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***Nikola L. Filipović, LLM.*[1]**

INTERNATIONAL COURT PRACTICE

DECISION OF EUROPEAN COURT OF JUSTICE OF 31. 5. 2018. IN CASE C-542/16 LÄNSFÖRSÄKRINGAR SAK FÖRSÄKRINGSAKTIEBOLAG V DÖDSBOET EFTER INGVAR MATTSSON AND LÄNSFÖRSÄKRINGAR SAK FÖRSÄKRINGSAKTIEBOLAG

1. Recitals

The Decision of European Court of Justice, which is the subject of this review, refers to the insurance mediation concept and/or scope of application of two Directives governing obligations to consult when concluding insurance contract tied to an investment fund - the Insurance Mediation Directive 2002/92 and Markets in Financial Instruments Directive 2004/39. The most interesting question is what legal advisory regime applies when selling insurance policies with investment elements: insurance advice or investment products advice.

The proceedings were instituted by a request from the Supreme Court of Sweden for a preliminary ruling concerning the construing of Directive 2002/92 on insurance mediation, on the occasion of two separate disputes brought before the Swedish Supreme Court at the time: *Strobel and Others / Länsförsäkringar* and/or *Länsförsäkringar / Dödsboet efter Ingvar Mattsson*.

2. Regulatory Framework

Under the Article 1. the Insurance Mediation **Directive 2002/92/EZ** defines its area of application: „This Directive lays down the rules for taking-up and pursuit of the activities of insurance and reinsurance mediation by natural and legal persons which are established in a Member State or which wish to become established there."

Article 2 of the Directive defines the *insurance mediation* as „activities of introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the

[1] Faculty of Law, University of Graz

administration and performance of such contracts, in particular in the event of a claim", whereas the *insurance intermediary* means „any natural or legal person who, for remuneration, takes up or pursues insurance mediation".

Article 4 of the Directive requires of the insurance broker to possess „professional indemnity insurance covering the whole territory of the Community or some other comparable guarantee against liability arising from professional negligence, for at least EUR 1000000 applying to each claim and in aggregate 1.500.000 euros for all claims in one year".

Article 12 of the Directive requires from an insurance intermediary the following: "when informing the Policyholder, to give advice based on an impartial analysis, he shall give such advice based on the analysis of a sufficient number of insurance contracts available on the market to be able to make a recommendation, in accordance with professional criteria, on which insurance contract would suit the needs of the Policyholder ", as well as" before concluding any contract, the insurance intermediary shall determine the Policyholder's requirements and needs, based on the information provided by the Policyholder and/or the reasons for advice on a particular insurance service". The advice should align with the complexity of the proposed insurance contract.

In terms of scope, the **Directive 2004/39 / EC** sets out the following: in the Article 1, that "the Directive applies to investment funds and regulated markets", and/or in the Article 2, that the Directive does not apply to "persons providing investment services from time to time in the course of their ordinary activity, if such activity is regulated by law or other regulations or codes of conduct for such activity, which do not preclude the provision of such services, "nor does it apply to" persons providing investment advice in the exercise of another professional activity not covered by this Directive, provided that such advice is free of charge."

Under the Article 4, the Directive defines an *investment company* as "a legal entity whose regular activity is to provide one or more investment services to third parties or perform one or more investment activities on a professional basis", *investment counselling* as "providing personal recommendation to clients at the request of a client or at the initiative of an investment company in respect of a single or multiple transactions relating to financial instruments."

In terms of the so-called "rules of business conduct", under the Article 19, the Directive provides the following: "if an investment service is offered as part of a financial service already regulated by other EU legislation or common EU standards on credit institutions and consumer credit, the service is not further subject to the obligations stipulated under the Article hereof".

National law. Sweden implemented the provisions of the Insurance Mediation Directive through the Insurance Mediation Act (Lag (2005: 405) om försäkringsförmedling). This act introduced requirements of the Directive into the national legal order and mediation became "a business activity consisting of the presentation or proposition of an insurance contract or other preparatory actions for the conclusion of an insurance contract, the conclusion of an insurance contract on behalf of third parties or assisting with the management of insurance contract and

its execution ". The insurance mediation can only be carried out with the approval of the Financial Supervision Agency. Obtaining the authorization is conditional on the fulfilment of conditions, including the condition that the contracted insurance shall cover the obligation of indemnity that can be claimed from the intermediary in case of default. It is the responsibility of the insurance intermediary to tailor his advice to the client's goals and needs and propose adequate solutions. If the client is a natural person and generally pursues goals that are not covered by his business activity, the intermediary should also discourage him from taking actions that may not be considered appropriate, having in mind the person's needs, economic situation and other circumstances.

3. Matter in Dispute and Legal Issues

Common for both legal cases is that bankruptcy proceedings were not instituted against the intermediaries and that the plaintiffs addressed their claim to an insurance company that had insured intermediaries against professional liability - *Länsförsäkringar.*

3.1. Länsförsäkringar/Dödsboet efter Ingvar Mattsson Case

European Wealth Management Group AB (EWMG) was a registered insurance intermediary company. In accordance with the conditions for obtaining a license to perform insurance mediation, EWMG had signed a professional liability insurance contract with the insurance company *Länsförsäkringar.* This insurance, in accordance with the legal definition, covered professional liability against the insurance mediation activity.

In January 2010, in accordance with the advice of an EWMG employee, Ingvar Mattson has invested SEK 500,000 (approximately EUR 50,000) under his capital life insurance into one of his structured financial instruments related to a capital life insurance policy. Investments have lost value due to financial market fluctuations.

As bankruptcy proceedings were instituted against EWMG, I. Mattson sued the insurance company *Länsförsäkringar*. In the lawsuit, I. Mattson claimed that EWMG intentionally or negligently violated their obligations towards him under the insurance mediation law. Furthermore, Mr. Mattson claimed that such conduct constituted a professional error, that is, the insured occurrence under the Länsförsäkringar liability insurance policy.

A key argument in the defence of *Länsförsäkringar* was that the advice provided by EWMG did not relate to capital life insurance but to an investment in the financial instrument to which the insurance was linked. Such advice (on investment of premiums in financial instruments) does not fall under insurance mediation concept, since they do not relate to the conclusion of the insurance contract itself.

The court of first instance and second instance ruled in favour of the plaintiff, and when the case was brought before the Supreme Court of Sweden, that Court decided to stay the proceedings and seek for a preliminary opinion from the European Court of Justice regarding the construing of the Insurance Mediation Directive, i.e. whether the rules on insurance advice or investment advisory services were to apply to this situation.

Addressed questions were, in particular, as follows:

1. Does the Directive 2002/92 apply to financial or other advice provided under insurance mediation but which do not *per se* relate to signing or extension of an insurance contract? In particular, what are the rules that apply to advice regarding capital investments under life insurance?

2. Whether the provisions of Directive 2002/92 and Directive 2004/39 or only the provisions of Directive 2004/39 apply to advice such as that referred to in the item 1. above, where such advice, by definition of Directive 2004/39 means an investment advice. That is, does a particular regime have primacy over another?

3.1.1. The Attitude of European Court of Justice

The Court concluded that the two issues should be considered jointly and summarized the problem as follows: "Does financial advice on investing capital provided under insurance mediation relating to the conclusion of investment (capital) insurance policies fall within the scope of the rules of Directive 2002/92 on insurance mediation, or Directive 2004/39 on financial instrument markets and if covered by both directives, does one directive have primacy over the other."

Since the Insurance Mediation Directive regime refers to mediation in concluding an insurance contract, the first question the Court asked in order to determine the legal regime applicable to this type of advice is whether a capital life insurance contract (generally speaking, insurance related to investment fund) generally falls under the term of insurance contract. The Court answered the question affirmatively by referring to the case-law in this area, in particular the judgment in González Alonso, Case C-166/11 of 1 March 2011.

The second question the court raised was whether the financial advice provided in the matter in dispute falls within the scope of insurance mediation, as defined under the Directive 2002/92. As the activity of insurance mediation is set up very broadly and inclusive of the very presentation and proposition of concluding an insurance contract, insurance mediation also includes *preparatory actions for concluding an insurance contract*, so the court's position was that the legal nature of the preparatory actions for concluding the contract is in no way limited by the Directive.

Moreover, the court considered that the case file indicate that the cash (investment) consisted of insurance *premiums* paid into the structured product, and therefore considered the investment an integral part of the insurance contract and that the advice relating to such investment fall within the preparatory action for concluding an insurance contract.

The Court also took into account changes in EU secondary legislation that were not in force at the time of the matter of fact. This was Directive 2014/65 on financial instrument markets, which amended the provisions of Directive 2002/92. The Court first noted that the definition of investment policies in Directive 2014/65 included insurance contracts with an investment element dependent on capital market fluctuations, which is also a feature of a capital life insurance contract - subject of a dispute, and confirms that such contracts are to be regarded as insurance contracts. Second, while the definition of insurance mediation remained unchanged, Directive 2014/65 introduced "additional" requirements with respect to investment insurance policies, and hence the mediation in the sale of such services was already covered by the rules of Directive 2002/92 prior to its amendment by Directive 2014 / 65.

With regard to the implementation of Directive 2004/39, the Court considered it necessary to determine whether the advice in the main proceedings falls within the definition of "investment advice" of this Directive. The Court considered that the advice provided in the present case falls, in principle, under this concept since the investment in question concerned an investment in a financial service and because an insurance intermediary falls under the definition of an "investment company" since the provision of such advice is its regular professional activity.

However, the court also considered that in this case the exception provided under the Directive 2004/39 or Article 2 (c) applies, which "excludes from the scope of application of the Directive persons providing part-time investment services as part of their regular activity if that activity is regulated by law or other regulations or code of conduct for that particular activity that does not preclude the provision of such services, "that is, the Article 2 (j) that provides for the exclusion from the scope of application of the Directive "the persons providing investment advice in the exercise of another professional activity not covered by the Directive, provided the provision of advice is free of charge."

The Court considered irrelevant that the insurance intermediary provided such advice on a regular and frequent basis, bearing in mind that the advice is provided every time within the scope of mediation concerning the conclusion of the insurance contract.

From the foregoing, the Court concluded, "financial advice on the investment of capital provided within the scope of insurance mediation relating to the conclusion of a capital life insurance contract is covered by the scope of the rules of Directive 2002/92 on insurance mediation".

3.2. Strobel et all. /Länsförsäkringar Case

The insurance intermediary company "Connecta Fond och Försäkring AB" (Connecta), was registered and licensed to perform insurance mediation. In accordance with the legal regulations, a professional liability insurance contract was concluded with the insurance company *"Länsförsäkringar"*.

Between 2004 and 2010, a number of people entrusted the Company with

sums to invest in one of the structured financial services linked to their capital life insurance. However, it turned out that the CEO of Connect Fund abalienated the amounts and the proposed financial services were fictitious. The director was reported to the police, the Supervision Agency revoked their operation license and the bankruptcy proceedings were instituted over the company.

Strobel (and others), who has lost the money, filed a lawsuit against an insurance company that insured the *Connecta Fund* against professional liability, claiming that they had ordered *Connecta Fund* to invest in life insurance, which they failed to do and thus violated their obligations under the Act on insurance mediation.

In its defence, *Länsförsäkringar* argued that the damage did not occur in connection with the insured activity (or rather that it was not a matter of professional liability) because services proposed were fictitious. The conduct of the CEO of Connecta should not have been covered by the insurance mediation concept.

However, the Swedish court ruled in favour of the claimant *Strobel et al.* When the proceedings reached the Supreme Court, they decided to refer to the European Court of Justice the issue whether the notion of insurance mediation included preparatory actions even if no contract had been concluded.

3.2.1. Position of European Court of Law

Essentially, the Court understood the question as "whether the concept of insurance mediation under Directive 2002/92 also covered preparatory actions for the conclusion of an insurance contract when the insurance intermediary does not intend to conclude an actual insurance contract". The Court started from the definition of insurance mediation under the Directive as "the activity of presenting or proposing an insurance contract or performing other preparatory actions for the conclusion of insurance contract or the actual conclusion thereof, or providing assistance in the management and execution of such contract, especially in the case of claim settlement, discovering that the definition was set out as a series of alternative actions, whereby each action individually represented the insurance mediation activities. Preparatory actions for the conclusion of an insurance contract were covered by the notion of insurance mediation, whether or not such preparatory actions would lead to the conclusion of the contract.

However, *Länsförsäkringar* submit in their defence that the preparatory activities of insurance mediation under the Article 2 (3) of Directive 2002/92 are limited to situations where the insurance intermediary intends to conclude actual insurance contracts. The Court therefore considered that there was no insurance mediation in the *Strobel et al. /Länsförsäkringar* case, given that the general director of Connecta had disposed of the sums paid by Strobel and others.

In its construing, the Court maintained that no expression under the definition of "insurance mediation" could be interpreted in such a way that the

activity must be accompanied by a particular intention of an intermediary that would qualify as insurance mediation.

In a broader context, the Court ruled that Directive 2002/92 aims to improve consumer protection in the field of insurance mediation. Should the scope of the Directive depend on the subjective intention of the insurance intermediary, it would be contrary to the principle of legal safety to the detriment of the clients of the intermediary, since it could invoke the intermediary's own fraudulent conduct in order to avoid liability under Directive 2002/92. In addition, the Directive entails an obligation for Member States to take all necessary measures to protect the client against the intermediary's inability to cede the premium for whatever reason.

From the foregoing, the court concluded that the insurance mediation term is an objective concept that does not depend on the intention of the intermediary to (not) conclude the insurance contract and that performing preparatory actions for the conclusion of the insurance contract, even when the intermediary does not intend to conclude an actual insurance contract, is covered by the term "insurance mediation".

4. Summary of Judgment

Investment insurance policies are a relative novelty in the Serbian market, although in Western Europe they have been one of the most attractive financial services since the mid-1990s. Logically, the issues of liability and obligation when concluding such contracts in Serbia are relatively unknown. Since Serbia has incorporated the provisions of Directive 2002/92 into its national law by adopting the Insurance Law (Official Gazette of the RS, No. 139/2014), the case law of the European Court of Justice in this area can present a useful guideline.

Investment insurance policies are classified as "risky" financial services, the Policyholders not always being fully aware of all the particularities of the contracts they conclude, primarily of the value of the sum insured being exposed to market fluctuations depending on the value of the financial instrument to which the policy is tied. Such value may rise, but likewise decline. As expected, all disputes relate to the latter situation, when the policyholders point out that the investment advice they received was not adequate, that is, was wrong.

ECJ confirmed that premium investment advice in such contracts falls under the term *insurance advice* rather than investment advice, if i*nvestment advice* intermediaries are not paid separately. *A contrario*, if the intermediary receives an additional remuneration for the investment advice, the investment service shall be deemed provided.

Therefore, the court's position in the case of *Länsförsäkringar / Dödsboet efter Ingvar Mattsson* is particularly important as it confirms that intermediaries are responsible for the investment advice they give to their clients when concluding a life insurance contract with investment elements, which at the same time means that a professional liability insurance contract concluded between insurance

companies and insurance intermediaries covers the risks associated with premium investment advice.

This represents a long-term risk, because the question of the advice adequacy and responsibility is raised only when adverse market fluctuations occur, which may be years after the conclusion of the insurance contract. In addition, this raises the question of how well insurance intermediaries (and anyone else who sells this type of insurance) is capable of providing investment advice. Traditionally, training and competence development of employees in the insurance industry focus on insurance policies (since this is the service they sell), not issues related to capital markets. However, since the view that capital investment advice is an integral part of the advice when selling investment insurance policies, it is clear that employees can give bad advice simply because they have not even been trained to give adequate investment advice.

The *Strobel et al./Länsförsäkringar case*, on the other hand, may be interesting because under the view of the European Court of Justice, preparatory actions for the conclusion of an insurance contract, even when the intermediary does not intend to conclude an actual insurance contract (hence fraudulent acts), fall within the term insurance. Such an attitude may have an impact on the risks arising from the insurance intermediary professional liability insurance policies, since it is clear from the defence arguments that insurance companies did not consider their professional liability policies to cover damage resulting from fraudulent actions committed by insurance intermediaries.

Translated from Serbian by: ***Bojana Papović***