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Insurance

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GERMANY

LAW AND PRACTICE: p.3

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The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Contributed by Clyde & Co LLP ***Authors:*** Dr Henning Schaloske, Dr Tanja Schramm Dr Daniel Kassing, Dr Kathrin Feldmann

Law and Practice

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Clyde & Co LLP is a major international law firm specialising in insurance and reinsurance with more than 1,400 legal professionals and 45+ of its own and associated offices. The insurance industry is at the core of Clyde & Co's strategy. About 70% of our lawyers advise on insurance matters. In addition, Clyde & Co focuses on other sectors at the intersection of insurance, such as aviation and marine, and has one of the leading litigation & arbitration practices. In addition to Clyde & Co's continental European offices in France, Spain and Greece, on 1 September 2016, Clyde & Co announced the opening of an office in Düsseldorf through the hire of two leading insurance partners, Dr Henning Schaloske and Dr Tanja Schramm, and insurance counsel Dr Daniel Kassing. The team joined from Noerr. The team consists of nine legal professionals (two partners, one counsel, two senior associates, three associates, one support lawyer). Over the past decade, the team has advised on many of the landmark and market-shaping claims in the German market, including 9/11, EM.TV, Siemens, SachsenLB, and others. The firm practises in the areas of Insurance & Reinsurance, D&O, E&O, Professional Liability, Product Liability, Property, Fidelity, Cyber, Digitalisation, W&I, Regulatory & Distribution, Litigation, Arbitration and ADR.

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1. Regulation

1.1 Regulation of Insurers and Reinsurers

European Level: Solvency II

On 1 January 2016, a major new prudential and supervisory regime called Solvency II came into force across the whole of the European Economic Area (EEA), consolidating and amending the previous life, non-life, reinsurance and insurance group directives as well as widely substituting previous national regulations. The aim of Solvency II is to create a single market for insurance in the EEA, thus providing a single set of key prudential requirements that apply consistently to insurance and reinsurance entities operating within the EEA, and enhance policyholder protection through establishing prudential requirements better matched to the true risks of the business.

The Solvency II framework is made up of three levels of legislation/guidelines: at level 1, there is the Solvency II Directive (2009/138/EC); level 2 consists of delegated acts, implementing acts and binding technical standards (together, the "Delegated Acts"); and level 3 takes the form of guidelines.

The Solvency II Directive follows a "three-pillar" approach that means it sets out a number of requirements for insurers and reinsurers in the EEA broadly in the following three categories:

- capital (ie, holding sufficient assets and qualifying capital to cover insurance liabilities and risk exposure);
- governance (ie, developing and embedding systems to identify, measure and proactively manage risk); and
- transparency (ie, making sufficient reporting and disclosure publicly to the market and privately to the relevant regulators so that they have the information they need to undertake effective, risk-based and proportionate supervision).

The Delegated Acts address issues that are more technical in nature and contain details on the valuation of assets and liabilities, eligibility of capital (own funds), equivalence, the internal model and rules related to insurance groups. They are directly applicable across the EEA without the need to be transposed into national regulation. There are also guidelines released by the European Insurance and Occupational Pensions Authority (EIOPA) that, despite not being legally binding, firms and regulatory supervisors are expected to comply with.

Insurance Supervision in Germany

The relevant supervisory authority for insurance undertakings, reinsurance undertakings and pension funds in Germany is the Federal Financial Supervisory Authority *(Bundes anstalt für Finanzdienstleistungsaufsicht*, or BaFin). Foreign insurers and reinsurers that intend to conduct business in Germany are also subject to supervision by BaFin.

Insurance supervision in Germany is mainly governed by the German Insurance Supervisory Act *(Versicherungsaufs ichtsgesetz*, or VAG). The Insurance Supervisory Act has more recently been revised, transforming the Solvency II Directive into domestic law as of 1 January 2016. According to the Insurance Supervisory Act, the primary objective of supervision by BaFin is to protect policyholders and beneficiaries. To fulfil this objective, BaFin monitors all business operations of (re)insurers within the framework of legal supervision in general and financial supervision in particular. Subject to the prerequisites set out in the Insurance Supervisory Act, BaFin may take measures against insurance undertakings that are appropriate and necessary to prevent or eliminate undesirable developments that threaten to harm the interests of policyholders; for example, if a (re) insurer did not comply with the statutory and supervisory requirements for conducting (re)insurance business. In addition to this general authorisation, BaFin is entitled to take certain special measures against a wide range of particular threats, ranging from appointing a special commissioner to replace the management board, supervisory board or other governing bodies of the company to revoking a (re)insurer's authority to carry out business. BaFin may also conduct ad hoc surveys, so-called stress tests or scenario analyses.

Besides BaFin, there are supervisory authorities at state level that are mainly responsible for supervising public insurers whose activities are restricted to the particular state in question and those private insurance undertakings that are of lesser economic and financial significance.

As mentioned, the Solvency II regime described above has been adopted in Germany by an extensive revision of the German Insurance Supervisory Act, which applies to insurers and reinsurers in Germany. In addition to the German Insurance Supervisory Act, there are certain regulations (delegated legislation) by which, based on respective authorisation in the German Insurance Supervisory Act, the German Federal Ministry of Finance concretises certain statutory provisions.

In order to provide guidance on its supervisory practice, BaFin issues Interpretative Decisions *(Auslegungsentscheidungen),* Guidance Notices *(Merkblätter)* or Circular Letters *(Rundschreiben)* on several topics. Even though not technically legally binding, the Circular Letters in particular are usually deemed as a clear indication of the regulator's expectations. Moreover, the publications will usually constitute a self-commitment of BaFin with the effect that BaFin has to treat similar cases alike. An important example for

such publications is the Circular on Minimum Governance Requirements dated 25 January 2017 (*Aufsichtsrechtliche Mindestanforderungen an die Geschäftsorganisation von Versicherungsunternehmen*, or MaGo). With the MaGo, BaFin has summarised the requirements and its expectations regarding the major areas of corporate governance of (re)insurers by bundling overarching aspects and explaining key terms such as "proportionality" or "administrative, management or supervisory body."

Besides, in individual cases, BaFin can issue Collective Decrees *(Sammelverfügungen)* and the orders contained therein are binding on all insurers addressed (for example, all primary insurers authorised to conduct business in Germany).

In addition to the provisions of the German Insurance Supervisory Act, (re)insurance undertakings have to adhere to a wide range of provisions of German law, for example, under Civil Law, Company Law and Data Protection Law. On its website, based on Article 146 of the Solvency II Directive, BaFin publishes a list of General Good Requirements, indicating the provisions EU/EEA insurers have to adhere to when conducting business in Germany on a freedom of services or freedom of establishment basis.

BaFin is also involved in international insurance supervision matters. In addition to contributing to the creation of a single European financial market, BaFin is represented in international bodies such as the International Association of Insurance Supervisors (IAIS) and is therefore involved in shaping international supervisory standards. By its IAIS membership and being a voting member in the IAIS Executive Committee as well as an active member of various IAIS committees and sub-committees, BaFin represents the interests of Germany as a core financial marketplace. BaFin deems the principles and standards developed by the IAIS as being of key importance for national supervisory practices.

A different supervisory regime applies to insurance intermediaries. The relevant authorisation requirements are set out in the German Commercial Code (*Gewerbeordnung*, or GewO). Insurance intermediaries are subject not to the supervision of BaFin, but of the competent local Chamber of Industry and Commerce (*Industrie- und Handelskammer*, or IHK) of their registered seat. International matters, such as the notification relating to an EU/EEA intermediary's intention to conduct business in Germany, are handled by the Association of German Chambers of Industry and Commerce (*Deutscher Industrie- und Handelskammertag*, or DIHK), which is the central organisation for all chambers of industry and commerce in Germany. A bundling of all supervisory aspects with BaFin has been occasionally discussed — ie, including insurance intermediaries — but, at least so far, this is not to be expected.

In Germany, a differentiation is made between insurance brokers (*Versicherungsmakler*) acting for and representing the interests of the policyholder, and insurance agents (*Versicherungsvertreter*) acting on behalf of the insurer. A licence may only be obtained as an insurance broker or insurance agent. This general differentiation is also strengthened by the German courts. According to settled case law of the German Federal Court of Justice, the insurance broker has to safeguard the policyholder's interests and provide best advice. On this basis, the Federal Court of Justice has recently further ruled that insurance brokers must not conduct claims handling services for the insurer.

2. Distribution

2.1 Insurance and Reinsurance Products

Currently, the Insurance Mediation Directive (2002/92/EC) (IMD) governs the distribution of insurance products by insurance intermediaries. However, as of 23 February 2018, the existing directive will be repealed and replaced by the Insurance Distribution Directive (EU/2016/97) (IDD), which is wider in scope and will introduce a wide range of requirements in respect of a distributer's registration, passporting, organisational structure, conduct of business, insurance-based investment products, sanctions and data protection.

The IDD, as published on 20 January 2016, is the result of a controversial debate, including a name change from the envisaged IMD 2 to IDD. The Directive aims, overall, to afford greater protection to customers and to achieve further harmonisation in insurance distribution throughout the EU Member States. It now explicitly also refers to the distribution of reinsurance.

The Directive only provides minimum standards, meaning that the member states may implement stricter rules where they consider it necessary for consumer protection reasons, a flexibility that may in the end turn out to be contrary to the goal to achieve a broad level of harmonisation and market integration in insurance distribution.

The Directive's cornerstones are, in particular, as follows:

- The IDD does not only apply to insurance intermediaries in the strict sense, but to insurance distributors in general. The provisions are intended to apply in cases where a customer obtains insurance coverage via an intermediary and where insurance coverage is taken out with the insurer directly or via comparison portals (except, for example, websites hosted by public authorities or consumer organisations that do not aim at insurance to be taken out).
- The publication of prices and costs shall become more transparent. Insurance intermediaries have to state the nature of their remuneration. They have to disclose whether

they are to receive a financial incentive for the sale of a product. There is, however, no obligation to disclose the amount of a commission payment. Similar rules apply for insurers that have to state which remuneration is granted to employees for insurance distribution. The Directive does not provide for a general ban on commission payments. Pursuant to the Directive, it may rather be chosen whether there shall be a commission (paid by the insurer) or fee (paid by the insured) as remuneration. However, the nature of remuneration must not be in conflict with the objective to obtain suitable insurance coverage for the customer.

- New provisions on transparency and business conduct aim to ensure that the customers take out insurance coverage that is really needed. Further, besides general status information, insurance distributors need to advise whether consultation is offered as well. A product information sheet tailored to the relevant insurance shall be used for all insurance products.
- In cases where products are sold accompanied by an insurance policy (cross-selling), the customers shall be able to choose whether they wish to purchase the main product with or without insurance.
- The requirements for the qualification of insurance intermediaries are raised and specified. Insurance intermediaries will be obliged to undergo further and regular training. Insurers shall offer training for their distribution staff.
- New rules on product oversight and governance (POG) are installed. Insurers and intermediaries that manufacture insurance products for sale to customers shall maintain, operate and review a process for the internal approval of each insurance product, or significant adaptations of an existing insurance product, before it is marketed or distributed to customers. This does not apply to large-risk insurance products.

While this does not constitute a formal external authorisation requirement for products, meaning basically General Insurance Terms and Conditions, it does lead to enormous administrative burdens for the affected insurers and intermediaries in the conception of insurance products. There is now a tougher sanctions regime, including, for example, personal liability of directors and officers of legal entities. Special rules are provided for insurance-based investment products.

In the course of the implementation on a European level, the EC is to provide technical advice on four subjects to specify the Directive (for example, a standardised format for the product information sheet). This Commission Delegated Regulation will be directly applicable in the member states and will be based on EIOPA preparations in the form of technical advice submitted to the Commission in February 2017 following public consultation. It is striking that the EIOPA paper provides detailed regulation proposals whereas the IDD is only intended to define general minimum standards.

On a German national level, on 21 November 2016, the German Federal Ministry for Economic Affairs and Energy *(Bundesministerium für Wirtschaft und Energie)* published a first draft of an IDD Implementation Act that has been much discussed since. On 29 June 2017, the German Parliament finally approved the German IDD Implementation Act in an updated version and the final step in the IDD implementation process was taken by decision of the Federal Council on 7 July 2017.

The implementation mainly affects the German Commercial Code (*Handelsgesetzbuch*, or HGB) as law governing insurance intermediation but also the German Insurance Supervisory Act *(Versicherungsaufsichtsgesetz)* and the Insurance Contract Act *(Versicherungsvertragsgesetz*, or VVG) to the extent there is insurance distribution by insurers. Some of the corresponding issues are described as follows.

In Germany there will continue to be a differentiation between two types of insurance intermediaries: insurance agents, acting on the side of the insurer, and insurance brokers, acting on the side of the insured. In addition to that, a new concept of honorary insurance consultants *(Honorar-Versicherungsberater)* will be implemented. Authorisation may still only be granted as an insurance agent, insurance broker or honorary insurance consultant.

Much debated is the issue of a ban of the current prohibition to pass on commissions. According to the IDD Implementation Act, insurance intermediaries must not grant or promise insureds or beneficiaries a special compensation in relation to an insurance contract, meaning in particular that they may not pass on the commission received in whole or in part *(Provisionsabgabeverbot)*. This is a rather surprising development because it had been widely expected that the ban on special compensations — previous provisions on that were highly controversial and subject to court decisions — would be dropped in the course of the IDD implementation. It is argued that granting or promising compensations would set the customer's focus on short-term cash incentives rather than on satisfying the customer's long-term needs. Further, the fear is that not having a ban would have a negative impact on consultation quality. It remains to be seen what the implications for the practice are; for example, how models of Fintechs where commission is not forwarded to the customer but donated to a good cause will be treated in the light of such a ban or how they will change.

Further details will be provided in a Regulation by the Federal Ministry of Economics, which will, for example, provide additional guidance on the training requirements. For that purpose, the existing Insurance Intermediation Regulation (*Versicherungsvermittlungsverordnung*) will be updated. Re-

markably, one of the last-minute changes in the parliamentary process was to include a parliamentary reservation with regard to the Insurance Intermediation Regulation, which means that prior to a decision of the Federal Council, the German Parliament will have three weeks to consider the regulation and amend or reject it; an uncommon requirement with regard to ministerial regulations.

3. Overseas Firms Doing Business

3.1 Overseas-Based Insurers and Reinsurers

As a general rule, conducting insurance business in Germany requires an authorisation. There are specific rules that provide a different legal framework for EU/EEA (re)insurers on the one hand and third-country (re)insurers on the other hand. While for EU/EEA (re)insurers the so-called single-licence principle applies, meaning that insurance undertakings having their registered office and licence in another member state may conduct business in Germany under the freedom to provide services or freedom of establishment, third-country insurers are subject to a stricter regime.

As a general principle, third-country insurers need to obtain an authorisation and establish a German branch office if they wish to carry on insurance business in Germany. The German Insurance Supervisory Act, which stipulates these requirements, provides for an exemption if primary insurers or reinsurers from third countries carry out solely reinsurance business in Germany through provision of cross-border services and if the EC has decided in accordance with Article172(2) or (4) of Directive 2009/138/EC that the solvency regimes for reinsurance activities carried out by undertakings in the relevant countries are equivalent to the regime described in that Directive, which currently is the case for Switzerland, Bermuda and Japan.

With regard to US insurers doing business in the EU, the United States and the EU have recently reached an agreement aimed at addressing the US lack of equivalency concerning the Solvency II directive. The agreement will allow US insurers and reinsurers to continue writing new business in the European market without having to establish a local presence in every European member state they want to be active in. Moreover, the agreement streamlines group supervision requirements for insurers and reinsurers operating in both jurisdictions.

For reinsurers domiciled elsewhere, the requirements for conducting business in Germany have been controversial. A respective interpretative decision dated 31 August 2016 by BaFin has received much attention and caused much debate as it was partly understood as creating new market barriers and protecting domestic insurers. With said decision, BaFin has specified some aspects regarding the conduct of reinsurance business in Germany by insurance undertakings situated in a third country, ie, a non-EU/EEA country. This interpretative decision refers to the conduct of reinsurance business by third-country insurance undertakings only. BaFin clarified that carrying on reinsurance business in Germany does not only include the execution of legal transactions, but also the main steps leading up to signing the contract and the performance of the contract. The decisive element is whether the third-country insurance undertaking deliberately targets the German market (for example, advertisement of specific products, an internet presence targeted at the German market and employees of the third-country insurance undertaking visiting customers with the aim of concluding reinsurance contracts) to offer reinsurance contracts to German insurers or to initiate such business. Deliberate targeting is also the case if the third-country insurance undertaking uses intermediaries situated in Germany or abroad to contact German insurers or to provide offers to the German market. Such activities would be classified as carrying on insurance business in Germany and, thus, trigger the authorisation requirement.

There is, however, no authorisation requirement if reinsurance contracts are concluded by correspondence *(Korrespondenzversicherung)*, because such activities are not deemed as carrying on business in Germany. The crucial elements here are that (i) the initiative to conclude the reinsurance contract must come from the German insurer and (ii) the reinsurance contract must be concluded by way of correspondence; for example, telephone, fax, e-mail or post. Taking into account the above clarification, for a national insurer's initiative to be given, the respective third-country insurance undertaking must not have distribution structures in Germany or have targeted the German market with, for example, advertisements. Pursuant to BaFin, insurance by correspondence also covers cases where a German insurance undertaking, on its initiative, authorises a third party, such as an insurance intermediary, to prepare and/or conclude a reinsurance contract.

Insurers should bear in mind that by law the supervisory authority is granted powers to order third-country insurance undertakings to cease conducting business immediately and to run off the business without delay. Also, the operation or commencement of reinsurance business without the necessary authorisation is considered a criminal offence under German law.

4. Transaction Activity

4.1 Mergers and Acquisitions Activities

The main aspect that comes to mind when considering transaction activities is run-off, which has been on the German insurance industry's radar for many years. In life and non-life insurance, several players have become well estab-

lished in the German market providing run-off platforms specialised in acquiring run-off business using different transaction instruments, such as portfolio transfer, transfer of companies, retrospective reinsurance or structured solutions. In particular, low interest rates and the new capital requirements under Solvency II are considered relevant factors contributing to an increase in run-off activity.

German insurance supervisory law does not provide for an official definition of run-off. However, there are rules governing the transfer of portfolios for primary insurers and reinsurers each. In the case of a portfolio transfer, BaFin has to approve the portfolio transfer agreement. This BaFin approval replaces the consent by policyholders that would otherwise be necessary under general civil law rules. With its decision, BaFin is supposed to ensure that the policyholders' interests are taken into account and their contracts remain active (insurance) or, respectively, the company taking on business fulfils the solvency requirements (reinsurance).

Today, run-off is particularly important for life insurers as several insurers have announced that they no longer want to underwrite any new business as the low-interest environment is particularly putting pressure on life insurers. However, BaFin has stated that, currently, it does not see a particular run-off trend even though in recent years BaFin has dealt with three transfers of business to run-off platforms. Not least due to the strict legal requirements, a transfer of business is a complex issue and there are no indications for a wave of consolidation to come.

Besides portfolio transfers, transformations of (re)insurers pursuant to the German Transformation Act (*Umwandlungsgesetz*, UmwG) also require BaFin approval.

With regard to investments, it is to be noted that specific requirements apply to owners of a qualified participating interest, being those who directly or indirectly hold at least 10% of the share capital or voting rights or who by other means are in a position that makes it possible to exercise a significant influence over the company's management. The owners of a qualified participating interest have to be reliable and meet the requirements of a sound and prudent management. Supervisory law provides for certain notification requirements in relation to the acquisition of qualified participating interests, in particular if certain thresholds are met or fallen short of (for example, 20%, 30% or 50% of the voting rights or share capital).

On the German insurance market, currently a lot of investment is seen in the field of Insurtechs.

5. Insurtech

5.1 Insurtech Development and Collaborations

There are many different business models across all stages of the value chain of insurance products that have been presented in recent years.

While developments are ongoing, it can be observed that at the beginning (and still) in Germany, the majority of Insurtechs were established in the fields of insurance distribution and contract management. Accordingly, to date, many Insurtechs operating in the German market seem to have taken the role of insurance intermediaries. When acting as insurance intermediaries, Insurtechs have to apply for a licence with their local Chamber of Industry and Commerce, and be registered with the insurance intermediary register. Other Insurtechs intend to provide added value to policyholders by aiding policy management.

However, recently, the first Insurtechs are becoming established as risk carriers or are in the process of doing so and obtaining BaFin approval; for example, for health insurance (Ottonova) and property/casualty insurance (Element, Flypper, One).

If Insurtechs apply for an authorisation as an insurance undertaking, they have to fulfil the same legal requirements that apply to other insurance companies. In particular, there is no "regulatory sandbox" as in the United Kingdom, where businesses may test innovative products, services, business models and delivery mechanisms in the real market, with real consumers with restricted authorisation. Neither with regard to authorisation requirements nor ongoing supervision does German supervisory law and BaFin differentiate between traditional undertakings and Insurtechs. However, the principle of proportionality applies, which means that the application of supervisory rules and guidelines has to be weighed against the type, extent and complexity of the risks to which the individual undertaking is, or could be, exposed. While it is to be determined, in consideration of the particular circumstances, how/to what extent the relevant rules apply, the principle of proportionality does not allow for the rules not being applied at all; the purpose of each provision always needs to be fulfilled. However, the principle is intended to ensure that the burden placed on (re)insurers — including Insurtechs acting as risk-carriers — mirrors what is necessary based on the individual risks of the undertaking.

As regards the necessary licence, it is in particular to be noted that authorisation to conduct insurance business may only be granted to a public limited company (*Aktiengesellschaft*) or Societas Europaea (*Europäische Aktiengesellschaft*), mutual society (*Versicherungsverein auf Gegenseitigkeit*), public corporate body and institution under public law (*Körperschaft und Anstalt des öffentlichen Rechts*). The authorisation can differ

depending on the lines of business that shall be covered. Further, it is of utmost importance for Insurtechs to consider that there are particular requirements to be observed regarding the persons who effectively run the insurance undertaking or perform key tasks and as regard financial resources. Furthermore, insurers, besides insurance business, must only conduct business activities that are directly related to insurance business.

Despite new market entries and business models, established insurers do not see a significant risk in these developments, not least because they founded some of the new entrants themselves or participated in the founding.

On a general level, support for Insurtechs and digitalisation-related developments have been observed. In two cities that particularly stand for the German insurance industry, Insurtech hubs have been created. In Cologne, a registered association (*eingetragener Verein*) was founded by several insurers, the InsurLab Germany, which is intended to develop tailor-made solutions for the digitalisation needs of the German insurance industry together with local and international start-ups. In May 2017, the German government announced Munich as a location for another Insurtech hub as part of a Digital Hub Initiative. In July 2017, in a joint initiative, 12 insurers from the Munich area founded a registered association to build the digital transformation together actively and support Munich in becoming an attractive location for the best international start-ups.

6. Emerging Risks and New Products

6.1 Risks and Regulator's Reponse to Risks

Cyber

Certainly on top of the list of emerging risks currently affecting the German market is cyber. Not least due to recent cyber attacks, the awareness of this risk and related insurance coverage have increased.

In Germany, the first insurers started to cover cyber risks only a few years ago. Since then, cyber insurance has become one of the most debated topics on the insurance market. At the same time, potential policyholders often still remain sceptical as to whether they should take out a cyber policy. This is also a result of the very different coverage approaches taken by different carriers, which makes it difficult for policyholders to compare offers. This was one reason for the German Insurance Association (*Gesamtverband der deutschen Versicherungswirtschaft*, or GDV) to develop new model terms and conditions (*Musterbedingungen*) for cyber products, which shall in particular provide further guidance to small and mid-sized companies, and sensitise them for cyber risks. The GDV has already developed model terms and conditions for many other common insurance products, and intends to support the development of the cyber insurance market. The new model wording should also make it easier for insurance brokers to get a better market overview and provide best advice to their clients.

The GDV model wording is divided into four parts. Part one includes general information about the scope of coverage. Accordingly, financial loss caused by an information security breach will be covered. An information security breach is defined as an impairment of the availability, integrity and confidentiality of electronic data or an information processing system. Furthermore, the information security breach has to be a result of specific events, like unauthorised access to electronic data of the policyholder. Such clear definition of the subject matter and scope of insurance is definitely an improvement because current wordings differ greatly. The model wording could also help to harmonise the definition of the insured event, which currently varies from policy to policy. Part one defines the insured event as the damage that is verifiably identified for the first time. Like the majority of German cyber policies, part two of the standard policy conditions implements certain cyber-related services, such as forensic and call centre services as well as crisis communication. Parts three and four specify coverage for financial loss. While part three covers financial loss resulting from third-party damage claims based on statutory liability provisions, part four deals with certain first-party losses, such as business interruption losses and costs incurred for data recovery. It will be interesting to see to what extent the new model terms and conditions will lead to a harmonisation of different coverage approaches and an increase of the sales volume of German cyber policies.

Recent cyber attacks have shown that cyber extortion — ie, the demand of ransom payments — is of particular practical relevance. The question of whether insuring ransom payments is permissible under German regulatory law has been subject to frequent discussions. Due to a lack of specific cyber-related rules or publications, it was referred to BaFin's general approach in relation to kidnap and ransom policies. Coverage of kidnap and ransom payments was deemed inadmissible until 1998 for being contrary to public policy. Since then, the regulator's approach has become less strict to some extent. However, in particular, it was still inadmissible to combine respective coverage with other coverage or to advertise the product. In June 2017, though, BaFin publicly commented on its intention explicitly to allow coverage of cyber extortion. The announced Circular Letter on the details of the relevant supervisory practice is yet to be published.

Warranty and Indemnity

In recent years, warranty and indemnity (W&I) insurance and related products have gained an increasingly important role in the M&A markets. Through W&I, the seller may significantly limit its liability for warranties, giving it the op-

portunity to have at its disposal a large part of the sales proceeds and not have to deposit money on an escrow account for several years. On the other hand, additional investment protection is an advantage for the buyer.

Being a relatively young product, W&I is highly complex, in particular because there is de facto no standard coverage, but any policy has to be customised. W&I is of particular relevance in transactions involving private equity firms. Challenges of the W&I business are seen in increased claims frequency and the fact that this is single-premium business. While W&I was originally structured as coverage taken out by the seller, according to studies, the great majority are now buyers' policies.

Big Data

Particularly due to digitalisation and new customer demands, the insurance industry's processes and approaches have been continuously changing over the past few decades. These developments are not limited to sales and distribution (for example, online marketing and distribution) but extend to consulting, underwriting, portfolio management or claims settlement. In the end, there are arguably no areas of business that are not more or less affected. Today, the nature and amount of data available as well as the speed and intensity with which data may be analysed influence, for example, the determination of tariffs, product development, marketing strategies (such as a more targeted approach to customers) and claims handling. At the same time, online tools, software applications and artificial intelligence have become part of the service strategy.

As regards product development and tariffing, two keywords have become well known on the German insurance market: vitality and telematics. Behind this, there is an approach to offer individual and behaviour/usage-dependent tariffs. Customers shall have the benefit of being offering individualised products and be motivated to loss-preventing behaviour.

Such products involve several new challenges — including, but not limited to, data protection aspects — and it remains to be seen if and to what extent there will be a sustained impact; for example, on damages figures.

7. Recent and Forthcoming Legal Developments

7.1 Legal Developments and Impact

Reform of the Money Laundering Act

On 22 February 2017, the German Federal Government agreed on the proposal of an act to implement the Fourth EU Money Laundering Directive into German law and transfer and reorganise the Financial Intelligence Unit (FIU). The German Money Laundering Act *(Geldwäschegesetz*, or GwG) from 2008 is to undergo a complete reform. Its objective is to prevent and combat money laundering and terrorist financing. The new act came into force on 26 June 2017.

One of the key elements of the new law is the introduction of a central electronic transparency register, which will contain information about the beneficial owners of companies, ie, all natural persons who own or control a company or at whose instigation a business relationship has been founded.

The legislator's aim was to keep the bureaucratic effort for companies at a minimum by accessing information from existing registers such as the trade register. In addition to the FIU, supervisory authorities and law enforcement agencies, companies and institutions subject to the Money Laundering Act will also be allowed to access the register to fulfil their obligations under the law. Other entities who can present a legitimate interest, such as journalists or non-governmental organisations, will be able to access the register as well.

The reformulated Money Laundering Act will have a risk-based approach to allow authorities and companies to use their resources more efficiently. In future, all obliged entities pursuant to the Money Laundering Act will have to document their own risks as well as those of their subsidiaries in Germany and abroad, and base the measures they take against money laundering and terrorist financing on these findings.

Sanctions under the new Money Laundering Act will also increase significantly. The maximum sum for administrative offences pursuant to the Money Laundering Act is to rise from EUR100,000 to EUR5 million for banks.

Insurers writing life or accident insurance with premium redemption and/or grant loans used to benefit from simplifications concerning the identification procedure. Pursuant to the German Insurance Supervisory Act, an insurer had already fulfilled its identification obligation if it had made sure that the premium payment was made from a bank account within the EU by direct debit. This provision has been deleted without replacement. In the legislator's opinion, the mere fact that a payment is made from an account by direct debit does not sufficiently prove that the bank account belongs to the contracting party.

From an organisational point of view, the new law will also entail the restructuring and expansion of the FIU previously based at the Federal Criminal Police Office *(Bundeskriminalamt*, or BKA) within the portfolio of the Federal Ministry of the Interior. From now on, it will be based at the Central Customs Authority *(Generalzolldirektion)* as an administrative authority within the portfolio of the Federal Ministry of Finance.

General Data Protection Regulation
Whilst the EEA data protection regime is not specific to insurers, it is certainly a challenge for many. The data protection law currently in effect in the EEA is derived from the first Data Protection Directive (Directive 95/46/EC). On 25 May 2018, the General Data Protection Regulation (EU 2016/679) (GDPR) will replace the existing regime. It seeks to harmonise data protection procedures and enforcement across the EU, and achieve consistency with the existing system for ensuring privacy online. It will be directly binding on data controllers in all Member States immediately upon coming into effect without the need for implementation by EEA states. Many of the new provisions will have a significant impact on data controllers and processors who are active within the EEA, including those who are located outside it but who monitor the behaviours of EEA consumers, or offer them goods or services. Importantly, the penalties for breach of the new regime will be much more substantial. Changes are also given with regard to the data breach notification because under the GDPR regime, the precept of rule and exception is reversed with regard to the notification of the responsible authority. Under the current law, a duty to notify the authority applies only in the case of special data breaches and serious harm, but under the GDPR, the duty to notify the competent authority will be the standard case. Moreover, under the current law, there are equal requirements for the notification of the authority and the data subject, whereas the GDPR differentiates between these, providing more exemptions for the notification of the data subject than the authority.

On a German national level, a reformed Data Protection Act (*Bundesdatenschutzgesetz*, or BDSG) has been passed to align German data protection with the new GDPR. The national law is in particular of relevance where the GDPR provides for flexibility clauses. However, given the higher rank of the European provisions, the rules on a German national level must only be applied where they are not in conflict with European law.

Insurance Block Exemption Regulation
The Insurance Block Exemption Regulation (IBER), first adopted in 1992 and prolonged in 2003 and 2010, expired on 31 March 2017. The IBER granted an exemption to the application of competition rules to certain types of agreements in the insurance sector, ie, agreements on joint compilations, tables and studies as well as agreements on co-(re) insurance pools.

The purpose of adopting the Regulation in 1992 was to save administrative costs for companies and the Commission at a time when restrictive agreements between competitors still had to be notified to the EU Commission for prior approval. The notification requirement was removed by the modernisation of antitrust control in 2004. From 2004, companies had to self-assess their agreements for compliance with Article 101 of the Treaty on the Functioning of the EU. When prolonging it for the second time in 2010, the Commission considerably reduced the scope of the Regulation from four to two exemptions.

On 13 December 2016, after hearing various stakeholders from the insurance industry and weighing the options, the Commission decided not to prolong the IBER for two main reasons: firstly, the number of co-(re)insurance pools covered by the Regulation has dropped significantly since 2010 and secondly, the Horizontal Guidelines on horizontal co-operation agreements between companies introduced in 2011 contain exhaustive information for companies to assess whether their information exchanges are compatible with EU competition law. In addition, the Commission opted for the expiry of the Regulation as it would not trigger significant costs for national budgets and administrations.

8. Other Developments

8.1 Promoting Alternative Risk Transfer

Compulsory Insurance for Natural Disasters
In recent years, there has been a recurring debate about the introduction of compulsory insurance for natural disasters, especially in connection with damages resulting from floods.

In regions frequently affected by floods, it has become extremely hard for owners to insure their property. Even in areas affected only every ten years, insurers often demand increased premiums. Consumers' associations have argued that, in order to decrease the premiums, it is necessary to introduce compulsory insurance for all house owners.

The GDV has voiced concerns that municipalities and states will lower their efforts to ensure efficient protection against floods if they can no longer be held accountable for damages. On the other hand, the GDV estimates that about 99% of all buildings in Germany can easily be insured against floods and heavy rainfall. More exposed buildings might require higher deductibles.

In conclusion, while the discussion is revived each time there is a flood or similar event in Germany causing severe losses, a compulsory insurance for natural disasters has not been introduced as of yet.

Collective Redress
On a global level and especially compared to the US, the continental European legal system is traditionally much more reserved when it comes to mass claims and exorbitant damages. As there are no uniform EU provisions, there are a number of different regimes in the member states.

While the German legislator has been rather reluctant as to the possibility of a collective redress mechanism similar to those in the US or the UK, there have been some developments regarding the introduction of collective redress mechanisms in Germany in recent years. In reaction to a large number of claims by Deutsche Telekom investors, the Capital Markets Model Case Act (*Kapitalanlegermusterverfahrensgesetz*, or KapMuG) was introduced in 2005. Also, in its current revised version, the act has a relatively limited scope as it only applies to capital market matters. Moreover, it is debatable whether the provisions have been successful. Considering the length of the proceedings initiated so far, it appears that the KapMuG has not necessarily helped to cut down the time it takes to reach a judgment.

In competition law matters, collective interests may be enforced by way of a representative action brought by an association. Other initiatives to introduce collective redress mechanisms have failed and it has been difficult to convert consumers to mass claims due to relatively low amounts of damages in most cases.

The recent "Dieselgate" scandal has given a taste of what may be to come in Europe and Germany in terms of collective redress. The case's extremely high media coverage and large number of potential claimants could leverage mass claims in Germany. Either way, Dieselgate gives a good overview of a claimant's options when it comes to enforcing their interests collectively and has certainly professionalised the claims landscape in Germany. There has been close co-operation between domestic and foreign players, and an increase in litigation PR to attract potential claimants and increase pressure on defendants to find an amicable solution. In addition, more and more foreign litigation funders have seized the opportunity and entered the German market. Even outside the VW case, there are a number of D&O cases financed by litigation funders.

As regards the VW case, the internet platform MyRight is one of the key players that have to be mentioned. Plaintiffs can assign their claims to MyRight, which then pursues the claims in co-operation with a US law firm. In the case of success, MyRight retains 35% of the profits. At the time of writing, the co-operation intended to file a "class action" based on the allegation of invalid European certificates of conformity in September 2017. So far, approximately 30,000 consumers have supposedly registered.

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At the same time, the emissions scandal has once again revived discussions in Germany on the introduction of a collective redress mechanism for consumers. The Federal Ministry of Justice has submitted an unpublished draft for the introduction of a model declaratory action intended to create a collective redress mechanism similar to the proceedings in capital market matters. Actions shall be brought by consumers' associations, chambers of industry and commerce or chambers of trade, and be published in an electronic register kept by the Federal Ministry of Justice. Affected consumers shall be able to register their claims against a payment of EUR10.00 and will not require legal representation. In addition to the model proceedings, claimants shall still be allowed to bring individual actions.

A major disadvantage is that a decision in the model proceedings will not automatically result in an individual, enforceable claim for the claimant. Claimants will instead have to enforce their claims afterwards on the basis of the model decision, meaning that the model proceedings will not lead to a decrease in the number of individual actions.

Product Oversight and Governance

Despite already being part of the changes brought by IDD as illustrated above, the topic of product oversight and governance (POG) qualifies to be particularly highlighted in line with consumer-related aspects as well. While POG must not be mistaken for a supervisory authorisation requirement for products or policy wordings, it does entail a company-internal approval procedure. The provisions, which will be specified by Commission Delegated Regulation/EIOPA guidelines, affect the entire product cycle, ie, from product development up to market exit.

Insurance undertakings and intermediaries that manufacture any insurance product for sale to customers are required to set up internal processes with a view to ensuring collective consumer protection by protecting consumers from "inappropriate" or "unsuitable" products. Moreover, potential legal uncertainties or disputes following the roll-out of products shall be prevented. POG is intended not only to ensure the profitability of products, but also to take account of customer interests and minimise loss potential.

Life Insurance

In 2014, the German legislator passed a law to reform German life insurance, in particular with a view to protect German life insurers in the light of the low-interest environment

that is deemed a significant risk for German life insurers. In their annual press conference in May 2017, BaFin officials advocated certain facilitations relating to interest reserves. Whilst BaFin has expressly stated that, in its view, no life insurance undertaking is existentially endangered, BaFin also urged insurers to adapt their portfolios to the low-interest environment. Besides, experts expect an increase in run-off solutions.