on Solvency II: Supervision of Group Solvency for Groups with Centralised Risk Management, paras. 3.137 and 3.138.
1072 Cf. Conway, p. 141.
1073 Riesenhuber in: Europäische Methodenlehre, § 11 para. 16 with a reference to the Wendelboe Case.
1074 Ibid, § 11 para. 20.
the adjusted solvency. Nevertheless, it does not seem as if the legislator has made a simple mistake by copying the wording from the Insurance Group Directive, because the rules are repeated at levels 2 and 3. Instead, there seems to be an underlying assumption that own funds can always be downstreamed to subsidiaries and that only upstreaming from a subsidiary to a parent may be problematic. To treat own funds differently for group solvency depending on whether the own funds are held by the parent or another group undertaking, leads to differences in the treatment of groups depending on their group structure: If the parent undertaking is an insurance undertaking, its own funds are eligible at group level, whereas they may be uneligible if the same insurance undertaking is subsidiary of another undertaking, for instance an insurance holding. This different treatment lacks a justification and is therefore discriminatory.

8.2.3.2.2 What is meant with “availability”?

Article 222 (3) Solvency II Directive restricts the eligibility of own funds that cannot

“[…] effectively be made available to cover the Solvency Capital Requirement of the participating insurance or reinsurance undertaking for which the group solvency is calculated”,

without further specifying what is meant with availability.

Article 330 (1) Delegated Regulation requires supervisory authorities to take the following criteria into consideration when assessing the availability of own-fund items of related undertakings:

“[…](a) whether the own-fund item is subject to legal or regulatory requirements that restrict the ability of that item to absorb all types of losses wherever they arise in the group;
(b) whether there are legal or regulatory requirements that restrict the transferability of assets to another insurance or reinsurance undertaking;
(c) whether making those own funds available for covering the group Solvency Capital Requirement would not be possible within a maximum of 9 months;
(d) whether, where method 2 is used, the own-fund item does not satisfy the requirements set out in Articles 71, 73 and 77; […]”
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Criterium (a) corresponds to the definition of “fungibility” proposed by CEIOPS in its Advice on the Assessment of group solvency.\(^{1076}\) According to CEIOPS, availability means that own funds must be both “fungible” and “transferable”.

The term fungibility is neither used in the Delegated Regulation nor in EIOPA’s guidelines. EIOPA’s Guideline on group solvency is surprisingly silent on how to assess the availability of own funds, taken into consideration that CEIOPS had dedicated about eight pages on that question in its Advice to the European Commission\(^{1077}\). But even in CEIOPS’ paper, it does not become entirely clear what is meant by “capacity to absorb losses wherever they arise in the group” in contrast to transferability of own funds (as expressed by CEIOPS) or assets (as laid down in Article 330).

The lack of more specific guidance in EIOPA’s guidelines may be a reaction to the harsh critique rendered by the insurance industry to CEIOPS’ advice. Even though it is not explicitly stated, it seems as if CEIOPS considered own funds to be eligible only if they (or more correctly: corresponding assets) can be transferred to another group undertaking without any consideration: In Annex I, it discusses as possible ways to transfer dividends, capital reductions and share buy backs. Loans are only discussed in the context of the group support regime that was still included in the Draft Directive at that time.\(^{1078}\) Many representatives from the insurance industry criticised CEIOPS’ position as too conservative and held that even not fully transferable own funds held by insurance undertakings within the EEA always could be made transferable by setting up intra-group loan mechanisms.\(^{1079}\)

While it is understandable that the insurance industry is interested in achieving full eligibility of own funds at group level, it is far from clear that the possibility of intra-group loans should be taken into consideration, apart from the fact that there may be company law barriers for such loans. If the possibility to grant a loan was decisive, there would be no reason to consider minority shares in own funds or restricted own funds to be ineligible, since (partly-owned) subsidiaries could simply render a loan to another group undertaking.

There is, of course, a risk that the lack of clear rules leads to differences in interpretation and thereby to differences in the application of the rules in the member states, despite coordination attempts. The treatment of equalisation reserves (technical provisions prescribed by Swedish and German GAAP for non-life insurers: *säkerhetsreserv* and *Schwankungsrückstellung*, respectively, which are recognized as own funds and not considered liabilities for Solvency II purposes)\(^{1080}\) is an example: Finansinspektionen

\(^{1076}\) CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09, para. 3.150.

\(^{1077}\) Ibid, pp. 30-38 of a total of 59 pages.

\(^{1078}\) Ibid, p. 53.

\(^{1079}\) CEIOPS, Summary of Comments on Consultation Paper 60 - CEIOPS-CP-60/09 CP No. 60 - L2 Advice on Group Solvency Assessment, 20 October 2009, p. 8. See also pp. 13, 17, 23 30.

\(^{1080}\) That equalisation reserves should be recognised as own funds was proposed already early in the Solvency II process: Bericht der Arbeitsgruppe Versicherungstechnische Rückstellungen an den VA-Unterausschuss „Solvabilität“, September 2002, para. 161.
considers them to be unavailable at group level, whereas in Germany, the equalisation reserve held by a non-life insurance subsidiary seems to be considered available. While the rules on the calculation of equalisation reserves differ between Germany and Sweden, they share the same objective: To provide a long-term reserve for the volatility of losses over the years in non-life insurance, for instance hail insurance where there may be very few losses during several years and large losses in other years. In both jurisdictions, the equalisation reserve must be dissolved if it exceeds a maximum amount at the end of a financial year. Otherwise, the reserve may only be dissolved – somewhat simplified – to compensate for a loss in the respective class of non-life insurance. Considering these restrictions, Finansinspektionens treatment of the Swedish equalisation reserve as unavailable at group level seems correct, while it remains to be explained why own funds covering the Schwankungsrückstellung seem to be considered available at group level.

8.2.3.2.3 Availability to cover the group SCR or the solo SCR?

As already mentioned, another ambiguity relates to the question, for what exactly own funds must be available: For covering the group SCR or the solo SCR of a parent undertaking? Article 222 (3) Solvency II Directive speaks of the availability “to cover the Solvency Capital Requirement of the participating insurance or reinsurance undertaking for which the group solvency is calculated”, whereas Article 330 (1) Delegated Regulation speaks of the availability to cover the group SCR.

In the Swedish transposition of the Directive norm in chapter 13 § 6 FFFS 2015:8, a different wording is applied: According to this provision, the ability to make own funds accessible to other group undertakings, is relevant (“Kapitalbasposter […] som inte faktiskt kan göras tillgängliga för övriga företag i gruppen”), which is a third variant, because it refers to more group undertakings than only the participating insurance undertaking.

The English, French, German and Spanish wordings in the Directive may leave some room for the Commission’s interpretation in the Delegated Regulation that availability to cover the group SCR is meant, whereas the Swedish wording refers very clearly to the solo SCR of the participating insurance undertaking. However, also in the other four language versions, a literal interpretation tends more towards the solo SCR rather than the group SCR, because the legislator could easily have referred to the group SCR if that would have been meant – in fact, the wording would have been much more straightforward than the current one – and the reference to the group solvency simply

1082 Kraft, Gruppenaufsicht, p. 168. I also checked the reasons for the ineligibility of own funds mentioned in the SFCR 2016 of a number of German insurance groups and did not find any that state that own funds covering the equalisation reserve of related insurance undertakings would be unavailable at group level. Krämer expects that only those own funds that are explicitly mentioned in Article 330 Delegated Regulation will be treated as unavailable, in: Prölls/Dreher VAG, § 254 para. 17.
1083 In Germany, the existence of the Schwankungsrückstellung is laid down in § 341h (1) HGB, and its calculation and dissolution are regulated in § 29 RechVersV and the Annex to § 29.
1084 In Sweden, the säkerhetsreserv is regulated in chapter 4 § 16 Finansinspektionens föreskrifter och allmänna råd om årsredovisning i försäkringsföretag, FFFS 2015:12 and Finansinspektionens föreskrifter och allmänna råd om normalplan för skadeförsäkringsföretags beräkning av säkerhetsreserv, FFFS 2013:8.
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seems as an attribute to describe which participating insurance undertaking is meant, in case there are several ones.

The same result can be achieved with a systematic interpretation: Referring to the solo SCR is consistent with the requirement that only the availability of related undertakings must be assessed, whereas own funds of the ultimate participating insurance undertaking always are fully eligible for the coverage of the group SCR – their availability to cover the solo SCR does not need to be questioned.

The reference to the solo SCR in Article 222 (3) is, however, incomplete, because it only refers to the solo SCR of a participating insurance undertaking for which group solvency is calculated, leaving open which SCR shall be relevant when the group is headed by an insurance holding.

The group SCR, as the reference point depicted in Article 330 (1) Delegated Regulation is, however, not a suitable reference point either, because the group SCR is the group capital requirement of a fictitious group and funds cannot be transferred to a fictitious entity. The group SCR could both theoretically and practically be covered with all own funds held by group undertakings. The obligation to restrict unavailable own funds only makes sense if own funds covering the group SCR are expected to be able to be transferred to other group insurance undertakings regardless of their position in the group structure. The Swedish implementation norm therefore reflects the objective of the restriction best: The own funds must be transferable to other undertakings in the group. However, this cannot mean that transferability to every single group undertaking is meant and must be tested – otherwise a group with a hybrid life insurance undertaking would have huge problems because no entity might be able to transfer own funds to it. In most cases, transferability to the parent undertaking at the top (regardless whether it is a participating insurance undertaking or an insurance holding) will be a sufficient indicator, which might be the reason why the Directive refers to the participating insurance undertaking.

8.2.3.3 The eligibility of minority interests in own funds

The treatment of own funds held by partly-owned subsidiary is probably the most obvious problem, especially if the subsidiary is fully consolidated, i.e. for the calculation of group solvency, it is treated as if it was wholly-owned.

The problem can be illustrated with the following example: A is an insurance undertaking and holds 60 % of the shares in insurance undertaking B, and 60 % of the shares in insurance undertaking C. B and C are both listed companies with 40 % of the shares being held by hundreds of individual shareholders. Even if the individual minority shareholders may not claim any particular assets from B or C, they have a general interest in the assets of the company, corresponding to the size of their shareholding. For B and C, accordingly, the minorities’ interests in the own funds amount to 40 %.
Under the assumption that there are no diversification effects and no intra-group transactions, the group SCR would be the sum of the solo SCRs of A, B and C. This is due to the fact that full consolidation is applied for the risk assessment, i.e. one hundred percent of the risks in B and C need to be taken into consideration for the calculation of the group Solvency Capital Requirement at the level of parent undertaking A.

In the consolidated financial statements, according to Article 24 (4) New Accounting Directive, minority interests need to be shown separately on the balance sheet as non-controlling interests. In IFRS group accounts, according to IFRS 10.22, this is done by presenting non-controlling interests separately within “equity” in the balance sheet. In addition, the minorities’ interest in the result is shown separately in the profit and loss statement.

An argument for an unlimited recognition of minority interests in own funds could be that all own funds, including the minorities’ interests, need to be taken into account at group level, i.e. should count for covering the group SCR, because full consolidation also means that one hundred per cent of the risks of the partly-owned subsidiary contribute to the group SCR. It would only be consistent to treat assets and liabilities equally.

Against recognizing minority interests in a subsidiary’s own funds as group own funds speaks that these own funds may not be available to cover losses incurred by other group entities. In principle, there are two ways how own funds from a partly-owned subsidiary could be transferred to its majority shareholder. The first would be to dissolve the subsidiary’s capital reserves, if necessary and possible, and to distribute a dividend to the subsidiary’s shareholders. This requires a resolution by the subsidiary’s general
meeting. The minority shareholders would have to get their proportional share. In other words, in normal cases\textsuperscript{1085} the majority shareholder will have to share any distribution with the minority shareholders. The second possibility would be that the subsidiary grants the majority shareholder or another group entity a loan.

The legislator has seen the problem that there are legal obstacles to the effect that not all own funds available at solo level can be made available at group level.

8.2.3.3.1 Article 222 Solvency II Directive

Article 222 (3) Solvency II Directive does not explicitly mention minority interests in own funds, but it seems to be the only norm in the directive that could be applicable to minority interests in own funds. An argument against its applicability could be that according to the heading, the provision deals with the elimination of the double use of eligible own funds, which does not cover minority interests. However, a systematic reading reveals that only the first paragraph concerns the double use of own funds, whereas this does not apply to paragraphs 2 to 5. An application of Article 223 (3) and (4) would have the effect that minority interests in own funds up to an amount corresponding to the solo SCR of the undertaking are nevertheless recognized as group own funds. If the provisions in the directive were to be applied on minority interests in own funds, it would depend on the structure of the remaining own funds of the subsidiary, in how far they would count as group own funds, because they are aggregated with surplus funds and subscribed but not paid-up capital of the related undertaking.

Consequently, Article 221 shows that the legislator has not entirely disregarded the fact that an undertaking may have shareholders outside the group, but it has refrained from formulating any specific rules in the directive for the treatment of minority interests in own funds. The background for this may be that the legislator considered the provision in Article 222 to be sufficient to cover even the recognition of minority interests. Another possibility is that it considered Article 221 to deal exhaustively with minority interests – in that case minority interests would be fully eligible at group level when the consolidation method is applied.

Article 222 is applicable to both users of the consolidation method and users of the deduction and aggregation method. Concerning the deduction and aggregation method, however, Article 233 (2) (b) provides that the group own funds consist of the sum of the own funds of the participating undertaking calculating the group SCR and its proportional share in the own funds of related undertakings. Minority interests are in this case automatically excluded from group solvency, and Article 222 would not have any relevance with regard to minority interests for users of this method – this might indicate

\textsuperscript{1085} An exceptional case would be the existence of a profit and loss transfer agreement between the majority shareholder and the partly-owned subsidiary.

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that the provision is not applicable to minority interests at all. Consequently, the directive is not clear about how minority interests in own funds shall be treated.

Figure 8.2.3.3.1 no. 1 shows the effect of an application of Article 222 on two examples of partly-owned subsidiaries. Subsidiary A has shareholders outside the group holding one third of the shares and subsidiary B has minority shareholders holding 40%. Both subsidiaries have own funds amounting to 600 and a solo SCR of 200. If the eligibility of the minority interests in the own funds was determined according to Article 222 (3), all minority interests would be eligible in the case of subsidiary A, whereas in the case of subsidiary B, own funds amounting to 40 would not eligible at group level. In both cases, it is assumed that, apart from the minority interests, there are no other own funds that are unavailable at group level.

![Diagram showing eligibility of minority interests in own funds at group level](image)

### 8.2.3.3.2 Article 330 Delegated Regulation

Article 330 Delegated Regulation contains a detailed provision on the eligibility of such own funds that are considered not to be available at group level. Some of the ambiguities in an earlier draft of the provision from October 2011 have been eliminated, but, as will be shown, the provision is still not entirely clear and remains difficult to apply.

The Commission seems to understand Article 222 (3) Solvency II Directive to cover minority interests, because the corresponding provision to Article 330 in the draft delegated acts (Article 323 SCG 3 in the draft from March 2014) referred to
Articles 222 (2) to (5) and therefore purported to contain specifications of these directive provisions.

According to Article 330 (4) (a) Delegated Regulation, “any minority interest in a subsidiary exceeding the contribution of that subsidiary undertaking to the group Solvency Capital Requirement” is not considered to be effectively available at group level. Already this wording is unclear, which becomes transparent when trying to “translate” it into a mathematical formula – an exercise which has to be done by all undertakings that have to calculate their group SCR. After all, Article 330 is part of a set of rules describing how to calculate the coverage of the group SCR with own funds. What does “the contribution of the subsidiary undertaking to the group Solvency Capital Requirement” mean? Is this equal to the solo SCR of the subsidiary or not? Even the wording “minority interest in a subsidiary” requires interpretation. The provision only makes sense, if the minority interests in the own funds of the subsidiary are meant and the wording implies that minority interests in all own funds (and not only those exceeding the solo SCR) are meant.

The next doubts arise when trying to figure out what to do with the unavailable own funds. Paragraph (4) merely tells us that some minority interests in own funds are not available at group level, but does not explicitly deal with the question how to treat these unavailable own funds for the purposes of calculating coverage of the group SCR.

The systematic structure of Article 330 is as follows: Paragraphs (1) and (2) lay down criteria to be taken into account by the group supervisor when assessing whether own-fund items in a related undertaking cannot be made effectively available at group level and how to assess the amount of unavailable own funds. Paragraph (3) contains a list of own-funds items that are assumed to be unavailable. For these own-fund items, the assumption can be rebutted. Paragraph (4) contains a list of own-fund items that cannot be considered to be effectively available at group level, among others, as already discussed above, (all or parts of) minority interests in subsidiaries. In contrast to those items that are assumed to be unavailable, there is no possibility to demonstrate that the ineligibility of items considered unavailable leads to inappropriate results. Paragraph (5) deals with the question how many of the own-funds unavailable at group level may be taken into consideration for covering the group SCR, or, in other words, at which level the unavailable own funds are subjected to a so-called “haircut”. Paragraph (6) determines how the contribution to the group SCR shall be calculated.

According to paragraph (5), own-fund items that cannot effectively be made available to cover the group SCR, shall be included “up to the contribution of [the related undertaking] to the group Solvency Capital Requirement”. How the contribution is calculated, depends on whether the group SCR is calculated with the standard formula

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1086 This is also supported by the wording in the earlier draft of October 2011: “[…] any minority interests in the eligible own funds exceeding the contribution […].” The new wording has presumably been inserted in order to avoid the ambiguity relating to whether “exceeding” referred to minority interests or to eligible own funds.
or with a group internal model. For the latter case, Article 330 (6) (b) states that the contribution corresponds to

“[…] the Solvency Capital Requirement of that related undertaking multiplied by a percentage corresponding to the proportion of the diversification effects at group level that are attributed to that related undertaking, determined by that internal model, provided that the sum of such percentages for all the related insurance and reinsurance undertakings, insurance holding companies or mixed financial holding companies included in the consolidated calculation based on the internal model equals 100 %.”.

This provision can be translated into the following formula:

\[
\text{Haircut level} = \text{Contr}_{\text{sub}} = \text{SCR}_{\text{solo}} \times \text{Div}_{\text{sub}}
\]

where
\[
\text{Contr}_{\text{sub}} = \text{Contribution of the partly-owned subsidiary to the group SCR},
\]
\[
\text{SCR}_{\text{solo}} = \text{the Solvency Capital Requirement of the partly-owned subsidiary},
\]

and
\[
\text{Div}_{\text{sub}} = \text{the percentage of the diversification effect attributed to the partly-owned subsidiary; a percentage between 0 and 100 %}.
\]

The term “haircut level” is hereinafter used to describe the amount until which own funds that are unavailable to cover the group SCR are nevertheless eligible to cover the group SCR. The complete formula would be the following:

\[
\text{Minorities eligible at group level} = \max(0, \text{unavailable minorities} - \text{SCR}_{\text{solo}} \times \text{Div}_{\text{sub}}).
\]
Figure 8.2.3.3.2 no. 1 shows how many of the subsidiary A’s own funds in Figure 8.2.3.3.1 no. 1 are not eligible at group level if the calculation method in Article 330 Delegated Regulation and a group internal model is applied. It is assumed that 20 % of the diversification effects are attributable to A. However, the definition of the contribution lacks a reference to the absolute amount of the diversification effects. That 20 % of the overall diversification effect attributes to A does not necessarily mean that its SCR needs to be reduced by 20 % as has been done in the Figure: Let us assume that the diversified group SCR of the group to which A belongs is 30 % lower than the sum of the SCRs of all undertakings included in the calculation and that 20 % of the difference can be attributed to A. If the sum of all SCRs was 1200 and the group SCR was 840, the group-wide diversification effect would amount to 1200 – 840 = 360, whereof 360 × 0.2 = 72 could be attributed to A. The diversified solo SCR of A then amounts to 200 - 72 = 128, i.e. it is 36 % lower than the “real” solo SCR.

That this amount is actually meant, can be derived from the provision in Article 330 (6) (a) on the determination of the contribution to the group SCR in those cases where the standard formula is used. According to this provision, the contribution is equal to

“[…] the proportional share of the Solvency Capital Requirement of that related undertaking multiplied by a percentage corresponding to the proportion that the diversified component of the consolidated group Solvency Capital Requirement […] bears to the sum of the Solvency Capital Requirements of each of the undertakings including in the calculation of that
diversified component of the consolidated group Solvency Capital Requirement”.

If we assume a simple group structure where all undertakings need to be fully consolidated and are insurance undertakings (i.e. there are no undertakings that are not subsidiaries and no credit institutions, investment institutions etc. whose SCR needs to be calculated in accordance with the relevant sectoral rules applicable for these undertakings), the provision can be translated into the following formula:

\[
\text{Haircut level} = \text{Contr}_{\text{sub}} = \frac{\text{SCR}_{\text{solo}} \times \text{SCR}_{\text{group}}}{\sum \text{SCR}}
\]

where

\[
\text{SCR}_{\text{group}} = \text{the group Solvency Capital Requirement taking into account the diversification effects between the subsidiaries and the ultimate parent undertaking. Usually, the group SCR is therefore lower than the sum of the solo SCRs, and}
\]

\[
\sum \text{SCR} = \text{the sum of the SCRs of all entities included in the group solvency assessment.}
\]

With this calculation method, the diversification effect is distributed equally over all undertakings, i.e. it is irrelevant whether anything of it can be attributed to A or not. Below is an example that shows the effects of the calculation method, if the diversification effect amounts to 30%:

Eligibility of minority interests in own funds at group level
Art. 330 Delegated Regulation (standard formula)

![Diagram showing the calculation of the SCR and the haircut level](image)

Figure 8.2.3.3.2 no. 2
It can be noted, that both calculation methods lead to different, stricter results than the application of Article 222 of the Directive. The calculation method resembles the method applied in Article 222 (3) Solvency II Directive, with the difference that not the solo SCR of the related undertakings constitutes the limit, but its lower contribution to the group SCR.

**8.2.3.3.3 EIOPA’s Guideline on group Solvency**

Guideline 14 of EIOPA’s Guidelines on group solvency from 2015 also deals with the treatment of minority interests. The guideline states that

"The participating insurance or reinsurance undertaking, the insurance holding company or the mixed financial holding company should calculate the amount of minority interests in the eligible own funds, to be deducted from the group own funds, for each subsidiary, in the following order:

1. calculate the eligible own funds exceeding the contribution of the subsidiary to the group Solvency Capital Requirement;

2. identify and deduct the amount of non-available own funds exceeding the contribution of the subsidiary to the group Solvency Capital Requirement from the eligible own funds calculated in step 1;

3. calculate the part of minority interests to be deducted from the group own funds by multiplying the minority share by the result of step 2."

In the explanatory comment, two examples are presented enabling the reader to understand how EIOPA considers that minority interests needed to be treated:

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Figure 8.2.3.3.3 no. 1

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In the example, the subsidiary’s contribution to the group SCR is 100, its own funds amount to 160, and 20% of its shares are held by minority shareholders. 120 of its own funds are not available at group level for reasons other than minority interests.

In the second example (Figure 8.2.3.3.3 no. 2), the situation is largely the same as in the first, with the difference that only 40 of the own funds are not available at group level before consideration of the minority interest.

From this can be derived that EIOPA considers that the following formula should be applied:

\[
\text{Haircut level} = \text{minority share} \times (\text{OF}_{\text{sub}} - \text{OF}_{\text{na}} - \text{Contr}_{\text{sub}})
\]

where

\[
\text{OF}_{\text{na}} = \text{other non-available own funds}.
\]

The formula for the contribution to the group SCR is provided in Technical Annex I:

\[
\text{Contr}_{\text{sub}} = \frac{\text{SCR}_{\text{solo}} \times \text{SCR}_{\text{group}}}{\sum \text{SCR}^{1088}}.
\]

This formula is identical to the one derived from Article 330 (6) (a) Delegated Regulation for users of the standard formula.

The main difference to my interpretation of the provision in the Delegated Regulation above is that the minority share in the excess own funds is deducted, which has the following economic consequences for the example applied in Figure 8.2.3.3.3 no. 3:

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1088 In the Technical Annex, the formula is stated as \( \text{Contr}_j = \text{SCR}_j \times \text{SCR}_{\text{diversified}} / \sum \text{SCR}_{\text{isolo}} \).
Eligibility of minority interests in own funds at group level (EIOPA’s Guidelines on Group Solvency)

EIOPA’s method has in this case the effect that fewer own funds are eligible at group level: \(600 - 153.3 = 446.7\) compared to \(600 - 60 = 520\) when applying the method derived from the Delegated Regulation.

The same method was already proposed by EIOPA in the technical specifications for the preparatory phase from April 2014\(^{1089}\) and in Guideline 18 of EIOPA’s consultation paper on guidelines for Pillar I requirements.\(^{1090}\) It also leads to the same result as the method applied in a calculation example in an Advice paper issued by its predecessor CEIOPS in 2009.\(^{1091}\)

However, CEIOPS contradicted itself in this paper because the advice formulated there in paragraphs 3.199 and 3.200 did not correspond to the calculation method applied in its example in Annex 1. In that example, the haircut level was not set at the minority’s share in the solo SCR (as formulated in paragraph 3.199), but in relation to the diversified solo SCR, or to be more precise: at the contribution of the minority interest in the group SCR.\(^{1092}\) This calculation method leads to the same result as the one in the Guideline on group solvency.

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\(^{1089}\) EIOPA, Technical Specification for the Preparatory Phase (Part I), EIOPA-14/209, 30 April 2014, p. 361. The Technical Specifications were explicitly aimed to be used only in connection with any quantitative assessment. Thus, they did not claim to lead to consistent supervisory practice or to a uniform application of supervisory law as required by Article 16 of the EIOPA Regulation. Consequently, the specifications were not legally binding. Of course, they are nevertheless interesting as a source of information, especially because they purported to reflect the content of the Solvency II Directive as amended by the Omnibus II directive and of the Draft Delegated Acts available at the time of drafting.

\(^{1090}\) EIOPA, Consultation Paper on the proposal for Guidelines on Solvency II relating to Pillar 1 requirements, EIOPA-14/036, 2 June 2014.

\(^{1091}\) CEIOPS, Advice for Level 2 Implementing Measures on Solvency II: Assessment of Group Solvency, CEIOPS-DOC-52/09.

\(^{1092}\) Ibid, p. 52.
In EIOPA’s Technical Specifications for the Solvency II valuation and Solvency Capital Requirements calculations\textsuperscript{1093}, a calculation method was laid down corresponding to the one derived from Article 330 Delegated Regulation for users of the standard formula. This document was issued in preparation of the Long-Term Guarantee Assessment, a quantitative impact study conducted by EIOPA in the spring of 2013 at the request of the European Commission, the Council and the European Parliament. The specifications were applicable to quantitative tests only.

Section G 2.6 of the Technical Specifications deal with group own funds. Specification G.39 required groups to

“[…] deduct the part of own funds of related undertakings that is not available for covering the group Solvency Capital Requirement from the relevant own funds item of the consolidated group own funds […]”.

Minority interests were dealt with in specifications G.44 and G.45. According to G.44,

“All minority interests in the available own funds (calculated after the deduction of non available own funds) exceeding the contribution of an insurance or reinsurance subsidiary to the group SCR, should be considered as non available for covering the group SCR.”

The qualification in parentheses leaves the impression that the specification needed to be interpreted in such a way that “exceeding” refers to minority interests and not to own funds. Specification G.45 then referred to G.42 for the calculation of the contribution of the subsidiary to the group SCR. G.42 in turn stated the following formula: Contribution of SCR\textsubscript{soolo} to SCR\textsubscript{group} = SCR\textsubscript{soolo} × SCR\textsubscript{group}/\sum SCR\textsubscript{SCR}.\textsuperscript{1094}

This also constitutes the haircut level laid down in the Technical Specifications and corresponds to the method provided for in the Delegated Regulation for users of the standard formula.

8.2.3.3.4 Eligibility of minority interests in own funds – short first assessment

The history of the different methods for treating minority interests in own funds proposed by the Commission and by CEIOPS/EIOPA shows that it is obviously not easy to decide how this should be dealt with – otherwise there would not have been so many different (inconsistent) proposals. Whether the differences in the documents always are intentional or not, is difficult to tell. The ambiguities still left in the wording of Article 330 (4) also illustrate how difficult it is to formulate clear and unambiguous rules, especially how to verbally express a mathematical formula.

For insurance undertakings that were trying to prepare themselves for Solvency II prior to its implementation, this had the consequence that there was an uncertainty concerning the group solvency assessment. Of course, it is especially unfortunate that the methods prescribed in the Directive, in the Delegated Regulation and in EIOPA’s guidelines all differ from one another. Even though the Solvency II regime is supposed


\textsuperscript{1094} This formula also corresponds to the formula based on one of two possible interpretations of the first draft of Article 323 SCG3 (6) from October 2011, which has been deleted in the Delegated Regulation.
to be principles-oriented, legal certainty requires that at least the level 2 norms are sufficiently clear and precise because otherwise they do not fulfil their primary aim to promote a uniform implementation in the EU.

It is doubtful whether Article 330 (5) Delegated Regulation is a valid supplement to Article 222 (3) Solvency II Directive when it determines the haircut level at the contribution to the group SCR instead of the solo SCR as laid down in the Directive. As suggested in chapter 2.3, a provision in a delegated act that is incompatible with the level 1 text, must be considered as *de facto* amending the level 1 text, even if the wording of the level 1 text is not explicitly changed. The delegation norm in this case, after all, only empowered the Commission to “specify” the technical principles laid down in Article 225. The rationale behind the provision in the Directive seems to be that own funds covering the solo SCR form sort of a “floor” that a group should always have. These own own funds thus have to stay within the group at all times and therefore, it is logical that they are treated as being eligible at group level. The rationale behind reducing this level to the diversified SCR in the Delegated Regulation is probably that the group solvency ratio might be misleadingly high, if the solo SCR was decisive, because it might include excess own funds that cannot be transferred to other group undertakings.

To give an example: If all subsidiaries of a group only had own funds that are unavailable at group level, the group would show a higher group solvency ratio if there were high diversification effects: For a group with five subsidiaries, each having a solo SCR of 100, a diversified SCR of 80 and own funds of 110, according to Article 222 (3) Solvency II Directive, own funds of 500 would be eligible, whereas only 400 would be eligible according to the Delegated Regulation.

Whether the method required by EIOPA in the Guidelines really is an *intra legem* interpretation of Article 330 with regard to the haircut level, can also be debated, because the wording of Article 330 is difficult, if not impossible, to align with Guideline 14.

The methods derived from the directive and from the Delegated Regulation have a logical shortfall, however, because by “filling up” the diversified/undiversified solo SCR first with the minority interests in the own funds, they treat the minority shares in the own funds as if it was possible to distribute the parent undertaking’s share in the own funds separately from the minority shares. However, a distribution of profit needs to be done proportionately, i.e. it is not possible to say that the minority interests in the own funds primarily cover the solo SCR whereas the parent undertaking’s share forms excess own funds.

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1095 Please note that the first draft of the directive provided for the possibility to provide so-called "group support", i.e. according to the proposal, parent undertakings would have had the possibility to provide their insurance subsidiaries with just enough capital to cover their Minimum Capital Requirement (MCR) and to provide a parental guarantee to fill the gap between the MCR and the SCR. As I understand it, the group support regime would have given groups with large diversification effects extended possibilities to use these for capital allocation measures, i.e. to finance a larger part of their subsidiaries’ capital requirements with loans. The concept of group support met fierce resistance particularly from member states with many insurance undertakings with parent undertakings in other member states, see van Hulle, Solvency II: state of play and perspectives, p. 178.
The method to be applied according to EIOPA’s Guideline is more logical in this respect, because it fills the solo SCR with proportional shares of minority interests and the parent undertaking’s interests in the own funds and then considers the remaining minority interests in the excess own funds as unavailable at group level. This corresponds to the company law reality in so far as these own funds cannot be distributed to the parent undertaking. EIOPA’s interpretation is therefore understandable and in principle logically correct, when it requires minority interests in own funds that exceed the SCR to be deducted and holds minority interests in own funds up to the SCR to be eligible. The methods prescribed in the Directive and in the Delegated Regulation are in this respect not only unrealistic with regard to minority shares in own funds, since there are other constellations where this could lead to questionable results. One of them, namely, whether the Swedish prudence principle might lead to an ineligibility of own funds at group level, is discussed in chapter 9.4. The Guidelines thus try to correct the inconsistency of Articles 330 (4) and (5) Delegated Regulation, which first state which own funds are unavailable and then provide that unavailable own funds are eligible only up to the contribution to the group SCR.

8.2.3.4 Eligibility of own funds in insurance undertakings operated on a mutual basis

Own funds in related Swedish hybrid companies must be considered not available because an insurance company that is not allowed to distribute profits, cannot transfer excess own funds to its parent undertaking or sister companies. As a consequence, when applying method 1, the own funds of the hybrid company are eligible up to its diversified SCR. In practice, groups including hybrid companies are recommended to combine methods 1 and 2, i.e. to include the hybrid company with the deduction and aggregation method while using the consolidation method for the remaining group companies. The own funds of a related hybrid life insurance company are then eligible up to the amount representing its solo SCR (without recognition of any eventual diversification effects).\textsuperscript{1096} Finansinspektionen usually approves the combination of both methods in these cases.\textsuperscript{1097}

8.2.3.5 Concluding remarks

The rules on the eligibility of own funds at group level are very complicated, poorly drafted and reveal inconsistencies between the Directive and the Delegated Regulation. It is therefor doubtful whether the norms in the Delegated Regulation are still covered by

\textsuperscript{1096} Cf. Länsförsäkringar AB, Solvens och finansiell ställning i försäkringsverksamheten 2016, p. 4; Folksam Sakgruppen, Solvens- och verksamhetsrapport 2016, p. 4.

\textsuperscript{1097} Examples are Länsförsäkringar Livs Försäkrings AB, Länsförsäkringar AB, Solvens och finansiell ställning i försäkringsverksamheten 2016, p. 7; and Förenade Liv Gruppförsäkring AB, Folksam Sak-gruppen, Solvens- och verksamhetsrapport 2016, p. 4.
the delegation of power to adopt delegated acts that supplement the Solvency II Directive. The obligation to identify and restrict the eligibility of own funds at group level reveals an underlying expectation that excess own funds will in fact be transferred from one group undertaking to another group undertaking with a solvency deficit. Against this background, it is surprising and inconsistent that own funds held by the ultimate participating undertaking with a few exceptions are eligible, notwithstanding whether they can be transferred into a subsidiary or not. Equally confusing are the diverging rules in the Directive and the Delegated Regulation with regard to the availability of own funds (availability to cover the participating insurance undertakings solo SCR, or the group SCR, or something else) and with regard to the eligibility of minority interests.

It is surprising and dissatisfying that the rules on the eligibility of own funds in the Delegated Regulation are formulated in such an unclear way, inconsistent with the Directive and not always reflecting what EIOPA considers to be the correct way of calculating the eligibility of own funds, especially taking into consideration that several of CEIOPS/EIOPA’s publications deal with the issue.

8.3 Economic effect of different calculation methods

In chapter 8.2.3.3.3, the effects of the different calculation methods have already been illustrated with a few examples. In this chapter, the assessment of the effects will be deepened, and extended to include proportional consolidation as an alternative to full consolidation as well as the deduction and aggregation method. The examples are based on a rather simple group structure with an insurance holding as ultimate parent undertaking and five insurance undertakings as subsidiaries. The purpose of this exercise is to get a better understanding of how different consolidation methods and methods to calculate the amount of ineligible own funds influence group solvency.

The examples are fictitious and not based on existing insurance groups for several reasons. First, it is impossible to find two insurance groups that only differ in their group structure, but are otherwise identical. Second, the structures of existing groups are very complex, so that too many other factors than the group structure play a role in the calculation of the group solvency requirement – the impact of the group structure and the consolidation method would not become transparent. To take an existing group and vary the data input, for instance by assuming that the shareholding in a 100 % subsidiary is lowered to 55 %, could be an alternative. However, it would require the support by an insurance group that would need to conduct the calculations and be willing to share the data with the public, because the calculation of the group SCR cannot be done simply on the basis of publicly available company data (such as the consolidated accounts) due to the many adjustments that would be necessary.
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To use fictitious examples is therefore both easier to generate and more adequate because it enables to focus on the consolidation issue and to ignore other circumstances that may have an impact on the group solvency requirement.

8.3.1 The basis case

The examples are variations of the following basis case:

An insurance undertaking is ultimate parent undertaking in the EU. It has five subsidiaries, all of which are insurance undertakings in the EU. For simplification purposes, all own funds are classified as tier 1 and are fully fungible and transferable, and there are no intra-group transactions or double gearing of own funds. Only when the shareholding is less than 100 %, the minority interests in the respective subsidiary’s own funds are not considered fully transferable. Since the subsidiaries are assumed to be active on a variety of insurance markets, a diversification effect of 20 % is assumed to lead to a group solvency requirement which lies 20 % below the sum of the solo SCR of the subsidiaries and the ultimate parent. The diversification effect is assumed to be equally attributable to all group companies, unless mentioned otherwise.

When applying the deduction and aggregation method, the diversification effect is not recognized.

Basis Case

<table>
<thead>
<tr>
<th>Subsidiary 1</th>
<th>Subsidiary 2</th>
<th>Subsidiary 3</th>
<th>Subsidiary 4</th>
<th>Subsidiary 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>SCR solo: 100</td>
<td>SCR solo: 300</td>
<td>SCR solo: 100</td>
<td>SCR solo: 100</td>
<td>SCR solo: 100</td>
</tr>
<tr>
<td>OF solo: 300</td>
<td>OF solo: 500</td>
<td>OF solo: 150</td>
<td>OF solo: 120</td>
<td>OF solo: 140</td>
</tr>
</tbody>
</table>

Figure 8.3.1 no. 1

OFsolo = own funds of the respective entity; OFgroup=own funds at group level
SCRsolo = Solvency Capital Requirement of the respective entity
SCRgroup = group Solvency Capital Requirement
OFgroup = ΣOFsolo = 1330
SCRgroup = ΣSCRsolo - diversification effect = 800 × 0.8 = 640
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Assumptions:
- all subsidiaries are insurance undertakings with their head office in an EU member state
- all own funds are tier 1
- all own funds other than minority interests in own funds are available at group level
- diversification effect 20 %, equally distributed over all subsidiaries
- there are no intra-groups transactions or double gearing

8.3.2 Example 1: Wholly-owned subsidiaries

Example 1 is based on the basis case with the specification that all five subsidiaries are wholly-owned subsidiaries. The group solvency ratios according to the various calculation methods are as following:

<table>
<thead>
<tr>
<th>Method</th>
<th>Full consolidation and haircut as in Art. 222 (3) of the Directive</th>
<th>Full consolidation and haircut as in EIOPA’s Guideline on group solvency</th>
<th>Full consolidation as in Art. 330 Delegated Regulation</th>
<th>Proportional consolidation (without haircut)</th>
<th>Deduction and aggregation method (without haircut)</th>
</tr>
</thead>
<tbody>
<tr>
<td>group SCR</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>800</td>
</tr>
<tr>
<td>Group OF eligible at group level</td>
<td>1330</td>
<td>1330</td>
<td>1330</td>
<td>1330</td>
<td>1330</td>
</tr>
<tr>
<td>OF non-eligible at group level</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Group Solvency Ratio</td>
<td>207.8 %</td>
<td>207.8 %</td>
<td>207.8 %</td>
<td>207.8 %</td>
<td>166.3 %</td>
</tr>
</tbody>
</table>

The calculation applies the formulas developed in chapter 8.2.3.2.2.

With all subsidiaries being wholly-owned, there are no minority interests in the subsidiaries’ own funds that could be deducted. As expected, the results are therefore the same for all calculation methods based on consolidation. The non-recognition of diversification effects leads to a considerably lower group solvency ratio with the deduction and aggregation method (166.3 % compared to 207.8 %).

8.3.3 Example 2: Majority-owned subsidiaries

Example 2 is based on the basis case with the specification that the parent undertaking merely holds majority shareholdings in the subsidiaries.

For proportional consolidation, the following formula is applied:
\[ \text{SCR}_{\text{group}} = \text{Diversification effect} \times (\text{shareholding}_{\text{Sub1}} \times \text{SCR}_{\text{soloSub1}} + \text{shareholding}_{\text{Sub2}} \times \text{SCR}_{\text{soloSub2}} + \text{shareholding}_{\text{Sub3}} \times \text{SCR}_{\text{soloSub3}} + \text{shareholding}_{\text{Sub4}} \times \text{SCR}_{\text{soloSub4}} + \text{shareholding}_{\text{Sub5}} \times \text{SCR}_{\text{soloSub5}}), \]

where

\( \text{shareholding}_{\text{Subx}} \) is the percentage held in the capital of Subsidiary X and \( \text{SCR}_{\text{soloSubx}} \) is the solo SCR of Subsidiary X.

It is further assumed that diversification effects are recognized even when proportional consolidation is applied.

The shareholding in each subsidiary is 60%, so that there are minority interests amounting to 40% in all subsidiaries.

<table>
<thead>
<tr>
<th>Method</th>
<th>Full consolidation and haircut as in Art. 222 (3) of the Directive</th>
<th>Full consolidation and haircut as in EIOPA’s Guideline on group solvency</th>
<th>Full consolidation as in Art. 330 Delegated Regulation</th>
<th>Proportional consolidation (without haircut)</th>
<th>Deduction and aggregation method (without haircut)</th>
</tr>
</thead>
<tbody>
<tr>
<td>group SCR</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>416</td>
<td>520</td>
</tr>
<tr>
<td>Group OF eligible at group level</td>
<td>1310</td>
<td>1070</td>
<td>1290</td>
<td>846</td>
<td>846</td>
</tr>
<tr>
<td>OF non-eligible at group level</td>
<td>20</td>
<td>260</td>
<td>40</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Group Solvency Ratio</td>
<td>204.7 %</td>
<td>167.2 %</td>
<td>201.6 %</td>
<td>203.4 %</td>
<td>162.7 %</td>
</tr>
</tbody>
</table>

As expected, a lower shareholding has a negative effect on the group solvency ratio. For all methods except for the methods prescribed in EIOPA’s Guidelines, the difference is relatively small, however, ranging between 3.1 and 6.2 percentage points. EIOPA’s method leads to a significant drop with 40.6 percentage points.

### 8.3.4 Example 3: Subsidiaries with one majority and one minority shareholder

In example 3, the subsidiaries have two shareholders with their seat in the EU. The majority shareholder UP1 holds 51% of the shares in each subsidiary and minority shareholder UP2 holds 49%. The shareholders do not have joint control.

UP2 is not an insurance undertaking and does not hold any other participations in regulated entities apart from its shareholdings in Subsidiaries 1 to 5 (which are not subsidiaries of UP2).
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For the majority shareholder UP1, this structure leads to the following group solvency ratios:

<table>
<thead>
<tr>
<th>Method</th>
<th>Full consolidation and haircut as in Art. 222 (3) of the Directive</th>
<th>Full consolidation and haircut as in EIOPA’s Guideline on group solvency</th>
<th>Full consolidation as in Art. 330 Delegated Regulation</th>
<th>Proportional consolidation (without haircut)</th>
<th>Deduction and aggregation method</th>
</tr>
</thead>
<tbody>
<tr>
<td>group SCR</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>365.6</td>
<td>457</td>
</tr>
<tr>
<td>Group eligible at group level</td>
<td>1283</td>
<td>1011.5</td>
<td>1258</td>
<td>737.1</td>
<td>737.1</td>
</tr>
<tr>
<td>OF non-eligible at group level</td>
<td>47</td>
<td>318.5</td>
<td>72</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Group Solvency Ratio</td>
<td>200.5 %</td>
<td>158.0 %</td>
<td>196.6 %</td>
<td>201.6 %</td>
<td>161.3 %</td>
</tr>
</tbody>
</table>

For minority shareholder UP2, its shareholdings constitute participations in the meaning of Article 13 (20) Solvency II Directive. UP2 is a participating undertaking according to Article 212 (1) (a), but it is not an insurance holding company as defined in Article 212 (1) (f) because none of its shareholdings qualifies as a subsidiary due to UP2’s lack of control. UP2 and its participations form a group as defined in Article 212 (1) (c) (i), but are not subject to group supervision and are not obliged to calculate a group solvency requirement.

A comparison between 60% shareholdings (Example 2) and 51% shareholdings shows that a lower shareholding leads to a lower group solvency ratio, with the effect being largest with the method to be applied according to EIOPA’s Guidelines and smallest with proportional consolidation.

8.3.5 Example 4: Mixture of 51 % and 49 % shareholdings

Example 4 is a variant of example 3.

UP1 is still majority shareholder with 51 % in Subsidiaries 1 and 2, but only holds 49 % in Subsidiaries 3, 4 and 5. UP2 holds 51 % in those subsidiaries. There is no joint control and UP1 does not exercise a dominant influence on Subsidiaries 3, 4 and 5. Consequently, these undertakings are participations and not subsidiaries of UP1.

This has consequences for the consolidation method to be applied for “Subsidiaries” 3, 4 and 5. Article 335 (1) (d) Delegated Regulation requires the application of the adjusted equity method.
For the adjusted equity method, the following calculation method is applied:

\[ \text{Value}_{\text{Sub1}} = \text{shareholding}_{\text{Sub1}} \times \text{OF}_{\text{Sub1}}. \]

This value corresponds to the amount of own funds eligible at group level.

For the calculation of the group solvency ratio, the proportional share of the solo SCR needs to be taken into consideration (Article 336 (1) (b) Delegated Regulation). According to EIOPA, diversification effects are not recognized.\(^{1098}\) A haircut is in principle even applicable when the adjusted equity method is applied. However, since the adjusted equity method has the effect that minority interests already are eliminated, there is no practical application for a haircut of minority interests in own funds for Subsidiaries 3, 4 and 5.

<table>
<thead>
<tr>
<th>Method</th>
<th>Full consolidation and haircut as in Art. 222 (3) of the Directive + equity method</th>
<th>Full consolidation and haircut as in EIOPA’s Guideline on group solvency + equity method</th>
<th>Full consolidation as in Art. 330 Delegated Regulation + equity method</th>
<th>Proportional consolidation (without haircut)</th>
<th>Deduction and aggregation method + equity method</th>
</tr>
</thead>
<tbody>
<tr>
<td>group SCR</td>
<td>547</td>
<td>547</td>
<td>547</td>
<td>360.8</td>
<td>451</td>
</tr>
<tr>
<td>Group OF eligible at group level</td>
<td>1073.9</td>
<td>885.7</td>
<td>1002.4</td>
<td>728.9</td>
<td>758.9</td>
</tr>
<tr>
<td>OF non-eligible at group level</td>
<td>47</td>
<td>235.2</td>
<td>118.5</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Group Solvency Ratio</td>
<td>196.3 %</td>
<td>161.9 %</td>
<td>183.3 %</td>
<td>202.0 %</td>
<td>161.6 %</td>
</tr>
</tbody>
</table>

The loss of control of Subsidiaries 1 and 2 leads to a significantly lower group solvency ratio when applying the method derived from the Delegated Regulation (183.3 % compared to 196.6 %). When applying the method derived from the Solvency II Directive, the group solvency ratio falls with 4.2 percentage points.

When using the method prescribed in EIOPA’s Guidelines, the opposite is achieved: The solvency ratio increases with 3.9 percentage points, i.e. the loss of control has a slightly positive effect on the group solvency ratio. This is due to the fact that the group SCR decreases substantially (from 640 to 547) because the SCR of “Subsidiaries” 3, 4

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\(^{1098}\) EIOPA, Consultation Paper on the proposal for Guidelines on Solvency II relating to Pillar 1 requirements, EIOPA-14/036, Guideline 24, p. 361 para. 2.61.
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and 5 does not need to be taken into consideration in full any longer. In the example, this effect is larger than the non-recognition of diversification effects. Also when applying proportional consolidation or the deduction and aggregation method, the solvency ratio is minimally higher than when all subsidiaries are held with a 51 % majority.

8.3.6 Example 5: Merger of two subsidiaries

Example 5 is a variant of examples 1 and 2. Subsidiaries 3 to 5 are assumed to be merged on Subsidiary 1. As a consequence, their own funds are aggregated in Subsidiary 1 and amount to 710. The post-merger solo SCR of Subsidiary 1 is assumed to be 20 % lower than the sum of the pre-merger solo SCRs of Subsidiary 1 and Subsidiaries 2 to 5 due to diversification effects that are recognized within the merged solo entity, i.e. it is equal to 320 (0.8 × 400).

Since nothing has changed from a group perspective, the group SCR must still amount to 640. As a consequence, the diversification effect at group level is considerably diminished to 11.1 % because a part of the diversification is now already included in the solo SCR of Subsidiary 1.

Example 5a): The insurance undertaking holds 100 % in Subsidiary 1.

<table>
<thead>
<tr>
<th>Method</th>
<th>Full consolidation and haircut as in Art. 222 (3) of the Directive</th>
<th>Full consolidation and haircut as in EIOPA’s Guideline on group solvency</th>
<th>Full consolidation as in Art. 330 Delegated Regulation</th>
<th>Proportional consolidation (without haircut)</th>
<th>Deduction and aggregation method</th>
</tr>
</thead>
<tbody>
<tr>
<td>group SCR</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>720</td>
</tr>
<tr>
<td>Group OF eligible at group level</td>
<td>1330</td>
<td>1330</td>
<td>1330</td>
<td>1330</td>
<td>1330</td>
</tr>
<tr>
<td>OF non-eligible at group level</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Group Solvency Ratio</td>
<td>207.8 %</td>
<td>207.8 %</td>
<td>207.8 %</td>
<td>207.8 %</td>
<td>184.7 %</td>
</tr>
</tbody>
</table>

As expected, for all calculations based on full or proportional consolidation, this scenario leads to the same results as example 1, because due to the lack of other shareholders, all own funds are fully recognized. The example illustrates that where shareholdings amount to 100 %, the group structure does not influence the group solvency ratio when consolidated accounts are used (under the assumption that all own funds are fully available and transferable at group level).
When the deduction and aggregation method is used, the merger has a significantly positive effect on the group solvency ratio (184.7 % post-merger compared to 166.3 % pre-merger), because it enables the group to use the otherwise not recognised diversification effects between former Subsidiaries 1, 3, 4 and 5.

Example 5b): The insurance undertaking holds 60 % in both Subsidiary 1 (post merger) and Subsidiary 2.

<table>
<thead>
<tr>
<th>Method</th>
<th>Full consolidation and haircut as in Art. 222 (3) of the Directive</th>
<th>Full consolidation and haircut as in EIOPA’s Guideline on group solvency</th>
<th>Full consolidation as in Art. 330 Delgated Regulation</th>
<th>Proportional consolidation (without haircut)</th>
<th>Deduction and aggregation method</th>
</tr>
</thead>
<tbody>
<tr>
<td>group SCR</td>
<td>640</td>
<td>640</td>
<td>640</td>
<td>419.6</td>
<td>472</td>
</tr>
<tr>
<td>Group eligible at group level</td>
<td>1330</td>
<td>1066</td>
<td>1330</td>
<td>846</td>
<td>846</td>
</tr>
<tr>
<td>OF non-attributable at group level</td>
<td>0</td>
<td>264</td>
<td>0</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Group Solvency Ratio</td>
<td>207.8 %</td>
<td>166.6 %</td>
<td>207.8 %</td>
<td>201.6 %</td>
<td>179.2 %</td>
</tr>
</tbody>
</table>

This scenario can be compared with example 3. A significant increase (plus 17.9 percentage points) can be observed in the results generated with the deduction and aggregation method, which again can be explained with the fact that the merger has made diversification effects accessible to the group. According to the method derived from the Delegated Regulation, the group solvency ratio amounted to 201.6 % pre-merger and 207.8 % post-merger, i.e. a difference of 6.2 percentage points. The merger has in this case the effect, that all minority interests in own funds are eligible at group level. The latter also applies to the method derived from the Directive.

When using the method prescribed in EIOPA’s Guidelines, the group solvency ratio remains almost the same (minus 0.5 percentage points).

8.3.7 Further analysis of the results

The examples show that all full consolidation methods may lead to a haircut of the minorities’ share in the own funds, but with very different effects depending on the situation. The method derived from the directive tends not to lead to a haircut, unless a
majority-owned subsidiary has a very high solvency ratio and/or a large percentage of external shareholders.

As mentioned, the full consolidation methods require complete consideration of all risks in a majority shareholding. At the same time, not to own all shares in an undertaking has itself a risk-mitigating effect from the parent undertaking’s perspective, because in case of an insolvency of the subsidiary, the parent shares the loss with the other shareholders. The full consolidation methods, however, recognize this risk mitigation only partly by holding minority interests in own funds to a varying extent to be eligible at group level. This could be considered as inconsistent because other risk-mitigating factors are taken into consideration in the calculation of the group SCR.

The method prescribed by EIOPA in the Guidelines on group solvency leads to a low group solvency ratio in almost all cases except for wholly-owned subsidiaries. Only the deduction and aggregation method, which does not allow for the recognition of diversification results, leads in some cases to similarly low or even lower results. These methods are thus the most conservative ones since they consider more own funds to be ineligible at group level than the other methods. In practice, it is safe to assume that the method prescribed by EIOPA is demanded by national regulators and applied by the insurance industry when the consolidation method is applied.

If we assume that the numbers in the examples refer to million EUR, the fictitious group would be a relatively small one with a group SCR of 640 million EUR and own funds amounting to 1.33 billion EUR in example 1. In example 2 with the parent undertaking holding 60 % in all subsidiaries, the own funds eligible at group level are with EIOPA’s method 240 million EUR lower compared to the results achieved with the method derived from the Directive and 220 million EUR lower compared to the method derived from the Delegated Regulation. Based on EIOPA’s Guidelines, a group with wholly-owned subsidiaries would need 260 million EUR less own funds than an otherwise identical group with 60 % shareholdings in the subsidiaries to have the same group solvency ratio of 167.2 %.

A negative aspect of the calculation method prescribed in the Guideline is that it is not very advantageous from a parent undertaking perspective if a majority-owned subsidiary is over-capitalized, because the minority interests in the excess own funds are not recognized at group level. This might incentivize the parent undertaking to use its influence to work for a high profit distribution rate to reduce surplus funds. A lower solo solvency ratio would, however, contravene the interests of the subsidiary’s policyholders in a strong capital base of their insurer. Depending on the size of the distribution effects, the size of the shareholding and the solvency ratio of the subsidiary, it might be more

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1099 This can be compared to the group SCR reported by the Folksam sak group of 7.88 billion SEK (approx. 760 million EUR), Folksam Sak-gruppen, Solvens- och verksamhetsrapport 2016, p. 21, or the group SCR of the Alte Leipziger Hallesche Group of approx. 1.2 billion EUR, Alte Leipziger-Hallesche Konzern, Solvency and Financial Condition Report, p. 140.
favourable for the parent undertaking to apply the deduction and aggregation method with regard to partly-owned subsidiaries. The full consolidation methods, particularly the method in EIOPA’s Guideline are favourable to groups with wholly-owned subsidiaries, whereas it may discourage groups from letting external investors become shareholders in a group entity, for instance by entering into joint ventures or by undertaking an IPO of a subsidiary. Parent undertakings with existing majority-owned subsidiaries might consider acquiring those shares owned by external shareholders to turn such subsidiaries into wholly-owned ones, because this could have a positive effect on the group solvency ratio. However, this does not necessarily constitute the best use of the parent undertaking’s assets from a risk-allocation perspective, for instance.

The full consolidation of all risks has the effect that groups with a majority shareholding contributing significantly to the diversification effects in the group have a significantly lower group solvency ratio than an otherwise comparable group with a wholly-owned subsidiary, especially when the method prescribed in EIOPA’s Guidelines is applied. This could be considered as having a discriminatory effect that, as the case may be, only partly can be alleviated by applying the deduction and aggregation method.

The results also show that the method derived from the Directive and proportional consolidation lead to relatively small differences as long as all group entities are subsidiaries.

Of course, it can be debated, what a “relatively small” difference is. The Generali group, for example, stressed in a press release that the run-off of its German traditional life insurance business will increase the group solvency ratio by 1.7 percentage points and pointed out that this will free resources to support further growth.\(^{1100}\) Obviously, Generali considered this increase as sufficiently significant to include it in its information to the public.

Since diversification effects are not recognized for participations, the difference to the proportional consolidation method increases when many participations belong to the group, because the proportional consolidation method has been applied in such a way that it allows for the recognition of diversification effects attributable to both subsidiaries and participations. Proportional consolidation avoids the problem that the risk-mitigating effect of partly-owned subsidiaries is not taken into consideration and therefore avoids the disadvantages that may be suffered by groups with partly-owned subsidiaries, but does not provide a solution to the general problem that all consolidation methods treat groups as a single entity.

\(^{1100}\) Generali, Press Release of 2017-09-28: Generali accelerates the implementation of its strategic plan for excellence and long-term value creation in Germany.
8.4 Comment on the consolidation methods

As mentioned above, Solvency II largely requires application of the same consolidation methods as IFRS, albeit with some modifications concerning consolidation at equity and the application of proportional consolidation which is not applied anymore in IFRS accounting. Which consolidation method is the most appropriate cannot be said in general, but depends on the purpose of the consolidated accounts.

In financial accounting, two main theories can be distinguished. According to the proprietary theory or parent company concept, the group annual accounts serve the information interests of the parent company’s shareholders and creditors, so that the group financial statements are an “extension” of the parent company’s accounts. Minority shareholders of group subsidiaries are considered to only have a subordinated information interest in the performance of the group as a whole and are treated as lenders. A strict application of this theory requires the application of proportional consolidation of majority-owned subsidiaries, i.e. if the parent undertaking owns 60 % of the shares in a subsidiary, only 60 % of the subsidiary’s balance sheets positions are taken up in the group balance sheet. According to van Mourik, the proponents of this theory view a company as “a vehicle that enables the company’s owners to maximise the profit generated by the entity and to maximise the increase in their wealth”. Consequently, the objective of group accounting is to give these owners the necessary information for their decision to buy, hold or sell shares.

The opposing concept is the entity theory which focuses on the corporation as an entity separate from its proprietor. The entity concept considers all owners of equity, i.e. also non-controlling shareholders of subsidiaries, as owners of the consolidated equity, and consequently deems them to be interested in the performance of the entire group. The underlying view of the company according to the entity theory is that the company is a “vehicle to provide goods or services valued by customers, provide employment to employees, and to provide a fair return to investors”. According to this concept, the management of the company does not operate solely in the interests of the shareholders, but is obliged to balance the interests of the company’s stakeholders.

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1103 Küting, Grau and Seel, p. 41.
1108 van Mourik, p. 226.
1109 Ibid, p. 225.
This theory conforms with full consolidation and separate disclosure of the minority interests in the group’s equity and results.\textsuperscript{1110}

The theories do not only have influence on the appropriate consolidation method and disclosure of non-controlling interests, but also on the valuation methods to be applied, and are applied not only with regard to group accounting but also as theories underlying accounting at solo level.

In practice, financial accounting systems often combine elements of both approaches.\textsuperscript{1111} IFRS has moved towards the entity theory,\textsuperscript{1112} requiring full consolidation of subsidiaries and having given up the possibility of using proportional consolidation of joint ventures in favour of equity accounting. § 310 HGB still permits proportional consolidation in these cases, but has in some other respects been aligned to IFRS group reporting.\textsuperscript{1113}

Whereas proportional consolidation is not used any more in IFRS accounting, the Swedish expert committee encharged with analysing the need for new rules on municipal accounting and reporting, proposes to prescribe proportional consolidation as the standard consolidation method with regard to all companies in which a municipality\textsuperscript{1114} has a significant interest, which is assumed to be the case if the municipality owns at least 20% of the voting rights of a company.\textsuperscript{1115} The expert committee argues that the purpose of municipal group accounting is to disclose the costs incurred by and the obligations of the reporting municipality because the municipality’s task is to provide services to the public rather than to generate profit.\textsuperscript{1116} This argumentation bears some similarities to the proprietary theory in that the addressee of the group reporting is a single group of stakeholders, namely “the public” or the citizens who are recipients of the municipal services and some form of “owners” (though not in a legal sense) of the municipality. Since many municipalities hold shares in companies together with other external shareholders, full consolidation would overestimate costs for service delivery, while equity accounting would underestimate the costs.\textsuperscript{1117}

\begin{itemize}
\item \textsuperscript{1110} Küting, Grau and Seel, p. 41; less explicit: Riahi-Belkaoui, p. 216.
\item \textsuperscript{1111} Kam, p. 309.
\item \textsuperscript{1112} Küting, Grau and Seel, p. 41.
\item \textsuperscript{1113} Küting and Seel, p. 59.
\item \textsuperscript{1114} The proposal applies both to municipalities (Swedish: kommuner) and county councils (Swedish: landsting). For simplification, only the term municipality is applied here.
\item \textsuperscript{1115} SOU 2016:24, En ändamålsenlig kommunal redovisning. Betänkande av KomRed, pp. 244, 252. Proportional consolidation is already the recommended consolidation method, but Swedish law lacks an explicit provision to this effect. The committee suggests to allow equity accounting when there are specific reasons and this is compatible with a true and fair view. An example is the participation in a very large undertaking, where proportional consolidation would have the effect that the positions in the group financial statements are dominated by this undertaking, p. 254.
\item \textsuperscript{1116} SOU 2003:14, Princíper för ett moderniserat solvenssystem för försäkringsbolag, p. 253.
\item \textsuperscript{1117} Torbjörn Tagesson, Arguments for proportional consolidation; the case of Swedish local government, Public Money & Management (2009), pp. 215-216, at p. 216.
\end{itemize}
8.5 On the perspective of the group Solvency Capital Requirements

As we have seen, in accounting theory, it is important to be aware of the addressee of the consolidated reporting, as this has consequences for the choice of an adequate consolidation method and for how minority interests are shown.

The same question can be asked with regard to the group Solvency Capital Requirement. Does the group Solvency Capital Requirement apply a parent undertaking perspective, comparable to the proprietary concept in financial accounting, or does it focus on the policyholders of all group entities similar to the entity approach according to which consolidated accounts are set up to inform the equity holders of all group undertakings?

Most of the times, the perspective applied does not have any practical relevance, which may explain why it does not seem to have been discussed before. It is, however, important for the question whether a group internal model with a so-called Limited Liability Put Option is approvable, i.e. an assumption that the parent undertaking will not support a subsidiary under certain circumstances, which is discussed in chapter 11.2.2.

To develop an understanding of group solvency, it is helpful, if not indispensable, to know which perspective is applied.

The Solvency II legislation does not explicitly state which approach is taken and contains provisions indicating in both directions. Article 230 (1) Solvency II Directive on the group SCR merely refers to the rules concerning the solo SCR, where Article 101 (3) states that the solo SCR “shall correspond to the Value-at-Risk of the basic own funds […] subject to a confidence level of 99.5 % over a one-year-period”. Translated to the group SCR, this means that the basic own funds at group level with a probability of 99.5 % shall not be entirely consumed within a one-year-period. This seems to tend more towards a proprietary concept, since the consumption of own funds to some extent can be influenced by the parent undertaking (for instance by not injecting funds into a subsidiary). Recital 106, on the other hand, indicates towards an approach focusing on the policyholders of all group entities (similar to the entity approach in accounting):

“Is is necessary to ensure that own funds are appropriately distributed within the group and are available to protect policy holders and beneficiaries where needed. To that end, insurance and reinsurance undertakings within a group should have sufficient own funds to cover their solvency capital requirements.”

The recital vaguely indicates that the idea behind the group SCR is to designate the amount of own funds necessary to ensure that all policyholders of group undertakings receive payment when due.
The full consolidation requirement in Article 335 (1) Delegated Regulation also suggests an “all policyholders approach”, whereas the possibility to return to proportional consolidation when a majority-owned subsidiary does not meet its SCR indicates a proprietary concept (Article 221 (1) Solvency II Directive), because it allows the group to lower the group SCR when there are external shareholders – in a situation when the solo SCR of a partly-owned subsidiary is not met and its policyholders are in acute need of protection. Prerequisite for a return to proportional consolidation is that the group supervisor is convinced that the parent undertaking’s responsibility is strictly limited to its share in the capital, i.e. a parent undertaking’s perspective is applied in this regard.1118 However, EIOPA’s guidelines on group solvency reveal a profound unease with this possibility, indicating that EIOPA tends towards an “all policyholders approach”, i.e. a group SCR that reflects the ability to meet all group undertakings’ obligations towards their policyholders. The following expectation expressed in 2006 by CEIOPS in its advice to the European Commission in 2006, could also be understood as indicating in this direction:

"[...] that the group SCR should be calculated according to consolidated data so that diversification benefits resulting from intra-group offsets on consolidation and the fact that the different insurance portfolios in the group are treated as one get recognised".1119

Other provisions that can be interpreted in both directions are the rules on the eligibility of own funds at group level: To limit the eligibility of non-transferable own funds can be understood as an expression of the “all policyholders concept”, since it is motivated with the desire to ensure that excess own funds covering the group SCR can be transferred to other group undertakings, which serves the objective of policyholder protection. On the other hand, the rules also contain elements indicating towards the proprietary concept because own funds of the parent undertaking are with a few explicit exceptions always considered to be eligible, notwithstanding whether they can be transferred into a subsidiary or not, whereas other group undertaking’s own funds must be transferable to the parent undertaking.1120 The recognition of diversification effects at group level also indicates towards a proprietary perspective because it does not reduce the risk for policyholders but for parent undertakings and benefits therefore in the first place parent undertakings by enabling them to finance a part of the own funds required at solo level through debt.

1118 See chapter 8.2.2.2.
1119 CEIOPS, Advice to the European Commission in the framework of the Solvency II project on sub-group supervision, diversification effects, cooperation with third countries and issues related to the MCR and SCR in a group context, para. 2.11.
1120 See chapter 8.2.3.1.
At level 2, the provisions do not give any guidance concerning the perspective from which the group SCR is calculated.

As has been shown, the Solvency II legislation is not consistent, indicating sometimes towards a parent undertaking and sometimes to an “all policyholders perspective”, with a slight overweight towards the latter. The latter is consistent with the objective of policyholder protection, being the primary objective of the Solvency II legislation and is further supported by recital 106 and by the fact that the eligibility of unavailable own funds is limited at all. The underlying understanding of the group SCR thus seems to be a perspective focusing on the policyholders of all group undertakings. It is important to note, however, that this is not an outspoken perspective and that there are a number of aspects in the Solvency II Directive that are inconsistent with this approach.

8.6 On the background of the calculation methods prescribed in Solvency II

As little as the perspective of the group SCR is made explicit in the Directive, as little do the Directive or any of the many preparatory documents I have consulted take up why the consolidation method has become the main method in the Solvency II Directive.

Group issues seem to have received relatively little attention compared to the solo SCR during the development of Solvency II. In the early documents, group issues were mainly mentioned with regard to the role of supervisory authorities with regard to insurance groups and the use of internal models. In its so-called second wave of call for advice from CEIOPS from 2004, the Commission merely requested advice from CEIOPS on the question whether the Insurance Groups Directive needs to be amended to make Solvency II workable. The Commission specifically excluded any discussion of the three calculation methods provided for in the Insurance Group Directive from the call for advice since it expected this to be covered by another report. In this other report, however, the possibility to prescribe one method is shortly discussed, but no recommendation was made to amend the Insurance Group Directive. The third wave of advice from early 2006 was not concerned with specific group questions and in

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1121 European Commission, Paper for the solvency subcommittee - Considerations on the design of a future prudential supervisory system, 28 November 2002, para. 72 ff.; European Commission, Note to the IC Solvency Subcommittee. Subject: Solvency II - Reflections on the general outline of a framework directive and mandates for further technical work, 19 December 2003, paras. 3.1.4, 3.4.3; European Commission, Draft amended framework for consultation on Solvency II, March 2005, para. 6
1122 European Commission, Specific Call for Advice from CEIOPS, December 2004, para. 12.4.
1123 Ibid, para. 12.3.
1125 See CEIOPS, Consultation Paper no. 9 - Draft Answers to the European Commission on the third wave of Calls for Advice in the framework of the Solvency II project. The final advice (CEIOPS-CP-03/06) is not available online anymore.
CEIOPS’ Advice on sub-group supervision and diversification effects from November 2006, the consolidation approach was taken for granted.1126 The first Directive Proposal from 2007 already contained the current system with the consolidation method as the preferred method 1 and the deduction and aggregation method as method 2.1127

At first glance, one could suspect that the preference for the consolidation method is the result of an early commitment to the IFRS consolidated accounts as the basis for the SCR calculation and therefore to the consolidation methods applied by IFRS, rather than a result of a thorough analysis of the available alternatives. However, in a report issued in 1995 by the so-called Tripartite group consisting of representatives of bank, securities and insurance regulators from several EC member states, Canada, Japan, the U.S., Switzerland, the Commission and the Basle Committee on Banking Supervision, several calculation methods for assessing the capital requirements of financial conglomerates were assessed and discussed.1128

The Tripartite Group considered that accounting-based consolidation “may be appropriate and useful” for homogenous groups, for instance a group subject to only banking or only insurance regulation.1129 For heterogenous groups, i.e. financial conglomerates, however, the Group considered it not to be an appropriate method at the time, among other due to differences in valuation principles, and decided not to analyse this method any further.1130 Instead, it discussed a variety of other possible calculation methods, namely “block capital adequacy”, total deduction method, risk-based aggregation, and risk-based deduction, and the “building block” prudential approach, according to which the consolidated accounts would be split up into the four blocks banks, insurance companies, securities firms and unregulated entities. Of these methods, it considered the latter three to be appropriate to provide “accurate insight into the risks and capital coverage” across the group, while effectively eliminating double gearing.1131

However, the Group was unable to agree on how partly-owned subsidiaries should be treated, with some members favouring full consideration of minority interests, and the others favouring proportional consideration. Some members also advocated an asymmetric approach combining full consolidation of risks with proportional consideration of own funds as being the most prudent approach.1132 This approach resembles the method prescribed by Solvency II with a full consolidation of risks and

1126 CEIOPS, Advice to the European Commission in the framework of the Solvency II project on sub-group supervision, diversification effects, cooperation with third countries and issues related to the MCR and SCR in a group context, November 2006, para. 2.11.
1128 The Supervision of Financial Conglomerates, paras. 104 – 173.
1129 Ibid, para. 108.
1130 Ibid, para. 108.
1131 Ibid, para. 130.
1132 Ibid, para. 148.
limitations to the eligibility of minority interests in own funds. In the report, it is pointed out that with full consideration, it is assumed that the controlling shareholder will support a subsidiary in distress. It provides the supervisor with an overall picture of the group, of which minority interests in own funds belong, but it is not capable of determining whether capital is adequately distributed in the group. Proportional consideration is described as providing a perspective “of the capital position of the parent company as a separate legal entity”.

The asymmetric approach is described as the most prudent result, because it ensures that the parent undertaking has the means to support a subsidiary in distress even if it is not obliged to do so. That this approach may overstate the parent undertaking’s liability was accepted by its supporters who were concerned that proportional consideration would be insufficient in cases where the parent undertaking’s liability exceeds its pro-rata share and where contagion risks within the group exist.

\[\text{1133 Ibid, para. 149.}\]
\[\text{1134 Ibid, para. 149.}\]
\[\text{1135 Ibid, para. 148.}\]
\[\text{1136 Ibid, para. 148 f.}\]
PART IV

THE COMPANY LAW REALITY OF UNDERTAKINGS IN AN INSURANCE GROUP
9 The relationship between insurance group undertakings in the light of company law

In chapter 4, the concept of limited liability as a feature of both German and Swedish company law and some major differences between German and Swedish company law have already been introduced.

In this part IV, it is further explored how German and Swedish company law regulate the relationship between group undertakings, especially between a parent undertaking and its subsidiaries in order to define the company law reality against which the compatibility of the Solvency II calculation method is measured.

This purpose limits the depth of the analysis in so far as a pure de lege lata perspective is applied and that it suffices to provide an overview of the legal framework applicable to German and Swedish insurance groups. Answers to unclear topics do not need to be provided because the lack of clarity is part of the company law reality and will often influence how companies act in a crisis situation. For instance, if it is unclear whether a certain measure would constitute an illegal value transfer, it is assumed that a prudent management will abstain from executing the measure. Instead, it will consider modifying the measure or executing a different measure. In a crisis situation (including a crisis in an affiliated company), the management is presumably not very inclined to enforce a measure with uncertain legal consequences not only because of the risk of damage claims and potential harm for the board members’ professional reputation but also because intra-group transactions need to be reported to the group supervisor so that there is a risk for regulatory intervention. The group supervisor will usually have an interest in solving financial difficulties in an insurance undertaking belonging to the group, but potential conflicts of interest among different supervisory authorities and the group supervisor cannot be entirely excluded despite close collaboration within the college of supervisors. A subsidiary’s supervisor may not always be enthusiastic if an insurance undertaking under its supervision transfers own funds to a related undertaking in a different member state.\[1137\] This will probably also influence the management’s attitude. If a subsidiary has minority shareholders, a prudent management will also have to consider their interests when being confronted with a demand by its parent undertaking.

For the purposes of this chapter, a Swedish insurance group is defined as an insurance group with the ultimate parent undertaking registered in Sweden and at least one direct subsidiary being an insurance undertaking registered in Sweden. A German insurance

group consists of an ultimate parent undertaking in Germany with at least one German insurance undertaking as subsidiary.

What I have chosen to call the “company law reality” encompasses all company law rules insurance undertakings and insurance holdings in a group have to follow. Some issues have already been mentioned in chapter 4, for instance the association forms open for insurance undertakings in Swedish and German law, the existence of “hybrid” insurance companies in Sweden, some differences concerning the monistic board system in Sweden and the dualistic board system in Germany, or the possibility of issuing partly paid-in shares in German law.

The presentation in this chapter is limited to those matters that are considered to be of relevance in the course of the study. These can be divided into three categories:

- Limits to a parent undertaking’s entrepreneurial freedom to help a subsidiary in need (chapter 9.1)
- A parent undertaking’s legal possibilities to exercise influence on its subsidiaries (chapter 9.2)
- Rules on (downstream and upstream) transfers of assets between group undertakings from parent undertakings to subsidiaries (downstream asset transfers) (chapter 9.3.)

The chapter’s structure follows these categories. Within each category, first German and then Swedish law is presented. Where relevant, it is distinguished between wholly-owned and majority owned companies, mutuals (Versicherungsvereine auf Gegenseitigkeit and ömsesidiga försäkringsbolag) and life insurance undertakings operated on a mutual basis (hybrid companies).

For the purposes of the following presentation, it is presumed that Solvency II does not alter the company law reality. Among German scholars, a discussion has arisen, whether a special “insurance group law” is coming into existence under the influence of Solvency II. This discussion will be taken up in chapter 10.
9.1 On a parent undertaking’s obligation to support or not to support a subsidiary in distress

Even if a parent undertaking is not directly responsible for a subsidiary’s debts, it may otherwise be inclined to support a financially distressed subsidiary. The following chapter deals with the question whether it is entirely up to the management’s discretion to try to save a subsidiary, or whether there are situations where it is obliged to support a subsidiary or to refrain from doing so.

Absent any leges speciales in German and Swedish law, the question needs to be answered by taking recourse to the rules on the liability of managers and supervisory board members, because these stipulate the consequences for the decision takers if their decision to save or not to save a subsidiary later on turns out to be harmful to the company. This could be the case, if the subsidiary falls bankrupt despite financial help received by the parent undertaking, thereby increasing the loss suffered by the parent undertaking. Since my assumption for the purposes of this study is that board members will act in such way that liability will not arise, procedural aspects and formal requirements for liability claims are not described in detail.

9.1.1 German law

§ 93 (2) AktG deals with the liability of the members of the management board of an Aktiengesellschaft towards the company. According to § 188 (1) sentence 1 VAG 2016, § 93 AktG is also applicable to the management board of insurance mutuals.

If the conditions in § 93 (5) AktG are fulfilled, the company’s claim can be raised by the company’s creditors. Liability towards shareholders or other third parties can also be based on general tort law, namely § 823 (2) BGB or § 826 BGB, provided the respective requirements of these norms are met. § 823 (2) BGB, for instance, requires a breach of a norm that aims at the protection of the claimant (Schutzgesetz).

§ 93 (1) sentence 1 AktG defines the duty of care that management board members have to comply with: They are obliged to apply the “care of a diligent and conscientious manager” (Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters). Sentence 2 codifies the business judgement rule stemming from U.S. company law according to which the duty of care is not violated if the management board members when taking entrepreneurial decisions have reason to believe that they are acting on the basis of

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1138 Krieger speaks of the internal liability’s primary function to influence the board members’ behaviour, Krieger in: MHdGR AG, § 26 para. 2. Also Skog stresses the educational function of the rules on liability, Skog, Rodhes Aktiebolagsrätt, p. 217.

1139 Hüffer/Koch AktG, § 93 paras. 61-62.

1140 Entrepreneurial decisions (unternehmerische Entscheidungen) are described as a conscious decision that typically involves a choice of one of several alternatives in situations requiring risk-taking and uncertainty with
adequate information to the benefit of the company. Paragraph 4 stipulates that the members of the management board are not liable towards the company if the action is based on a decision by the general meeting. Liability towards creditors is not excluded by such a resolution. An approval by the supervisory board is not sufficient to avoid liability in any case (§ 93 (4) sentence 2).

An entrepreneurial decision that causes damage to the company may only be privileged by the business judgement rule if it is in compliance with the law and the articles of association. This also means, however, that decisions that are in compliance with law and the articles of association still constitute a breach of the duty of care if they are not privileged by the business judgement rule. Negligence is presumed when a breach of a duty of care is established. Concerning the question whether a decision by the management board of the parent undertaking to support or not support a subsidiary in need is privileged by the business judgement rule, the board members have to comply with the following requirements in their decision taking:

The management board has to decide which action conforms best to the company’s interest, taking into account all available options (i.e. giving or denying support, and the different options how to give support) and the risks connected to them. Usually, the consequences of the various options will be connected with a considerable degree of uncertainty: Whether a prognosis is correct that the supporting measures will be sufficient to save the subsidiary from insolvency, or that a subsidiary will manage to get over a crisis without financial intervention, will only prove right or wrong later. Whether a decision is privileged by the business judgement rule, needs to be assessed from an ex ante perspective – the knowledge that a decision in hindsight proved to be disastrous is irrelevant.

In many cases, there will not be a clear answer which action complies best with the parent company’s interest in a long-term profit increase or a strengthening of competitiveness. The business judgement rule grants a wide discretion to the management board with regard to the assessment of whether an action (or wilful omission) is in the best interest of the company. Only when the management board has assessed the risks wrongly in an extremely irresponsible manner, the action is not privileged and represents a breach of the duty of care.

regard to the future consequences of the decision; see Spindler in: MüKo AktG, § 93 paras. 41 – 44; Hüffer/Koch AktG, § 93 para. 16.
1141 Hüffer/Koch AktG, § 93 para. 16; Spindler in: MüKo AktG, § 93 para. 73.
1142 Wiesner in: MHdGR AG, § 26 para. 15.
1144 Hüffer/Koch AktG, § 93 para. 23, with reference to the preparatory works.
1145 Bank in: Patzina et al., chapter 6 para. 59.
1146 Hüffer/Koch AktG, § 93 para. 23.
however, responsible for assuring that they base their decision on adequate information.\textsuperscript{1147}

From all of this follows that in most cases, the management of the parent undertaking is free to decide whether it uses the company’s capital or other measures to help a subsidiary, but there may be cases where the discretion is limited in such a way that only one decision is the correct one, i.e. where it would be extremely irresponsible to act in a different way. Factors that need to be taken into consideration and that in exceptional cases may limit the board’s discretion are:

- The amount that is required to save the subsidiary
- Its size in relation to the parent undertaking’s financial situation
- The probability that the rescue attempt succeeds
- Contagion risks if the subsidiary fails without support
- Contagion risks if rescue attempt fails
- Reputation risks.

If the subsidiary with a high probability could be saved with relatively small means and its insolvency would constitute a much larger loss to the parent company than the capital required, the only correct decision would be to assist the subsidiary. In other words, the management and supervisory boards of the parent undertaking would have an obligation to try to save the subsidiary.

At the other end of the scale, there are situations where the attempt to save the subsidiary with a high probability would endanger the survival of the parent undertaking itself because its own financial stability would be at risk if it tried to support the subsidiary.\textsuperscript{1148} In such a case, the only correct decision is not to inject funds.\textsuperscript{1149} Instead, the parent undertaking could try to find an external investor, and, in the worst case, let the subsidiary go bankrupt.

Neither is the management board allowed to waste the company’s assets,\textsuperscript{1150} which might be the case if the prospects of saving the subsidiary are very small. In such a case, a rescue attempt might constitute a breach of the duty of care, especially if the capital required is not negligibly small in relation to the parent undertaking’s equity.

It is important to note that the burden of proof lies with the management board (§ 93 (2) sentence 2 AktG). The reason for this reversal of the burden of proof is that the management organ is considered to have better knowledge of the background of the decision than the supervisory board that is representing the company in the liability claim against members of the management board.\textsuperscript{1151} Another important procedural aspect is that the general meeting’s approval of the company’s administration according to

\textsuperscript{1147} Spindler in: MüKo AktG, § 93 para. 48; Hüffer/Koch AktG, § 93 para. 20.
\textsuperscript{1148} Cf. Spindler in: MüKo AktG, § 93 para. 55; Bank in: Patzina et al., chapter 6, para. 70.
\textsuperscript{1150} Spindler in: MüKo AktG, § 93 para. 70.
\textsuperscript{1151} Hüffer/Koch AktG, § 93 note 53.
§ 120 (2) sentence 2 AktG does not constitute a waiver of liability claims (in contrast to corresponding resolutions of the general meetings of other associations).

The business judgement rule also applies to the members of the supervisory board who need to apply it in their supervision of the suitability and efficiency of the management of the company or when being asked by the management board to approve its decision.\(^{1152}\) The supervisory board is not obliged or even allowed to reverse a decision by the management board that is privileged by the business judgement rule.\(^{1153}\) Only when it considers a measure to be unjustifiable, is it allowed and obliged to stop it.\(^{1154}\)

9.1.2 Swedish Law

Chapter 29 § 1 ABL deals with the liability of the board directors and the CEO towards the company, the company’s shareholders and third parties. According to this provision, a director or the CEO is liable towards the company (so-called “internal liability”) for damages that he has caused\(^{1155}\) in office intentionally or negligently. Liability towards shareholders or other third parties (so-called “external liability”) has a higher threshold, requiring a breach of the ABL, the Accounting Act or the articles of association (chapter 29 § 1 ABL). Not any breach is sufficient, but liability requires an intentional or negligent breach of a provision aiming at the protection of shareholders or external stakeholders, mainly creditors.\(^{1156}\) A difference to German law is that the burden of proof lies with the person claiming liability.\(^{1157}\)

If the parent undertaking is a försäkringsaktiebolag, also a breach of the FRL may lead to liability towards third parties (chapter 11 § 51 FRL 2016), particularly policyholders.\(^{1158}\) A corresponding provision applicable to insurance mutuals can be found in chapter 21 § 1 Cooperative Societies’ Act, which is applicable by way of reference in chapter 12 § 87 FRL 2016. Since the acts in question neither require nor prohibit that a parent undertaking attempts to save a subsidiary from insolvency, liability towards a creditor or shareholder of the parent undertaking for failure to support a subsidiary seems extremely unlikely. Liability for a futile attempt to save a subsidiary would require a breach of relevant provisions of the ABL or the FRL, such as the rules


\(^{1153}\) Ibid, paras. 93, 998.

\(^{1154}\) Ibid, para. 93.

\(^{1155}\) Swedish authors usually stress that adequate causality is required: Sandström, p. 408; Östberg, p. 449 with further references. This is also true for German law without being explicitly taken up in German doctrine.

\(^{1156}\) HD, NJA 2014 p. 272 (BDO-målet), para. 67; Sandström, p. 413; Östberg, p. 451 f.

\(^{1157}\) Dotevall, Bolagsledningens skadeståndsansvar, p. 72.

\(^{1158}\) In the preparatory works, also a liability towards third parties for breaches against the company’s actuarial and capital investment guidelines has been discussed and was found not necessary, Prop. 2009/10:246, En ny försäkringsrörelselag, p. 275 f. It was noted, however, that such breaches may at the same time constitute breaches against the stability principle laid down in the FRL: SOU 2006:55, Ny associationsrätt för försäkringsföretag, p. 305.
on value transfers or the general provision. As long as these rules have been complied with, no liability towards creditors or shareholders arises.

As already mentioned, for liability towards the company, the hurdles are lower. Apart from breaches of the above named acts, also other actions or omissions may lead to the CEO’s or a director’s liability, if they negligently or intentionally cause damage to the company. For the assessment of negligence, circumstances like the breach of legal provisions or of binding instructions by higher company organs, such as the board of directors in the case of the CEO, or of the general meeting in the case of directors are of importance since they lead to a presumption of negligence.1159

Neither the ABL nor the FRL contain explicit rules on how to assess negligence. The preparatory works speak of a duty of care applicable to an independent trustee (Swedish: syssloman)1160, however without giving further guidance how to define this duty of care with regard to the CEO and directors. Dotevall holds that, where no breach of statutory law, the articles of association, binding instructions or the like has taken place, the business judgement rule is applicable also in Swedish law, requiring the directors to not promote their own personal interests and to base their decision on sufficiently comprehensive documentation.1161 According to Östberg, Swedish law lacks a business judgement rule, but knows a similar principle, granting a wide discretion to the board of directors so that only exceptional cases may lead to liability.1162 Similar to German law, Swedish law thus acknowledges that business decisions often involve a considerable degree of uncertainty and risk taking and therefore grants a certain level of discretion to the directors. Dotevall holds that it is not possible to determine generally the exact level of risk that is privileged by Swedish law.1163 This level needs to be determined on a case-by-case basis taking into account the business and financial situation of the company in question.1164 Liability may arise if a measure is deemed to be too risky, for instance because its consequences are difficult to predict and its financing is unclear or because of its size in relation to the company’s equity.1165

These examples remind of the criteria developed above with regard to German law. It can be concluded that also according to Swedish law, the decision to inject capital into a financially distressed subsidiary normally is a matter of discretion privileged by the

1159 Dotevall, Bolagsledningens skadeståndsansvar, p. 63; Bergström and Samuelsson, Aktiebolagets grundproblem p. 137; Östberg, p. 446.
1160 Prop. 1997/98:99, Aktiebolagets organisation, p. 184. Since the rules on directors’ liability have remained unchanged in the 2005 ABL, the preparatory works still have authority.
1161 Rolf Dotevall, Liability of Members of the Board of Directors and the Managing Director - A Scandinavian Perspective, 37 The International Lawyer (2003), pp. 7-22, at p. 11;
1162 Östberg, p. 449.
1163 Dotevall, Liability of Members of the Board of Directors and the Managing Director - A Scandinavian Perspective, p. 11.
1165 Dotevall, Bolagsledningens skadeståndsansvar, p. 111.
business judgement rule, but in exceptional situations, the board of directors may be obliged to either try to save the subsidiary in a crisis situation or to leave it to its own destiny, as the case may be, in order to avoid personal liability. Whether the limits of the entrepreneurial discretion are exactly the same in German and Swedish law, is irrelevant in the context of the present study.

A difference to German law is that the general meeting’s approval of the administration hinders liability claims by third parties, unless the approval was based on incomplete information.1166

9.2 On a parent undertaking’s influence on its subsidiaries

The consolidation approach applied in Solvency II presupposes that a parent undertaking is able to enforce its will upon a subsidiary. In a crisis, group companies may have diverging interests. A relevant issue for the purpose of this study is how parent undertakings may exercise influence on a subsidiary’s business decisions. In a single undertaking not belonging to a group, no particular problems arise because the management organs (CEO and board of directors in the case of Swedish companies and management board and supervisory board in the case of German companies) may take all necessary decisions (within the ambit of their respective competences, of course), but in a group context, conflicts between the interests of parent undertakings and subsidiaries may arise. The most important instruments of exercising influence are through representation in the subsidiary’s organs and by giving instructions to a subsidiary.

9.2.1 German law

In German Aktiengesellschaften, parent undertakings may exercise influence through resolutions of the general meeting, which elects the supervisory board that in turn appoints the members of the management board, and through instructions rendered to the subsidiary.

9.2.1.1 General meeting

According to § 118 (1) AktG, the general meeting is the main instrument for the exercise of shareholders’ rights. Usually, a parent undertaking has all or the majority of the votes in a subsidiary’s general meeting. With a 3/4 majority in an Aktiengesellschaft, it has enough votes to change the articles of association including the object of the company’s business (§ 179 (1) AktG) and therewith decide which lines of insurance business an

1166 Chapter 29 §§ 7-11 ABL. For a more detailed description, see Bergström and Samuelsson, Aktiebolagets grundproblem, pp. 135 – 137; Östberg, p. 454 f.
insurance subsidiary may conduct. With a simple majority, it can also appoint the shareholders’ representatives in the supervisory board (Aufsichtsrat) (§ 101 (1) AktG). In insurance groups, subsidiaries’ supervisory boards are often composed entirely or predominantly of management board members or senior managers of the parent undertaking. The removal of a supervisory board member requires a ¾ majority (§ 103 (1) 2 AktG). A simple majority is sufficient to decide upon the distribution of profits to the shareholders. The general meeting cannot represent the company towards third parties and does not have competence to manage the company.\(^{1167}\)

As already mentioned, the general meeting only has competence to decide on those issues assigned to it by law, most importantly:

- the appointment and removal of supervisory board members
- the use of distributable profits
- the ratification of the acts of the management board members and supervisory board members
- the appointment of the external auditors
- amendments of the articles of association
- the appointment of auditors for the examination of matters in connection with the formation or the management of the company
- the dissolution of the company and its continuation
- the conclusion or amendment of enterprise agreements
- squeeze-out decisions
- merger or split-off
- integration of the company into another company.\(^{1168}\)

According to § 119 (2) AktG, the general meeting may only decide upon matters of the management of the company if requested by the management board. An unwritten competence of the general meeting has been developed by case law (“Holzmüller” cases), requiring the management board to request the general meeting’s consent to significant changes in the structure of the company.\(^{1169}\) The changes must be similarly comprehensive as in the Holzmüller case, where assets amounting to about 80 % of the assets were transferred to a subsidiary, and require approval by the general meeting with a ¾ majority.\(^{1170}\)

The management of a German Aktiengesellschaft is obliged to execute valid resolutions of the general meeting. A resolution may be invalid (nichtig) or may be contested (angefochten) and annulled by a competent court. The reasons for invalidity are exhaustively listed in § 241 AktG and include infringements of certain formal

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\(^{1167}\) Hüffer/Koch AktG, § 119, para. 11f.

\(^{1168}\) See the list of items in § 119 (1) AktG and Hüffer/Koch AktG, § 119 paras. 7-9.

\(^{1169}\) BGHZ 83, 122 (Holzmüller).

\(^{1170}\) BGHZ 159, 30 (Gelatine).
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requirements, an unethical (sittenwidrig) content of the resolution and violation of provisions in the interest of the creditors of the company or the public interest. A resolution can be contested on the grounds that it breaches against the law or against the articles of association. Consequently, if the execution of a resolution would lead to a breach of insurance regulatory law, for instance a profit distribution would lead to a breach of the SCR, it would be contestable.

A resolution can be contested within one month after its adoption by each shareholder (with certain qualifications) or the management board in its entirety following a unanimous decision of the board.\textsuperscript{1171} Also individual members of the supervisory board or management board have standing to contest a resolution if they would commit a criminal act or administrative offence or become liable by executing the resolution. The board is obliged to contest a resolution if its execution could harm the company.\textsuperscript{1172}

To conclude, the competences of the general meeting only give a parent undertaking of a German insurance company very limited rights to exercise influence on the subsidiary. Most important are the right to decide upon the use of the distributable profits and the right to appoint the shareholders’ representatives among the supervisory board members.

9.2.1.2 Supervisory board

The supervisory board’s task is to supervise the management board of the company (§ 111 (1) AktG). It shall adopt by-laws for the management board including a list of measures which the management board may not take without the supervisory board’s consent. These may also be listed in the articles of association. The supervisory board’s veto right with regard to the measures requiring its consent does not have a corresponding positive instruction right, i.e. it is not entitled to order the management board to enter into certain transactions, since this would constitute an undue interference with the management board’s exclusive responsibility to manage the company.

The supervisory board must act in the interest of the company and must not give preference to group interests.\textsuperscript{1173} A member of the supervisory board cannot be obliged to follow the instructions of any third party, for instance the majority shareholder, and neither may he or she voluntarily bind him- or herself to follow such instructions.\textsuperscript{1174} If a member of the supervisory board also is a member of the management board or supervisory board of the parent undertaking or is employed by another (group) company – which often is the case in group constellations – he or she must therefore act in the interest of the subsidiary when acting as a supervisory board member. In case of a

\textsuperscript{1171} Hüffer/Koch AktG, § 245 para. 36.
\textsuperscript{1172} Ibid, § 245 para. 36.
\textsuperscript{1173} Krieger in: MHdGR AG, § 70 para. 39.
\textsuperscript{1174} Hoffmann-Becking in: MHdGR AG, § 33 para. 7.
conflict of interest, he or she may also refrain from voting. If the duties to act in the interests of two companies are permanently incompatible with each other, a supervisory board member may need to give up one of these positions.1175

9.2.1.3 Management board

According to § 84 (1) AktG, the supervisory board appoints the members of the management board for a determined period of time which may not exceed five years. The management board of an insurance company must consist of at least two members (§ 33 (1), 188 (1) 1 VAG 2016). The supervisory board may appoint one management board member to be chairman of the management board (§ 84 (2) AktG). In insurance groups with an insurance holding at the top, the chairmen of the management boards of the major subsidiaries are often also members of the management board of the holding. The general meeting may revoke an appointment when an important cause for the revocation exists (§ 84 (3) AktG), such as a severe breach of duties, the inability to manage the company properly, or the general meeting’s resolution of no-confidence for the board member in question. A revocation according to these rules is seldom applied. In case of a persistent disagreement between the supervisory board and a management board member on the management of the company, it is more common that the supervisory board and the management board member agree to terminate the appointment prematurely. Board members may also resign.

The management board has exclusive responsibility for the management of the company, whereby it is obliged to observe the interest of the company.

9.2.1.4 Instructions by a parent undertaking

As already mentioned, if the parent undertaking has a domination agreement with a direct subsidiary (or an unbroken chain of domination agreements to an indirect subsidiary), it is according to § 308 AktG entitled to give binding instructions to the subsidiary’s management board, as long as the interests of the subsidiary’s insured are not unduly interfered with. Neither may the execution of the instruction lead to a breach against the articles of association, for instance against the business objects, or against mandatory accounting rules.1176 Managers of subsidiaries with a domination agreement sometimes demand to get a written instruction from the parent undertaking when requested to take a measure they are opposed to.

Usually, domination and profit transfer agreements are concluded with wholly-owned subsidiaries, but there is no prohibition to conclude them with a subsidiary with minority shareholders. In that case, the minority shareholders are according to § 304 (1) AktG entitled to receive annual payments by the

1175 Hoffmann-Becking in: ibid, §33 para. 80.
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dominating shareholder as a compensation. However, in the exceptional situation where a subsidiary with a domination agreement has minority shareholders, the legal situation is the same as for a wholly-owned subsidiary with such an agreement, i.e., the parent undertaking may instruct the subsidiary to take all measures, even disadvantageous ones, without having to compensate the subsidiary, provided that the measures do not constitute a disadvantage to the subsidiary’s policyholders.

If the parent undertaking does not have a domination agreement with its insurance subsidiary, it does not have the right to give binding instructions to the subsidiary. Usually, there are nevertheless countless contacts between the parent undertaking and the subsidiary where the parent undertaking expresses wishes what the subsidiary should do. Often, the subsidiary will follow its parent’s wishes. In other words, the parent undertaking often interferes with the subsidiary. However, this may lead to a parent undertaking’s obligation to compensate the subsidiary or to liability towards the subsidiary according to § 311 (1) AktG. This rule prohibits the parent undertaking from exercising its influence on the subsidiary to the disadvantage of the latter unless the parent compensates the subsidiary for the disadvantage. Consequently, German group corporate law in principle forbids a parent undertaking to give instructions to the management board of a subsidiary, but does not ignore the fact that parent undertakings frequently want to influence their subsidiaries’ business.

In the absence of a domination agreement, the management board of a subsidiary is not obliged to follow a formal instruction or informal request from its parent undertaking, notwithstanding whether its execution would be detrimental to the company or not. If the execution leads to a disadvantage for the company, it may only follow its shareholder’s wish, if the disadvantage can be quantified and will be compensated for (§ 311 AktG) – otherwise the management board breaches its duty of care and may be liable towards the company.

Even if no communication about a compensation has taken place, the subsidiary receives a compensation claim, if a disadvantageous measure has been induced by the parent undertaking.

In order to count as a relevant interference by the parent undertaking in this context, it suffices that the parent in some way has influenced the subsidiary to take a disadvantageous measure, for instance by suggestions, proposals, guidelines or direct orders. The influence does not necessarily have to stem directly from the parent undertaking’s board of management, but may be exercised by employees of the parent undertaking, if their actions from the subsidiary’s perspective are attributable to the parent. Similarly, the addressee of the interference may be a member of the

1177 Hüffer/Koch AktG, § 304 para. 4. § 304 AkG does not state whether the dominating shareholder or the dominated subsidiary are obligors of the annual compensation payment to the minority shareholders. The prevailing opinion holds that the dominating shareholder is obligor, because in the usual case of a combined domination and profit transfer agreement, the subsidiary’s annual profit is transferred to the dominating parent.
subsidiary’s management or supervisory board or any of its employees.¹¹⁸⁰ It is not necessary that the parent undertaking’s representatives understood that they were influencing the subsidiary.¹¹⁸¹ If a management board member of the parent undertaking also is member of the management or supervisory board of the subsidiary, the prevailing view in legal doctrine is that there is a presumption that a disadvantageous measure has been influenced by the parent undertaking.¹¹⁸²

It suffices that the subsidiary had reason to believe that it was following its parent’s wish.¹¹⁸³ As already mentioned, in order to lead to a compensation claim, the measure or omission must constitute a disadvantage for the subsidiary. A disadvantage is understood as any “reduction of or concrete threat to the financial situation of the company”.¹¹⁸⁴ The Federal Court of Justice (Bundesgerichtshof - BGH) has developed the following definition:

“Each reduction of or specific risk for the financial position of the company without having regard to any quantifiability, as far as the impairment is a result of the company being a subsidiary [...]”.¹¹⁸⁵ [own translation].

Thus, the measure must have an actual or potential negative effect on the financial position of the subsidiary. Whether a measure is disadvantageous is tested from an ex-ante-perspective.¹¹⁸⁶ Favorable later developments that could not be foreseen do not hinder the qualification as a disadvantage.¹¹⁸⁷ According to the BGH, a measure is not disadvantageous if a diligent manager of an unaffiliated company in the same situation would have been allowed to take the same measure.¹¹⁸⁸ For this test, the court applies the same standards as for a breach of the duty of care by a member of the management board according to § 93 AktG, including the business judgement rule.

Consequently, in order to be considered a disadvantage, the measure or omission influenced by the parent must pass a two-fold test: It needs to impair the financial situation of the subsidiary, and the management board of the subsidiary would not have

¹¹⁸⁰ Hüffer/Koch AktG, § 311 para. 17; Müller in: Spindler/Stilz AktG, § 311 para. 18.
¹¹⁸⁴ Habersack in: Aktien- und Konzernrecht, § 311 para. 39; Krieger in: MHdGR AG, § 70 para. 82.
¹¹⁸⁵ Original wording: “jede Minderung oder konkrete Gefährdung der Vermögens- und Ertragslage der Gesellschaft ohne Rücksicht auf Quantifizierbarkeit, soweit die genannte Beeinträchtigung als Abhängigkeitsfolge eintritt”, BGHZ 141, 80, (Konzernumlage), p. 1707; BGHZ 179, 71, (MPS), para. 8a.
¹¹⁸⁶ BGHZ 175, 365, (UMTS-Lizenzen), para. 19; BGHZ 179, 71 (MPS) para. 13c.
¹¹⁸⁸ BGHZ 190, 7, (Dritter Börsengang der Telekom AG), para. 38; BGHZ 175, 365 (UMTS-Lizenzen) para. 11; BGHZ 141, 80 (Konzernumlage), p. 1708; Altmeppen in: Mükö AktG, § 311 para. 190; Vetter in: Schmidt/Lutter AktG, § 311 para. 41.
been allowed to take the measure if the company had not been a subsidiary, all other circumstances remaining the same.\textsuperscript{1189} The requirement of a breach of duty of care is derived from § 317 (2) AktG, which relieves the parent undertaking and its members of the management board from liability for not granting compensation for a disadvantageous measure imposed on a subsidiary if the management of an independent company would have taken the same measure. § 317 (2) AktG is read as a rule on the burden of proof rather than as a limitation of liability, so that it has relevance also in the context of § 311 AktG. Indeed, it would be inconsistent if a disadvantage that does not involve a breach of the duty of care would have to be compensated for according to § 311 AktG, but would not incur liability for damages in case of a failure to provide compensation.\textsuperscript{1190}

The legal nature of the compensation claim is debated. According to most commentators, it is a claim \textit{sui generis},\textsuperscript{1191} whereas others consider it to be a claim for damages for wrongful management (\textit{Schadenersatzanspruch für pflichtwidrige Geschäftsführung})\textsuperscript{1192}.

The compensation does not need to be in cash, but may consist of other economic benefits, such as a favourable transaction with the parent undertaking (for instance the provision of services without remuneration).\textsuperscript{1193} If the compensation has not been effectuated during the financial year during which the interference has occurred, parent and subsidiary are obliged to enter into a legally binding agreement on which benefit shall be rendered and when it shall be due (§ 311 (2) AktG).\textsuperscript{1194} The compensation serves as a justification of the interference of the parent undertaking to the subsidiary’s detriment.\textsuperscript{1195} As a result, as long as it compensates the subsidiary for any disadvantages, the parent undertaking may place its own interests above the interests of the subsidiary, and the subsidiary is entitled, but not obliged, to respect the parent undertakings implicit or explicit wish. However, if the disadvantage is not quantifiable, it cannot be justified by a compensation and remains an illegal interference that may give rise to liability claims.\textsuperscript{1196}

Breaches against § 311 may lead to a liability for damages suffered by the subsidiary due to the uncompensated disadvantageous measure both by the management board of the subsidiary according to § 93 (2) AktG and by the parent undertaking and its management board according to the above mentioned § 311 (1) AktG. According to § 317 (4) in connection with § 309 (4) AktG, the liability claim may not only be raised by the subsidiary’s board of management or its supervisory board, but also by any shareholder of the subsidiary, which may become relevant if there are minority

\begin{itemize}
\item \textsuperscript{1189} Vetter in: Schmidt/Lutter AktG, § 311 para. 40.
\item \textsuperscript{1191} Hüffer/Koch AktG, § 311 para. 37 with further references.
\item \textsuperscript{1192} Altmeppen in: Műko AktG, § 311 para. 320.
\item \textsuperscript{1193} Habersack in: Aktien- und Konzernrecht, § 311 para. 62.
\item \textsuperscript{1194} Krieger in: MHdGR AG, § 70 para. 75.
\item \textsuperscript{1195} Habersack in: Aktien- und Konzernrecht, § 311 para. 5.
\item \textsuperscript{1196} Habersack in: ibid, § 311 para. 43; Müller in: Spindler/Stülz AktG, § 311 para. 40.
\end{itemize}
shareholders. Even creditors that cannot obtain satisfaction from the company may raise the claim.

The objective of the compensation obligation is the protection of the subsidiary’s creditors and of minority shareholders, if any.\textsuperscript{1197} Even if it may be difficult in many cases to clearly establish a disadvantage and the adequacy of a compensation measure, the rules are said to have a disciplinary effect because they force managers of both parent and subsidiary undertaking to consider the effects of a measure beforehand.\textsuperscript{1198} Compliance with § 311 is further promoted by the obligation of the management board of the subsidiary to set up an annual report on the company’s relations to its parent undertaking (\textit{Abhängigkeitsbericht})\textsuperscript{1199} where it needs to list all transactions with the parent undertakings and its affiliated undertakings, all measures and omissions induced by the parent undertaking including their benefits and disadvantages and the compensation granted for disadvantageous measures. The report must be presented to the supervisory board, but not to the shareholders or the public. In the report, the management board also has to declare whether the company in each single case has received an adequate consideration or compensation (§ 312 (2) AktG). The report is examined by the company’s external auditor, and incorrect statements or failure to list relevant transactions or omissions leads to a liability by the members of the board of management and of the supervisory board of the subsidiary to the company according to § 318 AktG.

The provisions on the compensation obligation are an important restriction to the parent undertaking’s possibilities to exert influence on a German insurance subsidiary, even if the hurdle for a compensation requirement is quite high due to the requirement a measure would breach against the duty of care of the managers of a non-affiliated company.\textsuperscript{1200}

Nevertheless, my impression is that they contribute to an increased awareness by the management of a parent undertaking on the consequences of its interferences and, more importantly, lead to an awareness on the part of the management of a subsidiary on its right to ignore instructions. This if, of course, highly dependent of the group structure and management style applied.

\textsuperscript{1197} Hüffer/Koch AktG, § 311 para. 1.
\textsuperscript{1198} Altmeppen in: Müko AktG, Vor § 311 para. 29.
\textsuperscript{1199} Habersack in: Aktien- und Konzernrecht, § 311 para. 6.
\textsuperscript{1200} Please note that the situation is entirely different for subsidiaries in the form of GmbH, where the shareholders are entitled to give binding instructions to the management.
9.2.2 Swedish law

The general features of Swedish law with regard to the division of competences and their right to give instructions to a company’s CEO have already been outlined in chapter 4.1.3.2. Here, a more detailed description follows.

9.2.2.1 General meeting

Unlike German law, there is no exhaustive list of competences of the general meeting of a Swedish insurance company. The competences of the general meeting include, of course, all the competences of its German counterpart (including appointment of the directors), but apart from these, the general meeting may with a simple majority also take binding resolutions on management issues (chapter 7 § 40 ABL). If the resolution is valid and does not breach against the FRL, the board of directors is obliged to execute it (chapter 8 § 41 section 2 ABL e contrario, chapter 11 § 11 section 2 FRL 2016 e contrario).

Every shareholder has a right to request the board of directors to include topics on the agenda of a general meeting according to chapter 7 § 16 ABL. Shareholders holding at least 10% of all shares also have the right to request the board of directors to convene an extraordinary general meeting with two weeks notice (chapter 7 § 13 ABL). A sole or majority shareholder thus always has the possibility to request a general meeting within a few weeks. The general meeting, however, does not have competence to exercise management decisions or to represent the company towards third parties.\footnote{Åhman, p. 406 ff.}

In Swedish company law, it is generally accepted that provisions with the objective to protect (the existing) shareholders can be set aside if all shareholders agree – the so-called “SAS-principle”.\footnote{Prop. 2004/05:85, Ny aktiebolagslag, p. 202; HD, NJA 1981, p. 1117; NJA 2013 p. 117; Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 20; Niklas Arvidsson, Associationsrättsligt samtycke och skadestånd, Svensk Juristtidning (2014), pp. 653 - 661, p. 653 f.; Sandström, p. 20; Stattin, p. 203; Östberg, p. 35 f.; Bergström and Samuelsson, Aktiebolagets grundproblem, p. 62; Åhman, p. 660 f., see also Stattin, p. 138.} A resolution may therefore even breach against the articles of association if all shareholders agree, for instance against the business object or the profit purpose stated there.\footnote{Åhman, p. 660 f.} However, this does not concern breaches with an ongoing effect in the future.\footnote{Bergström and Samuelsson, Aktiebolagets grundproblem, p. 62; Åhman, p. 660 f., see also Stattin, p. 138.} Furthermore, a unanimous resolution may not set aside certain non-dispositive provisions of the ABL, namely those protecting third parties.

Stattin gives the following example: A unanimous resolution by the general meeting that the company shall enter into a transaction that falls outside the business objects is valid, even if the execution of the contract takes a longer time, whereas the general meeting would not be allowed to adopt a resolution.
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according to which the company for an indetermined period of time repeatedly shall enter into such transactions or form a subsidiary for such transactions – unless it changes the articles of association.1205

Whether the possibility to deviate from the articles also exists for insurance companies, is unclear. The preparatory works to chapter 11 § 6 FRL 2016 suggest that the legislator considered the general meeting to be bound by the articles of association.1206 Since chapter 2 §§ 8, 9, 15 FRL 2016 require the articles to be approved by Finansinspektionen before registration, it would seem at least surprising if all shareholders (or the sole shareholder) in a general meeting could adopt a valid resolution involving a breach of the articles of association since this would weaken the regulator’s position. According to chapter 18 § 1 no. 1 FRL 2016, Finansinspektionen may impose regulatory sanctions against an insurance undertaking that acts contrary to its articles of association, which also speaks against a possibility for the general meeting to unanimously set aside the articles of association. On the other hand, this would also mean that a sole shareholder of a profit-distributing insurance company would be bound by the profit purpose and could not give an instruction that would breach against it – even if the insured would not be negatively affected.1207

Many Swedish insurance undertakings, for example, offer premium-free “pregnancy insurance” covering health and accident risks of pregnant women and their unborn children. Presumably, these undertakings have calculated that sufficiently many parents continue insuring their children with them that the profits from these new children accident and health insurances exceed the losses from the pregnancy insurances, but without such business calculations, free insurances could be considered to breach against the profit purpose. Therefore, an adequate solution might be anyway to apply the above-mentioned standards also for insurance undertakings, possibly with the modification that provisions in the articles of association of an insurance undertaking sometimes can be regarded as also having a policyholder protection dimension, even if this would not be the case in an ordinary limited company. An example could be a breach of the business objects, which often also would constitute a breach against the prohibition to conduct non-insurance business or would not be encompassed by insurance classes for which the insurance company is authorized.

According to chapter 11 § 11 section (2), chapter 12 § 30 FRL 2016 and chapter 7 § 42 section (2) Cooperative Societies’ Act, the boards of directors and the CEO of an insurance company or mutual are not allowed to execute a resolution that is null and void or that has been annulled by a competent court or arbitral tribunal, or that is invalid because it breaches against the FRL. A resolution is a nullity if not even all shareholders

1205 Stattin, p. 211.
1206 Prop. 2009/10:246, En ny försäkringsrörelselag, p. 239: ”Även om samtliga här behandlade riktlinjer är avsedda att vara bindande för verksamheten på samma sätt som bolagsordningen kan man ställa sig frågande till varför bolagsstämma skä vara bunden av styrelsens riktlinjer”.
1207 See Åhman, p. 750.

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unanimously would be allowed to take it, if the resolution has not been taken unanimously by all shareholders although this was required, or if the general meeting had not been summoned in accordance with the law (chapter 7 § 51 section 2 ABL). 1208

According to the preparatory works to the corresponding provision in the 1975 ABL, a resolution is also null and void (ogiltig) if its execution would constitute a criminal action or would violate against good faith (goda seder), in contrast to a mere violation of private law that might lead to liability claims. 1209

According to chapter 7 §§ 50, 51 ABL, the CEO and each individual member of the board of directors, without the specific requirements laid down in German law, have standing to file an annulment claim within three months (in nullity cases without any time limit). The grounds for annulment are breaches of the ABL (including a breach of the general provision), the articles of association and the Accounting Act. Compared to German law which encompasses breaches of any law as a ground for annulment, the grounds for contesting a resolution of the general meeting are consequently more limited.

According to chapter 11 § 6 FRL 2016, a shareholder, the board of directors, a member of the board of directors and the CEO are also entitled to challenge the validity of a resolution of the general meeting if the resolution is incompliant with guidelines on technical provisions adopted by the board of directors. This provision is applicable only to insurance companies that are not allowed to distribute profit, i.e. hybrid life insurance companies. For insurance mutuals, there is no corresponding norm.

Before 2016, also a breach against internal investment guidelines was a ground for annulment. The deletion is a consequence of the deletion of a corresponding explicit obligation of the board of directors to set up such internal investment guidelines. 1210

The provision’s objective is policyholder protection as well as stability and predictability in the operation of the insurance undertaking, and it constitutes an exception to the rule that the general meeting is not bound by decisions of the board of directors. 1211 The preparatory works explicitly state that this annulment reason is not applicable to insurance companies that may distribute profit. 1212 The limitation of the right to challenge such a resolution is surprising because the company is obliged to follow the guidelines according to chapter 10 § 23 section (1) FRL 2016 and Finansinspektionen may impose sanctions in case of a breach (chapter 18 § 1 FRL 2016). When abolishing the possibility of annulment for profit-distributing insurance companies in 2010, the legislator wanted to cease treating profit-distributing insurance

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1208 Sandström, p. 200; Stattin, p. 157: “invalidity ex tunc”. The ABL does not explicitly state that such resolutions are a nullity, but merely extends the period for contesting such a resolution in court to infinity.
1209 Prop. 1975:103, Regeringens proposition med förslag till ny aktiebolagslag m. m., p. 413.
1210 Prop. 2015/16:9, Genomförande av Solvens II-direktivet på försäkringsområdet, p. 606. See also chapter 9.2.2.1.
1211 See Prop. 2009/10:246, En ny försäkringsrörelselag, p. 239 ff.
1212 Ibid, p. 246.
companies differently from other limited liability companies. The preparatory works also state that breaches of such internal guidelines often also constitute a breach of the stability principle or regulatory provisions on the calculation of technical provisions.\textsuperscript{1213} This implies that, unless the stability principle or regulatory law is violated, the execution of a resolution that leads to a breach of such internal guidelines is not subject to regulatory intervention, and that the board of directors and CEO are obliged to execute such a resolution.

To which extent chapter 11 § 11 section (2) FRL 2016 really prohibits board members and the CEO to execute resolutions in breach of the FRL (or other such instructions from a sole shareholder) is not entirely clear. According to Frostell and Gabrielsson, the corresponding provision in the FRL 1982 was not applicable if a resolution became binding because it was not challenged within 3 months.\textsuperscript{1214} If the board of directors or CEO intentionally or negligently fail to apply for annulment of a resolution, they could be liable to the company, however.\textsuperscript{1215}

According to Bergström and Samuelsson, the board of directors is not obliged to execute a resolution with an instruction concerning a management measure if the execution would cause damage to the company, but they also concede that the limits for the board’s obligation to follow the instructions of the general meeting are not entirely clear.\textsuperscript{1216} Stattin suggests that a general prohibition to execute a resolution exists if it not by itself, but in connection with other instructions, violates the company’s interest, even if it does not directly breach against the ABL, Accounting Act or the articles of association.\textsuperscript{1217} As a general principle, the board of directors is not allowed to execute a resolution on management matters, even if it has not been formally contested, if it is obviously not in the company’s interest.\textsuperscript{1218} This is consistent with the Swedish concept of company interest which consists of the shareholders’ common interests rather than an individual interest of its own, so that a unanimous decision by all shareholders according to the SAS principle cannot be contrary to the company’s interest.\textsuperscript{1219} If all shareholders have agreed to the resolution, however, the board of directors is nevertheless obliged to execute a resolution,\textsuperscript{1220} unless its execution would breach against rules aimed at the protection of third parties, for instance creditor protection rules.\textsuperscript{1221}

It seems doubtful that this applies without modifications to insurance undertakings when a breach of the FRL is at hand, even without any breach of criminal provisions.

\textsuperscript{1213} Ibid, p. 246.
\textsuperscript{1214} Hans Frostell and Edmund Gabrielsson, Kommentar till Försäkringsrörelselagen m. m. (3rd edn 2002) p. 225.
\textsuperscript{1215} Ibid, p. 226.
\textsuperscript{1216} Bergström and Samuelsson, Aktiebolagets grundproblem, p. 75; see also Dotevall, Aktiebolagsrätt , p. 216.
\textsuperscript{1217} Stattin, p. 204.
\textsuperscript{1218} Prop. 1975:103, Regeringens proposition med förslag till ny aktiebolagslag m. m., p. 382 f.; Åhman, p. 750; Östberg, p. 255 with further references.
\textsuperscript{1219} See chapter 4.1.4.2.
\textsuperscript{1220} Åhman, p. 750; Östberg, p. 256.
\textsuperscript{1221} Johansson, p. 123.
First, a breach of regulatory provisions may lead to regulatory sanctions against the insurance company, which is not in the company’s interest. Second, since the objective of regulatory law is the protection of policyholders and the stability of the financial markets, it is not at the disposal of the shareholders or members.\textsuperscript{1222}

To sum up, a sole or majority shareholder of a Swedish insurance company thus has the possibility through the general meeting to give binding instructions to the board of directors and the CEO even on management matters. The board of directors and the CEO are obliged to execute such resolution unless they are a nullity, have been annulled or if their execution would lead to a breach of regulatory law.

9.2.2.2 Direct instructions by a parent undertaking

For a shareholder’s instruction to be binding for the board of directors, it must have been taken by the general meeting, i.e. it does not suffice that the CEO of the parent undertaking orally or in writing gives orders to a subsidiary’s board of directors.\textsuperscript{1223} Both Skog and Stattin acknowledge that, in practice, parent undertakings often influence their subsidiaries this way. The correct way of exercising influence is, however, via the general meeting, i.e. the shareholders cannot meet informally and give orders to the board of directors.\textsuperscript{1224} According to Stattin, this concerns also instructions rendered by a parent undertaking, and as, it seems, by a sole shareholder.\textsuperscript{1225} Only if an informal meeting despite breach of some formal requirements can be regarded as a general meeting, for instance because minutes of the meeting have been kept as if it was a general meeting, the participation and consent of all shareholders can according to the SAS principle heal the breach of formal requirements.\textsuperscript{1226} According to Stattin, the SAS principle is not applicable for decisions taken outside a general meeting, because it can only mend shortcomings in but not “create” a general meeting.\textsuperscript{1227} Other authors apply the SAS-principle for all decision processes by the shareholders and hold that the shareholders’ omnipotence gives them the right to take unanimous decisions even outside a general meeting.\textsuperscript{1228} This wide application seems to be supported by the Högsta Domstolen.\textsuperscript{1229} The Supreme Court applied the SAS-principle to an informally taken decision by the board of directors that consisted of all members of a housing cooperation at the time of the decision. The member’s unanimous consent was thus clearly established outside a general meeting. The Court also pointed out that an association’s

\begin{footnotes}
\footnote{1222}{See Dotevall who states that the prohibition to enforce instructions by the general meeting also extends to instructions whose execution would lead to a breach of other statutes, Dotevall, Aktiebolagsrätt, p. 206.}
\footnote{1223}{Skog, Rodhes Aktiebolagsrätt, p. 264; Stattin, p. 271.}
\footnote{1224}{Dotevall, Bolagsledningens skadeståndsansvar, p. 41; Stattin, p. 273.}
\footnote{1225}{Stattin, p. 310.}
\footnote{1226}{Ibid p. 273.}
\footnote{1227}{Ibid, pp. 272, 310.}
\footnote{1228}{Bergström and Samuelsson, Aktiebolagets grundproblem, p. 62.}
\footnote{1229}{NJA 2013 p. 117. See chapter 4.1.4.2 for a short summary of the case.}
\end{footnotes}
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interest is equal to the interest of its members. If this was taken seriously, the board of directors would breach against the company’s interest if it does not follow an informal instruction by the sole (or all) shareholders. However, the fact that it may be impossible for a subsidiary’s board of directors to assess whether the parent undertaking’s instruction is based on a valid decision taken by the competent company organ, supports the opinion of Stattin and Åhman, who claim that an informal instruction is not binding for the board of directors.1230

9.2.2.3 Board of Directors

A parent undertaking of an insurance company that may distribute profit, has through its majority in the general meeting the possibility to appoint all directors, with the exception of the employee representatives. As already mentioned, this is different in a hybrid insurance undertaking, where at least one board member must be elected by the policyholders or an interest organisation. The requirement that at least half of the board members of such a company may not be employed by a group undertaking also limits the shareholders’ influence somewhat.

Via the board of directors, the majority or sole shareholder has significant influence on a subsidiary, but it is important to note that the individual members do not have a duty of loyalty arising from company law towards single shareholders, and are not obliged to follow orders by them.1231

As the case may be, such a duty may, however, arise out of a trustee relationship between a director and a shareholder.1232 However, Stattin points out that the trustee relationship concerns the relationship to the general meeting as the organ that (normally) has appointed the director.1233 To me, it is unclear whether this means that a director that has been appointed by an organisation in accordance with a provision in the articles of association, has a duty of loyalty towards this organisation and how this relates to the obligation to follow the company’s interest.

All directors (including the employee representatives, who are not allowed to take part in decisions where the trade unions’ interest may collide with the company interest) have a duty of loyalty towards the company and have to observe the company’s interest.1234 Chapter 8 § 23 ABL forbids directors to take part in board decisions in case of a conflict of interests, but explicitly excludes decisions concerning transactions with other group companies, even if a director also is a director in the other undertaking.1235 The board of directors may give binding instructions to the CEO by taking a formally valid decision.

1230 Stattin, p. 273; Åhman, p. 724 f.
1231 Östberg, p. 140.
1232 Ibid, p. 140.
1233 Stattin, p. 274.
1234 See Johansson, pp. 131-138.
9.3 Asset transfers between group companies

If a group undertaking is in a severe financial crisis and needs additional own funds, the question arises how funds can be transferred from other group companies to the group company in need.

As explained above, Solvency II only restricts the eligibility of own funds of related undertakings, but not of the ultimate parent undertakings, if such own funds cannot be transferred to other group undertakings. The EU legislator seems to have the understanding that downstreaming funds from a parent undertaking to a subsidiary generally does not meet any legal restrictions, in contrast to transfers from subsidiaries to parent undertakings or other related undertakings that may be subject to company law restrictions.

This chapter therefore distinguishes between transfers from a parent to a subsidiary and those from a subsidiary to a parent or to other group undertakings.

9.3.1 Assets transfers from a parent undertaking to a subsidiary in financial distress

In principle, there are three main instruments to increase the own funds of a subsidiary:1236 By increasing the share capital of the subsidiary and subscribing to new shares, by injecting capital into the capital reserves of the subsidiary (without the issuance of new shares), or by granting a loan to the subsidiary.

Depending on why the subsidiary is in financial difficulties, a loan may have to comply with certain regulatory qualifications in order to solve the difficulties. An ordinary, not subordinated, loan does not qualify as own funds and therefore only relieves from financial difficulties, if these consist solely of a lack of liquidity, provided that the subsidiary’s assets after taking the loan still exceed its liabilities and that the loan is compliant with national regulatory law at all. If the subsidiary is in difficulties because it does not meet its SCR anymore, the loan needs to qualify as own funds of a tier 1 quality. A tier 2 or tier 3 quality is also sufficient, provided that the limits for the eligibility of these categories of own funds have not been reached already. If the subsidiary does not meet its MCR, the loan needs to fulfil the criteria for basic own funds of a tier 1 or tier 2 quality.

When the own funds are to be provided by another subsidiary, this can be done either via the parent undertaking or directly from a well-financed subsidiary to the subsidiary in distress, for instance by providing a loan that meets the above-mentioned criteria.

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1236 There are other possibilities like merging another company onto the subsidiary or of providing reinsurance to the subsidiary but these are of subordinated importance in this context.
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9.3.1.1 German law

Capital increases, injections into the capital reserve of subsidiaries and granting loans to subsidiaries are in principle all allowed by German law. The formal and material requirements for these measures are shortly described in the following.

9.3.1.1.1 Capital increases

A capital increase of a German Aktiengesellschaft requires a resolution of the general meeting with a 75 % majority of the share capital present at the voting, unless the articles of association require a different majority (§ 182 AktG). The minutes of the general meeting must be certified by a notary public and the capital increase must be registered in the Commercial Register in order to become effective. Before registration, at least 25 % of the capital increase must have been paid in. Partly paid-in shares are only allowed if this laid down in the articles of association, which is very common for insurance undertakings.

If all shareholders agree, some of the formal requirements for the general meeting may be waived, such as the 30 day notice period (§ 123 (1) AktG), or the requirement of a proposal for a resolution to be presented by the management board and the supervisory board (§ 124 (3) AktG), which speeds up proceedings considerably. At best, a capital increase can be registered on the same day as the general meeting has taken place, but usually, it will take a few weeks. If the subsidiary has minority shareholders and all formal requirements have to be fulfilled, the whole procedure from convening the general meeting until registration usually takes a few months. In any case, this does not include the time needed for internal decision-making. For instance, the by-laws for the management board often state that capital increases in subsidiaries require not only a decision by the management board of the parent undertaking, but also of its supervisory board.

If the capital is increased by an injection of an asset other than cash, so-called contributions in kind, an external auditor appointed by the Commercial Register needs to confirm that the value of the asset reaches at least the amount of the capital increase (§ 183 AktG). If the parent undertaking holds all shares, it is common that the nominal capital increase is much lower than the value of the contribution (the rest is recorded either as a premium (Agio) in the restricted capital reserve according to § 272 (2) no. 1 HGB\textsuperscript{1237} or in the free capital reserve according to § 272 (2) no. 4 HGB\textsuperscript{1238}). If it is obvious that the value of the asset exceeds that of the nominal amount of the capital increase, the review by the external auditor takes less time and should be less costly.

\textsuperscript{1237} This requires that the premium is part of the resolution of the general meeting, see Hüffer/Koch AktG, § 9 para. 8.
\textsuperscript{1238} If the resolution remains silent on the premium, see ibid, § 9 para. 9.
If the assets fulfil the following qualifications, an external audit is not necessary according to § 183a AktG in connection with § 33a AktG: The assets to be contributed are securities or financial instruments listed on an organised market and are valued at the weighted average price at which they were traded during the last three months prior to the contribution, or the assets have been valued by an independent expert not more than six months prior to the contribution. If the parent undertaking does not hold all of the shares, though, there is a risk that minority shareholders holding at least 5% of the share capital make use of their right to request the appointment of an external auditor if the actual value of the assets might be lower than the value of the capital increase. If the company has decided not to request an external audit, the Commercial Register may register the capital increase not earlier than four weeks after announcement of the resolution in the company journal, in order to give minority shareholders the possibility to request the appointment of an external auditor.

If the subsidiary has minority shareholders, these have the right to participate in the capital increase, i.e. to subscribe to new shares in proportion to their participation in the company (§ 186 AktG). The subscription right may be excluded by the general meeting with a three fourth majority (§ 186 sec 3 AktG), if this is in the company’s interest and the exclusion is not disproportionate in relation to the shareholders’ interest in keeping their proportional share in the company.1239

9.3.1.1.2 Capital injections

An alternative to a formal capital increase is the injection of cash or other assets into the free capital reserve as defined in § 272 (2) no. 4 HGB. Such a capital injection increases the basic tier 1 own funds of the subsidiary and should therefore provide immediate relief to a subsidiary with solvency problems.

Especially when assets other than cash are injected, parent and subsidiary often enter into a short agreement stating that the parent transfers title to the asset as a contribution into the free capital reserve. The injection must not be connected with an obligation of the subsidiary to pay it back under certain circumstances or to pay any kind of consideration.1240

Depending on the exact wording of the by-laws of the management board, the management board of the subsidiary may be obliged to seek approval by the supervisory board before accepting a capital injection.1241 Likewise, on the part of the parent undertaking, management and sometimes also supervisory board approval will be necessary. Since a capital injection does not require a resolution by the general meeting or registration in the company register, it is normally less time-consuming and involves lower transaction costs than a formal capital increase. Depending on the kinds of assets to be injected, other more or less time-consuming formal requirements involving

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1239 See ibid § 186 paras. 25-35.
1240 Merkt in: Baumbach/Hopt HGB, § 272 para. 9; Regierer in: BeckOK HGB, § 272 para. 43.
1241 An approval requirement may be based on the kind of asset to be injected (for instance, real estate) or on a general requirement to subject all capital increases to supervisory board approval, which may be interpreted as even encompassing injections into the capital reserves.
transaction costs may be necessary to comply with: If shares in another insurance undertaking are supposed to be contributed, notification requirements to BaFin or other regulatory authorities may have to be observed, or a notarial deed and registration in the real estate register may be necessary in the case of the contribution of real estate, to name a few examples.

Since the free capital reserve does not fall under the restricted reserves mentioned in § 150 AktG, it may be dissolved easily, so that the injected capital is not locked in the same way as funds contributed into the share capital. Instead, it can be retrieved when the subsidiary does not need it anymore to fulfil its solo SCR.

Since a capital injection increases the company’s equity without the issuance of new shares, it is in practice only available to a subsidiary with a sole shareholder or if all shareholders agree on injecting capital, for instance on the basis of a shareholders’ agreement. If the subsidiary has minority shareholders, these would otherwise profit from the capital injection without having to contribute proportionately. Lacking such a proportional contribution, the management board members of the parent undertaking would breach against their duty of care if they injected capital into the subsidiary.

9.3.1.1.3 Loans

As already mentioned, the parent undertaking may grant a loan to the subsidiary to support a subsidiary in financial difficulties.

If the subsidiary is a German undertaking, the parent undertaking’s repayment claim is subordinate in rank after all other creditors in an insolvency of the subsidiary according to § 39 (1) no. 5 Insolvency Statute, notwithstanding whether the conditions of the loan explicitly state that it is subordinated or not. Since the prohibition to take loans derived from the prohibition to conduct non-insurance business has now been codified in § 15 (1) sentence 3 VAG 20161242, German insurance undertakings are in general not allowed to issue non-subordinated debt anyway. The taking up of subordinated debt is allowed, however.

Depending on the size and conditions of the loan, it will require the approval of the management boards, and often also of the supervisory boards, of both borrower and lender, i.e. of both the subsidiary and the parent undertaking.

9.3.1.2 Swedish law: Capital maintenance rules

Notwithstanding whether a Swedish parent undertaking is an insurance holding, most probably in the legal form of an aktiebolag, an insurance company (försäkringsaktiebolag) or a mutual (ömsesidig försäkringsbolag), the parent

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1242 The provision states that, as a rule (regelmäßig), borrowings (Fremdmittel) constitute a breach of the prohibition to conduct non-insurance business, and thus opens up for exceptions.
undertaking is obliged to observe the capital maintenance rules when moving assets to a subsidiary, be it by capital increase, capital injection, loan or other measures.

When the parent undertaking is an aktiebolag or a försäkringsaktiebolag, the capital maintenance rules in chapter 17 ABL apply. These rules set limits for value transfers from limited liability companies to third persons. Since they apply to value transfers from a parent undertaking to a subsidiary (“down-stream”), and to “up-stream” value transfers from a subsidiary to a parent undertaking as well as “sideways” from one subsidiary to another, they are relevant both in the context of this asset transfers to subsidiaries (dealt with in chapter 9.3.1.3) and on asset transfers from a subsidiary to the parent or a sister company (dealt with in chapter 9.3.2.2). They are therefore analysed in this separate chapter.

9.3.1.2.1 On value transfers from insurance companies

Chapter 17 § 1 ABL, which is also applicable to insurance companies by way of reference in chapter 11 § 1 FRL 2016, defines four different measures as value transfers:

1. distribution of profits;
2. acquisition of a company’s own shares;
3. reduction of the share capital or statutory reserve for repayment to the company’s shareholders;
4. another business event (affärshändelse) that leads to a reduction of the company’s wealth and that is not of a purely commercial nature for the company.

The three first-mentioned measures are connected with certain formal requirements in the ABL and are in legal doctrine often called “open value transfers”. The fourth form does not have a corresponding formal procedure but rather encompasses other forms of value transfers that do not fall under the three first ones. This form is usually called “covert value transfer” (förtäckt värdeöverföring). It covers both transfers to a shareholder and to other parties.

A business event is defined in the preparatory works as a change in the size or composition of a company’s wealth that are the effect of the company’s economic relationship with others, for example distributions, capital injections, or the creation of

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1243 Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 83; Bergström and Samuelsson, Aktiebolagets grundproblem, p. 220.
debts or receivables. The term business event needs to be understood in a wide sense encompassing all sorts of transactions.

A strong indicator for a reduction in wealth is that the consideration that the company receives for its performance is worth less than its performance. This is to be assessed according to “general principles” without regard to the accounting effects, so that a sale at book value may constitute a value transfer if the real value of the item sold exceeds book value. According to Andersson, each party’s performance needs to be attached with a market value taking into account the conditions of the contract and other factors that influence the price of a service or product. A direct reduction in wealth occurs if the company’s wealth shrinks immediately after the transaction, whereas an indirect reduction takes place if the company’s wealth stays the same but would have increased if the company had entered into a contract at market value.

The third requisite for a covert value transfer is that the business event is not of a purely commercial nature. This is the case if the transaction does not have, or at least partly lacks, a commercial objective, which needs to be assessed primarily based on objective factors rather than on subjective factors based on the parties’ will. Other factors that need to be taken into consideration are the parties’ relation to each other (such as the kind and amount of influence one party has on the other), the character of the transaction (whether the transaction falls within the company’s ordinary business or not), and the size of the discrepancy between performance and consideration. The fact that a transaction in hindsight has been disadvantageous for a party does not necessarily mean that it constituted a value transfer. Even if the performance and the consideration to be received are unbalanced from the start, the transaction may nevertheless have a commercial background, and in that case, no value transfer occurs.

It is important to note that both open and covert value transfers may be lawful or unlawful, so there is no automatism that covert value transfers are unlawful per se.

1245 Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 93.
1248 Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 94.
1249 Ibid, p. 94 f.
1250 Prop. 2004/05:85, Ny aktiebolagslag, p. 371 f.
1251 Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 99.
1255 Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 99.
Chapter 17 § 2 ABL states how value transfers are allowed to take place, namely by following the Acts rules on

1. distribution of profits;
2. acquisition of the company’s own shares;
3. reduction of the company’s capital;
4. gifts.

Again, it is important to note that covert value transfers may also take other forms, such as a sale below market price or loans with below-market interest rates to shareholders. Such a covert value transfer is nevertheless valid if the substantive requirements for value transfers described below are fulfilled and if all shareholders give their consent to the transaction. The permitted forms are therefore the only possibility for lawful value transfers if not all shareholders agree.

In 2015, a fifth form of permitted value transfer was inserted into chapter 17 § 2 ABL, namely value transfers agreed upon in an agreement on group-internal financial support approved by the companies’ general meetings according to chapter 6b § 6 Banking Supervision Act\(^{1256}\) or chapter 8b § 6 Securities Market Act\(^{1257}\).

This form of value transfers was inserted to implement Article 19 (4) Banking Recovery and Resolution Directive\(^{1258}\) ("BRRD") which requires member states “to remove any legal impediments in national law to intra-group financial support transactions that are undertaken in accordance with this Chapter”. According to Article 19 (5) (b) BRRD, intra-group financial support may take the form of a loan, the provision of a guarantee, the provision of assets for use as collateral or a combination of these. The provision aims at enabling group companies to give financial support to distressed affiliated credit institutions or investment firms in other member states that fulfil the requirements for early intervention according to the directive because they infringe or are likely to infringe in a near future their statutory capital or liquidity requirements. The rendering of group-internal financial support is subject to a number of conditions such as reasonable prospect that the support significantly improves the financial situation of the distressed group entity, that it is in the interest of the entity providing the support, and that it would not jeopardize the liquidity or solvency of the entity providing the support (Article 23 BRRD). The provision of financial support requires a corresponding agreement between the supporting and the receiving entity. When entering into the agreement, none of the parties may be in a situation that justifies early intervention measures (Article 19 (8) BRRD), so that the agreement as such may become part of the required recovery plan that credit institutions and investment firms must set up to prepare for a possible future crisis. The agreement needs be approved first by the supervisory authority and then by the general meetings of all parties. Article 19 (7) specifies a number of “principles” with which the

\(^{1256}\) Lag (2004:297) om bank- och finansieringsrörelse.
\(^{1257}\) Lag (2007:528) om värdepappersmarknaden.
\(^{1258}\) Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms.
agreement need to comply. Interestingly, the Swedish legislator did not consider it necessary to implement most of them into Swedish law, for instance the requirements that

“(a) each party must be acting freely into entering the agreement;

(b) […] each party must be acting in its own best interests which may take account of any direct or indirect benefit that may accrue to a party as a result of provision of financial support;

(c) each party providing financial support must have full disclosure of relevant information from any party receiving financial support prior to determination of the consideration for the provision of financial support and prior to any decision to provide financial support; […]”.

According to the preparatory works, there was no need to implement these provisions, because “the freedom to enter into a contract is the starting point of Swedish contract law” anyway, companies always have to act in their own interest and a company simply should refrain from entering into an agreement if it does not have sufficient information.1259

Germany, on the other hand, has chosen to explicitly implement the requirements. § 23 (1) BRRD-Umsetzungsgesetz1260 reveals a significantly different understanding of what is meant by “entering freely into the agreement”, because it forbids other persons including parent undertakings to instruct a company to enter into an agreement on financial support. Such an intervention by a parent company would be allowed according to Swedish law. Whether the Swedish transposition really is in compliance with the Directive, seems doubtful.

The wording of chapter 6b § 2 Banking Supervision Act is a bit unclear when it comes to the question whether also insurance undertakings may be party to an agreement on group-internal financial support. The provision states that such agreements may be entered into by, inter alia, mixed financial holding companies and a subsidiary. Since subsidiary is not defined, this could encompass an insurance undertaking being part of a financial conglomerate. However, the purpose of an agreement on group-internal financial support is to give support to a subsidiary that fulfils the requirements for early intervention measures according to chapter 15 § 2b Banking Supervision Act or chapter 25 § 2b Securities Market Act.1261 Since only credit institutions and investment firms

1259 Prop. 2015/16:5, Genomförande av krishanteringsdirektivet, p. 274: “Mot bakgrund av att frivillighet är utgångspunkt i svensk avtalsrätt saknas skäl för att införa en uttrycklig reglering med detta innehåll. Detsamma gäller i fråga om krishanteringsdirektivets bestämmelse om att varje part i avtalsförhandlingarna måste agera för att tillvarata sina egna intressen. Krishanteringsdirektivet förutsätter även att det givande företaget ska ges full insyn i relevant information från det mottagande företaget innan avtal om koncerninternt finansiellt stöd ingås. Om det givande företaget inte får tillgång till tillräcklig information, bör det vara upp till det företaget att inte ingå något avtal. Dets saknas därför skäl att i lag föreskriva en sådan förpliktelse.”


1261 See the definition of group-internal financial support in chapter 6a § 1 Banking Supervision Act.
(värdepappersbolag) can fulfill these requirements, insurance companies cannot be parties to an agreement of group-internal financial support as defined in the Banking Supervision Act and the Securities Market Act, at least not as potential receiver of support.

The provision on value transfers with regard to such agreements, cannot be applied analogously either to value transfers between insurance undertakings and their parent undertakings, because it constitutes a *lex specialis* for credit institutions, investment firms and their parent undertakings and as such needs to be interpreted narrowly.

This does not mean, however, that such agreements would necessarily be prohibited. Depending on the circumstances, they might constitute a covert value transfer and be allowed if the requisites for those value transfers are fulfilled (see below), or they may not classify as a value transfer at all.

- **Substantive requirements for value transfers: Coverage of restricted equity and prudence principle**

Value transfers are only permitted if they comply with the substantive capital maintenance rules in chapter 17 § 3 ABL. This provision is the central norm of the Swedish capital maintenance rules and is applicable to all value transfers to shareholders, both open and covert value transfers. According to § 3, a value transfer is unlawful if

- After the transfer, the restricted equity (*bundet eget capital*) is not covered any more (*täckningsprincipen* or *beloppsspärren*); or
- It is not justifiable taking into consideration the equity required by the company with regard to the type of business, its size and the risks connected with the business (*försiktighetsprincipen* - prudence principle); or
- It is not justifiable with regard to the equity required at group level if the company is a parent company.

Chapter 3 § 4 Insurance Accounting Act prescribes which items on the balance sheet constitute restricted equity, among other the company’s share capital, guarantee capital, the nowadays not obligatory reserve fund (*reservfond*), the revaluation reserve (*uppskrivningsfond*) and, in the case of life insurance companies that are operated on a mutual basis and life insurance mutuals, the consolidation reserve (*konsolideringsfond*). For the question whether the restricted equity is still covered with assets, the values applied in the statutory accounts are relevant. The equity not belonging to the restricted equity is called “free equity”, but the prudence principle limits

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1262 Bergström and Samuelsson, Aktiebolagets grundproblem, p. 222.
1263 The reserve fund is still obligatory for insurance companies operated on a mutual basis, chapter 12 § 71 FRL 2016.
1264 Chapter 11 § 19, chapter 12 § 70, and chapter 13 § 22.
the shareholders’ access to it. In the case of insurance companies that may distribute profits, the free equity usually surpasses the restricted equity considerably, so that the restricted equity does not constitute a high barrier for value transfers.

In the case of If Skadeförsäkring AB, for example, about 72% of the equity on the balance sheet for the financial year 2015 was free equity.

A more important substantive requirement in an insurance context is therefore compliance with the prudence principle.

The prudence principle hinders companies from exercising value transfers that are economically unreasonable, taking into account the company’s kind and size of business and the risks related to the business, as well as the absolute size of the restricted equity. Also, the company’s liquidity must not be put at risk, so that a value transfer is illegal if it may lead to the company’s inability to pay its debts during the following months, or possibly the following year. If the company has subsidiaries, also the group’s financial situation needs to be taken into account.

Non-coverage of the SCR at solo level would without doubt conflict with the prudence principle. Probably, one would even have to go further, so that a distribution could breach the prudence principle even if the SCR is still covered, but decreases considerably. Two aspects speak for this interpretation: First, the SCR is supposed to protect policyholders, but not subordinated creditors, i.e. it is calculated without consideration of subordinated creditors. The prudence principle, however, aims at protecting the company’s creditors, which I understand as encompassing also the protection of creditors with subordinated claims. Second, a responsibly acting management will usually not be satisfied with a solvency ratio of 100 %, but will aim at a considerably higher coverage.

If the solvency ratio comes too close to 100 %, there is a not very remote risk that the SCR will not be covered anymore in the closer future because the capital requirements fluctuate depending, for instance, on the development of interest rates. If a value transfer has the effect that the solvency ratio gets too low, it would thus breach against the prudence principle. Of course, there is no objective limit for when the solvency ratio is too low. At least, when it would get as low as 110 %, the

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1265 Andersson, Kapitalskyddet i aktiebolag - En lärobok p. 124. Life insurance undertakings operated on a mutual basis do not have free equity since all profit that is not allocated to the policyholders as guaranteed or conditional future bonuses needs to be allocated to the consolidation reserve, SOU 2012:64, Förstärkt Försäkringstagarskydd, Betänkande av livförsäkringsutredningen, p. 123.
1266 If Skadeförsäkring AB (publ), Årsredovisning 2015, p. 8
1267 Cf. Andersson, Kapitalskyddet i aktiebolag - En lärobok, p. 123.
1268 Prop. 2004/05:85, Ny aktiebolagslag, p. 751.
1269 Ibid, p. 752.
1270 Andersson, Kapitalskyddet i aktiebolag - En lärobok, p. 127.
1271 Bergström and Samuelsson, Aktiebolagets grundproblem, p. 222; Andersson, Kapitalskyddet i aktiebolag - En lärobok, p. 122 f.
1272 According to Andersson, key figures such as capital ratios need to be taken into consideration according to industry practice, Andersson, Kapitalskyddet i aktiebolag - En lärobok, pp. 126, 129.
prudence principle hinders the transaction, because at this level, both the company’s management and its supervisory authority should normally be concerned and think about ways to strengthen the financial situation rather than transferring assets out of the company, but with a more conservative view, even a considerably higher threshold could be justified, maybe somewhere around 130 %.

A breach or near-breach of the group SCR would without doubt constitute a breach of the prudence principle if the value transfer concerns an ultimate parent company that is responsible for the coverage of the group SCR according to Article 218 (2) of the Solvency II Directive. With regard to other insurance undertakings within a group, particularly when the ultimate parent undertaking at group level is an insurance holding company, it is less clear whether their obligation to ensure coverage of the group SCR laid down in Article 218 (3) Solvency II Directive affects the level of prudence required.

Also other regulatory requirements are relevant for compliance with the prudence principle. If a value transfer has the effect that the company no longer meets its overall solvency needs identified in the ORSA, this is a strong indicator that the value transfer breaches against the prudence principle. However, if the expected lack of capital lies several years in the future and the company has a realistic plan how it intends to meet its overall solvency needs, I would not necessarily see a breach of the prudence principle.

9.3.1.2.2 On value transfers from life insurance companies that are operated on a mutual basis

Life insurance companies that are operated on a mutual basis are not allowed to distribute profits to their shareholders. As mentioned earlier, this is the ordinary form of life insurance company in Sweden, i.e. a life insurance company is not allowed to distribute profit unless its articles of association permit profit distributions. Such a non-distributing life insurance company is thus a hybrid between an insurance company and a mutual.

Chapter 11 § 17 FRL 2016 contains special rules for the use of profits in both hybrid and in profit-distributing life insurance companies. Profits must be used for bonuses to policyholders unless the articles of association or the Insurance Accounting Act allow other uses such as coverage of losses or profit distribution.

With regard to life insurance companies that are operated on a mutual basis, the prohibition to distribute profits to shareholders leads to a prohibition of covert value transfers as well, even if all shareholders agree, because profits may only be used for the benefit of the company’s policyholders, and this purpose would be undermined by covert

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1273 In an analysis of the 2016 Solvency and Financial Conditions Reports, a solvency ratio of 120 % was used to identify insurance undertakings with a low ratio: ‘99 insurers sailing close to the wind’, Solvency II Wire (24 October 2017).

1274 Normally, an intra-group transfer of own funds does not influence the group SCR. However, if own funds available at group level are transferred to another group entity, where they are not considered to be available at group level, this may negatively affect the coverage of the group SCR.
value transfers.\textsuperscript{1275} This is consistent with the outcome in the Skandia arbitration from 2008.\textsuperscript{1276}

Skandia was at the time sole shareholder of Skandia liv, a life insurance company operating on a mutual basis. Skandia and its 100% subsidiary Skandia Asset Management managed the larger part of Skandia liv’s assets on the basis of a management agreement. In 2002, Skandia liv and Skandia Asset Management entered into a new asset management agreement. On the same day, Skandia sold Skandia Asset Management for 3.2 billion SEK to the Norwegian company DnB. Without the asset management agreement with Skandia liv, DnB would not have purchased Skandia Asset Management at all, because the value of the company was highly dependent on the asset management agreement with Skandia liv.

In a majority decision with one dissenting arbitrator, the arbitral tribunal held that the asset management agreement did not have a commercial nature because the fees to be paid by Skandia liv were 50% above market price. Skandia was ordered to compensate Skandia liv for that part of the fees that exceeded market fees that Skandia liv had already paid. Concerning those fees that Skandia liv would have to pay during the remainder of the duration of the asset management agreement, the arbitral tribunal declared Skandia to be obliged to pay a corresponding compensation upon Skandia liv’s documentation of the actual fees paid.\textsuperscript{1277} In 2009, the parties reached a settlement whereby Skandia liv renegotiated the agreement with DnB, and Skandia paid a compensation to DnB.\textsuperscript{1278} In 2012, Skandia liv was sold for 600,000 SEK to a newly established foundation and then bought its former parent undertaking Skandia.\textsuperscript{1279} This ended the six-year period under which Skandia was an indirect subsidiary of South-African Old Mutual that had acquired control over Skandia through a hostile takeover in 2006. Skandia liv was transformed into an insurance mutual in 2014.

According to Gorton, the drastic fall of stock prices in 2002 which hit some Swedish life insurance companies hard, revealed the inherent conflict of interest connected with life insurance companies that are operated on a mutual basis when it became apparent that some parent undertakings of such hybrid life insurance undertakings had circumvented the prohibition to distribute profits to the shareholder by selling property or – as in the Skandia case – by selling services at high prices to the life insurance subsidiary.\textsuperscript{1280} In 2004, the FRL was amended to limit the shareholders’ influence on hybrid companies by requiring that the majority of the directors have to be independent from the shareholders.

9.3.1.2.3 On value transfers from insurance mutuals

For insurance mutuals (ömsesidiga försäkringsbolag), special capital maintenance rules in chapter 12 FRL 2016 apply. §§ 63-67 deal with payments to guarantors and holders

of debenture contributions (förlagsandelar). These groups have contributed guarantee capital and other subordinated capital, and are entitled to profits only if provided in the articles of association (chapter 12 § 64 FRL 2016). The possibility for mutuals to issue debentures was introduced in 2011.\textsuperscript{1281} The distributable amount is limited according to § 64 section 2 to the mutual’s annual profit, profit reserves and free equity after deduction of bonuses to be allocated to policyholders, an eventual annual loss, other amounts that must be allocated to the restricted equity, and those amounts that shall be allocated for other purposes than profit distribution according to its articles of association. If the mutual is a parent undertaking that is obliged to set up consolidated accounts, the limits also apply to the consolidated profits and the consolidated equity. § 64 sections 3 and 4 contain provisions corresponding to the prudence principle.\textsuperscript{1282}

For life insurance mutuals, §§ 68 and 69 state that the annual profit that is allocated to the free equity must be allocated as bonus (återbäring) to the policyholders to the extent it may not be used for profit distribution or to cover losses according to the articles of association, inter alia. For the allocation of bonuses, absent any rules to the contrary in the articles of association or the insurance policies, the contribution principle applies according to which the bonus shall reflect each policy’s contribution to the profit. For non-life insurance mutuals, there is no corresponding provision. According to the preparatory works, the legislator did not want to hinder these mutuals to continue allocating their profits to their members by other ways than bonuses as long as the mutual’s articles of association state how the distribution of profits is supposed to take place.\textsuperscript{1283}

In the context of this study, asset transfers between insurance undertakings, and in particular, their limits, are of interest. With regard to insurance mutuals, one could imagine a transfer of assets from one mutual to another (for instance a life insurance mutual to a non-life insurance mutual)\textsuperscript{1284} with the purpose to support the other mutual in distress, or a capital injection into a subsidiary in severe difficulties. If these asset transfers lacked a commercial character, they would constitute covert value transfers, if the transferor was a limited company. They would be unlawful unless the substantive requirements for value transfers were fulfilled and all shareholders agreed. So, how are covert value transfers dealt with if the transferor is an insurance mutual?

Chapter 12 FRL lacks an explicit general provision on covert value transfers corresponding to chapter 17 § 1 no. 4 ABL or chapter 12 § 1 no. 4 Cooperative Societies’ Act, because it only speaks of value transfers to guarantors and debenture holders. In general, one can observe that the rules on distribution of profit in chapter 12 FRL 2016

\begin{footnotes}
\item[1281] Prop. 2009/10:246, En ny försäkringsrörelselag, p. 312.
\item[1282] See Prop. 2015/16:4, Modernisering av lagen om ekonomiska föreningar, p. 193.
\item[1283] Prop. 2009/10:246, En ny försäkringsrörelselag, p. 329.
\item[1284] See chapter 7.4.1.3.6 on the treatment of horizontal groups with identical management in a Solvency II group context.
\end{footnotes}
are to a large extent based on the legislation in chapter 12 FRL 1982\textsuperscript{1285} and – despite several amendments – still bear some similarity to the rules in chapter 12 ABL 1975, which served as a model for the rules in the FRL 1982.\textsuperscript{1286} For example, in contrast to today’s rules in chapters 17 and 18 ABL (and the corresponding provisions in chapters 12 and 13 Co-operative Societies’ Act), both value transfers and distribution of profits are dealt with in the same chapter in FRL 2016, which corresponds to the legislation in ABL 1975. An explanation for this may be the “shift” towards the Cooperative Societies’ Act as “background or model legislation” for insurance mutuals with the FRL 2010. It took until 2016 for the rules on value transfers in the Cooperative Societies’ Act to be aligned to those in the ABL 2005.

Rules on unlawful value transfers can be found in chapter 12 § 67 FRL 2016, according to which a guarantor or holder of debentures is obliged to return any payments that he has received in violation of the rules in the FRL – in contrast to chapter 17 § 6 ABL and chapter 12 § 7 Cooperative Societies’ Act which oblige everyone who has received an unlawful value transfer to pay it back to the company or association (unless he was in good faith in case of a covert value transfer).

The provision also speaks of distributions to guarantors or debenture holders in violation of the provisions in the Cooperative Societies’ Act. This must be understood as a reference to the rules on distributions in the course of a mutual’s liquidation, since chapter 12 § 63 FRL 2016 only refers to these provisions.

It is not clear whether chapter 12 FRL 2012 must be interpreted in such a way that all covert value transfers by a mutual are per se unlawful and must be restituted according to general principles or by an analogous application of chapter 12 § 67 FRL. A second possibility could be that covert value transfers are simply not covered at all by the rules in chapter 12 FRL 2016, so that their legality must be assessed on the basis of other provisions, such as the general provision forbidding the favouring of some policyholders over others or the rules on conflicts of interest. A third possibility is that the legal practice on covert value transfers applicable to limited liability companies also is applicable to insurance mutuals. This practice was developed on the basis of the ABL 1975 and is today codified in ABL 2005. ABL 2005, however, covers a wider range of transactions than ABL 1975.\textsuperscript{1287} If the practice on covert value transfers was applicable without modifications, the general meeting of a mutual could with a unanimous resolution agree, for instance, to the acquisition of an asset for a consideration significantly above market price, or to the injection of capital into an insolvent subsidiary (provided the free equity was sufficient and the prudence principle was not violated).

\textsuperscript{1285} Prop. 2009/10:246, En ny försäkringsrörelselag, p. 326.
\textsuperscript{1286} See Prop. 1981/82:180, Regeringens proposition om försäkringsrörelselag, m. m., pp. 261-264.
\textsuperscript{1287} Prop. 2015/16:4, Modernisering av lagen om ekonomiska föreningar, p. 152.
At first glance, it may seem unlikely that the general meeting of a mutual with thousands of members ever would take a unanimous resolution, but it is important to bear in mind that it is very common that the members are represented by delegates in the general meeting. My own experience is limited to the general meeting of a German VVaG, where it was the rule rather than the exception that the general meeting approved the boards’ proposals unanimously.

However, the preparatory works to the FRL 1982 indicate that the rules do not cover other covert value transfers:

“[…] Like the new Companies Act, the prohibition to distribute profits is not only applicable to distributions in cash, but also to transfers of other assets. However, it only concerns distributions to shareholders, or guarantors in that capacity (see prop. 1975:103 pp. 475-476). […] It is worth reminding that a transaction between the company and a third party that violates the company’s business object or purpose, for example a gift or overly generous legal act other than in those cases falling under § 11, is invalid according to 8 chapter 16 §.” [own translation].\(^{1289}\)

§ 11 was a provision entitling the general meeting to decide upon donations for charitable and comparable purposes, including, for instance, expenses for the organisation of research symposia.\(^{1290}\) Corresponding provisions are chapter 12 § 72 FRL 2016 and chapter 17 § 5 ABL. Chapter 8 § 16 FRL 1982 stated – somewhat simplified – that an action by which a director or other signatory of the company exceeded his authority, was invalid, and corresponds to today’s chapter 7 § 43 Cooperative Societies’ Act, which is applicable by reference in chapter 12 § 24 FRL 2016.

The provision distinguishes between breaches against a company organ’s “behörighet” and “befogenhet”, which both have been translated as “authority”,\(^{1291}\) whereby breaches against the “befogenhet” generally only lead to invalidity if the other part knew or ought to have known that the company’s representative exceeded his “befogenhet”.

Also the preparatory works to the FRL 2010 note that the rules only deal with illegal value transfers to guarantors and debenture holders, but do not discuss any other value transfers to other parties.\(^{1292}\) A decision by Finansinspektionen from 2000 directed to the insurance mutuals Folksam sak and Folksam liv indicates that the supervisory authority considered the case law on the corresponding provisions in the ABL 1975 to be applicable to insurance mutuals.\(^{1293}\) There, Finansinspektionen referred to a case by the

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\(^{1288}\) Author’s comment: The corresponding provision in the FRL 1982 was applicable to both mutuals and insurance companies.

\(^{1289}\) Prop. 1981/82:180, Regeringens proposition om försäkringsrörelselag, m. m., p. 261.

\(^{1290}\) See ibid, p. 266.

\(^{1291}\) English translation of ABL 2005, available in the Karnov database, accessed 2017-10-06.

\(^{1292}\) Prop. 2009/10:246, En ny försäkringsrörelselag, p. 328 f.

\(^{1293}\) Finansinspektionen, 14 December 2000, FI Dnr 4859- och 4861-00-303.
Supreme Court from 1997\textsuperscript{1294} where the court applied the provision on the obligation to return unlawful value transfers by analogy to a third party, but also held that a donation or an overly generous legal act (other than permitted charitable donations) constitute a breach against the business objects and therefore are invalid according to the rules on transgression of a representative’s authority. Finansinspektionen also stated that such a transaction cannot be ratified with the unanimous consent of the general meeting, taking the equity principle into consideration.\textsuperscript{1295} As already mentioned, the equity principle (skälighetsprincipen) has been abolished in 1999 with regard to insurance policies entered into since 2000.

Since the ABL 1975 formed the background for the rules on value transfers in the FRL 1982, it seems reasonable to read today’s rules in chapter 12 against the background of the legal development that has occurred since then, for instance concerning illegal covert value transfers to third parties. In the preparatory works to the ABL 1975, it was stated – as in the preparatory works to the FRL 1982 – that overly generous contracts to the benefit of third parties were invalid as acts exceeding the representative’s authority, however, with the modification – omitted in the preparatory works to the FRL 1982 – that such a transaction was valid if all shareholders agreed and if it only concerned distributable (free) equity.\textsuperscript{1296} To only subject such transactions to the rules on transgression of competence, may be too narrow, though, because a transaction constituting a covert value transfer is not necessarily invalid, as the example of the asset management agreement above market fees in the Skandia arbitration example shows.

From the preparatory works to the FRL 2010 can be derived that the legislator was well aware of the legislation and case law on the ABL and the Cooperative Societies’ Act 1987. The amendments of the latter in 2016 also led to some corresponding amendments in chapter 12 FRL 2016.\textsuperscript{1297} However, the structure of the rules on value transfers and distribution of profit remained unchanged.

The objective of the rules on profit distribution and bonuses was obviously to ensure that a profit distribution to guarantors and debenture holders does not exceed the permitted amounts and that all other profits are allocated as bonuses to the policyholders to the extent they do not have to be used for other purposes, such as allocation to the profit reserves. Thus, the rules in chapter 12 intend to protect the policyholders, who in the case of an insurance mutual are both creditors and members (or "co-owners" – Swedish: ”delägare” – in the language of the FRL). Therefore, it seems adequate to interpret the rules on profit distribution in chapter 12 FRL 2016 as granting at least as much protection against unlawful value transfers than the ones in the ABL and the Cooperative Societies’ Act. Covert value transfers in the sense of chapter 12 § 1 no. 4

\textsuperscript{1294} HD, NJA 1997 p. 77.
\textsuperscript{1295} FI Dnr 4859- och 4861-00-303, p. 6.
\textsuperscript{1296} Prop. 1975:103, Regeringsproposition med förslag till ny aktiebolagslag m. m., 475 f.
\textsuperscript{1297} Prop. 2015/16:4, Modernisering av lagen om ekonomiska föreningar, pp. 192-294.
Cooperative Societies’ Act (equivalent to the corresponding norm in chapter 17 § 1 no. 4 ABL) therefore also constitute covert value transfers by a mutual, even if they constitute a value transfer to a third party other than a guarantor och debenture holder, and must be restituted by a transferee in bad faith.

The next question is then, whether a covert value transfer can be ratified by a unanimous resolution by the general meeting (provided it is compliant with the prudence principle and the restricted equity remains intact), or whether it is always unlawful. As mentioned, Finansinspektionen based its interpretation against a possibility of ratification on the equity principle. The fact that the principle was abolished for policies underwritten since 2000 may speak for a possibility of ratification (however, there probably still are a considerable number of older policies in force). 1298 Also, one could argue that since members of a mutual are in a comparable situation as shareholders or members of a cooperative society (ekonomisk förening), they should be able to unanimously agree upon covert value transfers – as the primary beneficiaries of the restrictions on profit distributions, they should be allowed to agree on a different profit use, even against the articles of association or the rules in chapter 12 §§ 68, 69 FRL 2016, as long as no other parties are negatively affected. This is an important difference to life insurance companies that are operated on a mutual basis. After all, the SAS principle is an important feature of Swedish company law.

However, important and possibly better arguments speak against such a possibility: In the preparatory works to the FRL 1982, the possibility to ratify overly generous transactions is not mentioned (in contrast to the otherwise very similar preparatory works to the ABL 1975), which indicates that this possibility should not exist in the case of a mutual. The legislator had two major possibilities to fully align chapter 12 FRL in this respect to chapter 17 ABL (with the 2011 reform) and the corresponding rules in the Cooperative Societies’ Act (with the 2016 reform). That this possibility has not been used, also indicates that no change in this respect was intended. This can be seen as an expression of the particular need for protection that policyholders are considered to have – beyond the level of protection granted to shareholders or members of a cooperative society. For instance, if a mutual’s general meeting is composed of representatives, at least half of them shall be appointed by the members or by organisations that can be regarded as representing the members’ interests (chapter 12 § 38 section (1) FRL 2016). In a cooperative society, such a requirement does not exist, so that the members’ representatives can be appointed by others than the members. 1299

1298 Frostell and Gabrielsson hold that there are good reasons not to change legal practice in this respect with regard to mutuals with older policies in force, but do not discuss the question in depth, Frostell and Gabrielsson, p. 276.
1299 Anders Mallmén, Sten Andersson and Bo Thorstorp, Kommentar till Lagen om ekonomiska föreningar, Zeteo (2016-10-16), commentary to 2 kap. 2 §, section 3 (7)
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It can be questioned if it is appropriate that the FRL allows half of the representatives to be appointed by others than the members or organisations representing their interests.

Chapter 12 §§ 40 - 41 FRL also contain limitations to the general meeting’s right to change the articles of association in certain respects, namely concerning the distribution of profits to guarantors or concerning the introduction of members’ liability for a non-life insurance mutual’s debts, and thereby protects policyholders in case of certain disadvantageous changes. Such changes with negative consequences for a member’s financial insurance-related interest are either not allowed or are connected with a member’s right to cancel the insurance policy. Also this particular protection of the member’s financial interests speaks against a possibility of ratifying covert value transfers.

Another aspect that speaks against a possibility of ratification by the general meeting is that others than members may be entitled to the profit: With regard to life insurance, chapter 12 § 69 states that bonuses shall be allocated to “policyholders and others with a right to receive compensation” (försäkringstagarna och andra ersättningsberättigade). According to chapter 12 § 1 FRL 2016, the articles of association may provide that even the insured are members if they are insured in an insurance policy provided by their employer on the basis of a collective agreement. Since this is not obligatory, it is possible that the insured are not members and thus not represented in the general meeting.

Against this background, it seems likely that covert value transfers by an insurance mutual always are unlawful, notwithstanding whether the general meeting has agreed unanimously or not. For the assessment whether a transaction constitutes a covert value transfer or not, the same criteria apply as for insurance companies or cooperative societies, i.e. whether it is a business event leading to a reduction of wealth that is of a purely commercial nature, or not.

9.3.1.3 Swedish Law: Asset transfers to a subsidiary

After this overview of the Swedish capital maintenance rules, the most relevant forms of transferring funds into a subsidiary shall be examined. One of the most common is probably by increasing the subsidiary’s share capital.

9.3.1.3.1 Capital increases and capital maintenance rules

For the parent undertaking, a capital increase in a solvent subsidiary usually does not constitute a value transfer, because the book value of the subsidiary increases accordingly so that the parent undertaking does not suffer a reduction in wealth.1300 This also applies when the parent undertaking is an insurance mutual or a hybrid life insurance company.1301

1300 Cf. Danelius, p. 551.
1301 Ibid, p. 549.
However, if the subsidiary is in financial difficulties, a capital increase may constitute a reduction in wealth and a covert value transfer if the capital increase does not lead to a corresponding increase in the share value. In this case, the capital increase would be lawful only if all shareholders of the parent undertaking agreed and if the substantive requirements (coverage of the free capital and prudence principle) were observed. The preparatory works do no state whether such a capital increase could be considered to have a purely commercial nature and therewith not constitute a covert value transfer – if the parent undertaking is an insurance mutual or a hybrid life insurance company, this would be the only way it could inject capital into a subsidiary with severe financial problems.

Where the subsidiary is a hybrid life insurance company and new shares are issued at a higher price than their nominal value (above par value), a wealth reduction takes place because the amount surpassing the nominal value becomes inaccessible to the parent undertaking in the future since it may only be used for the benefit of the subsidiary’s policyholders. Whether such a capital increase constitutes a (covert) value transfer depends according to Danelius on whether it has been undertaken on commercial grounds or not. He argues that for the evaluation of the purely commercial nature of such a transaction, the same standards should be applied as for transactions between companies and third parties, i.e. other persons than shareholders. The standard case discussed in this regard, however, concerns commercial transactions with independent third parties, where it is argued that a wealth reduction should not constitute a value transfer just because a company happened to make a “bad deal”.

It have doubts that a presumption for the commercial nature of a transaction between a parent undertaking and a hybrid life insurance company really applies, because the relationship between a shareholder and its subsidiary differs from that to an independent third party. This does not mean, however, that commercial reasons for injecting capital into a hybrid life insurance subsidiary are impossible. Danelius holds that a capital increase has a commercial nature if it is in the parent undertaking’s interest to prevent the subsidiary from getting into financial difficulties, particularly if this would negatively affect the public’s opinion about the parent undertaking, for example because parent undertaking and subsidiary use the same brand and are regarded as a unit by many customers.

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1302 Cf. Prop. 2004/05:85, Ny aktiebolagslag, p. 386. In this preparatory work concerning a special form of aktiebolag, namely a company with a limitation to distribute profit, which was introduced in 2005, a capital injection by a parent undertaking with a profit distribution limitation into a subsidiary is not considered to constitute a value transfer if the capital injection leads to an increase in the value of the shares and is done in the ordinary course of business of the parent.
1303 Danelius, p. 551.
1304 Ibid, p. 553.
1305 Prop. 2004/05:85, Ny aktiebolagslag, p. 748; Bergström and Samuelsson, Aktiebolagets grundproblem, p. 221.
1306 Danelius, p. 553.
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It is interesting to note how these factors, that we also meet in other contexts, namely as arguments for lifting the corporate veil and for not allowing proportional consolidation, here are used to justify the commercial nature of a value transfer.

_Danelius_ acknowledges that it is difficult to determine the value of a shareholding in a hybrid life insurance company, but considers nevertheless that the parent undertaking may have a legitimate interest in preserving this value, which may lie in lower administration, distribution and marketing costs thanks to the common use of such business functions. He goes as far as stating that where the subsidiary is obliged to strengthen its capital base in order to fulfil regulatory requirements or by order of the supervisory authority, “the commercial nature can normally hardly be questioned”.

_Sandström_ does not discuss the particular situation of life insurance companies that are operated on a mutual basis, but argues that the undertaking’s (subjective) understanding is relevant when assessing the commercial nature of intra-group transactions, because such transactions often are the result of a “mutual giving and taking between parent undertaking and subsidiaries” with a perspective of generating profit in the future. This argument needs to be applied carefully, however, when referring to undertakings that are not allowed to distribute profit to their shareholders.

Whether all these arguments really are valid in the case of a capital increase of a hybrid life insurance company that needs capital to restore its SCR, is far from clear. To apply a certain generosity has the practical advantage that a capital increase of a hybrid life insurance company in most cases would not constitute a covert value transfer, so that it would not be necessary to receive the consent of all shareholders of the parent undertaking – which could be time-consuming and difficult to obtain if there are many shareholders. This would certainly facilitate the financing of a hybrid life insurance undertaking. When reading the preparatory works, the impression arises that it is not the legislator’s intention that the rules on value transfers complicate capital increases in hybrid insurance companies. To the contrary, the legislator notes that the profit allocation in favour of the insured may lead to an unwillingness of the shareholders to inject capital, which does not sound as if the legislator sees any legal hinders. However, the fact that the shareholders are not allowed to participate in the profits of a hybrid life insurance company requires increased efforts to justify a capital injection into such a life insurance subsidiary – the injection can be compared with a donation. The financial attractiveness of being shareholder in a hybrid life insurance undertaking has been described as doubtful and their existence can often only be explained with historical

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1307 See chapter 7.2.2.2.
1308 Danelius, p. 553 f.
1309 Ibid, p. 554. Own translation. Complete original wording: “Om kapitaltillskottet lämnas till följd av att dotterbolaget är skyldigt att stärka sin kapitalbas enligt FRL eller Finansinspektionens föreskrifter eller beslut, kan affärsmässigheten i normalfallet över huvud taget knappast ifrågasättas […].”
1310 Sandström, p. 312 f.
A capital increase may have a commercial nature because it aims at preserving value consisting in lower administration costs for the parent undertaking, but this economic advantage must be a consequence of real economies of scale and not of overpricing.

A situation where a capital increase may have other non-commercial objectives, so that it would lack a commercial nature and therewith constitute a covert value transfer, would be imaginable if the capital increase is aimed at improving the subsidiaries’ (or the group’s) key ratios in order to secure managers’ bonus payments that are dependent on the fulfilment of certain key ratios.

In any case, it is highly recommendable for the administrative board of the parent undertaking to clearly document why it considers a capital increase of a subsidiary to have a commercial nature.

The results of the discussion on when the participation in a capital increase of a subsidiary is in compliance with the parent undertaking’s obligation to observe the capital maintenance rules are summarized in the figures below. Figure 9.3.1.3.1 no.1 deals with the situation that the subsidiary is not in financial difficulties. In all cases where a capital increase constitutes a value transfer, the substantive requirements needs to be fulfilled, of course.

### Capital increase of insurance subsidiary

<table>
<thead>
<tr>
<th>Parent (Insurance) undertaking</th>
<th>(Insurance) undertaking</th>
<th>Insurance mutual/hybrid insurance undertaking</th>
<th>Insurance mutual/hybrid insurance undertaking</th>
</tr>
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<tbody>
<tr>
<td>Subsidiary</td>
<td>Insurance undertaking</td>
<td>Hybrid insurance undertaking</td>
<td>Insurance undertaking</td>
</tr>
<tr>
<td>Value transfer</td>
<td>Capital increase/ injection leads to corresponding increase in share value:</td>
<td>Capital increase/ injection does not lead to corresponding increase in share value:</td>
<td>Capital increase/ injection leads to corresponding increase in share value:</td>
</tr>
<tr>
<td></td>
<td>No value transfer</td>
<td>Covert value transfer unless injection has a purely commercial character</td>
<td>No value transfer</td>
</tr>
<tr>
<td>Permitted or not</td>
<td>Permitted</td>
<td>If covert value transfer, permitted if all shareholders agree</td>
<td>Permitted</td>
</tr>
</tbody>
</table>

**Figure 9.3.1.3.1 no. 1**

In figure 9.3.1.3.1 no. 2, the subsidiary is in severe financial difficulties and it is assumed that the capital injection does not lead to a corresponding increase in the share value,

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notwithstanding whether the subsidiary is a hybrid life insurance undertaking or an insurance undertaking that may distribute profits.

### Capital increase of insurance subsidiary in financial distress

<table>
<thead>
<tr>
<th>Parent (Insurance) undertaking</th>
<th>(Insurance) undertaking</th>
<th>Insurance mutual/hybrid insurance undertaking</th>
<th>Insurance mutual/hybrid insurance undertaking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidiary</td>
<td>Insurance undertaking</td>
<td>Hybrid insurance undertaking</td>
<td>Insurance undertaking</td>
</tr>
<tr>
<td>Value transfer</td>
<td>Capital increase/ injection does not lead to corresponding increase in share value:</td>
<td>Covert value transfer unless injection is of purely commercial character</td>
<td></td>
</tr>
<tr>
<td>Permitted or not</td>
<td>If covert value transfer, permitted if all shareholders agree</td>
<td>If covert value transfer, permitted if all shareholders agree</td>
<td>Not permitted if covert value transfer</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Not permitted if covert value transfer</td>
</tr>
</tbody>
</table>

Figure 9.3.1.3.1 no. 2

#### 9.3.1.3.2 Formal requirements for capital increases

A capital increase in an insurance company requires one or more resolutions by the general meeting. If the capital increase exceeds the authorized capital usually provided for in the articles of association, it is necessary to change the articles of association. In that case, a 2/3 majority is required (chapter chapter 7 § 42 ABL). If the subscription rights of the existing shareholders shall be excluded, this also requires a 2/3 majority (chapter 13 § 2 ABL). If the capital increase is not effected in cash, but through a contribution in kind (*apportemission*), a subscription right does not exist (chapter 13 § 1 sec. a ABL), which is important if the subsidiary is not wholly-owned. For a capital increase effectuated by a contribution in kind, the company’s administrative board is obliged to present information to the general meeting on the facts that are relevant for the valuation of the asset (chapter 13 § 7 ABL) and the information needs to be reviewed by an external auditor (chapter 13 § 8 ABL). If it is not necessary to change the articles of association because the capital increase does not exceed the authorized capital, a resolution by the general meeting with a simple majority is sufficient. Often, however, in those cases, the general meeting has delegated the decision power to the administrative board in its resolution to change the authorized capital in the articles of association (chapter 13 § 35 ABL). The capital increase needs to be registered in the company register in order to become valid (chapter 13 § 39 ABL).

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9.3.1.3.3 Capital injections

Not only capital increases, but also capital injections by a parent undertaking must be in compliance with the capital maintenance rules.

Again, as long as the capital injection leads to a corresponding increase in the book value of the subsidiary, a reduction of wealth normally does not occur and a value transfer does not take place.

A capital injection into a Swedish undertaking is tax-free for the subsidiary, but not deductible for income tax purposes by the parent undertaking.\footnote{Skatteverket, Handledning för beskattning av inkomst vid 2012 års taxering, 2012, p. 1257.} Capital injections into wholly-owned (Swedish) subsidiaries are often given under the condition that the capital needs to be paid back once the company has enough free equity that can be used for that purpose and that a repayment is compliant with the capital maintenance rules.\footnote{Åhman, p. 550.} With a repayment obligation, the capital injection resembles more a subordinated loan than an injection of equity. Correspondingly, for taxation purposes, if it is repaid to the same parent undertaking, it is usually treated like the repayment of a loan, i.e. without negative tax-consequences.\footnote{Skatteverket, p. 1258 f. with reference to RÅ 1988 ref. 65.}

Such a repayment condition is, of course, not possible when the receiving entity is a hybrid life insurance company, since it does not have any free equity.

In some cases, from a tax perspective, it may be more advantageous to treat a capital injection as a group contribution (koncernbidrag), which is deductible at the level of the parent undertaking giving the injection and constitutes taxable income at the level of the subsidiary receiving the injection. In order to be classified as “koncernbidrag”, several requirements need to be fulfilled, inter alia with regard to an open disclosure in the financial statements of both the recipient and the parent undertaking, an on-going parent/subsidiary-relationship on a going-concern basis during the entire fiscal year (chapter 35 § 3 Inkomstskattelagen - Income Tax Act), and with regard to geographical restrictions: Subject to some exceptions, both companies must be Swedish (chapter 35 chapter §§ 2, 2a Income Tax Act).

9.3.1.3.4 Loans

Contrary to German law, Swedish law does not require loans by a shareholder to be subordinated. Provided that the rules on value transfers are complied with, the parent undertaking can therefore grant a loan ranking pari passu to a subsidiary. Such a loan would, however, not qualify as own funds and only relieve a distressed liquidity situation.
Grantsing a loan to a distressed subsidiary will in most cases not fall within the CEO’s competence to conduct the day-to-day business and requires then a decision by the board of directors.

9.3.2 Asset transfers from insurance subsidiaries to parent or sister undertakings

To assess the compatibility of the regulatory group capital requirements with company law, it is of particular interest to see how assets can be transferred from insurance subsidiaries to parent or directly to sister undertakings.

For a transfer of assets from a subsidiary to a parent undertaking, mainly the following possibilities exist:

- capital distributions (of profit, if necessary after a dissolution of reserves)
- loans
- sale of assets
- purchase of assets.

The three latter have in common that the transfer of assets (cash or other assets) is done in exchange for other assets (cash, other assets, or repayment and interest rate claim) and that they can be done directly to a sister company. A distribution does not involve a consideration of some sort and is granted to the parent undertaking.

Another measure to assist a parent or sister company in need could be to offer reinsurance because this may have an alleviating effect on the solo SCR of the sister company. However, this requires that the company providing reinsurance protection is licenced to do so.

9.3.2.1 German law

Since a German insurance subsidiary must have the form of an Aktiengesellschaft, the question how assets can be transferred from a subsidiary need to be answered on the basis of the AktG.

9.3.2.1.1 Profit distribution

A distribution of profit requires a resolution of the general meeting. Only exceptionally¹³¹⁶, the general meeting is competent to approve the annual accounts set up by the management board. Usually, this is the task of the supervisory board (§ 172 (1) AktG) that also needs to approve the management board’s proposal to the general meeting on the appropriation of profits (§ 170 (2) AktG). In this case, the general meeting

¹³¹⁶ § 170 (1) AktG: If management and supervisory board have decided to let the general meeting decide upon approval or if the supervisory board has denied approval of the annual accounts, the general meeting is competent to approve the accounts.
is bound by the accounts (§ 174 (1) AktG) and cannot increase the profit by dissolving profit reserves, but it is allowed to deviate from the management’s proposal on the use of profits. The management may propose to distribute the entire profit shown on the balance sheet.

The profit is calculated after contributions to the profit reserves, which are partly obligatory, and partly voluntary. Some of the profit reserves may not be dissolved to generate a profit for distribution to the shareholders.

If the subsidiary has a profit transfer agreement with its parent undertaking, not only the free capital and profit reserves, but also the restricted profit reserve (gesetzliche Rücklage) to the extent it has been accumulated during the term of the agreement may be dissolved and distributed as profit (§ 301 sentence 2 AktG). In the absence of a profit transfer agreement, the use of the restricted profit reserves is limited according to § 150 AktG, which does not allow for its dissolution in order to generate a distributable profit.

It is debated in legal literature whether the management and supervisory boards’ only duty in this context is to comply with the legal provisions concerning the use of the reserves when deciding upon a dissolution of profit or capital reserves in order to increase the distributable profit, or whether they may breach their duty of care even when the dissolution is compliant with these rules. The prevailing view in legal doctrine holds that this kind of decision is comparable to any other management measure (or supervisory measure in the case of the supervisory board), and therefore falls under the provisions in §§ 116, 93 AktG according to which members of the management and supervisory boards are liable for breaches of their duty of care, as privileged by the business judgement rule. Two groups of cases are discussed when liability may be relevant: The company’s existence is endangered if funds are withdrawn through a special dividend, or the withdrawal of funds will considerably complicate the company’s ability to carry out planned investments because it is impossible or disadvantageous for the company to receive external financing.

Other than by formal distribution of profits, § 57 (1) AktG prohibits the repayment of contributions to the shareholders. This encompasses covert repayments which may consist of a transfer of assets for which the shareholder does not pay an adequate consideration. However, within a group of affiliated companies, § 57 is set aside by the lex specialis in § 311 AktG. If the subsidiary has a domination and profit transfer

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1319 See ibid, pp. 455 – 466.
1320 Hüffer/Koch AktG, § 58 para. 1; Bayer in: Wulff Goette and Mathias Habersack (eds), Münchener Kommentar zum Aktiengesetz, vol 1, §§ 1 - 75 (4th edn 2016), § 58 para. 38.
1322 Hüffer/Koch AktG, § 311 para. 49; Krieger in: MHdGR AG, § 70 para. 74.
agreement with its parent undertaking, § 57 is not applicable according to § 291 (3) AktG, even if the payment has been the result of an instruction that is not covered by the domination agreement.1323 If the subsidiary is an insurance company, this would be the case, for instance, if the instruction collided with policyholders’ rights. § 309 (3) AktG provides some protection in this case by holding the dominating entity liable for the subsidiary’s damages resulting from illegal instructions.

9.3.2.1.2 Loans, sale and purchase of assets

The remaining measures considered here, i.e. the granting of a loan and the sale or acquisition of an asset, have in common that they are not of a company law nature. As with any other decision, the management board is obliged to observe the company’s interest when deciding upon the measure. This applies, of course, also to the conclusion of a reinsurance contract with a group undertaking. Depending on the size of the respective transaction, it may be subject to supervisory board approval.

The management board also has to assess the measure’s consequences on the solo solvency and take it into consideration in its ORSA.

As already mentioned, loans from a shareholder to a subsidiary are usually subordinated according to § 39 (1) no. 5 Insolvency Statute. According to this provision, a claim for restitution of a loan that has been granted instead of injecting equity capital is subordinate if the parent undertaking is a corporation that does not have a natural person as majority shareholder. The provision may also be applicable to a situation when a group undertaking grants a loan to a related undertaking. It is debated in legal literature when exactly this is the case, but it seems clear that the provision is applicable at least to loans that are given to an affiliated undertaking if the shareholder has a domination agreement with the lender, because in that case the shareholder may give an instruction to the lender to grant the loan instead of itself injecting equity capital or granting a loan.1324

9.3.2.2 Swedish law

Also for upstream asset transfers from insurance subsidiaries to parent or sister companies, the main question according to Swedish law is, whether the measures are in compliance with the capital maintenance rules. These are, of course, also applicable on asset transfers from a subsidiary to its parent undertaking or to another group undertaking.

1323 Koch, para. 36.
9.3.2.2.1 Profit distribution

A distribution requires a resolution of the general meeting. Despite the usual terminology that speaks of a profit distribution, it would be more correct to speak of a distribution of the free equity, since the free equity is available for distribution without a need to formally dissolve reserves.\footnote{Skog, Rodhes Aktiebolagsrätt, p. 87.} In a Swedish insurance company, the formal competence to approve the annual financial statements lies with the general meeting (chapter 11 § 1 FRL 2016, chapter 7 § 11 ABL). With regard to the distribution of the profit, the otherwise all-encompassing competence of the general meeting is limited, in so far as the general meeting may not decide upon a distribution that exceeds the amount proposed or approved by the board of directors. This limitation of the otherwise very wide competences of the general meeting is referred to as the “veto right” of the board of directors.\footnote{Prop. 2004/05:85, Ny aktiebolagslag, p. 403.} Exceptions to the veto right concern the situation where the articles of association explicitly provide for it or if the distribution has been requested by minority shareholders representing at least 10 % of the share capital (chapter 18 § 1 para. 2 ABL). Whether a unanimous resolution of the general meeting may set aside the board of directors’ veto, is being discussed by scholars.\footnote{See Andersson, Kapitalskyddet i aktiebolag - En lärobok, p. 131.} The general meeting decides upon a distribution of profit with simple majority of the votes (chapter 7 § 40 ABL).

When the procedural requirements for a profit distribution are observed, it constitutes an open value transfer according to chapter 17 § 2 no. 1 ABL. It is lawful, if the substantive requirements are fulfilled, i.e. after the distribution, the restricted equity must still be covered with assets and the prudence principle must be observed. The veto right has been upheld in the 2005 reform of the ABL because the board of directors was deemed to be able to better assess compliance with the substantive requirements for value transfers than the general meeting.\footnote{Prop. 2004/05:85, Ny aktiebolagslag, p. 403.}

If the procedural requirements are not observed, the profit distribution constitutes a covert value transfer that requires consent by all shareholders (and compliance with the substantive requirements, of course).

Chapter 11 § 29 FRL 2016 enables insurance companies to reduce their reserve fund (restricted equity) setting aside the corresponding norms in chapter 20 ABL. A reduction of the reserve fund requires approval by the district court and an assessment by Finansinspektionen on the consequences of the reduction for the insured.

If the subsidiary is a life insurance undertaking operated on a mutual basis, it is not allowed to distribute a dividend to its shareholders (chapter 11 § 16 FRL 2016). For a life insurance undertaking that may distribute profits according to its articles of association, the distributable profit is assessed after funds have been set aside for bonuses.
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to the policyholders. Whether and how bonuses are credited to policyholders may be laid down in the articles of association or in the insurance policies (chapter 11 § 18 FRL 2016). In the absence of any such rules, the bonuses shall be allocated to the policyholders in accordance with the contribution principle.\textsuperscript{1329}

9.3.2.2.2 Loan, sale and purchase of assets

Also other transactions, such as a loan to a parent or sister undertaking or the sale or purchase of an asset, must be in compliance with the rules on value transfers. A sale or purchase of an asset would constitute a value transfer if the consideration to be received or paid does not correspond to its market value.

9.3.3 Asset transfers within an insurance group: A fictitious scenario

Most of the issues discussed in the previous chapter do not pose any particular problems as long as all companies in a group are financially sound and follow the same strategy. However, at the latest when a severe crisis arises within a group, managers of all group companies will be inclined to do their best for just their company to be certain not to breach any company law obligations in order to avoid personal liability or regulatory consequences – after all, their future career prospects would be severely affected if the insurance regulator would not consider them fit and proper any longer due to severe incompliance with the law.\textsuperscript{1330}

This conflict can be illustrated with the following fictitious scenario:

Insurance undertaking B is a wholly-owned subsidiary of insurance undertaking A. B’s management\textsuperscript{1331} has decided that a part of the company’s strategy is to not let the solvency ratio fall below 160 %.\textsuperscript{1332} The company has referred to this strategic decision in its marketing in order to stress its financial strength. A has another subsidiary C in another EU member state, which is a considerably smaller insurance undertaking. When C falls into severe financial difficulties, A wants B to take the following measures:

- dissolve parts of its free reserves and distribute these to A (so that A can inject this capital as tier 1 own funds into C)

\textsuperscript{1329} Prop. 2009/10:246, En ny försäkringsrörelselag, p. 257.
\textsuperscript{1330} See 11.1.2.1 for a possible impact of the fit and proper requirements on management decisions.
\textsuperscript{1331} Management means in the following management board in case of a German undertaking and CEO in the case of a Swedish undertaking. It is assumend that the strategic minimum SCR ratio has been approved by the supervisory board and the board of directors, respectively.
\textsuperscript{1332} Examples for targeted solvency capital ratios that have been communicated by existing insurers amount to 130 % to 160 % in the case of British insurer RSA, RSA Annual Accounts and Report 2015, p. 26; Dutch insurer Aegon has communicated a targeted solvency ratio between 150 and 190 % for its operations in the Netherlands and at group level a range of 150 to 200 %: Aegon, 2 Q 2017 Results & Capital Update (10 August 2017), p. 2.
- grant C an unsecured, subordinated loan with a 10-year duration, which C does not have to pay back if it goes with a loss during the year preceding the maturity date (which would count as tier 2 own funds of C at solo level)
- purchase a service company from C (so that C gets some liquidity and can generate a profit from this transaction)
- stop writing new business in yacht insurance for pleasure boats in the Mediterranean (so that this business area can be taken over by C).

The management of B regards these measures to be harmful for B, because it considers the risk to be too high that C would not be able to pay back the loan, and because the loan would not be in compliance with B’s internal investment guidelines, since it would exceed the limits for exposure towards a single debtor. The management is convinced that B could not have any use of the service company since the latter’s main business is to provide services to C, and the management does not see any possibility for B to use the services itself or to find external customers. Apart from that, B’s solvency ratio would fall to 155% if all measures were taken, and the management expects this to negatively affect the development of new business. Furthermore, it does not consider a possible insolvency of C to create a significant reputation problem for B or to affect its business negatively, because C is geographically far away, has an entire different business model, and because C’s financial difficulty is mainly the result of the disadvantageous macro-economic situation in the member state where C is situated. Even though yacht insurance for pleasure boats in the Mediterranean only constitutes a very small part of B’s business, B’s management would rather not have to stop it because it is a very profitable line of business.

For the management of B, the question arises whether it is allowed or even obliged to follow its parent undertaking’s will or whether it may or must refuse to execute all or some of the proposed measures.

9.3.3.1 Discussion of the scenario according to German law

If B is a German Aktiengesellschaft, the measures proposed by parent undertaking A have to comply with German law.

- Dissolution of free reserves and distribution to parent undertaking A

The first measure proposed is the dissolution of free reserves by subsidiary B and distribution of a dividend to parent undertaking A. This measure requires that the management board and supervisory board\textsuperscript{1333} of subsidiary B dissolve free profit reserves and/or the free capital reserve (reserve according to § 272 (2) no. 4 HGB) when setting up the annual accounts to increase the profit accordingly so that the general meeting can

\textsuperscript{1333} Schnorbus and Plassmann, p. 451: “Annexkompetenz” of the management board and supervisory board.
decide upon its distribution. Since the management board is not subject to instructions by the supervisory board or the company’s shareholder, the management board cannot be forced to dissolve the reserves.

If subsidiary B has a profit transfer and domination agreement with parent A, profit that results from a dissolution of profit reserves that have been created before the conclusion of the agreement, does not increase the profit that is automatically transferred to A, but needs to be distributed as a dividend on the basis of a resolution of the general meeting, otherwise the dissolved reserve increases the profit to be transferred. This is the result of a decision of the Federal Fiscal Court (Bundesfinanzhof) from 2001.1334

- **Loan to sister undertaking C**

A also wants subsidiary B to give a subordinated loan with a 10-year-duration to sister undertaking C.

If subsidiary B has a domination agreement with A, A is in principle entitled to instruct B to give the loan to C, “provided that the interests of B’s policyholders are sufficiently observed and the fulfilment of the obligations towards the policyholders is not endangered”.1335 Since the loan would lead to a breach against one of the limits laid down in the investment guidelines, however, B would violate the regulatory requirements on an efficient risk management. The internal investment guidelines are part of the internal risk management guidelines forming part of the risk management of the subsidiary (§ 26 (5) VAG 2016). The requirements on risk management as the entire Solvency II legislation have the objective of policyholder protection, so that an instruction leading to a breach of regulatory law would be unlawful. Whether A could give B an instruction to change the limits, would depend on whether there are objective reasons indicating that the existing limit is too strict. The mere wish to enable B to grant a loan to C would in my view not be sufficient to change the limit. Even if the loan stayed within the investment limits, it would violate the policyholders’ interests, therewith rendering the instruction illegal, if B had to take the means for the loan from assets covering the technical reserves, since the restitution claim is less secure than alternative investments.

If B does not have a domination agreement, A is not entitled to instruct B. Since the loan would lead to a breach against an investment limit, B must refrain from granting the loan.

If the loan was granted (and stayed within the limits), A would be obliged to compensate B if the loan is disadvantageous for B according to § 311 AktG. In our scenario, the loan would clearly be the result of an interference by the parent undertaking.

The loan is supposed to be granted at a high interest rate reflecting the difficult financial situation of the borrower. Lender B would therefore get the chance to receive

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1334 See BFHE 196, 485. The decision has met some criticism, see Hüffer/Koch AktG, § 301 para. 8.

1335 See the wording required by BaFin on the restriction of the instruction right in Wilm in: Handbuch des Versicherungsaufsichtsrechts, § 19 para. 43.
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High interest during the subsequent years. If C survives and does not fulfill the conditions for a default in year 9, the loan would therefore generate a high yield. However, it is connected with a high risk of default and does not fully qualify as own funds for lender B compared to a less riskful investment. Since the probability is not very remote that C will not be able to pay the loan back, it would involve a concrete risk for a later negative impact on the financial situation of B. If subsidiary B was not a subsidiary of A, it would probably constitute a breach of duty if its management board granted an unsecured loan to company C, taking into account the long duration and the subordination of the loan in the light of the difficult financial situation of C.1336 The loan would therefore be disadvantageous to B, and A and B would have to agree upon an adequate compensation to be granted by A. This agreement would have to be done at the latest at the end of the fiscal year (§ 311 (2) AktG). The compensation does not necessarily have to be in cash, but could consist of other advantages.

In our scenario, an adequate compensation could be that A gives B a security for the loan or a promissory note to compensate B if C fails to pay the loan back. The compensation measure does not necessarily need to be related to the disadvantageous measure.1337 As mentioned above, if subsidiary B would not receive a compensation or at least a legal claim against parent undertaking A by the end of the financial year, A and the members of its board of management would be liable against B. However, since B is a wholly-owned subsidiary, liability would usually only be claimed if B becomes insolvent.

Since subsidiary B is subject to insurance supervision at solo level and because the loan would have to be reported to the group supervisor – depending on its size either ad-hoc or in the annual reporting – it seems sound to assume that the board of B in the absence of a domination agreement would not grant the loan on the conditions supposed unless A provides adequate compensation, which might render the loan less attractive to A.

-Run-off of yacht insurance

Another measure that A wants B to take to support subsidiary C is to discontinue underwriting yacht insurance in the Mediterranean and to suggest the policyholders to renew their policies with C instead of B. If B has a domination agreement with A, A’s management is entitled to instruct B to take these actions notwithstanding whether they are disadvantageous for B or not, unless they are disadvantageous for the policyholders.

The obligation not to violate the interests of the policyholders cannot be understood as protecting their interest in a renewal of their policies, so that the discontinuation of

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1336 Cf. BGHZ 179,71, (MPS), para. 13, where the BGH ruled that an upstream loan is not disadvantageous if it seems improbable that the loan will not be restituted. The court also stated that the subsidiary may not grant a loan to its parent if there is a concrete default risk.

1337 Hüffer/Koch AktG, § 311 para. 44.

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the business as such is not a relevant disadvantage that would render an instruction illegal.

In the absence of a domination agreement, the question is again whether the measures constitute disadvantages for B that require adequate compensation according to § 311 AktG. The proposal to cease writing yacht insurance so that C can take over the lucrative new business in this segment, is comparable to an omission to make use of a business opportunity. The non-use of a business opportunity may constitute a breach of duty provided that it was sufficiently concrete and would have been favourable for the company.\footnote{Mathias Habersack, Geschäftschancen im Recht der verbundenen Aktiengesellschaft, in: Gerd Krieger, Marcus Lutter and Karsten Schmidt (eds), Festschrift für Michael Hoffmann-Becking zum 70 Geburtstag (2013), p. 428, with further references.} According to Habersack, it is necessary that a third party is in principle willing to enter into a contract with the subsidiary.\footnote{Ibid, p. 428.}

In our scenario, there is a similarity to this in so far as B is supposed to cease writing new business, i.e. not to take the business opportunity to write new yacht insurance policies, but presumably, there are no specific customers yet who are already willing to enter into these insurance contracts. An important difference to the omission to use a business opportunity here is that the yacht insurance business is an established business unit and that the decision not to write new policies has a wider impact than the omission to enter into a (single) contract because the administration costs connected with the business unit will go down only marginally – claims handling and customer support for the remaining policyholders still need to be provided while the company will not get any new costumers. In other words, the cost ratio can be expected to rise. According to Koppensteiner, the withdrawal from a market is often an ambivalent measure. If withdrawal from a profitable market is concerned, it will usually be disadvantageous.\footnote{Koppensteiner in: KK-AktG vol. 6, § 311 para. 74.}

In our scenario, the yacht insurance business is profitable, and the board of an independent company would have no reason to give it up. Despite the wide discretion granted by the business judgement rule, it seems possible that the management would be considered breaching its duty if it gave up this profitable business. In the absence of a domination agreement between A and B, B’s management would therefore demand a compensation or refuse to follow A’s wishes in this regard.

- Acquisition of the service company

Also the proposed acquisition of C’s service company could be subject of an instruction by A, if B has a domination agreement with its parent undertaking.

Again, if B had to use funds covering the technical reserves to finance the acquisition, the measure might be incompliant with the interests of the policyholders, so that an instruction to this effect might be unlawful.
In the absence of a domination agreement, the consideration to be paid by C is, of course, an important factor for the question whether the acquisition would be disadvantageous to B. If the purchase price is sufficiently low and does not exceed the liquidation value of the service company, there is no risk for a reduction of subsidiary B’s wealth, so that its financial situation would not be impaired. In that case, the acquisition would not constitute a disadvantage and consequently, it would not be connected with an obligation to demand a compensation. Whether C in turn would be allowed to sell the service company at this minimum price is a question of the company law of the member state where C has its head office. If the price is higher than the liquidation value, there is a risk that B pays too much: B would probably have to write down the book value of the service company to the liquidation value if C becomes insolvent because the service company is exclusively working for C and would have difficulties to find other customers. Thus, a higher price would constitute a risk for B’s financial situation. The next question is whether it would constitute a breach of the duty of care of the management to buy the company if B was not affiliated to A and C. Taking into consideration B’s lack of interest in the company as such and the assumed difficulty of finding an external purchaser who would be prepared to pay a higher price than the liquidation value, a reasonable manager of an unaffiliated company would not buy the service company. An acquisition of the company would therefore constitute a breach of duty, so that B’s management only may follow its parent undertaking’s wish to buy the service company at a price higher than the liquidation value if B receives an adequate compensation. Such a compensation could, for instance, consist of a put option in favor of B to sell the service company to A at the same price if certain circumstances arise (such as C’s insolvency).

- *Breach of the solvency ratio target*

The breach of the targeted solvency ratio does not automatically constitute a violation of the interests of the policyholders that would render A’s instructions unlawful (when B has a domination agreement with A). Policyholder interests could be affected if the solvency ratio due to the measures fell below the “security margin” that BaFin expects insurance undertakings to calculate on an individual basis as a buffer against fluctuations of the SCR. Even taking a “security margin” into consideration, a decrease of the solvency ratio to 155 % would not by itself be harmful to the policyholder’s interests.

Whether BaFin’s requirement is an *intra legem* concretization or an *extra legem* or even *contra legem* requirement, can be discussed.

In the absence of a domination agreement, B’s management is, of course, free not to follow A’s wishes if it wants to avoid the potential negative consequences for the
business if the solvency ratio falls below the communicated minimum target ratio. If it decides to follow A’s instructions, it seems doubtful that the breach of the solvency ratio target would constitute a disadvantage requiring a compensation. Only in extreme situations, it seems imaginable that a conscious violation of a self-set benchmark – even if it was used in the marketing towards customers – could be considered a breach of the business judgement rule.

If company B is a German insurance undertaking in the form of an Aktiengesellschaft, only a profit distribution to the shareholder A falls into the competence of the general meeting. Concerning the loan, the acquisition of the service company and the renunciation of the writing of new business in pleasure boat insurance, the general meeting may only pass a resolution, if the supervisory or the management board refers the matters to the general meeting.

Consequently, if company B in the example above is a German insurance undertaking, the supervisory board does not have the right to order the management board to dissolve reserves, to stop writing pleasure boat insurance, to grant a loan to C or to purchase a service company from C, because it does not fall into its competence to order such measures. If the management board asked the supervisory board for approval of these measures, the general principle is that it may only take the company’s interests into consideration, which would probably speak against all four measures based on the wide notion of company’s interest applied by German law. However, German group corporate law allows the company to honour the wishes of its parent undertaking, even if the desired measure is disadvantageous to the company, provided that the parent undertaking compensates the company for the disadvantage. If no compensation has been taken place during the ongoing financial year, the size and form of the compensation needs to be determined at the latest at the end of the subsidiary’s financial year (§ 311 (2) AktG). The compensation does not need to consist of a payment, but may also consist of other benefits. If the disadvantage cannot be calculated, the inducement is unlawful.\textsuperscript{1342}

B’s supervisory board may therefore give its consent to the measures if A compensates B for the disadvantages connected with them. B’s management is entitled to refuse all of the requested measures.

9.3.3.2 Discussion of the scenario according to Swedish law

If B is a Swedish försäkringsaktiebolag, the measures must be in compliance with Swedish law.

\textsuperscript{1342} Krieger in: MHdGR AG, § 70 para. 84.
- **Dissolution of free reserves and distribution to parent undertaking A**

The proposed dissolution of free reserves and distribution to parent undertaking A requires a resolution by the general meeting according to chapter 18 § 1 ABL and compliance with the formal requirements in chapter 18. In addition, the substantive requirements for value transfers must be observed. Instead of a distribution, B could also render a *koncernbidrag* to A.

- **Loan to sister undertaking C**

The loan to C falls under the so-called group privilege and therefore does not constitute a prohibited loan to a shareholder or its related parties according to chapter 21 § 1 ABL, chapter 4 § 9 FRL 2016.

Until 2016, the FRL explicitly required insurance companies to set up investment guidelines, and a resolution by the general meeting that breached against investment guidelines could be annulled. Today, as already explained with regard to the treatment according to German law, investment guidelines must be considered to belong to those internal guidelines that are necessary for an effective risk management system (see chapter 10 §§ 2, 6, 7 FRL 2016). A breach of the internal investment guidelines would constitute a breach against the regulatory requirement to have an effective risk management. The CEO and board of directors would therefore at least be allowed, if not obliged, to refuse the execution of a resolution by the general meeting. Again, the question whether the board of directors may change the investment guidelines, depends on whether there are objective reasons for increasing the counterparty limits – other than to enable rendering the loan to C.

If the investment guidelines could be changed, the loan would still constitute a covert value transfer, because it would lead to a reduction in wealth. According to Swedish jurisprudence, a loan constitutes a covert value transfer if the borrower’s economy is of such a nature that it is not possible to rely on its ability to be able to pay back the loan.\(^{1343}\) In the example, the borrower is in an acute crisis, but not insolvent. The loan is subordinated, has quite a long duration, C does not give any security and is not obliged to pay back the loan if it goes with a loss the year preceding the redemption date. During these 10 years, C may recover or it may become insolvent, or it may show a loss at the end of year 9. This insecurity should be sufficient to consider that B cannot rely on C being able to pay back the loan so that the loan leads to a reduction in wealth. One would probably also have to say that the transaction does not have a purely commercial character because B’s main motive is to help its shareholder’s subsidiary and not to make a profit, even if the interest rate to be paid by C reflects the high default risk.

\(^{1343}\) Hovrätten för Västra Sverige dom 1993-12-16 i mål DT 38 (T 616/91), p. 3, cited by Andersson, Kapitalskyddet i aktiebolag - En lärobok, p. 102.
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Under the assumption that the restricted equity remains intact and the prudence principle
is not breached, the loan would nevertheless be lawful because sole shareholder A agrees
to it. For B’s management, it would be advisable to request at least a written instruction
by sole shareholder A, or even an instruction taken by the general meeting. This
instruction would be binding because – after a change of the investment guidelines – the
loan is compliant with regulatory law and corresponds to the company’s interest as
expressed by its shareholder.

If B had also had minority shareholders, the loan would be lawful if all shareholders agreed to it. Absent
a unanimous resolution, B would have a restitution claim according to chapter 17 § 6 ABL against C,
and against A (since a value transfer to a shareholder’s subsidiary at the same time constitutes a value
transfer to the shareholder itself). In addition to that, B’s management would breach against the general
provision if it granted the loan because it would favour one shareholder to the detriment of the company.

- Run-off of yacht insurance

With regard to the run-off of the yacht insurance business, the question is whether it may
constitute a covert value transfer if the company refrains from a profitable business
opportunity. According to Andersson, the case law weakly indicates that this may be the
case without being conclusive.1344 Legal doctrine seems to support this,1345 but the exact
limits are not clear. Andersson sees a risk that a wide application would violate the right
to conduct business, also, but not only, in groups of companies.1346

In the example, the situation is a bit different than in the situations discussed in
literature, because B is supposed to stop a profitable business line so that C can take over
these business opportunities, rather than refraining from taking up a new one. In such a
case, it seems justified to speak of a covert value transfer, because B would give up a
profitable business, i.e. reduce its wealth, without any commercial reason. In an arm’s
length transaction, B would demand a payment from a competitor for refraining to write
certain business.1347 Without such a payment from C, B’s decision to cease writing yacht
insurance in the Mediterranean would constitute a decision involving a reduction in
wealth that is not taken on a purely commercial basis. Neither the prudence principle nor
the prohibition to reduce the restricted equity would constitute any obstacle since the
run-off would probably not have a considerable effect on B’s SCR, given the limited
scope of the business. Again, since sole shareholder A wants B to take the measure, the
covert value transfer would be lawful.

If B had minority shareholders, all shareholders would have to agree to the run-off decision.

1344 Ibid, p. 96.
1345 See references in ibid, p. 96.
1346 Ibid, p. 97.
1347 The author knows of one case where an insurance undertaking sold so-called "Zeichnungsrechte" (underwriting
rights) to a competitor. The background of this case was competition law restraints. This type of contract must be
considered as relatively unusual.
Of course, it does not always constitute a covert value transfer if a company stops a profitable business: As long as it has purely commercial reasons, such a measure does not fall under definition of covert value transfer. For instance, a commercial reason could be that the long-term prospects for profitability are poor, so that it might be reasonable to close a profitable business before it turns unprofitable, or that the business is connected with significant reputational risks that could harm the company.

- **Acquisition of the service company**

Also the proposed acquisition of C’s service company needs to be discussed against the background of the capital maintenance rules, i.e. it could constitute a covert value transfer.

A reduction in wealth according to *Andersson* occurs if the consideration that the company receives is (objectively) worth less than its performance. Only if the company receives too little for its performance – in the current case: pays more than what the service company is worth – the existence or absence of commercial objectives with the transaction must be taken into consideration.

There are several recognized valuation methods for business enterprises. As long as the purchase price lies within the range of values calculated according to such accepted methods, even if it lies in the upper range, it seems difficult to claim that a reduction of wealth takes places. The calculation needs, of course, to be based on realistic assumptions, i.e. to “blow up” the value by assuming an increase of service fees or the acquisition of new customers would not be permitted. If the purchase price exceeds this valuation range, the acquisition would constitute a covert value transfer, since it lacks a commercial purpose: B does not have any use of the service company itself and does not regard it as a potentially profitable investment either. It would only buy it to please its parent undertaking (or to comply with A’s instruction) and to support C. Again, the acquisition would not breach against the capital maintenance rules if all shareholders agreed – under the assumption that the prudence principle and the rules on the protection of the restricted equity are complied with. If sole shareholder A gave B an instruction to buy the service company, B would have to exercise this order.

If A is not sole shareholder of B, there is no unanimous resolution by B’s general meeting, and the acquisition does not constitute a covert value transfer, it could nevertheless breach against the general provision, or against the duty of care to be applied by the management. The management might also overstep its authority because the acquisition could be regarded as a breach against the company’s business objects.

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1348 *Andersson, Kapitalskyddet i aktiebolag - En lärobok*, p. 89.
1349 Ibid, p. 89.
1350 Ibid, p. 80.
1351 *Andersson, Om vinstutdelning från aktiebolag*, p. 441.
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- Breach of the solvency ratio target

So far, we have regarded the proposed measures separately. We have seen that since A is sole shareholder, it may give a binding instruction to B to execute the measures. What has been disregarded so far is that all measures together lead to a decrease of B’s solvency ratio to 155 %. With this ratio, it is reasonable to assume that the restricted equity is still covered, even if there is no direct correlation between the restricted equity and the solvency ratio. Even though the usages in the respective insurance business and any eventual additional capital needs identified in the ORSA have to be taken into consideration for determining a solvency limit, a post-transfer solvency ratio of 155 % for a non-life insurer seems to be sufficiently high, so that the measures are in compliance with the prudence principle.

Another question is whether it plays a role that the company would breach against its self-set goal of an SCR ratio of 160 %. From a creditor protection perspective, one could argue that a breach of such a goal, if it has been communicated to the public, leads to a breach of trust of the creditors. However, my understanding of the prudence principle is that it is not concerned with protecting trust of the creditors, but solely with the protection of an adequate equity basis on the basis of economic considerations. As long as the equity base seems to be sufficient also with regard to possible future developments, other factors are irrelevant. As a consequence, the distribution in the example above would be valid.

9.4 Conclusions

As a starting point, German and Swedish law have opposing views on the relation between a stock corporation and its shareholders, with German law stressing the company’s independency by recognizing the company’s own interest that needs to be distinguished from the interest of its shareholders, and with exclusive competences reserved to the management board. Swedish law on the other hand focuses on the shareholders’ power to steer the company in their own interest. Despite these differences, however, when it comes to the details, German and Swedish law are not as far away from each other as it may seem from the start, even though important differences remain.

We have seen that both German and Swedish parent companies are relatively free in their discretion whether they want to try to save a subsidiary in distress or not, but also that the business judgement rule sets some limits to that freedom. In extreme cases, parent undertakings are either obliged or hindered to support a subsidiary in distress. Swedish law allows sole shareholders to exert more influence than German law does,

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1352 See Andersson on the various elements to be taken consideration, namely the company’s equity needs (“konsolideringsbehov”), required liquidity and the type of business, Andersson, Kapitalskyddet i aktiebolag - En lärobok, pp. 124 – 129.
and therewith corresponds slightly better to the group concept underlying the group SCR than German law. However, when minority shareholders exist, the parent undertaking’s possibilities to exert influence on a Swedish subsidiary, are considerably limited, since value transfers require the consent of all shareholders and instructions must be rendered by the general meeting and not by a shareholder.

In a German group, it does not matter whether a parent undertaking is a sole or majority shareholder. Instead, the most important distinction is the existence or non-existence of a domination agreement. With a domination agreement, the parent undertaking has quite encompassing instruction rights, but is in return obliged to cover an eventual annual loss of the dominated subsidiary. Without a domination agreement, the management of a subsidiary is not obliged to follow a parent undertaking’s instructions. Even if the hurdles for a disadvantageous measure requiring compensation are high, the scenario shows that measures that are taken solely to support another undertaking may constitute disadvantages because they are often designed to favour the distressed undertaking rather than taking the business interests of the supporting entity into account. Even if an instruction does not envisage a disadvantageous measure, German law gives the management of an insurance subsidiary the right to refuse to exercise it. Of course, the management of a subsidiary in such a situation has a conflict of interests: If a manager is too “obstructive” in the eyes of the majority shareholder, his term may not be renewed. How managers deal with this conflict of interests, will depend on their (and the subsidiary’s) status within the group, and whether there are other stakeholders, for instance minority shareholders, policyholders or supervisory authorities that have interests in the subsidiary.

- A comment on the rules on the eligibility of own funds at group level

The Solvency II rules on the eligibility of own funds at group level concern the question whether own funds can be transferred up-stream to the parent undertaking within certain time limits. As we have seen, the Swedish prudence principle hinders insurance undertakings from value transfers if the value transfer, for instance a distribution of a dividend, would lead to a solvency ratio that is below what a prudent management would accept. Consequently, in every prudently capitalized Swedish insurance undertaking, there are excess own funds that cannot be distributed to a parent undertaking, namely own funds up to a prudent solo solvency ratio. A tentative guess for such a prudent solvency ratio could be 120 %.

In that case, if a wholly-owned insurance subsidiary has a solo SCR of 100, a diversified SCR of 80 (contribution to the group SCR) and own funds of 150, only 30 of the excess own funds would be available at group level, provided that the possibility to render a loan really is irrelevant for the availability of own funds. Applying the rules on the eligibility of own funds on this subsidiary, we would come to the conclusion that
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own funds amounting to 120 are unavailable. According to Article 225 (3) Solvency II Directive, those unavailable own funds would be eligible up to the solo SCR, i.e. 100 of them would be eligible; 20 would be uneligible. According to Article 330 (5) and EIOPA’s Guidelines on group solvency, unavailable own funds exceeding the contribution to the group SCR would be ineligible, i.e. in this case own funds exceeding 80. Own funds amounting to 40 would have to be deducted from the own funds at group level.

Similarly, BaFin’s expectations expressed in the MaGo on a required extra “buffer” would, if valid, have to be taken into consideration of the eligibility of own funds at group level. According to my knowledge, such a haircut is at present neither demanded by Swedish nor by German regulators. If the rules on the eligibility of own funds were taken seriously, such a haircut would be necessary, even if this might be disadvantageous for Swedish and German insurance undertakings compared to their competitors in other member states where such restrictions might not exist.

It seems to be fairly safe to assume that insurance undertakings in all member states are at least hindered from transferring own funds that are necessary to cover their solo SCR. In other words: Own funds up to a solo SCR of 100 % are always unavailable - again provided that the possibility to grant a loan is irrelevant. With the methods prescribed by EIOPA and in Article 330 (5) Delegated Regulation, this would mean that own funds corresponding to the difference between the diversified SCR and the solo SCR always would have to be deducted from the group own funds. According to my knowledge, such a deduction is not done in practice, either.

This may not be what EIOPA has envisaged, because in one of its examples used in the explanatory comment to Guideline 14 (Figure 8.2.3.3.3 no. 1), the unavailable own funds of an insurance subsidiary do not reach the diversified SCR, whereas they exceed it in the other example (Figure 8.2.3.3.3 no. 2). EIOPA’s example is therefore only consistent, if own funds that can be borrowed to other group undertakings, are considered available at group level.
PART V

THE RELATIONSHIP BETWEEN REGULATORY AND COMPANY LAW
10 The current discussion on the relationship between regulatory and company law

A few of the Solvency II provisions have a direct connection with company law or can even be considered to be company law provisions, as _leges speciales_ to the company law rules applicable to companies that are active in other fields.\(^{1353}\)

In addition to those _leges speciales_ that already existed before Solvency II because they stem from the EU directives that have been repealed by the Solvency II Directive,\(^ {1354}\) only very few new provisions have been inserted that can be considered to have a company law nature.

Whether the governance requirements in Chapter IV of the directive have a company law nature can be discussed. To the extent they concern the organisation of the company at the level below the management body, i.e. at a level otherwise largely not regulated by company law, they can be compared to requirements in other areas of law on the organisation of a company. German data protection provisions, for instance, require companies to appoint a data protection officer if more than nine employees process or have access to processed personal data – however, this does not make them company law provisions. On the other hand, the organisation requirements in the Solvency II Directive concern areas that are at least partly already addressed in company law, namely concerning internal controls, risk management and internal audit (§§ 91 (2), 107 (3), 171 (1) AktG and chapter 8 § 49b ABL), so that they can be considered to have a company law nature.

With regard to the relation between group undertakings, Article 254 (1) Solvency II Directive is of interest here. It obliges members states to

> “[…] ensure that the natural and legal persons included within the scope of group supervision, and their related undertakings and participating undertakings, are able to exchange any information which could be relevant for the purposes of group supervision”.


\(^{1354}\) For instance, the provisions specifying which forms of associations are allowed to conduct insurance business and on the fit and proper requirements for the management and supervisory bodies of insurance undertakings.
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This provision has been implemented in § 276 VAG (new)\(^{1355}\) and in chapter 19 § 44 FAL\(^{1356}\). In both acts, the somewhat vague wording has been sharpened in such a way that they only concern the information necessary for the purposes of group supervision, which is stricter than the wording in the directive and leaves the companies concerned with the burden of proof that the information not only “could be relevant”, but is in fact “necessary”. The Swedish wording goes beyond the wording in the directive by imposing an obligation, and not merely a right, to deliver the information necessary. The German wording is less clear in this respect by giving the parent undertaking the right to request such information, without explicitly stipulating a corresponding obligation by the subsidiary. The provision must be interpreted in such a way that the subsidiary is obliged to deliver information that the parent undertaking requests, because the objective of the provision – to ensure that the parent undertaking is not hindered from complying with its Solvency II obligations due to information restraints – cannot be attained without a corresponding obligation on the part of the subsidiary.

Solvency II thus obliges member states to ensure that group companies may exchange necessary information, but it does not explicitly require member states to provide efficient tools for parent undertakings to implement the group-wide risk management, for instance.

This has triggered a debate among German lawyers, both in academia and in the insurance industry, on the relationship between Solvency II and company law. This part of the discussion in German legal doctrine concerns the relationship between companies belonging to a group, in particular with regard to the parent’s legal ability to enforce a group-wide risk management including the imposition of risk limits on subsidiaries.

Another related question, that is not relevant here, is whether regulatory norms may influence company law with regard to companies that are not subject to the regulatory norms. This is discussed under the term “Ausstrahlung”.\(^{1357}\)

In Sweden, the relationship between regulatory law and company law has received only little attention. During the implementation process, the question was addressed by the mixed financial holding company Länsförsäkringar AB in its comments on the first version of the implementation draft.\(^{1358}\) However, this contribution does not discuss the

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\(^{1355}\) § 276 Gegenseitiger Informationsaustausch

(1) Die in die Gruppenaufsicht einbezogenen natürlichen und juristischen Personen einschließlich ihrer verbundenen und beteiligten Unternehmen sind befugt, alle Informationen auszutauschen, die für die Anwendung der Vorschriften dieses Teils notwendig sind.

(2) Das oberste beteiligte Unternehmen kann von jedem anderen Unternehmen der Gruppe alle Aufklärungen und Nachweise verlangen, welche es zur Erfüllung seiner Pflichten nach diesem Kapitel benötigt.

(3) Die Bestimmungen des Bundesdatenschutzgesetzes bleiben unberührt.”

\(^{1356}\) “Tillgång till information: Ett försäkringsföretag som avses i 2 §, ett företag som ingår i samma grupp som ett sådant försäkringsföretag och sådana fysiska personer som avses i 37 § tredje stycket ska på begäran lämna information till varandra som behövs för att uppfylla kraven i detta kapitel.”

\(^{1357}\) Dreher, Ausstrahlungen des Aufsichtsrechts auf das Aktienrecht − Unter besonderer Berücksichtigung des Risikomanagement −, pp. 503-507; Weber-Rey, pp. 565-568. Both authors analyse whether specific regulatory rules are capable of influencing company law provisions for non-regulated companies, and draw the conclusion that such influences (“Ausstrahlungswirkungen”) de lege lata are rather exceptional: ibid, p. 588 f., Dreher, Ausstrahlungen des Aufsichtsrechts auf das Aktienrecht − Unter besonderer Berücksichtigung des Risikomanagement −, p. 538.

\(^{1358}\) Länsförsäkringar AB, Kompletterande remissyttrande, Dnr (Finansdepartementet) Fi2014/0170.
relationship between the Solvency II Directive and company law, but of a particular provision in the first implementation draft that lacked a corresponding Directive provision. The concern there seemed to be in the first place, that the parent undertaking’s instruction rights awarded by Swedish company law would be set aside to the benefit of a subsidiary that would be endowed with corresponding rights on the basis of the discussed provision.1359

10.1 Primacy of regulatory law over company law: A special group law for groups in the financial sector?

Tröger holds that a special group law for companies belonging to a group in the financial sector is emerging – a Sonderkonzernrecht for the financial sector, which supersedes the “ordinary” regulations on groups in the AktG.1360 He argues that regulatory law allocates the responsibility for the group-wide compliance to a parent undertaking.1361 This duty serves the objective of serving the public interest in stable insurance undertakings and can only be fulfilled if companies in a group have the possibility to impose necessary measures in the group. For Tröger, it is hard to justify why group law should be able to hinder the application of regulatory law.1362 He holds that the legislator does not trust in the barriers between group companies and therefore requires the fulfilment of regulatory requirements at group level.1363 The responsibility imposed on the ultimate parent undertakings for the group-wide compliance with regulatory law is an integral part of group supervision according to this view.1364 Tröger contends that, as a consequence, regulatory law influences company law by widening the responsibilities of regulated entities. Regulatory law according to this view supersedes company law to the extent necessary for the compliance with group regulatory requirements.1365

Tröger suggests that this means in practice that the aims of regulatory law are absorbed by company law.1366 As a consequence, in a de facto group, a measure aimed at fulfilling regulatory requirements at group level cannot breach against a subsidiary’s

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1360 Tobias Tröger, Konzernverantwortung in der aufsichtsunterworfenen Finanzbranche, 177 Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (2013), pp. 475-517, at p. 477. Tröger refers mainly to the prudential regulation in the banking sector, but holds that his arguments are equally valid with regard to the insurance industry, p. 487.
1362 Ibid, p. 486.
1363 Ibid, p. 484.
1365 Cf. Ibid, p. 517.
interests, i.e. cannot constitute a disadvantage if it is consistent with a group-wide risk strategy.\textsuperscript{1367}

An example for such a measure could be the allocation of risk limits to a subsidiary, where the subsidiary would be able and willing to bear a higher risk and therefore needs to abstain from insuring certain risks.\textsuperscript{1368}

Tröger holds that the subsidiary not only has a right to follow the parent’s instructions without claiming a compensation, but also a duty.\textsuperscript{1369} The regulatory obligations at group level according to this view also create duties at the level of the subsidiaries.\textsuperscript{1370}

10.2 Obligation to create an efficient group structure

Other scholars do not go as far as claiming the existence of a special group law and recognize the existing company law barriers. However, they claim the existence of an obligation to create a group structure that enables the parent undertaking to fulfil its Solvency II obligations as best as possible.\textsuperscript{1371} Such a group structure could require the conclusion of domination agreements with subsidiaries to be able to give binding instructions to a subsidiary,\textsuperscript{1372} or even the sale of a subsidiary or its merger on the parent undertaking.\textsuperscript{1373}

\textit{BaFin} seems to sympathize with this view. In its guidelines for the preparation to Solvency II addressed to all German insurance undertakings and insurance groups under the supervision of BaFin as group supervisor, the supervisory authority expressed in 2015 the expectation that groups “in their own interest” take adequate measures to ensure compliance with regulatory requirements, which may include the conclusion of

\begin{footnotesize}
\begin{enumerate}
\item Ib\textit{id}, p. 512: “Konkret bedeutet dies, dass das für das Schutzsystem der §§ 311 ff. AktG bestimmende Verbandsinteresse so überlagert ist, dass die verbundintegrerierende Einflussnahme zur Wahrnehmung von Gruppenverantwortung in der aufsichtsunterworfenen Finanzbranche nicht gegen ein beachtliches Eigeninteresse der abhängigen Gesellschaften verstößt”.
\item Cf. ib\textit{id}, p. 510.
\item Ibid, p. 511 f.
\item Ibid, p. 495: “Das materielle Bankenaufsichtsprogramm erweitert das Pflichtenprogramm der adressierten Organe des übergeordneten Unternehmens nicht unerheblich. Das eingangs konkretisierte Ziel der Gruppenverantwortung, ein gesteigertes öffentliches Interesse an der Normbefolgung zu bedienen, wird auf der Ebene des übergeordneten und derjenigen der nachgeordneten Unternehmen angemessen indas Verbandsrecht integriert.” Similar with regard to banking supervision law: Langen in: Andreas Schwennicke and Dirk Auerbach, Kreditwesengesetz (KWG) mit Zahlungsdienstaufsichtsgesetz (ZAG) und Finanzkonglomerate-Aufsichtsgesetz (FKAG) (3\textsuperscript{rd} edn 2016), § 25a para. 142 f.
\item Cf. with regard to banking supervision law: Malte Wundenberg, Compliance und die prüfungsgeleitete Aufsicht über Bankengruppen (2012), pp. 207 - 209.
\item With regard to banking supervision law prior to the amendments inserted in the course of the implementation of the CRD IV Directive: Andreas Schwennicke and Dirk Auerbach, Kreditwesengesetz (KWG) mit Zahlungsdienstaufsichtsgesetz (ZAG) (2\textsuperscript{nd} edn 2013), § 25a para. 114a; Wundenberg, pp. 207-209.
\item Also with regard to banking supervision law for the situation that a parent undertaking receives information from a subsidiary that indicate a possible future breach of regulatory requirements at group level: Torsten Fett and Stefan Gebauer, Compliance-Strukturen im faktischen Bankkonzern, in: Stefan Grundmann (ed), Unternehmensstrukturen im 21 Jahrhundert: Festschrift für Eberhard Schwark zum 70 Geburtstag (2009), p. 375, at p. 385.
\end{enumerate}
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domination agreements. In a circular on the minimum requirements on corporate governance from 2017, BaFin uses a less far-reaching wording:

“As far as compliance with the governance requirements at group level stand in tension with the possibilities permissible under company law or capital market law, the undertaking responsible for fulfilling these requirements and the affiliated undertakings must be aware of this and take adequate measures to ensure compliance with the requirements. To this end, the undertaking responsible for fulfilling these requirements must make adequate use of the existing instruments to exert influence. All undertakings subject to group supervision are obliged to cooperate in the fulfilment of the governance requirements at group level”[own translation].

The main argument against an obligation to conclude domination agreements recurs to the corresponding obligation to compensate the annual loss of the dominated subsidiary. This may in the worst case increase the insolvency risk of the dominating parent undertaking considerably. As Marcelli correctly points out, the conclusion of a domination agreement therefore requires a thorough risk analysis and would constitute a breach of the board members’ duty of care if there are significant risks in the subsidiary that could lead to the parent undertaking’s insolvency. But even where such risks are very remote, a domination agreement leads to a reallocation of risk within the group towards the dominating undertaking with an impact on its financial stability. To require parent undertakings to increase this risk, corresponds poorly with the aims of the Solvency II Directive, because the protection of policyholders and stable financial markets require financially stable insurance undertakings.

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1375 Rundschreiben 2/2017 (VA) - Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen (MaGo), para. 23. Original wording: „Soweit die Erfüllung der Governance-Anforderungen auf Gruppenebene in einem Spannungsfeld mit den gesellschafts- oder kapitalmarktrechtlichen Möglichkeiten steht, müssen sich das für die Erfüllung dieser Anforderungen zuständige Unternehmen und die gruppenzugehörigen Unternehmen dessen bewusst sein und angemessene Maßnahmen ergreifen, um die Erfüllung der Anforderungen sicherzustellen. Zu diesem Zweck hat das für die Erfüllung der Anforderungen auf Gruppenebene zuständige Unternehmen die vorhandenen Einwirkungsmöglichkeiten angemessen zu nutzen. Alle der Gruppenaufsicht unterworfenen Unternehmen haben bei der Erfüllung der Governance-Anforderungen auf Gruppenebene mitzuwirken (§ 246 Abs. 3 VAG).”

1376 Marcelli, p. 160 f.

Concerning an obligation to sell a rebellious subsidiary as a last resort, Marcelli rejects the idea *de lege lata* because the obligation to have a group-wide system of governance refers to the group “as it is” and does not require the creation of a certain group structure or the divestment of group undertakings.\(^{1378}\) She analyses the idea also *de lege ferenda* and comes to the conclusion that it would constitute a disproportionate interference with the parent undertaking’s fundamental property right as protected by Article 14 (1) Grundgesetz (Basic Law, the German Constitution).\(^{1379}\)

10.3 Primacy of company law over regulatory law: *Ultra posse nemo obligatur*

The opposing opinion holds that Solvency II does not influence company law other than where it contains norms with a company law character. According to this view, Solvency II does not change company law.\(^{1380}\)

The proponents of this view stress that regulatory law cannot require more than what is allowed by company law according to the principle “*ultra posse nemo obligatur.*”\(^{1381}\) One of the most comprehensive contributions arguing for this view comes from Dreher and Ballmaier. They criticize that regulatory law has been enacted solely with a centrally steered vertical group in mind where parent undertakings have unlimited power over their subsidiaries, disregarding horizontal group structures or limitations to the parent’s ability to enforce its will on its subsidiaries.\(^{1382}\)

They argue further that the Solvency II Directive does not claim priority over company law, but to the contrary accepts that undertakings falling under the Solvency II...
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regime also have to comply with company law.1383 This assertion is based, inter alia, on the following argument: Article 254 requires member states to ensure that group companies are allowed to exchange information necessary for fulfilling the Solvency II requirements at group level. Consequently, the legislator has been aware of company law hinders to the exchange of information and requires member states to remove them.1384 They further cite recital 141 of the preamble to the Solvency II Directive also showing that the legislator has realized that company law may limit the regulated insurance undertakings’ possibility to fulfil the requirements imposed by the directive:1385

“In particular, it is desirable that a group support regime operate on sound foundations based on [...] a harmonised framework on asset transferability, insolvency and winding-up procedures which eliminates the relevant national company or corporate law barriers to asset transferability.”1386

The authors criticize that Tröger’s theory of a special group law in the financial sector leads to a “law behind the law” (German: “Recht hinter dem Recht”) that is purely based on values.1387 They acknowledge the importance of financial regulation, but claim that legal obligations in one area of law could not be based on the telos of another body of law because this would make written law superfluous and open for all kinds of obligations that are purely based on a public interest.1388

De lege lata, according to this opinion, the regulatory duties of companies do not go further than what is allowed by company law. Bührle analyses the relationship between company law and regulatory law with regard to the decision making process within a management or supervisory board of a (German) insurance undertaking. He comes to the conclusion that the board members have a wide discretion as to the creation of a “practical concordance” between the company interest and regulatory law interests, whereby they de lege lata are not precluded from prioritizing the interest of the company.1389

1384 Ibid, p. 768.
1385 Ibid, p. 775 f.
1386 In the recital, CEIOPS and the Commission are asked to analyse the possibility of introducing a group support regime.
1388 Ibid, p. 772 f.
The proponents of this view argue that the tension between regulatory law and company law needs to be solved *de lege ferenda*. Dreher and Ballmaier argue that *de lege ferenda*, German law should give parent undertakings explicit general powers to enforce the regulatory obligations in the group, thereby creating legal certainty for companies subject to group supervision.\(^\text{1390}\) This would also fill the deficit shown by European law in this respect. Marcelli proposes a specific provision in the VAG that gives the parent undertaking the right to give binding instructions to the group undertakings necessary to implement the group-wide system of governance.\(^\text{1391}\)

\(^{1390}\) Dreher and Ballmaier, Solvency II und Gruppenaufsicht. Das Verhältnis von Aufsichts- und Gesellschaftsrecht bei der Gruppenaufsicht über Versicherungsunternehmen unter Einbeziehung der Gruppenaufsicht über Kreditinstitute und Finanzkonglomerate, p. 770 f.

\(^{1391}\) Marcelli, p. 230.
11 Solutions to solve the tension between the company law reality and the full consolidation requirement for the group SCR

The discussion in German legal doctrine on the relationship between company law and insurance supervision law has focused on the limits imposed by company law to the implementation of a group-wide governance system. The tension between the limitation of liability recognized by company law and the legal entity view applied in regulatory law has received less attention.1392

Currently, undertakings belonging to a group need to hold own funds both to fulfil the solo SCR and at group level to fulfil the group SCR, but there is no explicit requirement that own funds eligible at group level need to be moved to a group undertaking that is in breach of its solo SCR. In this chapter, possible solutions to solve this tension are discussed both de lege lata and de lege ferenda, taking recourse, inter alia, to the views presented in chapter 10.

The solutions discussed are summarized in the following table and can be sorted into two groups: Measures (in a wide sense) that require giving priority - entirely or to some extent - to regulatory law over company law and those that prioritize company law over regulatory law. In both categories, some measures solve the tension entirely or merely mitigate the consequences of the conflict. Some of the measures can be discussed de lege lata, whereas others clearly only can be analysed de lege ferenda. Finally, some measures would imply more radical changes to the existing legal order, whereas others would have a more moderate impact.

According to Article 242 (2) Solvency II Directive, ”the Commission shall make an assessment of the benefit of enhancing group supervision and capital management within a group of insurance or reinsurance undertakings”, including ”possible measures to enhance a sound cross-border management of insurance groups notably of risks and asset management”. In this assessment, the Commission shall

”[...] take into account new developments and progress concerning [...]"

1392 An important contribution has been made by Stefanink, Haftungsdurchgriff auf die Muttergesellschaft der Versicherungs-AG (2015).
(f) *a harmonised framework on asset transferability, insolvency and winding-up procedures which eliminates the relevant national company or corporate law barriers to asset transferability*.

This reveals an expectation that company law should be changed to facilitate asset transfers between group undertakings. To eliminate barriers to asset transferability would certainly be a step towards aligning company law with regulatory law, but it would only remove the tension entirely if it was accompanied with an obligation to transfer funds to group undertakings in financial difficulties. Barriers to asset transferability had been examined by the European Commission with regard to the banking sector in 2008.\(^{1393}\) The report vaguely suggested to investigate a new attempt to harmonize the legislation on corporate groups similar to the draft ninth company law directive or at least to introduce the concept of group interest.\(^{1394}\) Whereas this proposal has not been pursued, the financial group support systems provided for in the BRRD can be seen as a limited measure to remove transferability barriers. To my knowledge, a comprehensive approach to removing barriers to asset transferability either for all companies generally, or isolated for the financial or insurance sector, has not been initiated yet at the time of writing (May 2018).

Some of the solutions discussed in chapter 11.1 would require the removal of company law barriers to asset transferability. These are assumed to be insurance-specific rather than general amendments of company law applicable to all undertakings irrespective of their business.


\(^{1394}\) See ibid, para. 6.3
## 11.1 Solution 1: Company law follows regulatory law

The first set of measures that would solve the conflict entirely or at least partly _de lege lata_ or _de lege ferenda_ has in common that company law follows regulatory law. Regulatory law thus would become the “leading” area of law whereas company law for insurance undertakings needs to be applied or adjusted in such a way to ensure that own
funds are allowed to be used and are actually used to strengthen the solvency of a group undertaking in financial difficulties.

### 11.1.1 Prohibition of insurance groups

The most radical solution would be to completely align the legal situation of an insurance group to the assumption applied by Solvency II that the group is a single economic entity by requiring it to become a single legal entity. In other words, insurance groups would be required to conduct all insurance business within the same legal entity, which would basically be tantamount to a prohibition of insurance groups. This is, of course, not a requirement *de lege lata*.

Within a single insurance undertaking, own funds would always be available to cover losses arising from any business section (unless they are ring-fenced) so that restrictions to the availability of own funds elsewhere in the undertaking would not pose a problem. Neither would double gearing and the intra-group creation of own funds. A group Solvency Capital Requirement might even be superfluous if the prohibition to create insurance groups also would encompass the creation of insurance holdings at the top of a group.

However, such a solution would have serious disadvantages and is therefore not recommendable:

- It would require the abolishment of the separation principle laid down in regulatory law according to which life and non-life insurance are not allowed to be conducted within the same insurance undertaking. As explained above, the separation principle was introduced to protect holders of life insurance policies from having to bear the risk that losses from non-life insurance jeopardize their savings.
- Not only would life insurance policyholders have to bear the risks connected with non-life insurance, but also vice-versa. In the current low interest requirement where many life insurers struggle to earn the guaranteed interest, life insurance is no longer the haven of stability it might have been a few decades ago.
- To accumulate all insurance business in one legal entity would on the one hand internalize the diversification effects within one undertaking, i.e. to some extent, it would have a mitigating effect on the risks. On the other hand, the concentration of all risks within one entity would also eliminate the “firewalls” of limited liability between undertakings. The contagion risk would be much higher than in an insurance group and the consequences of a possible failure would hit many more policyholders compared to a situation where financial difficulties can be isolated to one or a few undertakings.
- To require existing insurance groups to merge their insurance business into one undertaking would pose a number of legal questions, for instance with regard to
partly-owned subsidiaries, and to an efficient supervision of potentially very large undertakings with business units in many EU states. Furthermore, it is doubtful, whether such a requirement would be in compliance with fundamental rights, particularly the freedom to conduct a business (Article 16 Charter of Fundamental Rights) and the right to property (Article 17), because it would alter the legal risks of current shareholders significantly.

11.1.2 An obligation to transfer own funds *de lege lata*

The conflict between regulatory law and company law could also be solved if undertakings belonging to an insurance group were obliged to support other insurance undertakings in the group, because in that case the economic entity assumption underlying the group SCR would be (relatively) correct.

As we have seen, neither German nor Swedish company law knows a general liability for a subsidiary’s debts. Neither does the Solvency II legislation contain any explicit rules imposing a parent undertaking’s liability for a subsidiary’s debts or requiring it to inject funds into a subsidiary in need. Article 218 (3) Solvency II Directive could be understood as imposing responsibility on all insurance undertakings in a holding-headed group for compliance with the group SCR, but this provision needs to be seen against the background of the limited role given to insurance holdings.1395 To interpret it in a way that would impose full responsibility for all insurance undertakings for compliance with the group SCR in holding-headed insurance groups, would therefore be discriminatory. Nevertheless, notwithstanding which undertaking in a group is responsible for compliance with the group SCR, this responsibility does not necessarily lead to an obligation to restore another undertaking’s SCR, since the group SCR can still be met despite a shortage at solo level, or the group SCR could be complied with by other means. Article 218 (3) seems to the result of a lack of legislative precision that reveals the EU legislator’s understanding that being part of a group is somehow connected with responsibility for the whole group.

Similarly, the full consolidation requirement and EIOPA’s restrictive attitude towards allowing proportional consolidation when a subsidiary’s SCR is no longer covered with own funds, reveal an expectation that parent undertakings take all efforts to support a failing subsidiary. The corporate governance requirements applicable to insurance groups require parent undertakings to implement coherent risk management systems throughout the group. The ultimate parent undertaking in an insurance group is therefore obliged to take an active role in the management of its subsidiaries.

If one accepted the idea of a special group law derived from the objectives of the Solvency II regulatory regime, also an obligation by parent undertakings to use all

1395 See chapter 7.7.2.
available means to save a distressed subsidiary could be justified with the same arguments: If company law barriers could be set aside in order to enable the parent undertaking’s obligation to establish a group-wide risk management system etc. and a subsidiary could not claim that a certain measure in this respect is disadvantageous for it, legal competences and obligations in company law would follow directly from the tasks allocated in regulatory law.Thinking one step further, a very similar argumentation could then also be invoked for a duty to save a subsidiary:

a) Solvency II requires insurance groups to have enough own funds to cover the group SCR.

b) The specific purpose of the group capital requirement is to prevent double gearing and internal financing, i.e. the use of the same own funds at several levels within a group, so that at group level, such own funds need to be “filled up” with more own funds (subject to diversification effects which would lower the amount of own funds needed).

c) Solvency II treats groups as if they were a single unit.

d) Solvency II’s general objective is the protection of policyholders.

e) Ergo, the own funds at group level must be used to save a subsidiary in distress, because otherwise the group solvency requirement would be quite useless.

This argumentation could be used in two ways: First, to establish a duty to use existing own funds at group level to support a distressed subsidiary. Or second, less far-reaching, to reconcile company law with regulatory law by establishing a duty in so far company law does not prohibit the support. In both cases, the limitation of liability would be partly suspended.

It is important to note, that none of the participants in the discussion on the relationship between Solvency II and company law actually goes as far as to claim that the company law concept of limited liability should not be applicable in an insurance group. Rather, the discussion deals with the competences of the parent to enforce the governance requirements at group level and the corresponding legal possibilities of the subsidiary to tolerate such interference.

A legal obligation to use own funds eligible at group level to restore a group undertaking’s solvency would in fact largely align the group solvency with the company reality, because the group solvency ratio would better reflect the actual use of own funds in a crisis situation. If the obligation only encompassed own funds exceeding the solo SCR, it would not have as potentially severe effects as the abandonment of the limitation of liability would have. However, even in that case, it is important to be aware of the fact that misinterpretations of the group solvency ration would still be possible: Due to the recognition of diversification effects, the group solvency ratio could be well above 100 % even though every single group undertaking could have a solvency ratio of merely 100 %, leaving no room for a transfer of assets.
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*De lege lata*, an absolute obligation to transfer own funds to another group undertaking, setting aside company law barriers, does not exist.\(^{1396}\) The Solvency II legislation is certainly adapted to a situation where parent undertakings have almost unlimited influence over their subsidiaries – which fits particularly poorly with the company law reality in Germany. However, it cannot be interpreted in such a way that is sets aside existing limitations neither to the transfer of assets between group undertakings nor to a parent undertaking’s influence over its subsidiaries. To the contrary, from Article 254 (1) Solvency II Directive can be derived that company law barriers need to be respected when complying with Solvency II. The provision requires member states to remove obstacles that could hinder group undertakings to exchange information relevant for the purposes of group supervision. As *Dreher* and *Ballmaier* correctly point out, the European legislator has been aware of possible obstacles to the fulfilment of the requirements at group level, but only addresses the issue of information transfer.\(^{1397}\) It had easily been able to go further and require the removal of other company law obstacles as well. Compared with an obligation to render information, an obligation to transfer assets to another entity would constitute a far more severe interference in an insurance undertaking’s rights – here its property rights – and would require an explicit legal basis. Article 221 (1) Solvency II Directive also indicates that Solvency II respects limited liability because it allows groups to apply proportional consolidation in certain cases, when the responsibility is “[… ] strictly limited to that share in the capital […].”\(^{1398}\) This provision would be superfluous if there was an absolute obligation to support a subsidiary.

If an absolute obligation does not exist *de lege lata*, how about the second interpretation leading to a relative obligation that respects the boundaries of company law? This interpretation could be applied to reconcile regulatory law and company law to some extent. Regulatory law would supersede company law in such a way that where company law leaves room for discretion or for interpretation, it needs to be applied in a manner that prioritizes the effectiveness of regulatory law.

Concerning the question whether parent undertakings have an obligation to try to help subsidiaries in distress, it has been explained above that there are situations where the management would be liable to the company either because it injected funds into a subsidiary, or because it refrained from doing so, and other situations where the business judgement rule leaves room for discretion (see Figure 11.1.2 no. 1).

\(^{1396}\) Schmid in: BeckOK VAG, § 293 para. 296.
\(^{1397}\) Dreher and Ballmaier, Solvency II und Gruppenaufsicht. Das Verhältnis von Aufsichts- und Gesellschaftsrecht bei der Gruppenaufsicht über Versicherungsunternehmen unter Einbeziehung der Gruppenaufsicht über Kreditinstitute und Finanzkonglomereate, p. 768.
\(^{1398}\) See chapter 8.2.2.2.
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Saving a subsidiary – managerial liability

<table>
<thead>
<tr>
<th>Discretion:</th>
<th>No discretion: Not allowed to inject funds into subsidiary</th>
<th>Business Judgement Rule: Managerial discretion</th>
<th>No discretion: Obliged to inject funds into subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of own funds:</td>
<td>OF not used to save subsidiary</td>
<td>Uncertain whether own funds are used to save subsidiary</td>
<td>OF used to save subsidiary</td>
</tr>
</tbody>
</table>

Figure 11.1.2 no. 1

With the argumentation above, the discretion granted by company law would be superseded by a regulatory duty to act in a way that corresponds most closely to the assumptions underlying the group solvency calculation. This would have the consequence that the management would be bound by the assumption that group own funds are used anywhere within the group if necessary. The discretion granted by the business judgement rule would be eliminated and the management would be obliged to use funds to save the subsidiary (see Figure 11.1.2 no. 2).

Saving a subsidiary – discretion superseded by regulatory law

<table>
<thead>
<tr>
<th>Discretion:</th>
<th>No discretion: Not allowed to inject funds into subsidiary</th>
<th>No discretion: Obligation to inject funds into subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of own funds:</td>
<td>OF not used to save subsidiary</td>
<td>Own funds are used to save subsidiary</td>
</tr>
</tbody>
</table>

Figure 11.1.2 no. 2

Not surprisingly, de lege lata, this solution meets similar objections as the theory of a special group law for insurance groups. The duty to inject funds into a subsidiary would be entirely based on assumptions underlying the group solvency calculation. An actual duty to inject funds is not explicitly mentioned anywhere in the Solvency II legislation. This would mean that regulated undertakings in principle would be obliged to do everything they can to render regulatory law effective. This would subject them to very vague obligations derived from an equally vague interpretation of the objectives of Solvency II and the purposes of the group solvency calculation. Furthermore, it would leave the parent undertaking’s board members with the responsibility to determine where
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exactly the line needs to be drawn between a company law obligation not to save and a regulatory duty to save a subsidiary.

In this context, also the abovementioned § 246 (3) VAG 2016 is of interest:

“All undertakings included in the group supervision are responsible for compliance with Part 5 of this act unless something different is laid down in this act.” [Own translation]

This provision does not have a counterpart in the directive and is not commented in the preparatory works. What exactly is meant with “responsibility” is not clear. Of course, the provision does not explicitly require parent or other group undertakings to save another group undertaking, but it imposes a vague form of responsibility for the group requirements. The widest form of responsibility would be an obligation for the actual compliance with all group-related obligations, for instance coverage of the group SCR, notwithstanding their legal and factual possibility to remedy a situation. Such an interpretation would be too far-reaching, imposing responsibility for circumstances that are beyond the subsidiary’s control. In a circular on the governance requirements, BaFin interprets the provision as establishing a duty to cooperate (“Mitwirkungspflicht”) that does not set aside company law or capital market law requirements. This interpretation takes into account the company law reality and does not require impossible actions from subsidiaries. BaFin expresses the expectation that parent undertakings make appropriate use of their steering instruments. The term “steering instruments” (German: “Einwirkungsmöglichkeiten”) implies that BaFin does not refer to injecting funds, but rather to the instruments available under company law to steer decisions of subsidiaries, but it is not far from that argument that parent undertakings need to apply their discretion in such a way that a subsidiary is supported unless forbidden by company law.

The cooperation requirement imposed on other group undertakings could mean, for instance, that when a subsidiary needs to decide between two equally attractive business opportunities, it needs to choose the one that is within the group’s risk tolerance limits rather than the one which would lead to a breach of these limits (constituting a breach against the risk management and internal control system required by Article 246). Or, if the subsidiary would like to underwrite a risk that would exceed the group’s limits for such risks (e.g. windstorm in Germany), it must refrain from this business if the parent undertaking promises to compensate it for any disadvantages due to the missed opportunity, i.e. the subsidiary’s management is not free to follow or not follow the parent undertaking’s order but has to take the decision that is both compliant with company law and avoids a breach of the regulatory requirements of the group. The duty to cooperate thus encompasses the obligation to refrain from actions that would cause the breach of regulatory law applicable on the group, for instance a breach of the group SCR, or a breach against the group’s risk management and internal control system. § 246 (3) VAG 2016 could be understood as encompassing a corresponding obligation to actually support another group company in order to restore group solvency.

1399 Original wording: “Für die Einhaltung der Anforderungen nach Teil 5 dieses Gesetzes sind alle der Gruppeneinheit unterworfenen Unternehmen der Gruppe verantwortlich, sofern dieses Gesetz nichts anderes bestimmt.”


1401 Rundschreiben 2/2017 (VA) - Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen (MaGo), para. 23.

1402 Ibid, para. 21: “Zu diesem Zweck hat das für die Erfüllung der Anforderungen auf Gruppebene zuständige Unternehmen die vorhandenen Einwirkungsmöglichkeiten angemessen zu nutzen.”
11.1.2.1 Pressure to save a subsidiary to meet fit and proper requirements?

The question is then whether other regulatory mechanisms could have a very similar effect, namely the fit and proper requirements for board members of insurance undertakings and insurance holdings laid down in Articles 42 and 257 Solvency II Directive. If board members risked or simply perceived the risk to be deemed unsuitable for a board position because a subsidiary has failed or because the competent supervisory authority considers the decision not to inject funds inadequate, they would have a personal motive to do everything possible to save a subsidiary.

This would be problematic because it creates an agency problem: Instead of taking a decision exclusively based on an assessment of what is best for the company’s interest (however defined), the board members’ personal interest in not harming its job opportunities in the financial sector could influence the decision. So, would such a concern be unfounded?

Article 42 (1) Solvency II Directive lays down that

“In insurance and reinsurance undertakings shall ensure that all persons who effectively run the undertaking or have other key functions at all times fulfil the following requirements:

(a) their professional qualifications, knowledge and experience are adequate to enable sound and prudent management (fit); and

(b) they are of good repute and integrity (proper).”

This provision obliges insurance undertakings to regularly assess the fitness and propriety of its board members. The appointment or non-removal of unsuitable board members may be sanctioned by the supervisory authority.

Whereas the fitness requirement generally speaking is concerned with the professional knowledge and experience of the board members, propriety refers mainly to the person’s honesty, character and financial soundness.

Article 273 (4) Delegated Regulation states that

“4. The assessment of whether a person is proper shall include an assessment of that person’s honesty and financial soundness based on

1403 To facilitate reading, the term “board members” is used rather than “persons who effectively run the undertaking or have other key functions”. For the discussion on to whom the fit and proper requirements apply, see chapter 7.6.4.1
1404 Chapter 18 § 1 FRL 2016; § 303 (2) No. 1 VAG 2016. With regard to members of the management board, BaFin expects to be notified before an appointment takes place: BaFin, Merkblatt zur fachlichen Eignung und Zuverlässigkeit von Geschäftsleitern gemäß VAG 2016-11-23, p. 4.
evidence regarding their character, personal behaviour and business conduct including any criminal, financial and supervisory aspects relevant for the purposes of the assessment.”

Propriety is usually evidenced by submitting an extract from the judicial record and financial soundness by submitting a document certifying that no bankruptcy proceedings concerning the individual are or have been pending. Article 273 (4), however, allows even other circumstances to weigh in into the assessment.

Also the fitness requirement is further concretized in Article 273 (2) and (3) Delegated Regulation:

“2. The assessment of whether a person is fit shall include an assessment of the person's professional and formal qualifications, knowledge and relevant experience within the insurance sector, other financial sectors or other businesses and shall take into account the respective duties allocated to that person and, where relevant, the insurance, financial, accounting, actuarial and management skills of the person.

3. The assessment of whether members of the administrative, management or supervisory body are fit shall take account of the respective duties allocated to individual members to ensure appropriate diversity of qualifications, knowledge and relevant experience to ensure that the undertaking is managed and overseen in a professional manner.”

None of the two provisions in the Directive and in the Delegated Regulation clearly state whether “qualifications” or “experience” could weigh negatively, not in the sense of lack of qualification or experience, but as a negative factor when a board member despite formally sufficient qualifications has shown significant deficits in its leadership. Recital 100 of the Delegated Regulation, however, states explicitly that past business conduct “could provide indications” as to a person’s integrity, i.e. as a negative factor with regard to a person’s propriety. It would indeed be inadequate and contrary to the aim of ensuring a sound management if actual deficits were not taken into consideration for the fit and proper assessment.

The question then arises what kind of past experience or behaviour may weigh negatively and “erase” otherwise sufficient qualifications and experience, or in other words: Where is the threshold for becoming improper to manage an insurance undertaking? Being deemed unfit or improper has considerable consequences for the individual, both with regard to his or her professional reputation and to the ability to exercise his or her profession, i.e. to make use of the freedom to choose an occupation as laid down in Article 5 of the Charter of Fundamental Rights of the European Union. The threshold must therefore be relatively high, at least when the supervisory authority
takes measures to remove or prevent the appointment of a board member due to impropriety.

This needs to be distinguished from those possible consequences for alleged misconduct such as the premature termination of the board member’s mandate that the competent company organ may decide upon according to the applicable company law.\textsuperscript{1405}

What are then possible situations where a current board member’s fitness or propriety may be questioned?

First, it is thinkable that a board member’s academic and professional qualifications were sufficient at the time of nomination but that subsequent changes in the business require additional knowledge. In that case, the board member could be asked to acquire that knowledge within a reasonable time, or the insurance undertaking could be asked to appoint an additional board member with sufficient expertise in that area.

Second, a board member’s health could be impaired due to illness or accident in such a way that he is no longer able to take well-founded rational decisions within a reasonable amount of time. If this was a long-term or permanent condition, this person might no longer be fit to run an insurance undertaking. A similar situation would arise if the board member was sentenced for a criminal offence (which does not necessarily need to be related to his professional career), leading to a negative reassessment of his propriety.

Third, a board member could reveal character traits\textsuperscript{1406} that could lead to a negative reassessment of his managerial skills, for instance narcissistic behaviour combined with choleric outbursts increasing the risk that other managers hide problems rather than revealing them and do not dare to raise objections. Unless such behaviour actually has contributed or led to serious financial or legal problems, it should normally not be a sufficient reason for a supervisory authority to remove the board member as improper, taking into consideration that such a decision would seriously affect the individual’s fundamental right to choose an occupation. Of course it may seem dissatisfactory both from the supervisory authority’s and from a consumer protection perspective that the supervisory authority cannot prevent the appointment or require the removal of a board member in such a case, but needs to wait for the risk to materialize. However, it cannot be the supervisory authority’s competence to decide which character traits board members need to have or may not have. The fit and proper assessment by the supervisory authority must instead be based on verifiable facts. Again, this does not preclude a premature termination of the board member’s mandate by the competent company organ.

Fourth – and this is the situation of interest here – the board member could have participated in board decisions that in retrospect were harmful to the company or that

\textsuperscript{1405} Whether the insurance undertaking’s policy for the internal ongoing assessment of fitness and propriety may be lower than the threshold for intervention by the supervisory authority, could be discussed, but does not have to be studied in this context. The same applies how the undertaking’s internal ongoing assessment relates to the limits company law may pose for the premature termination of board mandates.

\textsuperscript{1406} Cf. Dreher in: Prölss/Dreher VAG, § 24 para. 112, who mentions “personal weaknesses” such as mental desease or alcoholism.
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could be criticized as wrong on other grounds. Or, he could be responsible for such actions or decisions taken by employees, for example. Here, it is necessary to distinguish between situations where a breach of law or of internal rules has taken place and those not connected to any breach.

If no breach has taken place and the actions are privileged by the business judgement rule, this may not weigh negatively, because otherwise the insurance regulator’s fit and proper assessment would depend on the regulator’s judgement of the appropriateness of a certain decision. In our example, if the decision not to inject funds into a subsidiary is privileged by the business judgement rule, a board member involved in the decision cannot be deemed unfit solely because the supervisory authority would have liked a different decision.

Another example would be an insurance undertaking whose own funds shrink from a very comfortable level to almost below the SCR due to a combination of decisions, for instance a change of the investment strategy that in retrospect had an unfavourable timing, the start of a new business line that does not meet the ambitious expectations, and the change of tax laws in a non-EU state where a large, profitable subsidiary is situated having the effect that the distribution of profits from that subsidiary becomes subject to prohibitively high taxes.

If a breach has happened, the fit and proper assessment needs to take all relevant circumstances into consideration, such as

- The kind and gravity of the breach;
- Whether there is a history of breaches or it was a unique event;
- The board member’s role in the breach: Knowledge and handling of the situation once the breach becomes known.

Of course, it would be disproportionate if any breach of law sufficed to be deemed unfit by the supervisory authority. For example, there is no reason for a reassessment of the fit and proper requirements if a breach – such as a breach of the solo or group solvency requirement – is simply caused by adverse circumstances but cannot be attributed to other breaches of law, or if a breach reveals shortcomings that can be remedied, for instance mistakes in the supervisory reporting that can be avoided in the future with improved internal proceedings. Normal mistakes that may happen in any organisation, even well-organised ones, do not suffice to label a manager unfit to run an insurance undertaking.

Consequently, only very serious breaches are relevant. Breaches by a subsidiary are not per se relevant, but only when the board member can be held responsible for them.

11.1.2.1.1 The HQ Case

In this respect, a case decided by the Swedish Högsta Förvaltningsdomstolen is of interest. The case concerned an individual ("P.S.") whom Finansinspektionen

1407 HFD 2013:74.
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deeled to lack the necessary fitness to become a director of a Swedish investment undertaking. P.S had previously been a director of HQ AB, the parent undertaking of HQ Bank AB. In August 2010, Finansinspektionen had revoked HQ Bank’s licence after it had found serious deficiencies in the bank’s trading business and risk management. Finansinspektionen applied for the bank’s liquidation, but it was taken over by a Swedish investment bank a few days later.¹⁴⁰⁸ In November 2011, the general meeting of an investment undertaking elected P.S. to be member of the board of directors, and notified this to Finansinspektionen. The supervisory authority ordered the investment undertaking to remove P.S. from the board of directors within a time period of roughly three months, otherwise it would revoke its licence.¹⁴⁰⁹

Finansinspektionen argued that it did not have any doubts with regard to P.S.’ professional insights and experience in investment business, but deemed her not to be suitable (lämplig) to be a director because the board of directors of HQ AB had not complied with its “supplementary responsibility” as owner of HQ Bank to ensure its subsidiary’s compliance with regulatory law.

P.S. contested Finansinspektionen’s decision in the Stockholm Administrative Court (Förvaltningsdomstolen) that upheld the decision.¹⁴¹⁰ She won the appeal in the Administrative Court of Appeal (Kammarrätten) which repealed Finansinspektionen’s decision on the grounds that the supervisory authority’s motivation of the decision was insufficient.¹⁴¹¹ The court held that preparatory works to the Swedish banking and financial conglomerates legislation in fact indicate that a supplementary owner’s responsibility for a subsidiary’s compliance with regulatory law may exist. Absent any clear rules on the scope of this responsibility, it found, however, that legal certainty and transparency require the supervisory authority to explain how exactly P.S. and other board members had violated the standard of care required by them, instead of simply referring to the deficiencies found in the subsidiary.

Now it was Finansinspektionen’s turn to appeal to the Swedish Supreme Administrative Court (Högsta Förvaltningsdomstolen).¹⁴¹² The Court reversed the Administrative Court of Appeal’s decision by a majority decision supported by five judges and with one judge dissenting. The Court stressed that the fit and proper requirements are an important part of financial regulation, aiming at ensuring financial stability and consumer protection. Persons whose fitness and propriety are not clearly established should not be allowed to be members of the board of directors of a financial

¹⁴⁰⁹ A description of the shortcomings in HQ Bank and an analysis from a banking law perspective can be found in ibid, pp. 274 – 281.
¹⁴¹⁰ Förvaltningsrätten i Stockholm, decision of 13 June 2011, summarized in HFD’s decision, pp. 2-5.
¹⁴¹¹ Kammarrätten i Stockholm, decision of 13 april 2012, summarized in HFD’s decision, pp. 5-9.
¹⁴¹² Högsta Förvaltningsdomstolen, decision reported on 22 November 2013, HFD 2013 ref. 74. The case is analysed by Söderström, Söderström, p. 155 f.
company or a financial holding company.¹⁴¹³ The Court held that the directors of a financial holding company

“[…] must be considered being responsible towards a subsidiary within the same group, particularly with regard to issues of decisive importance for the assessment of the financial situation” [own translation].¹⁴¹⁴

The Court further pointed out the collective responsibility of the board of directors and held that Finansinspektionen had not received any information by the investment company proving that P.S. was not responsible for the shortcomings in HQ Bank and that the supervisory authority therefore was entitled to demand her removal from the board of the investment company.¹⁴¹⁵ Based on this argument, the Court did not need to assess P.S.’ argument that she as a board member had taken a number of measures as soon as the board became aware of HQ Bank’s problems.

The HQ Bank scandal also resulted in criminal proceedings against several board members of HQ Bank and HQ AB, who in 2016 were freed in court from charges of fraud and accounting violations.¹⁴¹⁶ HQ AB’s liability claims against the former members of the board of directors of HQ AB with regard to compensation of losses in connection with the revocation of the licence were dismissed to the largest part in 2017.¹⁴¹⁷ Liability claims had been announced, but not filed yet, when the Supreme Administrative Court took its decision.

11.1.2.1.2 Conclusions on a possible impact of the fit and proper requirements

In the HQ Case, the Swedish Supreme Administrative Court applied a very low threshold of responsibility for shortcomings in a subsidiary for the purpose of the fit and proper requirements. The precedence value of the decision is, of course, diminished by the fact that it was not unanimous, but it is striking that the Court applies a kind of reversed burden of proof: The investment fund where P.S. had been appointed member of the board should have proven P.S.’ suitability at the time of notification.

The case is, of course, not directly applicable to the situation where the board of directors of a parent undertaking needs to decide whether to inject funds into a subsidiary to save it from insolvency. However, since financial difficulties often are caused by inappropriate management decisions or even breaches against regulatory law, the Court’s decision may very well have the effect that parent undertaking’s board members feel obliged to do everything possible to save a subsidiary once they become aware of the

¹⁴¹³ HFD 2013 ref. 74 ; ibid, p. 12.
¹⁴¹⁶ Stockholms tingsrätt, Decision of 21 June 2016, Case B 15982-11. The decision has not been appealed.
¹⁴¹⁷ Stockholms tingsrätt, Decision of 14 December 2017, Cases T 9311-11, T 9306-11, T 17512-11 and T 17809-11. The decision has been appealed by HQ that filed for insolvency proceedings shortly thereafter. At the time of writing, it is not yet clear whether the insolvency administrator will uphold the appeal.
problems in order to “collect points” that may weigh positively in a fit and proper assessment – in the expectation that it is more favourable for their fitness and propriety if the subsidiary at least does not fall insolvent.

The HQ Case may thus, at least in Sweden, lead to a factual shift of the line between “need to inject funds” and “may inject funds”. As mentioned above, this is problematic, because it increases the risk that board members do not only take the consequences for the company into consideration, but also potential consequences for their own professional career. In most cases, if a manager takes a decision in order to avoid liability, criminal sanctions, or a negative fit and proper assessment, this decision will also be in the interest of the company. However, in the described situation of a board of directors confronted with the question of supporting or not supporting a subsidiary in distress, a conflict of interest may arise.

I have difficulty to believe that the HQ Case would have had the same outcome in Germany. BaFin has in a few cases raised doubts as to the fitness and propriety of bank managers, but these have usually not resulted in formal administrative decisions. Rather, the supervisory boards have refrained from appointing these persons, or, in the case of the former CEO of Deutsche Bank, have accepted the resignation of the individual in question. From the reporting in the media, it seems as if BaFin in these cases based its assessment on concrete circumstances, such as lack of leadership experience or concrete examples of mismanagement attributed to the respective individual.

11.1.3 Ad-hoc obligation to transfer own funds *de lege ferenda*

If there is no legal obligation to support group undertakings *de lege lata*, the question arises whether such an obligation should be introduced *de lege ferenda*. This would have the advantage that the factual pressure to save a subsidiary posed by the application of the fit and proper requirements in Sweden would have a corresponding legal duty.

How could such a group solidarity regime be formed? There are, of course, several possible solutions, for instance:

- All insurance undertakings belonging to a group could be legally *obliged* to transfer own funds exceeding their solo SCR to a group undertaking that is in breach of its own solo SCR. If there is more than one well-capitalized insurance undertaking (including insurance holding undertakings with a nominal SCR), the law could prescribe a proportionate allocation of the support, for instance based on the premium income of the undertakings. It could also oblige the supported undertaking to start repaying the support once its own funds exceed its solo SCR

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with a certain margin – so that the support would at least economically – and possibly even legally – take the form of a loan. The law would have to state that it sets aside all company law provisions that may impose hinders to a transfer, so that German insurance undertakings, for instance, could not demand compensation according to § 311 AktG, and Swedish undertakings would not have to observe the rules on value transfers. This form of group solidarity is called compulsory support in the following.

- A less comprehensive solution could be that not all insurance undertakings automatically are encompassed by such a regime, but that the law facilitates and encourages transfer of own funds on a voluntary basis. Own funds exceeding the solo SCR of an insurance undertaking would then only be eligible at group level if the insurance undertaking and the undertaking responsible for calculating the group SCR (usually the ultimate parent undertaking at EU level) have entered into a support agreement to the effect that the parent undertaking is entitled (and obliged) to demand the transfer of own funds to a group undertaking in distress. Also in this case, the law would have to state that company law provisions may not hinder the execution of such agreements (similarly to Article 19 (4) BRRD). In the following, this form is called contractual support.

- A third possibility would be to require the transfer of own funds not to restore the SCR, but only the MCR, since non-compliance with the MCR requires faster action than non-compliance with the SCR and restoration of the MCR would give the subsidiary more time to submit a finance scheme for the restoration of the SCR without having to rely on group funds.

Contractual support has some resemblance to the intra-group financial arrangements laid down in Articles 19 - 26 BRRD and to the group support regime that had been proposed in the first proposal for the Solvency II Directive.

The group support regime in the proposal envisaged a possibility for group undertakings (i.e. not an obligation) to enter into group support agreements which allowed subsidiaries to only cover their MCR with own funds in exchange for a binding promise to inject own funds into the subsidiary if the MCR was no longer met. \(^\text{1419}\) Own funds surpassing the MCR would be transferred to the parent undertaking which only needed to cover the group SCR with own funds. This would have had the effect that the parent undertaking could use the diversification effects more efficiently compared to the situation where all subsidiaries must cover their solo SCR with own funds. Supporters of the group support regime claim that it enables groups to use capital more efficiently within a group \(^\text{1420}\) and that it is more transparent than complex intra-group transactions otherwise applied. \(^\text{1421}\) However, the group support regime met fierce resistance by a number of smaller member states with many foreign-owned insurance undertakings because they were not convinced that the promise would be fulfilled if the parent undertaking or the

\(^\text{1419}\) For a description of the group support regime proposed by the Commission, see Erdélyi, p. 128.
\(^\text{1420}\) van Hulle, Solvency II: state of play and perspectives, p. 178.
\(^\text{1421}\) Erdélyi, p. 128.
whole group would face financial difficulties. When the resistance grew during the financial crisis, the group support regime was removed from the Solvency II Directive Proposal and it was agreed to reconsider it later.

The major differences to the proposed Solvency II group support regime are, however, that group undertakings covered by a group support promise by their parent undertaking only would have had to cover their solo MCR with own funds – the difference between the solo MCR and the solo SCR would have been replaced by the group support promise. In the idea outlined above, the group undertakings are still obliged to cover their SCR with own funds and the support is promised not only by the parent undertaking vis-à-vis its subsidiaries, but by the subsidiaries towards its parent undertaking in order to enable the use of own funds at group level. Contractual support would have to be connected with some regulatory advantage in order to be attractive, for instance in the group SCR calculation or the ORSA process.

A legal obligation to transfer excess own funds to another group undertaking might have both favourable and unfavourable consequences for insurance undertakings and their policyholders. In principle, the same kind of arguments can be applied as for and against the possibility to create corporate groups.

Both a compulsory and a contractual support regime as outlined above would only concern own funds exceeding the solo SCR. This aspect would increase foreseeability that own funds at group level actually will be used to support a group undertaking in distress while at the same time ensuring that at least the solo SCR of the supporting entity remains covered, which is necessary to maintain policyholder protection.

From a critical legal perspective that regards groups of companies as inherently suspicious, compulsory support would have the advantage that – although less far-reaching than actual liability for a subsidiary’s debts – the losses would be kept within the group at least to a large extent instead of being externalized, i.e. the parent undertaking and its shareholders would not profit from letting a subsidiary fall insolvent because all available excess own funds would need to be injected into the subsidiary anyway. If the subsidiary nevertheless falls insolvent, it will at least have more assets to be distributed to the creditors.

A disadvantage would be that both forms of support would increase the contagion risk within the group, especially if the support provided from other group undertakings is not sufficient to restore the SCR and the subsidiary would eventually fall insolvent despite the support. In the worst case, all remaining group undertakings would just meet their SCR (but not more), leaving them more vulnerable than before to negative developments. If group support applied between all kinds of insurance undertakings within a group, including life and non-life insurance undertakings, the separation

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1422 van Hulle, Solvency II: state of play and perspectives, p. 178.
1423 Ibid, p. 178.
1424 See chapter 4.2.
principle would be substantially weakened. Holders of with-profit life insurance and pensions insurance policies would risk to receive lower insurance payouts if their insurer was obliged to transfer own funds to other group undertakings.

Another form of contagion risk is that both compulsory and contractual support would probably make it more difficult and costly to obtain external financing because lenders would react to the risk that another group undertaking consumes the excess own funds of the borrower.

Insurance intermediaries would have to take the solvency situation of all group undertakings into consideration when choosing appropriate insurers for their clients because a comfortable solvency ratio might soon deteriorate if other group undertakings have low solvency ratios. To merely observe the group solvency ratio would be insufficient because it is likely to be positively influenced by diversification effects: The group solvency ratio might be comfortably high even though one or several subsidiaries have low solvency ratios or do not even meet their SCR provided that there are enough well-capitalized subsidiaries and/or substantial diversification effects. This market observation would increase transaction costs for the acquisition of insurance protection for those customers that seek advice by an insurance intermediary or that take the financial situation of an insurer in consideration when choosing an insurer themselves.

Informed customers and intermediaries might prefer insurance undertakings that do not belong to an insurance group where the support obligation applies, for instance insurance mutuals (without insurance subsidiaries), or insurance undertakings belonging to a mixed-activity insurance holding company or to a financial conglomerate (without at the same time being part of an insurance group). Well-capitalized insurance undertakings belonging to a group with poorly capitalized insurers would risk to lose customers, which could further deteriorate the financial situation of the group.

Both compulsory and contractual support might lead to an overly risk-averse behavior by insurance undertakings. Innovative insurance products might not be be put on the market if they potentially risk to consume the excess own funds by other group undertakings. Existing insurance business might be put into run-off much earlier than before in order to prevent the consumption of other group undertakings’ own funds. Depending on the situation, this could be positive or negative. With an early run-off, a decision is taken before the financial situation deteriorates further and requires immediate measures and the likelihood that all policyholders and other creditors are fully paid is higher. Particularly in the case of with-profit products such as traditional life insurance products, however, a run-off is likely to affect the payments to policyholders negatively, because the cost ratio rises if no new business is written.

The moral hazard that board members of poorly performing group undertakings might rely on group support could be offset by the positive effects of “peer control”: Board members of well-capitalized group undertakings are likely to exert more pressure
on less-capitalized group undertakings to improve their financial situation and might be more inclined to contribute to a solution because “their” undertaking would be directly affected if the own funds of another group undertaking fall below its SCR. However, such increased attention does not necessarily lead to constructive solutions, since there is a risk that too many persons with diverging commercial as well as personal interests are engaged in the subsidiary in distress.

To what extent the positive and negative consequences in fact would materialize is, of course, hard to predict. A compulsory or contractual support would probably correspond to the expectations of many consumers who often are not fully aware of the identity of their insurer and do not distinguish between undertakings within a group. Some of the negative effects can be expected (to a somewhat lower degree, however) even without support as part of the reputation risk. Nevertheless, the increased contagion risk connected with compulsory group support matches poorly with policyholder protection and market stability as the main objectives of Solvency II.

Compulsory support would also raise questions with regard to the fundamental right to property laid down in Article 17 of the Charter of Fundamental Rights of the European Union, particularly if a subsidiary with minority shareholders would be obliged to grant support to a parent undertaking.

11.1.4 Obligation to transfer own funds to parent undertaking annually (de lege ferend)

Another variant of an obligation to inject excess own funds into a subsidiary in distress would be to (de lege ferend) oblige subsidiaries to annually transfer all excess own funds to the ultimate parent undertaking at EU level, which in turn is obliged to use them to fill up the solo SCR of its subsidiaries. This would constitute a compulsory group support with some similarity to the group support regime proposed by the EU Commission in the first Solvency II Directive proposal.

If a statutory obligation to transfer own funds to a parent undertaking concerned transferable own funds exceeding the solo SCR instead of the MCR, the group could not profit in the same way from the diversification benefits, but it would be ensured that each group undertaking continues to hold own funds covering its SCR.

Most of the arguments for and against an ad-hoc obligation to transfer own funds also apply to this variant. The group solvency ratio would not be misleading because it would be certain that excess own funds are used to cover the SCR of any group undertaking. A difference would be that it would be transparent for creditors that insurance undertakings belonging to a group never hold own funds exceeding their SCR – which might be a disadvantage compared to stand-alone insurance undertakings. If the parent undertaking is an insurance undertaking itself, it would be in a better position to profit from the excess own funds than its subsidiaries: Unless regulated otherwise, if both the parent
undertaking and its subsidiaries would not meet their SCR anymore – in the case of the parent undertaking without taking into consideration the own funds transferred from the subsidiaries –, the excess own funds would be used to cover the parent undertaking’s SCR first. This could give parent undertakings a competitive advantage over subsidiaries.

For better or worse, a particular peer control would probably not be exercised because the excess own funds need to be transferred anyway, disregarding the financial situation of the other group undertakings. If group undertakings were not allowed to keep their excess own funds, there is a risk that their board members are less incentivized to manage the undertakings in such a way that excess own funds are created, for instance by accepting higher risk which increases the SCR. In order to avoid this risk, the parent undertaking would have to steer its subsidiaries very closely.

The arguments against and the risks connected with an ad-hoc obligation are equally applicable for an annual transfer to the parent undertaking, which is why an obligation to transfer own funds is not recommended here.

11.1.5 Transfer of own funds ordered by supervisory authority *de lege ferenda*

Another less far-reaching solution to align company law with regulatory law could be to give the group supervisor after consultation with the college of supervisors *de lege ferenda* the right to order a group undertaking to transfer excess own funds to another group undertaking. It would be necessary to make clear that such an instruction sets aside company law restrictions. Compared to a compulsory support regime, an advantage would be that the supervisory authority would have to base its decision on an analysis of the potential positive and negative effects on all policyholders. Shareholder and lender interests would have to be considered with regard to any potential effects on the financial markets. If the risks outweigh the potential positive effects, the group supervisor would have to refrain from an instruction. The group supervisor’s decision would consequently replace the decisions of the companies’ boards.

This would have the following advantages: The supervisory authority would not take its decision in the interest of one single company, but would have to base it on an assessment of what is best to achieve the objectives of Solvency II, namely policyholder protection in the first place and stability of the financial markets in the second place. Policyholder protection aspects would have to be assessed with regard to all undertakings concerned, i.e. the policyholders of the insurer in distress and those of the group undertakings. The market stability objective requires the group supervisor not to entirely disregard creditors’ interests: If an undertaking was ordered to transfer so many own funds that its own solvency ratio does no longer have a comfortable margin above 100 %, this could have a negative impact on the market for insurance bonds and shares,
because it would send a signal to the financial markets that investors cannot rely on a comfortable financial situation of the issuer if there are other group undertakings that might be in need of capital.

For the board members of the undertakings ordered to support a group undertaking, it could be convenient not to be forced to take a decision themselves, and to be able to refer to the group supervisor’s order when being confronted with criticism by creditors, policyholders or shareholders or even liability claims – it would not be them who take an unpopular decision, but the group supervisor. The “moral hazard” problem connected with compulsory or voluntary support would be avoided because it is not certain that the group supervisor would order the transfer of own funds. “Peer control” would probably occur also when there is a risk of being ordered to support another group entity.

The crucial question is whether group supervisors would be willing to be responsible for such a decision. The conflict between company and regulatory law would not be entirely solved, because a portion of the excess own funds would in practice still not be used to support a subsidiary in distress.

11.1.6 Obligation of board members to prioritize group interests and policyholder interests *de lege ferenda*

Under the assumption that the competence to decide on the use of excess own funds shall remain with the boards of the undertakings concerned, the probability that own funds really are injected into a subsidiary in distress would increase, if board members were not obliged to serve the interest of the company (as defined in the respective jurisdiction) in the first place, but if group interests and, even more important, the interests of policyholders of all insurance undertakings within a group would have priority over shareholder interests and the interest of the single company. The starting point of such an assessment would be that excess own funds must be transferred unless important reasons speak against a transfer. This requires a careful consideration of the consequences of a transfer for the remaining group undertakings and their policyholders and for a possible material adverse impact on the future external financing of the group. Shareholder’ interests in profit maximisation would not be relevant parameters.

The competence to do this assessment would probably have to lie with the board of the parent undertaking that is in a better position than its subsidiaries to collect the information on which the decision needs to be based. If the parent undertaking has decided that a transfer of excess own funds from one group undertaking to another is in the interest of the group and of the policyholders, the other group undertakings would not be competent to refuse the transfer based on a diverging assessment.

For German law, §§ 311 and 317 AktG would not be applicable, i.e. a subsidiary would not have the right to claim compensation for such a measure because it is not in
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the subsidiary’s interest – because the subsidiary’s interest would not the decisive
criterion for this decision.

For Swedish law, this would mean that the rules on value transfers including the
prudence principle would have to be suspended, among other in order to make the
transfer of own funds from a life insurance mutual or a hybrid life insurance company to
a distressed subsidiary possible. A more drastic change would be the change in the
concept of company interest from a monistic one focusing on the shareholder interests
in profit or value maximisation to a pluralistic one excluding shareholder interests. For
German law, the change would not be as dramatic, since the notion of company interest
already today is a pluralistic one.

Another issue to be decided would be whether the orientation towards the group’s
interest would have to apply only in the situation where a group undertaking’s solo SCR
is not met anymore, or whether it should apply for all decisions within an insurance
group.

With regard to German banking supervision law, Weber-Rey and Gissing argue that a conflict between
company law and regulatory law can be avoided if the companies belonging to a group cooperate in the
development of a group-wide strategy, whereby the group strategy becomes part of each subsidiary’s
own strategy, thereby minimizing conflicts between the goals of parent undertakings and subsidiaries.1425
According to the authors, the strategic goals at group level interrelate with the group interest because the
group interest consists of the common interest of all group entities in the fulfilment of the group-wide
business and risk strategy and in the “[… ] entire group’s sustainable, successful activities in the market
avoiding threats to the continued existence” [own translation].1426 They hold that an obligation to
coopera in the development of a group strategy can be derived from § 25c (2) phrase 2 no. 1c
Kreditwesengesetz (German Banking Act) for subsidiaries belonging to a banking group,1427 a provision
lacking a corresponding norm in the VAG. Whether a common group strategy by itself would suffice to
justify asset transfers to a related undertaking in financial distress, is far from clear, however.

In the Commission’s Company Law Action Plan from 2012, the recognition of group
interest has been announced to be one area for future EU legislation in the field of
company law,1428 following a recommendation by the Reflection Group On the Future
of European Company Law to further investigate the benefits of regulation at EU level

1425 Daniela Weber-Rey and Evgenia Gissing, Gruppen-Governance - das Gruppeninteresse als Teil des internen
übergeordneten Instituts sowie der anderen nachgeordneten Institute sowie der anderen gruppenzugehörigen
Unternehmen an der Umsetzung der gruppenweiten Geschäfts- und Risikostrategien und das nachhaltige
erfolgreiche Agieren der Gruppe als Ganzes im Markt unter Vermeidung von Bestandsgefährdungen.”
1427 Ibid, p. 890.
1428 Commission, Communication from the Commission to the the European Parliament, the Council, the European
Economic and Social Committee and the Committee of the Regions: Action Plan: European company law and
corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, p. 15.
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on this matter.\textsuperscript{1429} This indicates an openness by the Commission towards this solution, even if the announced legislative proposal has not been presented yet.

11.1.7 Obligation to conclude domination agreements \textit{de lege ferenda}

For German groups, the transfer of own funds between group undertakings would be facilitated if all German insurance undertakings were obliged to enter into domination agreements with their parent undertaking, since §§ 311, 317 AktG do not apply and the parent undertaking would be able to instruct a subsidiary to transfer excess own funds to another group undertaking.

This would not solve the discrepancy between regulatory law and company law entirely, but at least remove the legal obstacle that constitutes the most significant difference between German and Swedish law with regard to the possibility to transfer own funds to a subsidiary in distress. As mentioned before, a domination agreement is connected with an obligation of the parent undertaking to compensate an eventual annual loss of the dominated undertaking. It therefore increases the contagion risk within the group, which is why the conclusion of a domination agreement \textit{de lege lata} may constitute a breach of the duty of care of the parent undertaking’s board members if this with a certain likelihood would lead to a significant financial burden.\textsuperscript{1430} Domination agreements between life insurance undertakings as dominated undertakings and non-life insurance undertakings are \textit{de lege lata} not approved by BaFin because they set aside the separation principle.

These aspects are contrary to the policyholder protection objective of Solvency II\textsuperscript{1431} and outweigh the increased certainty that excess own funds are used to support a group undertaking in distress, even more so because the parent undertaking’s board still would be bound by the interest of the parent undertaking in its decision to give an instruction or not.

11.2 Solution 2: Regulatory law follows company law

The second set of solutions accepts the existing company law restrictions and requires regulatory law to follow company law. Again, the efficiency of the measures discussed with regard to the degree of alignment between the two legal disciplines varies, and also

\textsuperscript{1430} Marcelli, p. 161, who discusses and rejects an obligation to enter into a domination agreement in order to enable the parent undertaking to exercise an effective group-wide risk management; Dreher and Ballmaier, Solvency II und Gruppenaufsicht. Das Verhältnis von Aufsichts- und Gesellschaftsrecht bei der Gruppenaufsicht über Versicherungsunternehmen unter Einbeziehung der Gruppenaufsicht über Kreditinstitute und Finanzkonglomerate, p. 788.
\textsuperscript{1431} Marcelli, p. 163.
with this respect, some solutions would clearly require a change of regulatory law whereas others can be discussed \textit{de lege lata}.

11.2.1 Abolishment of the consolidated group solvency requirement \textit{de lege ferenda} and replacement with a legal entity approach

A radical solution would be to abolish the group solvency requirement entirely and instead solely rely on the solvency capital requirements at solo level. With the way the solo Solvency Capital Requirement is calculated today, this would however enable insurance undertakings to rely on the group internal creation of capital or on double gearing without having to compensate for these effects anywhere.

An alternative could be to adopt a legal entity approach where group-related effects already are taken into account of at solo level. Legal entity approaches are applied in the U.S. and in Switzerland, with the Swiss system probably being the more sophisticated one.\footnote{Siegel’s research result is that the U.S. system of group solvency as of 2012 is “significantly inferior” to the Swiss system and to Solvency II with regard to its ability to meet a number of predefined objectives: Caroline Siegel, Solvency Assessment for Insurance Groups in the United States and Europe - A Comparison of Regulatory Frameworks, 38 The Geneva Papers (2013), pp. 308-331, p. 328.} The insurance regulatory system of Switzerland has been deemed to be fully equivalent to Solvency II by the EU Commission,\footnote{Articles 1 - 3 of the Commission delegated decision (EU) 2015/1602 of 5 June 2015 on the equivalence of the solvency and prudential regime for insurance and reinsurance undertakings in force in Switzerland.} to the effect that:

- Reinsurance contracts with Swiss reinsurers are treated in the same way as reinsurance contracts with reinsurers having their head quarter in the EU (Article 172 (2) Solvency II Directive);
- Where an insurance group subject to group supervision according to Solvency II has a Swiss insurance subsidiary, the solvency capital requirement and the own funds calculated according to the Swiss rules may be taken into consideration for the calculation of the group SCR according to Article 227 (1) Solvency II Directive;
- Where the ultimate parent undertaking has its head office in Switzerland, Member States according to Article 261 (1) Solvency II Directive shall rely on the group supervision exercised by the Swiss insurance supervisory authority.

Consequently, when a subgroup belong to a Swiss insurance group, it may be exempted from group supervision at EU level according to Guideline 5 of EIOPA’s Guidelines on group solvency. The national supervisory authorities and the (Swiss) group supervisor have to cooperate in the same way as when the college of supervisors was headed by a group supervisory authority in an EU member state (Article 261 (2) Solvency II Directive).

So, how does the legal entity approach applied in Switzerland work? In many aspects, the Swiss Solvency Test is similar to Solvency II: It requires a risk-based calculation of
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the capital requirement on the basis of a one-year-projection of the solvency balance sheet into the future. Similar to Solvency II, Swiss law subjects insurance undertakings to supervision both at solo and at group levels. Supervision at group level encompasses intra-group transactions and governance as well as group solvency. Here, Swiss law allows for two methods: The consolidated group SST (since 2015 the standard method according to Article 198a Swiss Insurance Supervision Ordinance\(^{1434}\)) and the granular group SST which can be applied with the Swiss insurance supervisory authority (Finma)’s approval (Article 199 Swiss Insurance Supervision Ordinance).

With the granular group SST, the group is not treated as a fictitious single entity, but as a collection of its legal entities.\(^{1435}\) The result of the granular group SST is therefore not one single group capital requirement. Instead, solvency requirements for every entity (or cluster of entities) are included in the calculation. The granular group SST is complied with if every single granular solvency requirement is met.\(^{1436}\) Capital transfers between group undertakings are only assumed to take place if a legally binding and enforceable so-called credit risk transfer instrument (CRTI) is in place.\(^{1437}\) Group undertakings are viewed to be connected with a “web of CRTIs”, for instance guarantees, retrocession agreements (i.e. group-internal reinsurance) or intragroup loans.\(^{1438}\) If an insurance subsidiary has received a guarantee by its parent undertaking, this will reduce its solvency capital requirement, but also lead to an increase of the parent undertaking’s solvency capital requirement.\(^{1439}\) This allows parent undertakings to downstream diversification effects to subsidiaries, because CRTI’s are also taken into consideration in the solo Solvency Capital Requirement.\(^{1440}\) Double gearing is taken account of in the granular group SST by considering it in the risk capital requirement: If the own funds already count for covering the capital requirement of one group entity, they are subject to a 100 % capital charge in other entities, and thus only can be taken into consideration once.\(^{1441}\)

The legal entity approach has been described as considering “all group members (i.e. the legal entities) individually but fully allowing for their mutual interactions”\(^{1442}\) and as assuming each group member “to behave in a way which is best in its own interest [and] within the constraints of its legal obligations and crti”\(^{1443}\). The legal entity approach was

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\(^{1434}\) Verordnung über die Beaufsichtigung von privaten Versicherungsunternehmen.
\(^{1435}\) Peter Chr. Hsu and Eric Stupp, Versicherungsaufsichtsgesetz (1st edn 2013), § 69 para. 35.
\(^{1436}\) Eidgenössische Finanzmarktaufsicht FINMA, Rundschreiben 2017/3 SST Schweizer Solvenztest (SST) (7 December 2016), para. 194.
\(^{1437}\) Hsu and Stupp, § 69 para. 35.
\(^{1438}\) FINMA, para. 190; Keller, p. 385.
\(^{1439}\) Keller, p. 390.
\(^{1440}\) Ibid, p. 390.
\(^{1442}\) The quotation stems from a presentation by the then Head of SST – Insurance Risk at FINMA, Thomas Luder. Thomas Luder, Swiss Solvency Test (SST) for Insurance Groups (FINMA 14 May 2009), slide 9.
\(^{1443}\) Thomas Pfeiffer, The SST Group Structure Model (26 February 2008), slide 11.
presented as being superior to a consolidated approach because rather than basing its calculation of an unrealistic assumption of the group as a fictitious entity, it considers a group as a set of legal entities plus information on the ownership structure of the legal entities plus information on capital transfer agreements and risk transfers between group members.\footnote{1444} Liabilities to third parties are not regarded as obligations of the group, but as obligations of the respective legal entity.\footnote{1445} If a group undertaking is in financial difficulties, its parent undertaking is assumed to inject further capital only if it is obliged to by a legally binding credit risk transfer instrument.\footnote{1446} For the granular solvency capital requirement of a parent undertaking, subsidiaries are treated as assets that can be sold at market value including future profits.\footnote{1447}

This approach seems to solve the conflict between company law and regulatory law in a better way than Solvency II, because it recognizes the legal boundaries between group undertakings instead of applying a fictitious economic entity approach, while at the same time taking the legal relationships among group undertakings into account. The assumption that parent undertakings will never support a subsidiary unless legally obliged, is, of course, a reversal of the assumption underlying a consolidated approach, and can equally be blamed for being over-simplistic. In reality, parent undertakings usually provide some (often limited) financial support to a distressed subsidiary. To me, it seems nevertheless more correct to base an assumption on the legal situation. With a legal entity approach, the problems connected with the identification of non-eligible own funds are avoided because own funds are not assumed to be transferred between group entities: If a CRTI (for instance a parental guarantee) would exceed the guarantor’s financial abilities, this would increase the counterparty risk attributed to the instrument.\footnote{1448}

In study from 2013, \textit{Siegel} compared the U.S., Swiss and the Solvency II group solvency systems based on five criteria: assessment of risk dependencies, fungibility of capital and recognition of diversification effects, prevention of multiple capital gearing, avoidance of regulatory arbitrage and implementation of supervisory colleges and scope of group supervision and treatment of non-regulated entities.\footnote{1449} Based on her findings, she deems the Swiss group structure model to be “slightly superior to Solvency II in terms of appropriately assessing risk dependencies and with regard to the recognition of group synergies and diversification effects”.\footnote{1450} However, according to her, also Solvency II represents a solid group capital assessment.\footnote{1451}

\footnote{1444} Ibid, slide 10.  
\footnote{1446} Ibid, p. 87.  
\footnote{1447} Ibid, p. 87.  
\footnote{1448} Ibid, p. 88.  
\footnote{1449} Siegel, p. 328.  
\footnote{1450} Ibid, p. 328.  
\footnote{1451} Ibid, p. 328.
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A consolidated approach is shown to have a lower risk or leading to regulatory arbitrage, i.e. to the transfer of own funds to entities in jurisdictions where the regulatory capital requirements are lower. The authors also observed more conservative results with a consolidated approach when computing the probability that all legal entities within a group will default at the same time (i.e. it computes a higher probability). With regard to the probability that only one legal entity will default, the results are the opposite, however. The authors also note that a consolidated approach is problematic when asset and liability return become highly correlated. All in all, the authors consider a legal entity approach to be superior to a consolidated approach, even if they deem it to be more complex.

Against the background of these positive assessments, it seems surprising that Switzerland has switched to a consolidated approach as the standard approach. The Swiss supervisory authority Finma states the following reasons for the change: Reduction of complexity, the factual importance of the consolidated approach, Finma’s competences to intervene as a solo supervisor, the exercise of supervision over foreign subsidiaries by local supervisory authorities and the possibility to return to the granular legal entity approach in case of material fungibility restrictions.

From the last reason can be concluded that the change in priority is not to be understood as a general departure from the legal entity approach in the sense that Finma has changed its mind about the conceptional advantages of the legal entity approach.

Switzerland’s granular group SST shows that it is possible to take the group structure into account for the calculation of a solvency capital requirement reflecting group aspects. A legal entity approach could therefore be a solution to align regulatory and company law. Whether such an approach is superior in all aspects is impossible to assess from a legal perspective, but the possibility to apply a legal entity approach instead of a consolidated approach in certain situations (material fungibility restrictions) seems interesting and deserves further attention.

11.2.2 “Limited Liability Put Option” in group internal models de lege lata/de lege ferenda

Since a consolidated approach disregards the boundaries between undertakings and therewith the limited liability enjoyed by parent undertakings, it has been suggested that groups are or should be allowed to take a so-called “Limited Liability Put Option”

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1452 Schmeiser and Siegel, p. 9.
1453 Ibid, p. 10.
1455 Ibid, p. 11.
1456 E-mail correspondence with Finma, (2017-09-05).
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(LLPO)$^{1457}$, also called “Default Put Option”$^{1458}$ or “Walk-Away Option”$^{1459}$, into consideration when using a group internal model.

11.2.2.1 How does a Limited Liability Put Option work?

The idea behind the Limited Liability Put Option is that the group SCR calculated with a group internal model should reflect or should at least be allowed to reflect that parent undertakings in certain situations would not support a subsidiary in distress and would leave it to its fate, leading to insolvency in the worst case. The LLPO would be an instrument allowing groups to reflect shareholders’ limited liability in their group solvency calculations. It is my understanding, that economically, the LLPO would have the effect that in those adverse scenarios where the parent undertaking would not be allowed or willing to support a subsidiary in distress, the subsidiary’s lack of own funds would not lead to a corresponding capital need at group level. In other words, in such a scenario, the subsidiary would be treated as if it was deconsolidated (as would be the case in an insolvency situation). Its risks would not be taken into consideration in the group SCR, and its own funds would not be considered at group level (in this scenario). As a consequence, fewer scenarios would lead to a complete loss of own funds at group level, which would influence the distribution curve so that the group SCR would be lower than without the LLPO.$^{1460}$

An example illustrates the effects of the LLPO on an adverse scenario. The example is based on the Basis Case used in chapter 8.3.1:

$^{1457}$ Brooks et al., at p. 386; Keller, p. 389; Rüdt, p. 41.
$^{1458}$ Stefanink, p. 250.
$^{1459}$ Heep-Altiner et al., p. 21 f.
$^{1460}$ As far as I have understood, actuaries achieve this result by treating the LLPO as an asset of the parent undertaking with an initial value reflecting the probability of its utilisation. In those scenarios where the LLPO is applied, its value increases and corresponds to the lack of own funds of the subsidiary in question. From a legal perspective, it is not obvious that the LLPO should be treated as an asset since it is inseparately connected to the holding of shares and cannot be divested separately.
It is assumed that all subsidiaries are wholly-owned. All excess own funds are fully transferable and there are no intra-group transactions or double gearing. The group applies a group internal model applying a large number of simulations of the consolidated solvency balance sheet.

At $t_0$, i.e. at the beginning of the 1-year-projection period, the consolidated balance sheet shows assets amounting to 6390 and liabilities amounting to 5060, i.e. own funds at group level of 1330.

Without the LLPO, one of the scenarios in the group internal model would have a significant adverse impact on the consolidated balance sheet at the end of the projection period $t_1$: Liabilities would rise to 5560 whereas the consolidated assets would drop to 5550 (see Figure 11.2.2.1 no. 2), i.e. in this scenario, all own funds would be consumed and the group would have a shortage of own funds amounting to 10.
When breaking down the result on the individual subsidiaries, it is revealed that all group undertakings except for the parent undertaking would lose own funds. Subsidiary 2 would be hit hardest and lose 700 of its assets while its liabilities would rise with 300, leading to a shortage of own funds of 500. If this scenario does not fall among the worst 0.5 %, the group SCR must be set at a level that the group’s own funds would not be consumed. Without the LLPO, the own funds would not suffice to cover the group SCR and the group would have to raise additional own funds or lower the group SCR by reducing risk.

With an LLPO, subsidiary 2 could be deconsolidated in this scenario, if it was assumed that the parent undertaking would not inject further own funds and let subsidiary 2 fall insolvent. This would have the following impact on the group solvency balance sheet: Consolidated assets would amount to 5050 and liabilities to 4560, i.e. instead of a shortage of own funds, the group would have excess own funds of 490. Consequently, with the LLPO, there would be no need to raise capital, and the group would have a lower group SCR than without it and therefore exhibit a higher group solvency ratio.

11.2.2.2 The permissibility of the LLPO de lege lata

For some actuaries, it seems to be self-evident that group internal models contain an LLPO: In a number of actuarial publications on modelling of group risks, it is applied without any discussion of its permissibility.1461 From the discussion in the German

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1461 See, for instance, in actuarial literature referring to Solvency II: Brooks et al., p. 389; Heep-Altiner et al., p. 21; without reference to Solvency II: Masayasu Kanno, Insurance Group Risk Management Model for the Next-
literature can be derived that at least BaFin has been confronted with it and has refused to authorize a group internal model with an LLPO.\textsuperscript{1462} Swiss Re reports that it uses two different versions of its internal group model: One that is approved by the Swiss supervisory authority (with LLPO) and one approved by the regulator in Luxembourg without an LLPO\textsuperscript{1463}, which may indicate that also the supervisory authority in Luxembourg considered an LLPO not to be in compliance with Solvency II. From the material publicly available, it is impossible to tell whether this reflects the opinion of all supervisory authorities in the EU or whether the LLPO has been discussed within EIOPA or in any college of supervisors. After all, according to Article 231 (2) Solvency II Directive, a college of supervisors shall reach a joint decision on the approval of a group internal model. However, since those final applications reflect the prior discussions with the group supervisor, it is possible that the applicants never formally requested approval of group model with an LLPO and that the question has never reached the level of a college of supervisors.

It is understandable if regulators are reluctant to approve an LLPO because it helps groups to lower their group solvency requirement by assuming not to support a distressed subsidiary and thereby allows them to profit from accepting the possibility of the subsidiary’s insololvency.

So, is an LLPO a permissible instrument to be applied in a group internal model according to Solvency II? Neither in the directive, nor in the Delegated Regulation, is it explicitly mentioned.

As Stefanink correctly points out, an LLPO would constitute a future management action, which could be allowed in accordance with Articles 230 (1), 121 (8) Solvency II Directive.\textsuperscript{1464} Article 121 (8) allows insurance undertakings to “take account of future management actions that they would reasonably expect to carry out in specific circumstances”. The provision also requires that the time necessary to implement such actions must be taken into consideration. Article 236 Delegated Regulation further concretizes under which circumstances a future management action can be reasonably expected.

With a literal interpretation, one could question whether the omission to inject own funds into a subsidiary would be a management action at all (Swedish:
The wording in Article 121 (8) (“carry out”, “implement”) implies that the legislator imagined some measure that the company would take rather than the situation that it would remain passive. However, very often, omissions are considered to be legally equivalent to actions, and it is possible to regard the assumed decision not to support the subsidiary as a management action.

The objective of allowing future management actions to be considered in internal models is to render the results derived from the model more realistic by acknowledging that managers will react to changes in the economic or financial situation. Taking into account that limited liability is the legal rule, it would be more realistic to require a future management action with regard to a decision to support a subsidiary rather than with regard to the decision not to support it. Putting it this way, the LLPO could be seen as an assumption with the content: “Parent undertaking P is assumed to support its subsidiaries unless the following circumstances apply (…)”. Thereby, the enterprise view applied for the calculation of the group SCR would be endorsed to a large extent.

Article 236 (3) Delegated Regulation lays down formal requirements for future management actions, among other that they must be part of a comprehensive future management actions plan that needs to be approved by the undertaking’s boards. Paragraph (1) contains material requirements for future management actions: They must be based on objective assumptions, realistic and consistent with the current (or changed) business practice and strategy, consistent with each other and with what the undertaking has communicated to the public. These requirements can be fulfilled by an LLPO, depending, of course, on the circumstances in each case.

However, another one of the requirements may constitute an obstacle to an LLPO. Article 236 (1) (d) reads as follows:

“assumed future management actions are not contrary to any obligations towards policyholders and beneficiaries or to legal provisions”.

Here, the relevant question is whose obligations are relevant. Is it the entity that is assumed to take a management action, or does it refer to all group undertakings? The LLPO itself is not contrary to the obligations of the undertaking refusing further support – usually the parent undertaking – nor is it contrary to any legal provision that this undertaking is obliged to observe. The insolvency of the subsidiary as a likely effect of the LLPO, however, would lead to a non-fulfilment of the subsidiary’s obligations towards its policyholders and to a continuous breach of its solo SCR and MCR, i.e. to a breach of the legal provisions that the subsidiary is obliged to observe.1465

The Swedish and French language versions refer to “the obligations of the undertaking” in singular (Swedish: företagets förpliktelser; French: ne son pas contraires à aucun engagement de l’entreprise d’assurance ou de reassurance), i.e. only those of the undertaking whose management action is assumed. The German and Spanish

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1465 Similarly: ibid, p. 254 f.
versions are equally unclear as the English (German: *Verpflichtungen gegenüber den Versicherungsnehmern und Anspruchsberechtigten*); Spanish: (*no sean contrarias a ninguna obligación frente a los tomadores y beneficiarios de seguros*).

A systematic interpretation gives some support to the wording in the Swedish and French version: In all five language versions, reference is made to “the insurance or reinsurance undertaking” (in singular) in Articles 236 (1) (b), (e), (2) (a) and (3) (e), all dealing with future management actions. With regard to Articles 236 (3) (b) and (3), the usage of singular and plural varies between the languages. In Article 236 (2) second paragraph, to the contrary, most language versions apply the plural form:

> “Insurance and reinsurance undertakings shall be able to explain any relevant deviations in relation to points (a) and (b).”

The use of both the singular and the plural form of “insurance undertaking” in the same Article is systematically coherent if one considers that assumed future management actions do not necessarily have to be actions to be taken by the management of the ultimate parent undertaking. Instead, they can be taken at any level within the group. An example could be a reallocation of assets in a subsidiary if certain circumstances occur. According to such a systematic interpretation, the assumed future management action must be in compliance with the obligations towards its policyholders and legal provisions, but not necessarily with the obligations of all group undertakings. For this interpretation speaks also that each undertaking in principle only needs to make sure that it fulfils its own obligations, but not those of other group undertakings.

Against this interpretation could be argued that Article 236 (1) (d) would only express a self-evident requirement unless it also referred to the obligations of other group undertakings – that a future management action may not assume a breach of the undertaking’s own contractual and legal obligations should be obvious. However, it seems as if this has been discussed with regard to the calculation of the solo SCR of life insurance undertakings,\(^\text{1466}\) which may explain the need for an explicit provision. Besides, the coherence requirements in Article 236 (2) can be also be considered to be rather self-evident, but are nevertheless explicitly laid down.

Of particular weight in EU law is, of course, a teleological interpretation and the proponents of the LLPO base their view explicitly on teleological arguments, however, not so much with regard to the interpretation of Article 236 (1) (d), but rather with regard to the permissibility of the LLPO as such:

*Rüdt* emphasizes that internal models are supposed to reflect the actual situation of the group as exactly as possible.\(^\text{1467}\) Not to allow the assumption that a parent undertaking – in extreme cases – would let a subsidiary go bankrupt, would render unrealistic results.

\(^{1466}\) Cf. Bauer, Reuss and Singer, p. 475 f.
\(^{1467}\) Rüdt, p. 23.
and a misleading basis for steering the group.\textsuperscript{1468} Stefanink comes to the conclusion that the need for realistic modelling not only allows the LLPO, but even makes it a necessary feature of internal models.\textsuperscript{1469} He tries to support the result of the literal and systematic interpretation of the provision in the Draft Delegated Regulation corresponding to Article 236 (1) (d) with a teleological argument. He refers to policyholder protection as the objective of Solvency II and to the complex interdependency of protected interests and holds that the interests of “a comparably small group of stakeholders – the insured of a distressed insurance undertaking” cannot supersede the interests of other stakeholders, such as other insureds, of the insurance group and the stability of the insurance sector.\textsuperscript{1470} He also correctly refers to the fact that limited liability is not suspended by Solvency II.\textsuperscript{1471} Stefanink’s argumentation is nevertheless unconvincing in this regard. Why the mere non-approval of the LLPO as an assumption in a group internal model, i.e. a higher group SCR, would lead to a one-sided preference of the interests of policyholders to the detriment of the stability of the insurance sector, is incomprehensible. This argument presupposes that the group SCR is connected with a corresponding obligation to use own funds to support a subsidiary, which is not the case.

The discussion on allowing the LLPO has a connection to the two different theories in financial accounts concerning the addressee of group annual accounts\textsuperscript{1472}: The proponents of an LLPO apply a parent undertaking perspective, which corresponds to the proprietary concept in financial accounting focusing on the shareholders of the parent undertaking. The adversaries of the LLPO probably have the policyholders of the group as a fictitious entity in focus for the group SCR, which bears some similarity to the entity approach according to which consolidated accounts are set up to inform the equity holders of all group undertakings.

As has been shown in chapter 8.6, the Solvency II legislation contains provisions indicating in both directions, but as is argued there, the understanding that is best in conformity with the objective of policyholder protection is that the concept of the group SCR focuses on ensuring that the group has sufficient own funds to ensure that all policyholders of group undertakings receive payment.

With this understanding, Article 236 (1) (d) Delegated Regulation needs to be understood as encompassing the obligations of all group undertakings: Since the Solvency II Directive also with the provisions on group supervision aims at protecting policyholders of all group undertakings, it would be contrary to this objective to allow group undertakings to use future management actions that would have the consequence that some policyholders in the group would not receive payment under certain

\textsuperscript{1468} Ibid, p. 23; Stefanink, p. 251.  
\textsuperscript{1469} Stefanink, p. 252.  
\textsuperscript{1470} Own translation. Ibid, p. 256.  
\textsuperscript{1471} Ibid, p. 256.  
\textsuperscript{1472} See chapter 8.5.
circumstances. According to this interpretation, therefore, an LLPO in a group internal model would not comply with Article 236 (1) (d) Delegated Regulation.

That representatives of insurance groups that want to apply an LLPO would not be content with this interpretation, would be understandable, since it required two steps: A teleological interpretation of the perspective to be applied for the calculation of the group SCR and a teleological interpretation against the wording in at least two language versions of the requirement that future management actions may not lead to a breach of obligations towards policyholders.

It would therefore be advisable if the EU legislator clarified both aspects: The perspective from which the group SCR needs to be calculated and an unambiguous wording in Article 236 (1) (d) Delegated Regulation.

Another provision that de lege lata would rim poorly with the LLPO is Article 221 (1) Sub (4) Solvency II Directive, which allows only in certain circumstances to apply proportional consolidation. If a partly-held subsidiary does not meet its SCR, a parent undertaking may under certain circumstances, above all when its liability is strictly limited to its capital share in the subsidiary, consolidate it proportionally. This reduces the group SCR, but is not equivalent to a deconsolidation, i.e. the solvency deficit must still be proportionately reflected in the group SCR and covered with own funds at group level. Since this possibility is only given with regard to partly-owned subsidiaries, it has the consequence that wholly-owned subsidiaries with a capital deficit must still be fully consolidated at group level.

11.2.2.3 Reflections on the LLPO

The advocates of the LLPO hold that a group internal model with an LLPO is more realistic than a model without it because it takes the fact into account that the board members of parent undertakings in certain, rather extreme, cases would be liable towards the company if they injected own funds into a subsidiary that is doomed to fail anyway, or if this would jeopardize the survival of the parent undertaking. In other words: Under certain circumstances, parent undertakings would take a management decision that would lead to a breach of contractual or legal obligations on the part of another group undertaking.

This argument is based on the assumption that Solvency II requires that in a conflict between policyholder protection and realistic calculations, the latter shall prevail – in fact, the proponents claim that this is the case already de lege lata.

Without the LLPO, the group would be required to hold own funds that it in certain extreme situations would not be allowed (or willing) to inject into a distressed subsidiary. With the LLPO, the group SCR could be regarded as more “honest” because it admits that there are situations where a subsidiary would not be saved, even though there is no guarantee either with an LLPO that excess own funds actually would be injected into a subsidiary. The group would have a higher group solvency ratio than without the LLPO, which could also raise false expectations.
In a number of provisions, the Solvency II legislation stresses the importance that internal models shall be realistic. The reason and precondition for allowing undertakings to calculate the group SCR with an internal model rather than with the standard formula is that internal models are often more appropriate to reflect (and model) the risk profile of the group (cf. Article 113 (1) (b) Solvency II Directive). According to Articles 230 (2), 120 Solvency II Directive, the group internal model must pass the use test, i.e. be widely used and play an important role in the group’s system of governance, which is more likely to be the case if it is realistic. This is certainly true with regard to how own funds would be used in a crisis situation. However, whether the group risk management really should work with assumptions that accept the insolvency of a group undertaking, is not obvious. If, for instance, the group risk management would test the effects of a proposed transaction on the group SCR with the group internal model, it would not be very helpful for risk management purposes if the group SCR would not be negatively affected, even though the insolvency risk of a subsidiary would increase significantly. With an LLPO, this risk might not be detected, or would at least require a thorough analysis of the effects on all group undertakings.

However, this does not mean that risk limits, for instance, need to be set at such a level that insolvencies could not incur at all – this would be impossible and is not required by regulatory law as the 99.5 % confidence level shows.

Even without the LLPO, the recognition of diversification effects at group level has the effect that a group solvency ratio of over 100 % does not necessarily mean that all group undertakings actual fulfil their solo SCR. There are possibly many scenarios falling within the 99.5 % confidence level where a subsidiary would not meet its SCR, MCR or even fall insolvent. The recognition of diversification effects as such can therefore be regarded as giving priority to realistic assumptions above policyholder protection because it allows groups to lower their group SCR – if policyholder protection had absolute priority, diversification effects should be irrelevant. On the other hand, negative diversification effects do not lead to a higher group SCR, which neither promotes a realistic calculation nor the interests of policyholders.

On the other hand, already the economic entity assumption underlying the consolidation method is unrealistic from a company law perspective. The rules on the eligibility of own funds at group level try to remedy the unrealistic assumptions and can be considered to serve policyholder protection purposes – consequently, a more realistic calculation does not necessarily conflict with policyholder protection. Future management actions will probably only be used by groups to lower their group SCR and not to increase it, which conflicts with policyholder protection, so the mere possibility to use them can be regarded as an indication to give priority to realistic assumptions.

The conflict between realistic assumptions and policyholder protection is thus not solved consistently in the Solvency II legislation, but there are examples where the legislator has given preference to “realism” above policyholder protection.
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So, should the LLPO be allowed, not as a feature of a legal entity approach similar to the granular SST applied by Switzerland, but within the current framework of the Solvency II regime? The LLPO would certainly be an important step towards an alignment between regulatory and company law. For allowing the LLPO speaks that it merely reflects what would happen if the subsidiary actually fell insolvent: It would be deconsolidated and not be reflected in the group SCR anymore.

False expectations could be prevented if the LLPO had to be explained to the public by the group applying it, which would increase transparency and prevent false expectations that a subsidiary would be saved. Why force a group to hold own funds for a situation in which they would not be used? If the LLPO was limited to exceptional, clearly defined situations, one could argue that its effects probably are rather marginal - on the other hand, one could wonder then why it should be necessary at all. Transparency requirements together with the need to approve the LLPO as part of a comprehensive future management action plan as required by Article 236 (3) by the management, administrative and supervisory bodies of the undertakings concerned would lead to a restrictive application on the part of insurance groups.

If one accepts that the group SCR is supposed to reflect the own funds required to ensure that all policyholders in the group receive payment, the LLPO cannot be allowed, because the group SCR simply would not reflect this amount.

The main argument against the LLPO is that it would enable groups to lower their group SCR so that they do not need to cover some of the most extreme adverse scenarios, i.e. it would suspend them from holding own funds for some of the worst scenarios falling within the 95.5 % probability – the group SCR would be diluted, so to say. Not allowing the LLPO means in effect: Groups need to have own funds to cover such extreme scenarios even if they are not going to use them to save a subsidiary. This may be connected with the hope that if the own funds are there, a way will be found to use them anyway – from a policyholder perspective, it would be a bit more comforting if the group at least had own funds to support a distressed subsidiary rather than that it does not, even if there is no guarantee that the funds will be used. Another concern is, what would happen, if the exercise of the LLPO over the course of time becomes more likely, i.e. it does not longer concern a few extreme scenarios with a very low probability, but a larger number of scenarios where the probability that one of them comes true, is significantly higher? If the subsidiary no longer met its solo SCR (not just in a few scenarios, but an actual deficit), should the group be able to apply the LLPO to lower its group SCR? On the other hand, there is risk that the group Solvency Capital Requirement as such contributes to a contagion risk: A parent undertaking that is required to cover a solvency deficit in a large subsidiary with own funds at group level may be forced to raise external capital at disadvantageous conditions in a situation where an important subsidiary is in distress and the group SCR is not fulfilled solely because of this subsidiary. This contagion risk could be reduced with an LLPO.
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As I see it, there is no clear case for the LLPO in the current Solvency II framework, even if some aspects are appealing. If the group SCR was understood to have a clear parent undertaking perspective, the main arguments against the LLPO would become invalid. It is therefore unsatisfactory that the Solvency II legislation is not explicit and even contradictory concerning the perspective to be applied.

11.2.3 Proportional consideration of shareholdings as standard method
de lege ferenda

The discrepancy between actual group structures and their treatment in the group SCR calculation is most obvious when partly-owned subsidiaries are concerned. Although Article 221 (1) Sub (1) Solvency II Directive suggests that a partly-owned subsidiary is considered proportionally, the reference to the consolidated accounts leads to an inclusion at 100 % when the consolidation method is applied.

This disincentivizes the holding of partly-owned subsidiaries even though the existence of minority shareholders leads to a risk reduction from the majority shareholder’s perspective. Furthermore, the current rules on the non-eligibility of own funds unavailable at group level incentivizes majority shareholders to keep the solvency ratio of partly-owned subsidiaries low.1473

Applying proportional consolidation subsidiaries would reflect the ownership situation of both wholly- and partly-owned subsidiaries correctly, while allowing groups to take advantage of diversification effects attributable to each subsidiary (in contrast to the deduction and aggregation method) and without incentivizing low capitalization of partly-owned subsidiaries. The current method disadvantages groups with partly-owned subsidiaries, particularly when there are considerable diversification effects between the subsidiary and the rest of the group and where there are important business reasons for maintaining a high amount of excess own funds in the subsidiary. An example could be a reinsurance subsidiary since its capital strength is an important criterion for cedants selecting suitable reinsurers. To take all subsidiaries into account proportionally, both with the consolidation and deduction and aggregation method, would eliminate this inequal treatment of wholly-owned and partly-owned subsidiaries. It would also fulfil the expectations raised by Article 221 (1) Sub (1) Solvency II Directive and it would render the complicated rules on the eligibility of minority shares in own funds superfluous. The deletion of Article 221 (1) Sub (3) and Sub (4) could also be considered because proportional consideration would be applied notwithstanding whether there is a solvency deficit in a subsidiary or not. The situation that a parent undertaking’s liability might not be limited to its share in the subsidiary’s capital would probably already today

1473 See chapter 8.3.7.
have to be taken into consideration as a risk, at least when an internal model is applied (for instance when a parent undertaking has issued a parental guarantee).

A shift to proportional consolidation would, of course, constitute a further move towards the proprietary concept focusing on the parent undertaking. But since it would still involve the elimination of all intra-group items, the main objective of group solvency, i.e. showing the solvency situation in a group without multiple gearing and intra-group financing, would be still be met.

Of course, it would only be a small contribution to soften the tension between regulatory and company law, since groups would still be treated as if they were a single entity, but it would at least remove one of the most obvious discrepancies and remove some incentives that are not necessarily in the interest of policyholders. An alternative to introducing proportional consolidation as the prescribed method for the consideration of all insurance subsidiaries could be to introduce proportional consolidation as an option available to groups beside the already existing possibility to apply for application of the deduction and aggregation method instead of applying full consolidation.

11.2.4 Abolish or restrict the recognition of diversification effects at group level *de lege ferenda*

The recognition of diversification effects at group level is consistent with the economic entity view applied for the calculation of group solvency because in a single legal entity, these effects are also recognized. If regulatory law shall follow company law more closely, the recognition of diversification effects can be questioned. As already mentioned, it benefits the parent undertaking and not the policyholders and is therefore poorly compatible with the policyholder protection perspective taken by Solvency II.

The recognition of diversification effects leads to a lower group SCR than the sum of solo SCRs and enables insurance holdings to finance parts of the own funds required in the group by raising debt. To only look at the group solvency ratio without taking the solo solvency ratios may therefore give the false impression that eventual excess own funds at group level could be transferred within the group, although these may be required to cover the solo SCR.

This can be illustrated with the following example: A group is headed by an insurance holding (with a notional SCR and own funds of 0) with three wholly-owned insurance subsidiaries, each having a solo SCR of 100 and own funds of 100. The group SCR amounts to 200 and the group own funds to 280, i.e. the group solvency ratio is 140 %. The impression therefore arises that there are excess own funds within the group, even though each subsidiary merely meets its solo SCR. The recognition of diversification effects builds on the assumption that excess own funds are freely transferable within the group because if circumstances with a diversifying effect materialize, one subsidiary may not meet its SCR any longer, whereas another one’s solvency ratio increases. As we have seen, with the current application of the eligibility rules, there is a considerable risk that such an asset transfer is not possible. However, the group solvency ratio of 140 % means that there is a margin for raising debt, i.e. a group undertaking that does
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not have to fulfil a solo SCR (in this case the instance holding undertaking at the top of the group) could take an external loan and inject it into a subsidiary without breaching the group SCR and thereby restore a subsidiary’s solvency.

A possible false impression concerning the existence of excess own funds could be avoided if diversification effects were not recognized. However, if all other elements of Solvency II, including the consolidation requirement, remained the same, this would only remove a small incompatibility with company law. With groups being required to report the effect of diversification effects on their group SCR in the group SFCR, their economic impact is transparent. Since all insurance undertakings are obliged to cover their solo SCR with own funds, even a large effect should not have any negative consequences for policyholders, since their level of protection would not be significantly better if diversification effects were not taken into account. The group would show a lower group solvency ratio and in the worst case have to raise capital, without significantly improving policyholder protection.

To abolish the recognition of diversification effects at group level would increase incentives to internalise diversification effects within one insurance undertaking and probably lead to mergers of subsidiaries. This would have some governance advantages, but would also lead to a higher contagion risk within such insurance undertakings. Even if changes in group structures are not negative per se, and often can be motivated with good reasons, it would be disproportionate to push groups to create larger entities only to safeguard the recognition of diversification effects.

11.2.5 Application of the “ultra posse nemo obligatur” principle de lege lata

In the German discussion on the relationship between Solvency II and company law, de lege lata, Dreher and Ballmaier have argued – with convincing arguments – that the application of the “ultra posse nemo obligatur” principle is the correct way of dealing with the conflict between regulatory and company law. The ultra posse principle derives from Roman law and is usually applied to protect individuals from obligations that collide with other obligations or that are objectively impossible to fulfil for anyone.\footnote{See also Winfried Hassemer, Ultra posse nemo obligatur, Zeitschrift für Rechtspolitik (2011), p. 192, at p. 192: “Ultra posse ist ein tief begründetes und funktionierendes Widerlager gegen die Kraftsprüche des "Wo ein Wille ist, ist auch Weg" oder des "Streng Dich an, nimmt Dich zusammen, die anderen können das auch". Diese Sprüche haben ihren vernünftigen Sinn, aber es wäre kaum auszudenken, hätten sie nicht auch eine feste normative Grenze, auf die man sich notfalls berufen kann.”.}

The principle is applied in civil, criminal and administrative law, and by the EU Courts. In Ecoppy, the Court of First Instance reasoned on the basis of the ultra posse principle that the Office for Harmonization in the Internal Market (now: European Unions Intellectual Property Office) did not breach against an obligation to examine all facts concerning a trademark application because it was
unaware of a fact that had not been pleaded by the applicant.\footnote{Court of First Instance, Judgment of 12 December 2002, Case T-247/01 (eCopy Inc. / OHIM), para. 47.} In \textit{DSV Road}, the applicant had by mistake filed two transit documents for the same goods imported into the European Union. The ECJ applied the \textit{ultra posse} principle to argue that the applicant could not be required to fulfil its obligation to present the goods at the customs office at the destination, because it was impossible for it since the goods appearing in the erroneous second documentation did not exist.\footnote{ECJ, Judgment of 15 July 2010, Case C- 234/09 (Skatteministeriet vs. DSV Road A/S), para. 34.} In both cases, the Courts thus applied the principle in situations involving objective impossibility to fulfil an obligation and not collisions of obligations. However, the fact that the Courts have recognized the principle at all, includes the possibility that they would also apply it in cases concerning conflicts between different obligations.

It is worth recalling that the above-mentioned discussion has mainly dealt with the governance requirements for groups. So, could the \textit{ultra posse} principle also serve as a way of handling the tension between regulatory law and company law with regard to the group solvency requirements? To start with, it is important to note that the principle \textit{limits} the scope of obligations according to regulatory law. It does not widen it, so that group undertakings are not obliged to remedy a deficit in the own funds at solo level of a related group undertaking. This is because the Solvency II Directive imposes responsibility for compliance with the solo SCR only on the respective insurance undertaking.

With regard to compliance with the rules on group solvency, it is necessary to distinguish between the rules on the calculation of the group solvency, the obligation to ensure coverage of the group SCR with own funds and regulatory sanctions in case of a breach of the group SCR. It is also necessary to consider the situation of the ultimate parent at EU level separately from the situation of insurance subsidiaries.

The rules on the calculation of the group solvency require a calculation method based on assumptions that conflict with company law, but they do not require any group undertaking to act in a way that is in conflict with company law: The parent undertaking merely needs to conduct the calculation in conformity with the provisions in the Solvency II legislation. Consequently, here, there is no field of application for the \textit{ultra posse} principle.

With regard to the obligation to cover the group SCR with own funds, I have already criticised the distinction made in Article 218 Solvency II Directive regarding the responsibility for coverage of the group SCR with own funds.\footnote{Chapter 7.7.} Article 218 (3) imposes responsibility for compliance with the group SCR on all insurance undertakings of a holding-headed group. It does not state how each single insurance undertaking is supposed to ensure coverage of the group SCR, so that one could again say that there is no conflict with company law because each undertaking is free to decide how it wants to fulfil this obligation. However, to use an extreme example, a literal interpretation would allow an insurance supervisory authority to pick one small insurance undertaking somewhere at the bottom at the group structure and require it to cover the group SCR.
with own funds. Such an obligation would clearly breach against the proportionality principle because such an undertaking would probably not be able to restore group solvency on its own – it would neither be able to reduce its risks sufficiently nor to raise sufficient external capital – and it does not have any company law instruments to force other group undertakings to help it. As argued in chapter 7.7, the responsibility laid down in Article 218 (3) therefore cannot be a strict obligation of insurance subsidiaries to ensure coverage of the group SCR, but must be understood as an obligation to cooperate in covering the group SCR, which includes both aspects of loyalty to the group and of proportionality. A duty of loyalty or cooperation widens the obligations of related insurance undertakings to include group aspects, whereas the proportionality principle has a limiting effect.

As already mentioned, two sorts of measures can be taken to restore group solvency: measures to reduce the group SCR and measures to increase the own funds eligible to cover it. An insurance subsidiary can contribute to lower the group SCR by reducing its own risk exposure (for instance by refraining from underwriting certain insurance business), by buying additional group-external reinsurance coverage, or by reallocating its assets to less riskful assets (for example by selling shares and reinvesting in government bonds). It can also increase the amount of own funds eligible at group level by raising capital outside the group (by a capital increase, or by issuing hybrid capital), provided that it can find investors that are willing to inject funds.

In case of a breach of the group SCR, the participating insurance undertaking or insurance holding company is obliged to submit a group recovery plan, which often will include a bundle of measures at various levels within the group. If the duty of cooperation is seen in connection with the group recovery plan, it must be interpreted as an obligation of insurance subsidiaries to assist – within the limits of company law – the undertaking at the top with restoring or maintaining coverage of the group SCR. For the group recovery plan, the ultimate undertaking needs to evaluate a variety of possible measures among other with regard to their feasibility, time aspects and possible negative consequences. This will require a dialogue with the group undertakings concerned, at least if they are expected to take specific actions. The duty of cooperation then requires related undertakings to support the ultimate parent undertaking in assessing the possibilities for restoring group solvency and in close collaboration with the parent undertaking to apply such measures that are compliant with company law.

Clearly, the *ultra posse* principle limits the cooperation duty in such way that it does not encompass measures that are not allowed by company law, such as measures that would not be privileged by the Business Judgement Rule, or breach against value transfer rules or formal requirements. A capital increase could, for instance require a resolution

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1478 The term ”duty of loyalty” can be understood mainly as a duty to refrain from illoyal actions, whereas a ”duty of cooperation” tends more towards an obligation to actively take measures. In the following, I will use the term ”duty of cooperation” in a sense that may includes both aspects.
by the general meeting. In that case, the duty to cooperate could consist in convening a general meeting with a capital increase on the agenda, but there is no obligation to exercise a capital increase if the general meeting of a partly owned subsidiary fails to approve it. It could also require a group undertaking to refrain from a profitable business opportunity. However, the duty to cooperate in the restoration of the group solvency ratio does not itself constitute a justification for measures that would otherwise contravene the subsidiary’s interest (either its own interest or the interest of its shareholders), especially if there are external shareholders. In that case, the subsidiary could be instructed by its shareholders to take certain measures, again within the limits of company law.

In a German de facto group, such an instruction may be connected with the parent undertaking’s obligation to compensate for a disadvantage because the cooperation duty does not set aside the obligation of the subsidiary’s management board to demand a compensation if it is asked to take a disadvantageous measure. Provided that the instruction is connected with a reliable compensation claim, the cooperation duty would lead to an obligation to follow the instruction.

Concerning the ultimate participating insurance undertaking (and, as argued in chapter 7.7.3.2.3, the ultimate insurance holding) the situation is different insofar as it has a clear obligation according to Article 218 (2) Solvency II Directive to ensure coverage of the group SCR. This obligation is of course, more far-reaching than the cooperation duty imposed on related insurance undertakings according to Article 218 (3). The ultimate undertaking is obliged to restore compliance with the group SCR, but it is free to choose the measures to achieve this. Even if it – supported by the Business Judgement Rule – has decided not to inject further capital into a subsidiary in distress, it is still obliged to comply with the group SCR. In that case, it could restore compliance by reducing risk, for instance by reallocating its assets or stopping certain kinds of business, and/or by raising external capital (and keeping it a parent company level). The obligation to ensure compliance with the group SCR might serve as a justification for measures that otherwise might breach against company law, for instance to raise external hybrid capital at a high interest rate, but the exact scope of this justification is not clear. A possibility would be to say that the board is obliged to take measures for restoring group solvency, but when assessing possible measures, it needs to choose the least harmful. This decision is again privileged by the Business Judgement Rule.

In extraordinary circumstances, it could be discussed whether it would be disproportionate to require the complete restoration of group solvency. An example could be if the efforts to restore the group solvency would pose a very high burden on the group undertakings without being able to remedy the underlying cause of the deficit (usually the own fund deficit at solo level of a large insurance subsidiary), or if the requirement to comply with the group SCR would collide with the attempts to restore the solo SCR since it would risk to shift the parent undertaking’s focus from improving the financial situation of the subsidiary to the benefit of the latter’s policyholders to
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restoring the solvency ratio of the fictitious group. The proportionality principle could also be necessary to complement the \textit{ultra posse} principle to ensure that the limitation of liability is not \textit{de facto} overruled by regulatory law: Otherwise, there would be a risk that compliance with the group SCR is insisted on mainly as a “penalty” for the parent undertaking’s “shamelessness” of invoking limited liability, and not out of a real concern for the financial soundness of the remaining group undertakings.

A consequence of the \textit{ultra posse} approach is that the measures that can be demanded in case of a breach of the group SCR depend on the applicable company law, which in turn contravenes the objective of enhanced supervisory convergence. It is also necessary to point out that even if the duty of cooperation may require measures to restore group solvency, this does not automatically mean that a deficit at solo level will be remedied, because the parent undertaking may have decided – supported by the Business Judgement Rule – not to inject further funds into the subsidiary.

Together with the proportionality principle, application of the ultra posse principle is the only way \textit{de lege lata} of handling the effects of the tension between regulatory law and company law when deficits of own funds at solo or group level arise, but they are not able to align the assumptions on which the calculation of the group SCR is based to the company law reality, i.e. this solution accepts in principle the economic entity approach applied for the calculation of group solvency.
PART VI

CONCLUSIONS AND FINAL REMARKS
12 Group solvency in the light of the relationship between regulatory and company law – conclusions and final remarks

This study is concerned with the question how the Solvency II group Solvency Capital Requirement must be understood in the light of the tension between regulatory and company law.

The study has shown that it is easier to describe how the group Solvency Capital Requirement cannot be understood than to describe what it exactly represents: It does not reflect the amount of own funds necessary to ensure that all group undertakings with a 99.5% probability will still be solvent after one year. Coverage of the group SCR with own funds does not necessarily mean that all group undertakings at present fulfil their solo SCR, either. And even if a group has excess own funds, these funds do not have to be used to fill a deficit of own funds that may arise in a group undertaking during the following twelve months. A high group solvency ratio therefore does not necessarily allow conclusions about the financial situation of the group undertakings. One must also be cautious when trying to draw conclusions about a group’s financial situation, because the group solvency ratio may differ depending on the ownership structure: A group with partly-owned subsidiaries may display a lower group solvency ratio than an otherwise identical group with wholly-owned subsidiaries.

The calculation of the group SCR is based in the first place on an economic entity view, which for the calculation of the group solvency ratio is partly corrected by the rules limiting the eligibility of unavailable own funds at group level: As a first step, the group is regarded as if it was a single undertaking, and in a second step, own funds that cannot be transferred from an insurance subsidiary to the parent undertaking are recognized only up to the subsidiary’s diversified SCR. This second step must necessarily be undertaken from a legal entity perspective.

This approach consequently tries to combine the fictitious assumption of a single economic entity with a realistic assessment of the transferability of own funds within this entity. The consolidation method is appropriate to eliminate the multiple use of own funds within the group which is one of the main objectives of the group SCR, namely to show the financial situation of the group without reliance on group-internal financing. The group SCR thus represents an amount of own funds that a fictitious entity consisting of all subsidiaries would need to ensure that with a probability of 99.5%, the own funds
are not entirely consumed within a 12-month-period. This very theoretical definition is bound to be misunderstood.

Originally, group solvency was developed to render the multiple reliance on own funds transparent and to force groups to hold additional own funds to compensate for this reliance on internal financing. This important objective is met with the deduction and aggregation method. Also the consolidation method is suitable for this objective, but with this method, the group SCR gets a different character, because on the one hand, the recognition of diversification effects enables groups to increase their reliance on external financing, i.e. to lower their group SCR compared to the deduction and aggregation method, and on the other hand, it requires groups to hold own funds even for "partly-owned" risks.

We have seen in chapter 8.5 that the rules on group solvency in the Solvency II legal framework display both features of a concept where the protection of all policyholders in the group is in focus and those of a concept where group solvency is regarded from a parent undertaking perspective, with a slight predominance of the first. Solvency II is not unique in revealing a mixture of both concepts, since this can also be observed in group accounting regulation, but nevertheless, it would be helpful if the perspective applied in the Solvency II legislation was more transparent and thereby more accessible for public debate. Solvency II allows the parent undertaking to profit from diversification effects, but not from the risk reduction that follows from sharing ownership in a subsidiary with external shareholders. The group SCR therefore combines methods leading to a high level of prudence (by applying full consolidation and deducting minority interests in excess own funds) with methods decreasing the level of prudence.

As far as I can see, the application of the consolidation method as the standard method for Solvency II has not been preceded by a public discussion. My initial suspicion that it was the result of an ill-considered alignment to IFRS consolidation and adherence to Solvency I methods, was not confirmed during the study, though. The report by the Tripartite Group from 1995 assessed the strengths and weaknesses of various methods of calculation of capital requirements for financial conglomerates, including the consolidation approach and the treatment of partly-owned subsidiaries (see chapter 8.6). How far the results of the report were considered in the preparation of Solvency II, is not transparent, however.

According to the Solvency II rules, eligible group own funds must be able to be transferred to the parent undertaking or cover the solo SCR of a group undertaking. The coverage of the group SCR with eligible own funds does not necessarily mean that excess own funds in fact will be used to restore the solo SCR of a distressed group undertaking.

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1479 See Darlap and Mayr, p. 41: "By definition, the acceptance of diversification effects for the determination of group capital requirements entails a reduction of the confidence level of the individual entity."
Consequently, in a group with a group solvency ratio surpassing 100 %, a group undertaking could have a solvency deficit despite the existence of readily available own funds elsewhere in the group.

The restrictions concerning the eligibility of non-transferable own funds reveal an unease with the economic entity approach and must be understood as an attempt to prevent that groups exhibit excess own funds that cannot be transferred to other group entities if a solvency deficit occurred elsewhere in the group, because this might raise false expectations. The rules on the eligibility of own funds are difficult to apply, however, and reveal several inconsistencies: They are based on the assumption that transferability restrictions only exist upstream from a subsidiary to a parent undertaking, but not vice versa. The company law analysis in chapter 9 has shown that this assumption is incorrect. Also, according to Article 330 Delegated Regulation, non-available own funds are eligible up to the diversified solo SCR, whereas Article 222 (3) Solvency II Directive speaks of the (solo) SCR.

Insurance groups are required to assess availability restrictions of own funds. This leaves room for national differences in the application of the Solvency II framework, since only some kinds of own funds are explicitly declared unavailable in Article 330 Delegated Regulation. Van Hulle refers to a survey conducted in 2015 by Insurance Europe among European insurance undertakings according to which more than two-thirds of the member states have ”gold-plated” Solvency II in their markets, i.e. imposed additional requirements, and encourages the insurance industry to closely monitor the implementation of Solvency II. Concerning the eligibility of own funds at group level, however, there is a risk for the opposite, i.e. a lenient interpretation of the rules resulting in the full recognition of own funds at group level, even though availability is doubtful. Examples that have been found during the study are the restrictions due to the prudence principle in Swedish company law and the treatment of the equalisation reserve (Schwankungsrückstellung) by German non-life insurers (chapters 8.2.3.2.2 and 9.4). In those cases, it is very unlikely that the local insurance industry will protest. Exactly at which level the prudence principle sets a limit for asset transfers, is not entirely clear. However, most likely, in all jurisdictions, own funds at least up to the solo SCR would have to be regarded as unavailable, because each insurance undertaking must comply with its SCR at all times. This is not done in practice, either. Particularly, when transferability restrictions are caused by national rules and concern own funds that are not explicitly exhibited on the consolidated solvency balance sheet, there is a risk that those assets are wrongly treated as fully eligible because their correct treatment is perceived as disadvantageous in comparison to the treatment of competitors in other EU member states.

1480 van Hulle, Solvency II: Reasonable Expectations, p. 326.
Apart from that, it is impossible to fully comply with the rules on ineligibility of own funds at group level, because the outcome of the availability assessment depends on the circumstances in each case and cannot always be predicted beforehand. It is therefore not possible to fully rely on the availability of own funds at group level, since the excess own funds in a group with a group solvency ratio above 100% may include own funds that only can be transferred to other group undertakings by way of a loan arrangement.

Despite an implicit underlying expectation that excess own funds will be used to restore a solvency deficit in a group undertaking, such an obligation does not exist *de lege lata*. While both supervisory authorities and the management organs of parent undertakings in most cases will have a common interest in avoiding a solvency deficit of an insurance undertaking, there will be cases where a management board after a diligent assessment of the situation will decide not to restore the SCR and in the worst case let a subsidiary fall insolvent. Even though a supervisory authority may be dissatisfied with this decision, it has to accept it as long as it is compliant with company law, and may, as I have argued in chapter 11.1.2.1, not use it for a negative fit and proper assessment – in contrast to possible concrete wrongful actions or omissions that have caused or contributed to the crisis.

Whether this underlying expectation will be accompanied by a future alignment of the company law rules applicable to insurance undertakings to the assumptions underlying the group SCR, remains to be seen. Insurance regulatory law could be a forerunner for a development of company law, but at present, despite the legislator’s expectations expressed in Article 242 (2) Solvency II Directive, steps towards an alignment between regulatory and company law cannot be observed. Such changes should be preceded by an open discussion and a thorough analysis of the possible positive and negative consequences.

The possibility to invoke limited liability within a corporate group certainly raises questions, particularly against the background of the experiences in the banking sector. It is not self-evident that groups are allowed to conduct their insurance activities in dozens of tightly-controlled different legal entities without own personnel and still be able to invoke limited liability if the business model fails despite having profited from a subsidiary during good times. A general parental liability would have to be accompanied with a removal of hinders to the transferibility of own funds. However, there are a number of aspects in which insurance groups – even international ones – differ from banks or multi-national corporate groups. Huge multi-national corporate groups (often in the manufacturing sector) often figure in the debate on corporate liability for environmental damage or liability for health damages or deaths due to poor working conditions, for instance. Such scenarios are not typical risks involved with the insurance business, even it is, of course, possible to imagine similar situations to occur within an insurance group.
The main objective of insurance regulation is the protection of policyholders and the insured. A general parental liability would be mainly in the interest of the policyholders of a distressed insurance undertaking, but not necessarily in the interest of the policyholders of other group undertakings. For instance, even if policyholders cannot place reliable trust in a continuous comfortable financial situation of their insurance company, it is not evident that their insurance company should have to use excess own funds to support another group undertaking that has miscalculated the necessary premium level and has attracted more price-sensitive customers. The protection of policyholders should already be safeguarded by supervision at solo level complemented by group supervision to ensure that group internal financing and group internal transactions do not jeopardize the solo undertaking’s financial position.

The numerous public consultations conducted in the course of the development of the adoption of the Solvency II legislation have given stakeholders unprecedented opportunities to pinpoint unexpected consequences of Solvency II rules and have certainly contributed to improve Solvency II. As van Hulle notes, however,

"[...] the consultation was so intense that it became difficult for people to respond to the consultations in time as they could no longer read all the consultation papers that were published by the EC or by CEIOPS/EIOPA".1481

In 2009, several dozen consultations were conducted by CEIOPS (resulting in 35 Advices to the Commission on 10 November 2009 alone, and a further 14 on 20 January 2010).1482 Not only the sheer amount was overwhelming. Even if stakeholders tried to fully comprehend the proposals in the consultation papers, this was not facilitated by the technical character of many consultation papers and the fact that inconsistencies between consultation papers and other documents existed. Probably only a few insurance groups had enough experts who could spend large parts of their working time on assessing the consultation papers. Furthermore, stakeholders sometimes did not have any reason to suspect that a consultation paper would contain controversial proposals since the wording in the Solvency II Directive seemed to be sufficiently clear. For example, Article 221 (1) Solvency II Directive requires thorough reading and some accounting knowledge to correct the initial wrongful impression that partly-owned subsidiaries would have to be consolidated proportionately (see chapter 8.2.2). Only at level 2, the full consolidation approach becomes fully visible. Restrictive provisions at level 2 or level 3 may also result in depriving Directive provisions of their applicability, as the discussion of Article 221 (1) Sub (4) in chapter 8.2.2.2 has shown. The provision deals with the proportional consolidation of subsidiaries with a solvency deficit. Its field of application has been

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1482 See the list of CEIOPS’ Solvency II Level 2 Advice at https://eiopa.europa.eu/publications/solvency-ii-final-l2-advice.
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narrowed so much by EIOPA’s guidelines that it is hard to think of a case where the provision may become applicable. The guidelines on the treatment of subsidiaries with a solvency deficit reveal an understanding that it is immoral not to support a subsidiary in distress. Even though such level 3 provisions are not *intra legem* concretizations of the Directive, they have a high practical relevance because it is very unlikely that their application will be challenged in court.

In principle, the consultation procedure is very positive from a democracy perspective: The possibility for stakeholders (and the entire interested public) to comment on EIOPA’s advice on future level 2 legislation or on the proposal for level 3 guidelines should – and in many cases probably has – lead to better regulation and to an increased acceptance of legislation among its addressees. Besides, it increases transparency since the input of stakeholders becomes more visible compared to lobbying behind closed doors, even if lobbying still happens, of course. My criticism is therefore not to be understood as a criticism against the consultation procedure as such. However, in the Solvency II case, the consultation was so intense and the topics consulted in many cases so complex that most stakeholders were unable to fully assess each consultation paper. Stakeholders may have learnt from this that they need to allocate more resources to monitor legislative proposals and consultations from the EU. Legislators and supervisory authorities have hopefully learnt that consultations only enhance the quality and legitimacy of rules if stakeholders have a realistic possibility to assess the proposals.

We have seen that Solvency II, including the rules on group supervision, are very complex. So, are they too complex? I would suggest that the answer to that question depends on which part of Solvency II is regarded. Insurance products have become much more diverse and sophisticated compared to earlier (but it seems to me not quite as sophisticated as many investment products) and insurance group structures more diverse. That these changes are reflected by increased risk management requirements and more sophisticated methods of calculating the capital requirements, is therefore not surprising. Nevertheless, I think that some parts of Solvency II have become overly complex. With the increasing complexity, it has become more difficult to attain expertise in insurance regulatory law. Considerable investments into the training of employees working with regulatory issues are necessary which increases the reliance of supervisory authorities and particularly insurance undertakings on the relatively small number of experts in regulatory law. My impression is that the increased complexity promotes a further fragmentation of the law1483 (and of legal expertise). This leads to an increased need of collaboration not only between lawyers and professionals of other disciplines, but also among lawyers specializing in different areas of law.

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1483 The term "fragmentation of the law" is most often used in international contexts, see for instance Matthias Lehmann, Legal fragmentation, Extraterritoriality and Uncertainty in Global Financial Regulation, Oxford Journal of Legal Studies (2017), pp. 406-434. Here, I mean an increased fragmentation within the same legal system.
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