Chapter 8
Supervisory Review of Key Functions

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Abstract  Picking up from the Chap. 7 examination of the term “key functions” and of the key function holders, this chapter undertakes an examination of the supervisory review of key functions. In particular, this inquiry involves the areas of supervision of the key function holders as to fit-and-proper monitoring, the issue of remuneration of key function holders, the duties of notice and disclosure attendant on a change in key function holders, and the powers of insurance supervisory authorities in the supervision of key function holders.

8.1 Introduction

The Solvency II Directive\(^1\) at Level 1, the DVO implementing it at Level 2, currently in draft form,\(^2\) as well as the CEIOPS Consultation Paper “Draft proposal for Level 3 Guidelines on the System of Governance” of December 2010\(^3\) and the future VAG [German Insurance Supervision Act] at Level 4\(^4\) often name the holders of key functions as the addressees of the rule or, in the case of the Governance Guidelines, their object. Since neither the term “key function holder” or even the term “key function” are specifically defined by law, and since numerous legal questions arise from the clarification of the legal requirements for both, clarity with respect to these legal requirements is a precondition for application of the legal rules addressed to key function holders.\(^5\) Building on this, the individual rules of the new insurance supervisory regime are then discussed with a focus on their relevance to key function holders in insurance undertakings.\(^6\) Among these, the requirements that such persons be “fit” (below, 8.2) and also “proper” (below, 8.3) have especially significant weight. Issues surrounding remuneration come to the fore as well since the new insurance supervisory regime also addresses remuneration in the area of key functions (below, 8.4). Finally, the examination turns to the duties of notice and disclosure that exist with respect to the supervisory authority and the public in connection with key function holders and their

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\(^2\) The abbreviation DVO when used here and after in reference to the Level 2 DRA signifies the EU Commission draft known as Draft Implementing Measures Solvency II, 31 Oct. 2011.

\(^3\) Hereafter: Governance Guidelines.


\(^5\) See on this point Dreher, “Begriff und Inhaber der Schlüsselpositionen nach Solvency II und VAG 2012” [in English: Concept and Holders of Key Functions under Solvency II and the German Insurance Supervision Act 2012 (Draft)], VersR (2012), 933 (Chap. 7, above).

\(^6\) Any mention of insurance undertakings in this chapter includes reinsurance undertakings.
subordinate staff members (below, 8.5), and whether the supervisory authority may recall these persons or restrict their activity, and if the authority is entitled to obtain information directly from them (below, 8.6).

8.2 The “Fit” Requirement for Key Function Holders and Their Subordinate Staff Members in Key Functions

8.2.1 The Two-Tier Qualification Structure in General

Recital 34 of the Solvency II Directive requires: “All persons that perform key functions should be fit and proper”. Art. 258 SG6, para. 3 of the DVO takes up this very general requirement with the following sentence: “The persons performing a function . . . shall have the necessary . . . expertise . . . to carry out their responsibilities”. Thus, the rules apply to all persons who engage in work included within the scope of a key function, irrespective of their position within the hierarchy of the key function. The European insurance supervisory regime rightly presumes that all staff members who are part of a key function must possess the knowledge and skills necessary to properly meet their responsibilities.

But art. 42, para. 1 of the Solvency II Directive goes further, formulating more than just general qualifications for all persons who hold key functions. Rather, the provision defines “fitness” as follows: “their professional qualifications, knowledge and experience are adequate to enable sound and prudent management.” This is mirrored in art. 263 SG11, para. 2 of the DVO, which defines still further the special fitness criterion applicable only to key function holders within the meaning of art. 263 SG11, para. 1 of the DVO.

Thus the two-tier qualification structure is clear in the very wording of the rules, according to which the special qualification requirements for key function holders are differentiated from the general qualification requirements that apply to all staff of the undertaking who work in such functions. A systematic analysis of the framework of regulations fully supports the assumption of this two-level qualification structure. To start with, the special qualification requirements are restricted to key function holders, as these individuals are understood in the insurance supervisory regime. The background for this, in turn, is the telos of the equivalence

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7 Other language versions of the Solvency II Directive hold likewise. See Dreher, VersR (2012), 933 (936 f.) (Chap. 7, above, at 7.3.1).

8 Concerning the irrelevance of using the term “key task” in place of “key function” in the German language version of the Solvency II Directive, see Dreher, VersR (2012), 933 at II 2 (Chap. 7, above, at 7.2.2).

9 However, in art. 42, para. 1 of the Solvency II Directive, these are prefixed by “persons who effectively run the undertaking”, which brings clear definition to the group that constitutes the addressees of the law. See Dreher, VersR (2012), 933 (934 f.) (Chap. 7, above, at 7.2.2).
between the key function holders and the persons who effectively run the undertaking. This equivalence of key function holders to the members of the governing body, which generally means the members of the managing board, is justified exclusively by the distinctive nature of the position of key function holder.\textsuperscript{10} This is the sole basis upon which enables art. 42, para. 1 of the Solvency II Directive to equate the holders of key functions with the management of the business even with respect to the special qualification requirements.\textsuperscript{11} These further requirements consequently pertain only to the key function holders as laid down in the insurance supervisory regime and defined in more detail previously.\textsuperscript{12} They do not, however, affect all other subordinate staff members in one of the key functions.

In addition, the qualification requirements themselves also demonstrate that they are directed exclusively toward these distinct key function holders. Thus art. 42, para. 1 a of the Solvency II Directive refers overall to “sound and prudent management”. For one thing, this cannot be required of all subordinate staff members in the key functions of an insurance undertaking. Such staff members have no influence on the management of the insurance undertaking and its business policies, especially on its appetite for risk. If the triad of “professional qualifications, knowledge and experience”, which is supposed to ensure sound and prudent management, were actually to extend to all subordinate staff members, then excluded from working in key functions would be graduates of an institution of higher education at the commencement of their careers, all persons moving between key functions within the insurance undertaking as well as those moving from another business area within the insurance undertaking into a key function, and those coming from another undertaking altogether. Extending these far-reaching qualification requirements to all staff in the key functions of an insurance undertaking would therefore both fail of its purpose and be incompatible with the principle of proportionality applicable under, i.a., art. 29, para. 3 of the Solvency II Directive in a general sense and Recital 31, sent. 3 of the Solvency II Directive for the organization of the key functions more specifically.

The system of qualification requirements under the Solvency II Directive includes the Level 2 rules in art. 263 SG11 of the DVO, referred to previously, which govern the implementation of art. 42, para. 2 of the Solvency II Directive. The requirements for fitness found therein go still further than those in art. 42, para. 1 a of the Solvency II Directive. Art. 263 SG11, para. 1 of the DVO requires “documented policies and adequate procedures” in order to ensure the fitness of key function holders at all times. Para. 2 provides numerous criteria for fitness that pertain only to holders of other key functions within the meaning of para. 1, as separate rules are provided for the members of governing bodies in para. 3.

In detail, art. 263 SG11, para. 2 of the DVO provides that the insurance undertaking would have to assess the occupational and professional qualifications

\textsuperscript{10}See Dreher, VersR (2012), 933 (937 f.) (Chap. 7, above, at 7.3.2).
\textsuperscript{11}See Dreher, VersR (2012), 933 (938) (Chap. 7, above, at 7.3.4).
\textsuperscript{12}See Dreher, VersR (2012), 933 (938 f.) (Chap. 7, above, at 7.3.5).
of a person as well as his or her knowledge and relevant professional experience within and outside of the insurance sector. It would also have to take account of the particular responsibilities and duties assigned to this person. Since art. 42 of the Solvency II Directive applies only to key function holders as laid down in the insurance supervisory regime, the implementation rules are also applicable only to key function holders as laid down in the insurance supervisory regime, and not to all staff members that work in a key function. Aside from this unambiguous conclusion from the perspective of the legal system, the area of personal application of the provision also reveals a contextual underpinning of stringent requirements for processes and qualifications that cannot and should not apply to all staff in a key function.

Finally, from a legal systematic perspective, and with art. 42, para. 1 of the Solvency II Directive and art. 263 SG11, paras. 1 and 2 of the DVO as background, Recital 35 of the Solvency II Directive confirms that the two-tier qualification structure applies to the qualification requirements for persons who operate in an area of a key function. According to the Recital, “the purpose of assessing the required level of competence, professional qualifications and experience of those who effectively run the undertaking or have other key functions should be taken into consideration as additional factors”. This means that the issuers of the Directive themselves assume that the qualifications level at the top of the undertaking—that is, the management and holders of other key functions—in part determines the qualifications level of subordinate staff members within a key function. In other words, Recital 35 of the Solvency II Directive pertaining to the qualifications of subordinate staff in key functions makes explicit the rather obvious notion that, with consideration given to the tasks and undertaking involved, a level of qualification lower than that required of key function holders is sufficient for the staff subordinate to them.

8.2.2 The Special Rules

8.2.2.1 The Actuarial Function

The general two-tier qualification structure is supplemented in the Solvency II Directive by special rules. To start with, there are special, function-specific rules in art. 48, para. 2 of the Solvency II Directive that apply to the actuarial function. They prescribe the following for this function:

13 These special rules cannot be examined in-depth in the present context.
The actuarial function shall be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the business of the insurance or reinsurance undertaking, and who are able to demonstrate their relevant experience with applicable professional and other standards.\(^{14}\)

Although the DVO contains no concrete details with respect to these function-specific rules, the opposite is found with the detailed rules in the Level 3 drafts.

### 8.2.2.2 The Outsourcing of Key Functions

Special rules also apply to the outsourcing of key functions. The outsourcing of key functions\(^{15}\) is permitted under art. 49 of the Solvency II Directive.\(^{16}\) Art. 264 SG12 of the DVO contains numerous implementation regulations in this regard. In this text, the DVO correctly presumes that outsourcing shall not be allowed to alter the obligations of an insurance undertaking arising from the Solvency II Directive.\(^{17}\) The following also applies to an insurance undertaking under art. 264 SG12, para. 6 a of the DVO:

The insurance undertaking ... shall ... verify ... that all staff of the service provider ... are sufficiently qualified and reliable.

At Level 3, Guideline 11 of the Governance Guidelines stipulates that the fit-and-proper requirements for holders of key functions in cases of outsourcing apply to those staff members of the service providers who assume the respective responsibilities.\(^{18}\) According to Explanation No. 3.33 to these Guidelines, the responsibility for the determination that staff members of the service provider satisfy these requirements falls to the insurance undertaking.

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\(^{14}\) For the somewhat flawed implementation legislation, see sec. 31, para. 3 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act].

\(^{15}\) Regarding supervision in the case of outsourcing see art. 38 of the Solvency II Directive.

\(^{16}\) Regarding implementation, see sec. 32 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act].


\(^{18}\) See also the relevant explanation at No. 3.33 ff. and the explanation at No. 1.11, sent. 3 of the Governance Guidelines.
8.2.3 The Fitness of Key Function Holders

8.2.3.1 The Requirements

Solvency II

The general qualification requirements already discussed apply to all persons who perform work in a key function, regardless of their level in the hierarchy.¹⁹ There are, however, special requirements in addition to these which arise from the higher qualifications demanded of the key function holders under the insurance supervisory regime. According to art. 42 para. 1 a of the Solvency II Directive, key function holders as laid down in the insurance supervisory regime must meet the following specific requirements for professional qualifications:

Their professional qualifications, knowledge, and experience are adequate to enable sound and prudent management (fitness requirement).

Art. 263 SG11 para. 2 of the DVO concretizes these rules at Level II with the following wording:

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 account of the respective duties allocated to that person and, where relevant, the insurance, financial, accounting, actuarial and management skills of the person.

Guideline 12 then follows at Level 3, along with explanations.²⁰ However, unlike other guidelines and explanations on this matter, this applies only to members of governing bodies.²¹ Other staff in the functions are covered only under the general explanations in No. 3.37 f.

The individual criteria of art. 263 SG11, para. 2 of the DVO are rather widely drawn. They require both professional and formal qualifications as well as relevant knowledge and experience. At the same time, however, they permit reasonable distinctions and the transfer of qualifications. This can be seen in the inclusion of qualifications from the overall financial sector and other areas of business in the criteria. It is also reflected in the consideration given to the specific responsibilities of a key function holder and the person’s skills in relation to the responsibilities.

In contrast, art. 263 SG11, para. 2 of the DVO does not provide detailed specifications for the legal requirement “sound and prudent management” as

¹⁹ See above, 8.2.1 and in detail below, 8.2.4.
²⁰ Governance Guidelines Nos. 2.12 and 3.39 ff.
²¹ See on this point also Governance Guidelines No. 3.1.
mandated under art. 42, para. 1 a of the Solvency II Directive. The skills required for management pertain mainly to members of the managing board as contained in art. 42, para. 1 of the Solvency II Directive. This is understandable, as the corporate management has to run the undertaking on its own responsibility set forth under sec. 76, para. 1 AktG [German Stock Corporation Act]. Thus the criterion of prudence in art. 42 of the Solvency II Directive should not be separately interpreted to be, as may first appear, an implied limitation on the undertaking’s freedom to act in accordance with its own appetite for risk. This becomes readily apparent in a comparative analysis of the various language versions of this directive.

VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]

Sec. 25, para. 1, sent. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] requires that persons who “have other key functions” are not only proper but also fit. Fitness is defined in sec. 25, para. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] as follows:

Fitness is contingent on the professional qualifications, knowledge and experience that ensure sound and prudent management of the undertaking. This requires adequate theoretical and practical knowledge of the insurance business and, in cases where management duties are performed, sufficient leadership experience.

The text of sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] clearly goes beyond the fitness criteria laid down in the European requirements for key function holders. The Statement of Reasons for the government’s draft reflects this only indirectly by providing for the implementation of art. 42 of the Solvency II Directive and by presuming that sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] “integrates the specific rules of sec. 7 a para. 1 of the VAG [German Insurance Supervision Act], earlier version”. Nevertheless, and in agreement with art. 263 SG11, para. 2 of the DVO in this

22 See on this point 8.2.1, above.
23 For a different view see Bürkle, “Europarechtliche Vorgaben für die interne Governance im Versicherungssektor” [in English: Requirements for Internal Governance in the Insurance Sector], WM (2012), 878 (881).
24 See, e.g., the English language version: “sound and prudent management” and the French language version “gestion saine et prudente”.
respect, the Statement of Reasons for the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] also points out that the specific requirements are based “on the respective key task and the responsibilities a person has while executing it”. “In addition, the nature, scale and complexity of the risks with which the business operations of the undertaking are associated have influence on the fitness requirement”.26

The legal requirements of “professional qualification”, “knowledge and experience” are also found in art. 42, para. 1 of the Solvency II Directive. The explanation of the requirement of “knowledge” in sec. 25, para. 1, sent. 3 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] with its reference to “adequate theoretical and practical knowledge” is not only an appropriate amplification of fitness but is also consistent with the corresponding requirement in art. 263 SG11, para. 2 of the DVO.

Sec. 25, para. 1 of the VAG RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] deviates, however, from art. 42, para. 1 of the Solvency II Directive and art. 263 SG11, para. 2 of the DVO in sentence 3 by specifying the requirement of “management experience” instead of simply “experience” as rendered in the Directive and the DVO, and then again in sentence 4 by requiring “a managerial position held with an insurance undertaking of comparable size and type of business for three years” in order to meet such management experience. Indeed, this is supposed to apply—continuing with the presumption of sec. 7 a, para. 1 sent. 3 of the current VAG [German Insurance Supervision Act]27—only for the “performance of management duties”, meaning that by contrary inference it does not apply to those specified later who have “other key tasks”. Nonetheless, there could be spillover effects.28 Overall, sec. 25, para. 1, sent. 4 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] sets the fitness standard at a very high level. Especially significant here is the trio of “three years”, “insurance undertaking” and “comparable size and type of business”. It is clear at the outset that the rule is incompatible with moves made by personnel between different sectors as well as with the current one-year orientation period for management positions in the banking sector, which has the approval of BaFin [Federal Financial Supervisory Authority]. And if one were to take the last of the three requirements literally, even the “advancement” of a person from a smaller to a relatively larger undertaking—regardless of the actual magnitude of the undertaking—would hardly be possible in the future.

26 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], id. n. 4 above, at Statement of Reasons for sec. 25 VAG [German Insurance Supervision Act] at 272.


28 On this methodical approach, see in detail Dreher, “Ausstrahlungen des Aufsichtsrechts auf das Aktienrecht” [in English: Effects of Supervisory Law on Corporation Law], ZGR (2010), 496.
The fixed 3-year requirement for management experience is as excessive an application of the Solvency II rules as the stipulation of insurance undertakings of comparable size and business type. Under the principle of full harmonization, these have no justification in national implementation law and—particularly after the DVO takes effect—have no legal effect due to the primacy of European law. This holds true even more so for the one other stipulation in the triad: that the experience must be in connection with an “insurance undertaking”. Art. 263 SG11, para. 2 of the DVO directly provides for consideration of “knowledge and relevant experience within the insurance sector, other financial sectors or other businesses”. Ultimately, this means that the staff in question may come to an insurance undertaking from another part of the financial services sector—or even from another field of business altogether—much the same as they can move to a larger insurance undertaking from a relatively smaller undertaking. And no rigid 3-year restrictions apply. Now, if this is the case even for the managing board members, meaning the persons who effectively run the business, it is certainly no different for the key function holders who are subordinate to them. Consequently, the direct reference to “insurance businesses” in sec. 25, para. 1, sent. 3 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], where key function holders are expressly mentioned, is not compatible with the Solvency II rules. Exclusively relevant, and sufficient in the final analysis, are knowledge and experience within the meaning of art. 263 SG11, para. 2 of the DVO.

Earlier, under the VAG [German Insurance Supervision Act] then in effect, the question arose as to whether knowledge of the German language was a necessary component of fitness for managing board members of insurance undertakings. While the literature in insurance supervisory law sometimes supported this idea, it was rejected from a number of perspectives, including as an interpretation of the relevant criteria—namely, knowledge of the substantive requirements of the responsibilities assumed and actual communication skill in the German language with the aid of language mediators. This applies even more so today following the completion of harmonization of insurance supervision by the Solvency II project for the time being. The outcome is also a product of basic European freedoms as well as the uniform applicability of supervisory law to insurance groups and other cross-border undertakings of relevance to insurance. Applicability to key function holders proceeds from the fact that they cannot be subject to different rules based on

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30 See, on sec. 7 a, para. 1, sent. 3 VAG Dreher, ZVersWiss (2006), 375 (401 f.).

31 Dreher, ZVersWiss (2006), 375 (397 f.) with further references.
their equivalence in terms of fitness requirements with managing board members of insurance undertakings under the Solvency II Directive. If overall governance is assigned in the future to financial supervision, as provided in sec. 289, para. 3 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act],32 it would mean that BaFin could apply its legal view on German language proficiency even to the general agents and management in the offices of German insurance undertakings in other EU/European Economic Area countries outside Germany in accordance with sec. 54, para. 2, sent. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act].

BaFin laid out its view of expertise requirements for supervisory board members in a non-binding notice dated Feb. 22, 2010.33 The standards described were met with enormous criticism due, for example, to their low qualification requirements, erroneous assumptions on corporate law, and certain implied ways to meet the requirements.34 The notice will be entirely obsolete when the new standards of the Solvency II system take effect. It can therefore have no legal significance for key function holders, even indirectly.

8.2.3.2 Proceduralization

The Policies

Under art. 41, para. 3, subpara. 1 of the Solvency II Directive, insurance undertakings “shall have written policies in relation to at least risk management, internal control, internal audit and, where relevant, outsourcing”. It must therefore encompass three of the key functions: risk management35 and compliance—which is included by virtue of its membership in the internal control system under art. 46, para. 1, subpara. 2 of the Solvency II Directive—and internal audit. Regarding the actuarial function, the Directive recognizes an obligation to establish policies

33 BaFin [German Federal Financial Supervisory Authority], “Merkblatt zur Kontrolle der Mitglieder von Verwaltungs- und Aufsichtsorganen gemäß KWG und VAG” [in English: Guidance Notice on Vetting Members of Administrative and Supervisory Bodies in accordance with the Banking Act and the Insurance Supervision Act] dated Feb. 22, 2010; the draft of a new version of the notice dated May 3, 2012 is currently in the consultation phase. The new notice contains no changes with respect to the matter discussed above.
34 See Dreher/Lange, “Die Qualifikation der Aufsichtsratsmitglieder von Versicherungsunternehmen nach VAG und Solvency II” [in English: Qualifications of Supervisory Board Members of Insurance Undertakings under VAG and Solvency II] ZVersWiss (2011), 211 (218 f.) (Chap. 6, above, at 6.3.2).
35 See also, on the risk management policies, art. 44, para. 2, subpara. 3 of the Solvency II Directive.
only indirectly, namely in art. 48, para. 1 i along with art. 41, para. 3, subpara. 1, sent. 2 of the Solvency II Directive. Added to these are further rules in the Solvency II system that also have implications for the need of policies of insurance undertakings. They proceed, i.a., from art. 263 SG11, para. 1, of the DVO, which states that insurance undertakings must establish, implement, and maintain “documented policies”.

Under art. 41, para. 3, subpara. 2, sent. 2 of the Solvency II Directive, the policies “shall be subject to prior approval by the administrative, management or supervisory body”. For German law, it is not entirely clear whether or not the supervisory board, as positioned in the German dual organizational structure of managing board and supervisory board, is addressed by this. The uncertainly arises from the role of the managing board, which, under sec. 76 of the AktG [German Stock Corporation Act], is fully responsible for the management of the company and thus also for enacting essentially all company policies. The supervisory board can therefore “approve” neither the policies of the undertaking, nor its reports (as suggested by art. 55, para. 2 of the Solvency II Directive), nor any internal model (as suggested by art. 35, para. 5 and 116, para. 1 of the Solvency II Directive). Rather, the policies and reports etc. are directly attributable to managing board. It alone bears the responsibility, and not some other board upstream from it. The text of the Directive in other language versions and the objective pursued by the issuer of the Directive in assigning policy responsibility support the fundamental accountability of the managing board for the policies extensively discussed in the Solvency II Directive. Excluded however, are policies concerning the fit-and-proper requirements for managing board members under art. 263 SG11 of the DVO. The same applies to policies concerning the qualification requirements for supervisory board members if the intention is to view supervisory board members as key function holders. For the policies affecting members of the managing board, the supervisory board of each company holds sole responsibility. This on its own impedes the use of predetermined, standardized qualification policies across the group for all persons who effectively run the insurance undertaking or hold key functions in it as laid down in the insurance supervisory regime.

The reverse holds true for the managing board, which bears responsibility for policies affecting subordinate staff members in their capacity as key function holders under the insurance supervisory regime. With these policies the managing board can and must govern the basic responsibilities and powers of each key function. Thus, in order to comply with the requirements of art. 263 SG11 of the DVO, it must also identify the group of key function holders under the insurance supervisory regime for the particular undertaking either abstractly or based on job descriptions. Further, it must establish the fit-and-proper requirements for these persons and their subordinate staff. Finally, the DVO also specifies, as mandatory in

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36 See on this point *Dreher, VersR* (2012), 933 (940) (Chap. 7, above, at 7.3.5.4).
37 See on this point, e.g., art. 263 SG11, para. 3 of the DVO.
38 See *Dreher, VersR* (2012), 933 (937 f.) (Chap. 7, above, at 7.3.2.3).
the subject-matter of such policies, the procedures that must be provided for and followed in order to enforce these requirements within the insurance undertaking.

The Establishment and Documentation of Fitness (“Assessment”)

Art. 263 SG11 of the DVO and the Level 3 Governance Guidelines place particular emphasis on the “assessment” as to whether key function holders meet the fit-and-proper requirements. Guideline 14 (b) and (c) of the Governance Guidelines thus expressly requires that the policies include “a description of the procedure of assessing fitness . . . both initially and on an ongoing basis” and “a description of the minimum situations that give rise to a reassessment of fitness”. 39 Thus an initial assessment of fitness must be made using a specific procedure, as well as reviews—whether regular or initiated by certain events—of assessments already made. This procedure must be included in the policies related to the key functions. 40 Consequently, numerous issues must be addressed by the policies, such as who is responsible for assessing which key function holder, what procedure must be followed in doing so, what evidence of formal qualifications must be submitted and in what executed form, how often or on what occasion is a review or recall of a current qualifications assessment necessary, 41 and what form of professional training is appropriate and necessary. 42

The increasing importance of formalized processes under Solvency II and the flood of documentation requirements for insurance undertakings that comes with it, 43 also extends to the assessment of fitness for key function holders. It is only by documenting these internal assessment processes that the managing board can be relieved with respect to have both provided for the necessary organizational processes and induced their actual implementation—as required by art. 263 SG11, para. 1, of the DVO. This may include acts of delegation throughout the operational structure. 44 However, the managing board itself must always form

39 See nos. 2.14 and 3.2.4 of the Governance Guidelines.
40 See explanation to Guideline 14 of the Governance Guidelines at No. 3.55: “The policies and procedures describe how the undertakings will assess the persons”.
41 See the three examples in No. 3.56 of the Governance Guidelines.
42 On this point see 8.2.3.3, below.
43 See on this point Dreher, “Die Solvenzanforderungen in der Versicherungsaufsicht nach Solvency II und VAG-RegE” [in English: Solvency Requirements in Insurance Supervision under Solvency II and VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]], at 4.2.3, ZVersWiss (2012), 381 (Chap. 6, above).
44 See on the significance of management responsibility in general and the associated limits on delegation authority from a corporate law view Dreher, “Nicht delegierbare Geschäftsleiterpflichten” [in English: Non-delegable Duties of Business Managers] in Festschrift für [Publication in Honor of] Klaus J. Hopt on his 70th Birthday on Aug. 24, (2010), 517 (518 ff.) with further references, and with respect to horizontal or vertical delegation as viewed by insurance supervisory law Dreher id., n. 43, above, at 4.1.1.
its own impression in assessing the fitness of the functional leaders and their deputies because key function holders are often very close to the managing board as a result of their distinctive job description and decision-making powers.

8.2.3.3 Timing and Retention of Qualification

Art. 41, para. 1 of the Solvency II Directive mandates that key function holders must meet the fitness requirements at all times. Art. 263 SG11, para. 1 of the DVO repeats this, once again with the words “at all times”. And at Level 3, the Governance Guidelines expressly provide as follows in explanation No. 3.38:

The fitness assessment ... includes arranging for further professional training as necessary, so that staff is also able to meet changing or increasing requirements of their particular responsibilities.

In other words, the fitness qualifications that the Solvency II system demands of key function holders must be present not only at the time an individual assumes the role, but permanently. To ensure this, insurance undertakings are required—according to the Level 3 explanations—to provide the appropriate and necessary professional training based on the “assessment” stressed earlier. The government’s draft of the VAG [German Insurance Supervision Act], on the other hand, does not speak to the matter of qualification timing or duration in either sec. 25 or in the Statement of Reasons.

The view, which is suggested and to some extent represented—including by BaFin in its notice dated February 22, 2010—in the context of the German insurance supervisory regime concerning the qualifications of supervisory board members, that such qualifications can be attained through additional training after the assumption of duties is inconsistent with corporate, liability, and supervision law and is not an issue with respect to the qualifications of key function holders in light of the Solvency II requirements. The question it presents, which has clear implications on liability, may be easily confused with another question but, from a strictly legal standpoint, must be kept separate. The question is, what supervisory consequences can a qualification have that, in the view taken here, is required from the very start, but missing at the time, and only earned while a supervisory or subsequent judicial proceeding is taking place? This is not a matter of liability arising from decisions made in the absence of the necessary qualifications. Rather, it concerns the relevant point in time for the legal assessment of supervisory

45 See on this point section “The Establishment and Documentation of Fitness (“Assessment”)”, above.
46 See above, section “The Establishment and Documentation of Fitness (“Assessment”)”.
47 See above, n. 33.
48 See Dreher/Lange, ZVersWiss (2011), 211 (218 f.) (Chap. 6, above, at 6.3.2).
measures or, in other words, whether it is actually possible to have an after-the-fact cure for deficient qualifications that had no impact in terms of legal liability. 49

8.2.4 The Fitness of Subordinate Staff to Key Function Holders

8.2.4.1 Solvency II

Under the two-tier qualification structure that underlies the Solvency II system, general qualification requirements also apply to the subordinate staff of key function holders. 50 As discussed previously, the Solvency II Directive in Recital 34—“fit and proper”—and the DVO in art. 258 SG6, para. 3—“necessary expertise”—rightly presume that all staff members who perform work in key functions possess the knowledge and skills necessary to properly carry out their duties. 51 The same applies pursuant to No. 3.31 of the Governance Guidelines for “all persons working within a key function”. This underscores a difference between the general qualification requirements for all staff members in key functions 52 and the special qualifications that apply only to key function holders. From Recital 35 of the Solvency II Directive 53 and No. 3.37 of the Governance Guidelines it also proceeds that the special level of qualification required of the key function holder in each individual case partly determines the lower, general level of qualification related to the tasks and the undertaking that are required of the subordinate staff in key functions, and that the qualifications and experience of other staff members in the undertaking must be taken into account in determining the qualification requirements for staff members in key functions.

It follows that an undertaking’s internal policies on key functions must, in accordance with these requirements and in consideration of the principle of proportionality, provide specific details not only on the required qualification profile of key function holders but also that of staff members in key functions. Added to this as further subject-matter of the policies are all of the other questions previously discussed in connection with the proceduralization of fitness and the qualification

49 See in detail on this point Dreher, ZVersWiss (2006), 357 (411 f.) with numerous references as well as, recently, “VGH München” [in English: Munich High Administrative Court], NJW (2011), 2822.
50 See above, at 8.2.1.
51 See above, at 8.2.1.
53 See on this point 8.2.1, above.
dates and content for holders of key functions\textsuperscript{54} if they also apply at the level of their subordinate staff members. The matter of professional development, i.a., through internal or external training, has material significance here. Guideline 14 (d) of the Governance Guidelines requires that the written policies for key function holders also include: “a description of the procedure of assessing fitness and proper requirements of other personnel, both initially and on an ongoing-basis”.

8.2.4.2 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]

The government’s draft of the VAG [German Insurance Supervision Act] itself does not address the matter of qualifications for staff members who are subordinate to key function holders. Only the Statement of Reasons for sec. 25 touches on it as follows: “All persons who are engaged in tasks identified as key tasks are subject to the requirements of sec. 24 of the VAG-E\textsuperscript{55}”. If this rule is taken literally, then any staff member who performs work for a key function is an addressee of sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]. But this would not be consistent with the wording of the rule, which appropriately speaks only to those persons “who effectively run the insurance undertaking or hold other key tasks”. Further, and most importantly, such excessive qualification requirements would be compatible neither with the two-part qualification structure of the Solvency II system nor with the principal of proportionality that underlies it. Thus, the Statement of Reasons for sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], despite its broadly formulated wording, has no ultimate legal significance in the present issue of qualification requirements for subordinate staff members of key function holders.

8.3 The “Proper” Requirement for Key Function Holders and Their Subordinate Staff Members in Key Functions

8.3.1 The Two-Tier Structure of the Proper Requirement and the Proceduralization of the Proper Requirement as Starting Point

In addition to fitness, the proper requirement of key function holders plays a significant role in the management of insurance undertakings. Under Solvency II, the two elements of the fit-and-proper requirements are of equal importance and

\textsuperscript{54} See above, 8.2.3.2 and 8.2.3.3.

\textsuperscript{55} The reference to sec. 24 is an editing error; sec. 25 is meant.
rank under the law. The chairman of the European Insurance Occupational Pensions Authority (EIOPA) stresses repeatedly that problems at insurance undertakings are primarily “attributable to the failure of management and not unmet capital requirements”.

With the personal proper requirement now brought to bear in addition to fitness, the issues that emerge are essentially the same. At the outset, it concerns the two-tier structure of qualifications—repeated here in a two-tier structure of proper requirement—and the proceduralization of the proper requirement under the sub-topics of policies, assessment, and documentation as well as timing and maintenance of the proper requirement. The parallel starting points proceed from what are fundamentally similar legal rules governing the fit-and-proper requirements in the Solvency II system. For example, CEIOPS Guideline 14 on Policies and Procedures applies to both areas.

8.3.2 The Proper Requirement of Key Function Holders

8.3.2.1 Solvency II

Under the overarching term “proper”, art. 42, para. 1 b of the Solvency II Directive requires that key function holders be “of good repute and integrity”. Art. 43 of the Solvency II Directive also provides detailed rules on the mutual recognition of proof of good repute or proof of no previous bankruptcy among the Member States by submission of the equivalent documents or assurance under oath. Recital 99 of the DVO expands on this in Level 2 as follows:

The past conduct of that person should be examined to see whether that person may not be able to effectively discharge his duties in accordance with the applicable rules, regulations and guidelines. Information regarding past conduct may be information sourced from criminal or financial records. A person’s past business conduct could provide indications as to that person’s integrity.

Along with this is art. 263 SG11, para. 4 of the DVO, according to which the assessment of the proper requirement includes the following:

An assessment of that person’s honesty and financial soundness based on evidence regarding their character, personal behaviour and business conduct including any criminal, financial, supervisory aspects and relevant for the purpose assessment.

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57 See above, at 8.2.1 and 8.2.3.
58 Recital 34, sent. 2 of the Solvency II Directive addresses only the necessary proper requirement.
Guideline 13 of the Governance Guidelines provides further requirements that are again accompanied by very detailed explanatory text. The actual criteria for good repute and integrity are found under the overarching term chosen in art. 42, para. 1 b of the Solvency II Directive. But the distinction is not always applied at the three levels, where one invariably finds the term “reputation” or “character” in place of the term “integrity”. The intent of the Solvency II legislator, however, is adequately described only with the overarching term of proper requirement. A central problem with evaluation under supervisory law of a person’s reliability, integrity, reputation, or character—to use the terms of the Solvency II system—is in designing an assessment that can be documented and legally enforced. In this respect, Recital 99 of the DVO provides guidance by stating a person’s past conduct can provide indications of future fulfillment of the proper requirement. Documents associated with criminal background or finances should be reviewed for this purpose. Art. 263 SG11, para. 4 of the DVO in fact requires that an assessment of “honesty and financial soundness” be based on evidence regarding the person’s character, personal behavior, and business conduct.

Governance Guideline 14 picks up the frequent reference to criminal conduct in the past and expands it to disciplinary or administrative offenses. As in art. 263 SG11, para. 4 of the DVO, Guideline 14 and its explanatory text stress that the offenses must be relevant to the purposes of supervision. Yet based on the aims of the Solvency II Directive and the scope of the law on supervision of insurance undertakings, the explanatory text for the relevant requirements overreach by, for example, stating that the entirety of consumer protection and corporate law are deemed relevant. The explanatory text is also unacceptable in consideration of the presumption of innocence as it would take account of ongoing investigations or enforcement measures outside of court proceedings—even in cases where these originate simply from professional associations. It also lists “honesty” as a component of the proper requirement. The important question in this respect is whether any conflicts of interest exist which would necessitate, for example, consideration of an individual’s financial situation.

As is the case with a number of terms used—such as character assessment under art. 263, para. 4 of the DVO—this requirement reveals that the Solvency II rules have lost sight of the principle of proportionality when it comes to assessing the proper requirement. Unless the aim is to have “see-through key function holders” with the same as members of the managing board and supervisory board—and if one respects the fundamental right to the protection of one’s own privacy and informational self-determination as required by law, then the assessment of the proper requirement cannot extend to a person’s private relationships.

The full focus of the proper requirement assessment is therefore on an individual’s professional and business affairs. For the reasons stated, there are just two

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59 No. 3.46 to 3.54 Governance Guidelines; see also the general Explanation No. 3.32, sent. 2 of the Governance Guidelines.

60 On this point generally see art. 249 SG1, para. 5 of the DVO.
avenues through which the proper requirement assessment can reach into the private sphere, be it for personal character or financial soundness. The first would be an assessment of objective, formally accessible data such as register abstracts, and the second would be consideration of any determinations made in relation to specific events, such as a personal bankruptcy for the head of risk management. Art. 43 of the Solvency II Directive itself makes clear that, under normal circumstances, meaning aside from essential additional findings related to certain events, “proof of good repute” in the form of an “extract from the judicial record” or equivalent document suffices. This is so because under para. 1 of this rule, a Member State that requires “of its own nationals proof of good repute ... shall accept ... as sufficient evidence in respect of nationals of other Member States the production” of such documents.61 It then stands to reason that art. 263 SG11, para. 4 of the DVO and the elaborate Governance Guidelines each require significant correction prior to adoption and should be restricted to standards that are constitutionally acceptable and legally practicable.

The determination as to whether and to what extent any facts related to professional matters or to private matters that either impact the assessment of the proper requirement or constitute an occasion for further assessment can generally be made through questionnaires.62 Using such questionnaires, information can be gathered regarding professional conduct (i.e., about violations of external or internal rules and policies in the past, even from previous superiors under certain circumstances) and also regarding private conduct, based on the position being filled or assessed for continuation (i.e. about special circumstances with professional relevance such as a personal bankruptcy or excessive personal debt with an individual’s overall net asset balance63).

Conclusions about present and future proper requirement drawn from past conduct have enormous significance in the present context. As much as an impeccable past indicates current and future fulfillment of the proper requirement, past supervisory offenses are hardly a monocular indicator of current or future non-fulfillment of the proper requirement. Specifically, a weighting of the circumstances at play in the past is needed. Of relevance to this are, for example the severity and duration of a legal infringement, the instance of the officials or judicial institution taking account of the right to appeal, as well as subsequent reviews of the facts and/or legal aspects, the length of time since the infringement and the “self-cleaning” of the person in question, especially through subsequent unblemished conduct.64 Against this background, Explanation No. 3.52 Governance Guidelines

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61 According to para. 2, even submission of a declaration under oath is sufficient in cases where a Member State does not issue such documentation.
62 Computer simulation could also be considered, involving, for example, decision-making in situations where conflict of interest or legal infringement plays a role.
63 Of course, this “personal balance sheet” is not to be disclosed to the insurance undertaking.
64 See in this regard, e.g., relevant methods in cartel procurement law of restoring the reliability of a public contracting entity within the meaning of sec. 97, para. 4, of the GWB [Act Against Restraints of Competition], Dreher, “Die “Selbstreinigung” zur Rückgewinnung der
rightly establishes that there can be no automatic designation of non-fulfillment of the proper requirement based on past supervisory infringements. Instead, each determination of the proper requirement must be made on a case-by-case basis.

Up to now, the notion of proper requirement found in trade law was always applied in the context of the control of the proper requirement with regard to managing board or supervisory board members, or of those who hold a significant interest. Already the past, this has been fundamentally objectionable due to the European origin of the proper requirement and the autonomous interpretation of terms in European law if the contours of such a term were discernible. Under the DVO and the Governance Guidelines, the situation is now not only prevailing but also especially important. This is so because both regulatory levels define and concretize the concept of the proper requirement in European law through art. 42 of Solvency II Directive to a far greater extent than before. Thus, the interpretation of the term “proper requirement” must now be made within the requirements and—to the extent they apply—without regard to German trade case law and literature.

8.3.2.2 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]

The Statement of Reasons for sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] presumes that “with respect to the personal proper requirement the same requirements apply for all persons within the scope of sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] regardless of the individual risk profile of an undertaking”. This statement draws a distinction between proper requirement and the requirements for fitness. The German legislator does not provide a basis for the uniform treatment apparently necessary for managing and supervisory board members and key function holders. It is unpersuasive in its substance and stands in contradiction to the European insurance supervisory regime.

Substantively, there is no common basis of evaluation for a uniform inquiry into the proper requirement for all persons. Managing board members, for example, are different from supervisory board members in their influence on the decisions of the undertaking. Unofficially, this leads to a higher standard of proper requirement for kartellvergaberechtlichen Zuverlässigkeit” [in English: The ‘Self-Cleaning’ for Restoration of reliability under Cartel Procurement Law] in Festschrift für [Publication in Honor of] Horst Franke on his 60th Birthday, (2009), 31 ff.; Dreher/Hoffmann, NZBau (2012), 265.

65 See as well, previously, Dreher, ZVersWiss (2006), 375 (389).
66 See Dreher, ZVersWiss (2006), 375 (385 ff.).
the former. For example, while the proper requirement of a managing board member comes under scrutiny for a past infringement of competition law resulting in a fine,\textsuperscript{68} such offense cannot carry the same significance for supervisory board members because it cannot impact the future functioning of the business in the same way. And, looking at past insider trading as an example, one must surely make distinctions within the managing board between a capital investment manager and a human resources or IT manager. With respect to the key function holders, these persons are subordinate to the managing board that runs the undertaking within the meaning of sec. 76, para. 1 of the AktG [German Stock Corporation Act] and thus do not have the same level of responsibility and decision-making power for the actions of the undertaking. Prior tax arrears of a specific undertaking, for example, would have different significance for each managing board member than for a key function holder such as the director of the actuarial function.

Setting aside the absence of a substantive foundation for the uniformity proposition for proper requirements in the VAG [German Insurance Supervision Act], the concept is also inconsistent with art. 263 SG11, para. 4 of the DVO. At this regulatory level, the test of whether a key function holder is proper takes place specifically on the following terms: “an assessment of that person’s . . . based on evidence regarding their”. In the same manner the explanations for Guideline 13 of the Governance Guidelines frequently emphasize the circumstances that shape the proper requirement assessment of the individual. Then, however, Explanation No. 3.53 cites nearly word-for-word the passage in the Statement of Reasons to the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] that was cited at the beginning of this section. On this matter, it suffices to point out that Level 3 provisions, which are essentially non-binding, cannot expand the law laid down in the Directive and DVO.\textsuperscript{69}

Why the government draft of the VAG [German Insurance Supervision Act] does not implement art. 43 of the Solvency II Directive\textsuperscript{70} even though it would ease the testing of the proper requirement enormously, is simply inexplicable. The simplified documentation of the proper requirement under this rule could be directly significant for personnel changes or movements between large insurance undertakings within the EU/European Economic Area Member States. From a legal view non-implementation also brings up a matter of basic freedoms. This concerns limitations on the free movement of labor under art. 45 of the AEUV [Treaty on the Functioning of the European Union] in cases where an individual from another EU/European Economic Area country intends to move to an insurance undertaking headquartered in Germany and the proof of the proper requirement issued by his or her current home country is not recognized in Germany.

\textsuperscript{68} See Dreher, ZVersWiss (2006), 375 (389 f.).
\textsuperscript{69} See Dreher, VersR (2012), 933 (935 f.) (Chap. 7, above, at 7.2.3).
\textsuperscript{70} See on this point 8.3.2.1, above.
8.3.3 The “Proper” Requirement for Staff Members Subordinate to Key Function Holders

8.3.3.1 Solvency II

As with the fitness, the two-tier structure of the Solvency II system continues in the proper requirements. Thus, it is already required in Recital 34, sent. 1 of the Solvency II Directive that “all persons who perform key functions” be “proper”. This category includes subordinate staff to key function holders. That this affects all staff in a key function also arises from the contrast with the duty of notice to supervisory officials that explicitly applies “only to key function holders” under Recital 34, sent. 2 of the Solvency II Directive. Explanation No. 3.31 of the Governance Guidelines also expressly repeats the validity of the “proper” criterion for all staff that work in a key function. Going far beyond the regulatory context, Explanation No. 3.53 even adds that the proper requirement applies to all employees of an insurance undertaking. The only correct pronouncement in connection with this is that individual graduated inquiries into repute and integrity based on specific responsibilities and authority must be conducted for other staff members—meaning also those in key functions.

8.3.3.2 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]

The government’s draft of the VAG [German Insurance Supervision Act] makes no specific statement on fit-and-proper requirements for the subordinate staff members of key function holders. Nothing other than the issue already discussed is found here,71 this issue being that the Statement of Reasons, in contrast to the text in sec. 25 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], wrongly seeks to encompass all persons working in key functions in the same manner as the key function holders themselves.

8.4 The Remuneration of Key Function Holders

Secs. 26 and 34 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] provide remuneration rules and a legal basis for a corresponding regulation in furtherance of sec. 64 b of the VAG [German Insurance Supervision Act]. They do not explicitly address key function holders on this matter. Although the “general governance requirements” under art. 41 of the Solvency II Directive and the associated legal basis in art. 50, para. 1 a of the

71 See above, at 8.2.4.2.
Solvency II Directive do not go into the subject of remuneration at insurance undertakings, the EU Commission in art. 249 SG1, para. 1 l of the DVO requires that the undertaking adopt written principles on their remuneration policy. Art. 265 SG13, para. 1 c of the DVO concretizes this, stating, i.a., that the remuneration policy applies to key function holders and must take into account their tasks and performance.

Art. 265 SG13, para. 2 of the DVO provides a total of seven remuneration principles that insurance undertakings must follow in establishing and implementing remuneration policies. These expressly apply to key function holders. They even include, under (b), the requirement that the variable part of remuneration for staff members in key functions—that is, not only that of the key function holders—must be independent of the performance of the operating units and areas they control. This has significance particularly when formulating the remuneration principles for key function holders and their subordinate staff members when the key functions are organized in a decentralized manner. The Governance Guidelines, which are to be revised with respect to remuneration policies after the DVO is adopted, currently contain no further information specific to the remuneration of key function holders.

8.5 The Duties of Notice and Public Disclosure for Key Function Holders

8.5.1 The Duties of Notice to Supervisory Authorities

8.5.1.1 Solvency II

As indicated earlier, there are particular duties of notice to supervisory authorities that affect key function holders. According to art. 42, para. 2 of the Solvency II Directive—as seen generally in Recital 34 of the Solvency II Directive as well as, with respect to outsourcing, art. 297 SRS4, para. 2 a of the DVO—any “change to the identity” of key function holders must be reported to the supervisory authority. Additionally, “all information needed to assess whether the persons are fit and proper” must be transmitted. Under art. 297 SRS4, para. 1 b of the DVO, the supervisory authority must be informed of the undertaking’s policies and processes to ensure compliance with the fit-and-proper requirements. Under art. 42, para. 3 of the Solvency II Directive, the supervisory authority must also be notified if a key function holder has been “replaced” because he or she “no longer fulfills these requirements”.

72 See Dreher, VersR (2012), 933 (939, 941) (Chap. 7, above, at 7.3.5.3 and 7.3.5.5).
73 See Governance Guidelines, Guideline 10 and Explanation No. 3.28 f.
74 See Dreher, VersR (2012), 933 (938) (Chap. 7, above, at 7.3.3).
Even the wording of the Solvency II rules shows that this is not a requirement for notice of a prospective transfer of the position of key function holder, but for notice of a transfer already accomplished. This is seen in the words “changes to the identity” and “replacement” of such a person, which denote past action. They refer to an event that has already occurred. Recital 98, sent. 2 of the DVO confirms this with the following passage:

However, acknowledging the need to avoid undue burden on insurance or reinsurance undertakings or supervisors, a notification by insurance and reinsurance undertakings should not imply pre-approval by the supervisory authority.

But, if there is no basis for checking in advance and obtaining pre-approval or rejection of an individual designated by the insurance undertaking to become a key function holder, then precisely such duty of pre-notice that fails of its purpose would cause an undue burden on insurance undertakings and supervisors that Recital 98, sent. 2 of DVO wishes to avoid. This obvious result of not requiring insurance undertakings to provide advance notice to the supervisory authority is also not in question in the contradictory Explanation No. 3.57 (a) of the Governance Guidelines, according to which a duty of notice exists “when a person . . . who is responsible for a key function is going to be or has been appointed”. This explanation is also inconsistent with Explanation No. 1.11 of the Governance Guidelines, according to which the notice pertains to “persons . . . being key function holders”.

Ultimately, further excessive rules attached to the duties of notice at Level 3 have no legal significance. Such can be seen in the requirement in Explanation No. 3.60 (c) of the Governance Guidelines in that a rationale for the person’s nomination as a key function holder be submitted in addition to the information the insurance undertaking must already provide to the supervisory authority under art 42 para. 2 of the Solvency II Directive. Nor do the facts substantiate that Explanation No. 3.63 of the Governance Guidelines should make a key function holder responsible for the content, completeness, and accuracy of the notice, while at the same time making the insurance undertaking responsible for its timeliness. Governance Guideline 14 (a) further requires that the undertaking’s policies describe the notification procedure to the supervisory authority, including the extent to which it involves the key function holders.

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75 See, on this issue, the hierarchy of the regulatory language in the Solvency II system, above, at 8.3.2.2.
76 It is noteworthy that only in this place the Explanation uses the term “application” instead of “notification”.
77 See on this point section “The Policies”, above.
8.5.1.2 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]

Sec. 44, no. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] currently includes a duty of notice for “the planned appointment . . . of other persons responsible for key tasks . . . including the information relevant to the evaluation of their qualification (sec. 25, para. 1)”.

Continuation of the current legal situation is the only rationale cited in the Statement of Reasons of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] 78 for this advance notice demand; and this demand contravenes the European insurance supervisory regime and must not be heeded should it survive unamended. There is also the requirement, according to sec. 44, no. 2 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], to give notice of “the retirement . . . of any of the persons named under No. 1 including information as to the reasons if this is relevant to the evaluation of his or her qualification (sec. 25, para. 1)”.

This obligation to state reasons for the replacement of a key function holder is also found in Explanation no. 3.62 (b) of the Governance Guidelines.

In contrast to the notice that a person has become a key function holder, 79 this sort of requirement to state the rationale for the replacement of a key function holder by an insurance undertaking can be justified. 80 Only such statement of rationale can occasion any necessary inquiry by the supervisory authority, which had prior opportunity to evaluate the qualifications and proper requirement of the person in question in the context of the duty of notice, into whether the replacement was based on reasons that are irrelevant rather than founded grounds such as retirement or promotion. The Statement of Reasons for the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], however, justifies the requirement for submitting the rationale by stating that the quitting persons “can be expected to seek a comparable position at another insurance undertaking” and thus the supervisory authority will be “in a position to conduct a particularly thorough examination when evaluating the qualifications of an applicant that has separated from another undertaking”. 81 This particular Statement of Reasons is not only the basis of an unsubstantiated prejudice against those

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78 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], id. n. 4 above, at Statement of Reasons for sec. 44 at 278.
79 See 8.5.1.1, above.
80 See regarding the current equivalent practice of the BaFin [Federal Financial Supervisory Authority] with the retirement of a managing board member Hasse, “Informations- und Offenlegungspflichten der Versicherungsunternehmen nach Solvency II” [in English: Information and Disclosure Obligations for Insurance Undertakings under Solvency II] in: Dreher/Wandt, eds., Solvency II in der Rechtsanwendung [in English: Solvency II in Legal Application], (Karlsruhe: Verlag Versicherungswirtschaft 2009), 61 (79) with further references.
81 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], id. n. 4 above, at Statement of Reasons for sec. 44 at 279.
who change employers and in doing so often climb the corporate ladder simply by virtue of their qualifications. Far more, it assigns the Supervisory Authority with a review of the qualifications of these persons that is not provided for in the Solvency II system, independent of any specific new responsibilities assigned to the current key function holder.

8.5.2 The Duties of Public Disclosure

Art. 51 of the Solvency II Directive requires that insurance undertakings publish a very extensive “report on solvency and financial condition”. This report shall also include a description of the system of governance. Based on this, art. 285 PDS4 of the DVO requires the following in the report: under para. 1 a, a description of the significant roles and responsibilities of key functions; under para. 1 c iii—factually unjustifiable—a description of the main characteristics of the system of occupational pensions and early retirement for key function holders, unless the remuneration report expressly excludes information on staff member remuneration; under para. 2, a description of both the fit-and-proper requirements and the procedure for assessing these requirements for key function holders. Sec. 50 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] correctly says nothing on this matter since the DVO becomes directly applicable law in each Member State when it takes effect.

8.6 Supervisory Recall and Prohibition of Exercise of Function for Key Function Holders in Cases of Fit-and-Proper Deficiencies and Supervisory Right to Direct Information from Key Function Holders

8.6.1 Solvency II

Art. 34, para. 2 of the Solvency II Directive grants power to the supervisory authorities to take measures “with regard to insurance or reinsurance undertakings, and the members of their administrative, management or supervisory body”. There is no supervisory authority to intervene with the subordinate staff of the managing

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board, such as key function holders, found here or anywhere else. On the contrary, Recital 98, sent. 3 of the DVO confirms that the only addressees regarding measures with respect to key function holders are the insurance undertakings:

“In the event that a supervisory authority concludes that a person does not comply with the fit and proper requirements set out in directive 2009/138/EC it should have the power to require the undertaking to replace that person.

Thus the supervisory authorities must direct their demand to replace a key function holder with another person exclusively to the managing board of the insurance undertaking. And this alone accords with the general rule regarding the key functions found in art. 258 SG6, para. 1, sent. 2 DVO, according to which each key function operates under the ultimate responsibility of the managing board.

8.6.2 VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act]

In contrast to the Solvency II rules, the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] directs in sec. 297 sent. 1 no. 1 that the BaFin [Federal Financial Supervisory Authority] shall not only demand the recall of a key function holder in an insurance undertaking but also “directly prohibit this person from the exercise of office” if “facts are present from which it ensues that the person does not meet the requirements of sec. 25”. In view of the Solvency II requirements, the latter is inconsistent with European law. In another inconsistency with the system, it deviates from the new provision added for compliance officers, taking effect on November 1, 2012, in sec. 34 d, para. 4, sent. 1, no. 1 of the WpHG [German Securities Trading Act], which provides the BaFin only with the authority “to prohibit the investment services enterprise from entrusting that staff member with the reported activity for so long as he does not satisfy the statutory requirements”. Considering the relevance to basic rights of the BaFin measures affecting the key function holders, the comparison between the VAG [German Insurance Supervision Act] and the WpHG requirements also highlights the deficiencies present in sec. 297, sent. 1, no. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] with respect to the proportionality of the supervisory power it provided for. This is so not only because of the missing “so long as” clause in the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision

84 See in more detail on the supervisory interventions frequently graduated in accordance with the principle of proportionality Dreher, ZVersWiss (2006), 396 (408 f.).
Act], but also based on a comparison of sent. 1, no. 1 to the expressly required prior “warning” by the supervisory authority when it intends to recall managing board or supervisory board members or to prohibit their exercise of the office in accordance with sec. 297 sent. 1, nos. 2 and 3 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act].

The criticism of the recall, in contrast, applies only to the terminology. A recall is a reversal of an appointment. But unlike managing board and supervisory board members, who are also included in sec. 297 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], key function holders are not appointed. They are assigned responsibility by the managing board. Thus they must be relieved of the responsibility if necessary, and dismissed without regard to this responsibility, if this is also required, or relieved of such duties in the insurance undertaking in advance of the effective date of such termination.

For the first time, sec. 299, para. 1, no. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] gives the BaFin [Federal Financial Supervisory Authority] a right to information from all “employees” of insurance undertakings and therefore from key function holders and their subordinate staff members. All employees are expressly obligated to provide information in such inquiries. To start with, this requirement is inconsistent with the European insurance supervisory regime for the reason stated earlier, namely that the Solvency II requirements provide no legal basis for such procedures to be conducted by the supervisory authorities with respect to the subordinate staff of the managing board. There is also the fact, specifically with regard to the informational duties of the insurance undertaking to the supervisory authority (“supervisory reporting”), that these duties according to art. 35 of the Solvency II Directive likewise extend only to the insurance undertaking and to the third parties named, none of which includes the subordinate employees to the managing board of the insurance undertaking. The implementation table attached to the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] for sec. 299, para. 1 no. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], therefore, can only refer to the stipulations of the Solvency II Directive, which simply do not justify this direct right of inquiry and a corresponding duty to provide information.

It must also be considered that a request for information directed by the BaFin [Federal Financial Supervisory Authority] directly to key function holders could lead to substantial conflicts of interest for them. The difference between a key function holder acting essentially under instruction in the interest of the company and an enterprise official implanted in the company in the public interest and not bound by instruction would become very apparent through this duty to provide information.

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85 See currently sec. 83, para. 1, sent. 1, no. 1 of the VAG, in which the duty to provide information does not extend to employees of insurance undertakings.

information. The duty to provide information on the part of key function holders to
the insurance supervisory authority would ultimately almost amount to the partially
existing reporting duty of the enterprise officials. Finally, key function holders
would be severely affected by this sort of indirect reporting duty in that they would
have be apprehensive about a recall or a prohibition of exercise of function any time
information requested by the supervisory authority is withheld.

8.7 Summary

1. The distinction between key function holders and subordinate staff members in
key functions remains meaningful in the qualification requirements of the
Solvency II Directive in a two-tier qualification structure. Accordingly, more
narrowly regulated qualification requirements apply to key function holders
particularly in the Solvency II Directive and the DVO. In contrast, for subor-
dinate staff members working in key functions, more general and lower
qualification requirements related to the specific responsibilities and undertak-
ing apply.

2. Special rules in the area of qualification requirements are seen in the Solvency
II Directive for the actuarial function and for the outsourcing of key functions.

3. The qualification requirements for key function holders under the Solvency II
Directive and the DVO are based on both professional and formal qualifications
as well as relevant knowledge and experience. They allow for reasonable
distinctions and the transfer of qualifications. Sec. 25 of the VAG-RegE
[Government’s Draft of a Tenth Act Amending the German Insurance Super-
vision Act], on the other hand, carries the current German standards forward. It
is therefore more strict relative to the Solvency II requirements and inconsistent
with European law in this respect. This is seen in the requirements trio of “three
years”, “insurance undertaking” and “comparable size and type of business”.
Indeed these criteria are supposed to apply only in the context of the “perfor-
mance of management duties”, meaning primarily to members of the managing
board. But they could spill over to key function holders in the insurance
supervisory regime. Sec. 25 of the VAG-RegE [Government’s Draft of a
Tenth Act Amending the German Insurance Supervision Act] also expressly
requires “theoretical and practical knowledge of the insurance business” for
key function holders. These far-reaching requirements are legally impermissi-
ble and excessive in substance for both groups because they would hinder
persons from changing industries and rising in the hierarchy of an undertak-
ing—including in the course of a change from one insurance undertaking to
another. The Solvency II rules, on the other hand, expressly take account of
knowledge and experience from other parts of the financial services sector and
from other fields of business. They do not apply a rigid 3-year restriction and
are not based on experience and knowledge from undertakings of comparable
size and business type.
4. Knowledge of the German language is not a qualification requirement for key function holders if they know the substantive requirements of the responsibilities assumed and communication skill in the German language can be insured with the aid of language mediators.

5. In addition to fitness, the Solvency II Directive also requires the fulfillment of the proper requirement for key function holders. The two-tier approach of a distinction between key function holders and their staff members also applies here. Regardless of the use of numerous additional terms in the Solvency II system such as integrity, reputation, and character, the term proper is the only relevant legal term. This term proper in the European law is essentially autonomous, which means it is independent of the German proper criteria under trade law.

6. When assessing the proper requirement, documents regarding past conduct such as register abstracts should be relevant for the determination. However, the Level 2 and 3 text of Solvency II is excessive in terms of the details it seeks from the private sphere of the addressees of the rule. This can be seen in the documentation requirements, the relevance of certain conduct in the past, and the relevance of certain proceedings before administrative authorities, courts, or even professional associations. The requirements are based on the concept of a fully transparent key function holder which is blind to basic rights. It loses sight of a fundamental principle of the Solvency II system: the principle of proportionality. This constitutional deficiency is found not only in the inquiry into repute and integrity for key function holders but also for members of the supervisory and managing boards since the Solvency II text encompasses all addressees of the fit-and-proper requirements essentially to the same degree.

7. It is not sustainable either factually or under European law if the government’s draft of the VAG [German Insurance Supervision Act] assumes a uniform concept of proper requirement for all addressees of the rule. The failure to implement art. 43 of the Solvency II Directive in the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] is also unsustainable on the facts and leads to avoidable legal problems in the free movement of labor in cases where key function holders engage in cross-border activity.

8. The Solvency II rules require an extensive proceduralization of the fit-and-proper requirements. This applies both to the policies required for the first time for key functions and to assessing and documenting that the requirements for the key functions under the insurance supervisory regime are complied with.

9. The insurance undertaking must establish, implement, and maintain documented policies in which they describe all significant aspects related to the key functions, the key function holders, and the subordinate staff in key functions. Because of the numerous topics to be addressed in the policies, they have an enormous scope and corresponding complexity. The policies that apply to the key function holders and the staff subordinate to them in key functions are the ultimate responsibility of the managing board. However, the supervisory board of the given insurance undertaking is responsible for the requirements
aimed at managing board members. This prevents the adoption by the managing board of an ultimate parent company of the group of group-wide fit-and-proper standards for all addressees of the rule.

10. The assessment and documentation of the fit-and-proper requirements for key function holders is the subject-matter of detailed rules in the Solvency II provisions. For this purpose, numerous process-oriented rules, i.a., are required in the policies of insurance undertakings; and these policies must be observed in practice. Professional training of key function holders and their staff is of special significance in this concern. As a rule, the managing board itself is required to assess the fit-and-proper requirement of key function holders.

11. The fitness and personal proper requirement of key function holders must be present “at all times” and permanent. From this it follows not only that post-hoc qualification following the assumption of duties as a key function holder is not countenanced but also that an obligation exists for continuous professional training in order to maintain the required fitness.

12. The DVO includes requirements for the remuneration of key function holders that especially affect the variable part of remuneration of key function holders in a decentralized structure of key functions.

13. The Solvency II requirements provide for certain duties on the part of insurance undertakings to notify the supervisory authority with respect to information on key function holders. This includes, i.a., after-the-fact information concerning the assumption of the responsibilities of a key function holder by an individual or the relief from responsibilities in the case of a current key function holder. The VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act], on the other hand, imposes an inconsistent duty on insurance undertakings to notify the BaFin [Federal Financial Supervisory Authority] even that such an event is intended.

14. In their “report on solvency and financial position”, insurance undertakings must disclose certain information to the general public concerning the organization of their key functions, the corresponding fit-and-proper requirements and their proceduralization as well as, in some cases, even the retirement benefits of key function holders.

15. Under the Solvency II requirements, the insurance supervisory authority can take measures solely against the insurance undertaking for the purpose of removing key function holders. In contrast, in addition to the supervisory authority’s recall demands to insurance undertakings, the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] also provides the supervisory authority with the direct power towards a person to prohibit the exercise of responsibilities as a key function holder if the fit-and-proper requirements are not, or no longer, met. Assignment of such power contravenes European law. It is also inconsistent with the principal of proportionality simply in consideration of basic rights and their relevance to these measures. Finally, it is not compatible with the financial services supervisory system.
16. The right to information provided for the first time in sec. 299, para. 1, no. 1 of the VAG-RegE [Government’s Draft of a Tenth Act Amending the German Insurance Supervision Act] with respect to all employees of insurance undertakings, and therefore with respect to the key function holders and their subordinate staff members, is inconsistent with European law.