Insurance & Reinsurance - Austria

Second-hand insurance policies: investment advisers' duty to inform applies

Contributed by **DORDA BRUGGER JORDIS**

June 26 2012

Introduction

Rules of conduct for investment advisers also apply to insurance brokers selling insurance policies that are similiar to investment products (ie, unit-linked or second-hand life insurance policies). Aggrieved investors need to prove not only the occurrence of damage, the amount of damage and the causal link, but also that the damage would not have occurred if the adviser had attended to his or her duties properly.

A recent Supreme Court decision(1) dealt with the brokerage of second-hand life insurance policies. Under any normal life insurance policy, the policy holder loses out financially if he or she terminates the policy early. In order to minimise such losses, an insured can sell his or her policy to investors specialising in the trade of second-hand life insurance policies. Such companies buy the policy for an amount that is higher than the current cash value of the policy, but less than its death benefit. After the policy is sold, the investor continues to pay the insurance premiums. If the policy expires or the original policy holder dies, the investor receives the insurance payout, including any eventual profits.

Investment advisers not only broker the purchase of individual policies, but also offer structured products or funds which provide a better diversification of risks in comparison with single policies. In practice, the participation certificate model or participation in a limited partnership construction is used.

Facts

USI, a company seated in Toronto, acquired a second-hand life insurance policy on behalf of a group of investors, which each acquired shares in the policy. The insured undertook a medical assessment where his life expectancy was determined, which served as the basis for the policy's average duration. The investors would receive the insurance sum upon the insured's death. The sooner the insured died, the higher the actual return would be. If the insured was still alive two years after the predicted date of death, a reinsurer would pay out the insurance sum. The policy premiums were paid by USI, the contracting party to this policy.

The plaintiffs wanted to invest money safely and turned to the defendant, which presented the second-hand policy as a safe investment. Although the defendant informed the plaintiffs of the currency risk, it did not mention the risk of an actual total loss if USI became insolvent. The plaintiffs claim that had they known of this risk, they would not have entered into the contract. After USI and the reinsurer became insolvent, the plaintiffs requested the full value of the second-hand policy from the defendant, since the defendant had not informed them about the insolvency risk. The defendant argued that its advice did not give rise to liability, since it had neither provided inadequate advice nor failed to provide advice.

The court of first instance dismissed the plaintiffs' claims. It held that it could not ascertain what had actually been discussed between the plaintiffs and the defendant with regard to the reinsurer. In particular, it could not be established that the defendant had created the impression that the insurance sum would be covered by an insurer in any event and not only in the aforementioned circumstances.

The plaintiffs appealed against this decision. The court of appeal granted the plaintiffs' claim based on Section 28 of the Brokers Act. It ruled that the plaintiffs' requirement of a safe investment had required a thorough risk disclosure. The defendant lodged an appeal with the Supreme Court against this decision.

Decision

The court of appeal did not base the defendant's liability on the lack of disclosure concerning USI's possible insolvency. In their answer to the defendant's appeal before the Supreme Court, the plaintiffs did not respond to the fact that the court of first instance had dismissed the defendant's obligation to inform the plaintiffs about the risk of its contracting partner's possible insolvency – a risk that is linked to every transaction.

In an earlier decision, the Supreme Court had ruled that the brokerage of second-hand policies only transfers existing rights and does not create a new insurance relationship.(2) Contrary to the court of appeal's decision, the Supreme Court held that no liability can be derived from Section 28(2) of the Brokers Act, which stipulates that an insurance broker is obliged to assess the insurer's solvency within the scope of professional information accessible to a broker. However, this provision regulates only the interaction between an insurance broker and the (potential) insured party. Hence, this provision did not apply to the contractual relationship between the plaintiffs and the defendant. Since the plaintiffs did not admit that information about USI's possible insolvency was readily available, an application of Section 28 (2) even by analogy would have been an insufficient basis for the defendant's liability.

According to the Supreme Court, the rules of good conduct contained in the Securities Supervision Act should apply to the sale of insurance policies that are similar to investment products by insurance brokers. The same should hold true for consultations by insurance brokers concerning this type of insurance product. The application of these rules is based on:

- Sections 11 to 18 of the 1996 Securities Supervision Act;
- Section 75(2) of the Insurance Supervision Act;
- Section 3(4) of the Brokers Act; and
- Section 28 of the Brokers Act.

The court of appeal applied these principles when justifying the defendant's liability. It stated that the defendant should have informed the plaintiffs about the "specific position of the reinsurer in the specific contractual relationship". However, the Supreme Court failed to clarify precisely what is to be understood by this statement.

The plaintiffs did not base their claims against the defendant on the fact that the law applicable to the contracts between the US insured, the US insurer, USI and the reinsurer should be Austrian law. Furthermore – contrary to the opinion of the court of appeal – the Supreme Court held that it cannot be taken for granted that the plaintiffs would have refrained from buying the second-hand policy if the defendant had disclosed the reinsurer's specific position; the concurring declaration related only to the insolvency of USI.

In principle, an aggrieved party must prove not only the occurrence and the amount of the damage, but also the causal link between the tortfeasor's conduct and the occurrence of the damage. The same holds true in proving that the damage would have not occurred had the tortfeasor acted dutifully.

The court of first instance issued a negative declaration concerning the discussion between the plaintiffs and the defendant relating to the reinsurer. According to this *non liquet* (a situation where there is no applicable/unclear law), the plaintiffs would not have met their burden of proof regarding the defendant's failure to disclose the reinsurer's position. The plaintiffs raised an objection against this declaration, but the court of appeal did not find it necessary to react. However, by holding the failure to disclose against the defendant, the court of appeal deviated from this negative declaration. Such a deviation can only be done by first undertaking an evidence repetition or evidence amendment (Section 488 of the Code of Civil Procedure).

Nevertheless, the Supreme Court ruled that there was no need to revoke the court of appeal's ruling. According to the court of first instance's ruling – which in this regard was not appealed against – it could not be determined whether the event covered by the reinsurance had happened or could still happen. Therefore, it was unclear whether a risk materialised for which "the specific position of the reinsurer in the specific contractual relationship" would be of significant influence. Hence, the causal link between the reinsurer and the plaintiffs' damages claim was missing and the defendant could not be held liable.

Comment

The good conduct rules originally developed by Austrian jurisdiction for investment advisers – which were subsequently codified in the Securities Supervision Act – apply consequentially to insurance brokers selling insurance policies which are similar to investment products (ie, unit-linked or second-hand life insurance policies). To the same effect, this holds true for consultations and advisory meetings relating to the sale of such financial products by insurance brokers.

For further information on this topic please contact Felix Hörlsberger or Marguerita Sedrati-Müller at DORDA BRUGGER JORDIS by telephone (+43 1 533 4795), fax (+43 1 533 4797) or email (felix.hoerlsberger@dbj.at or marguerita.sedrati-mueller@dbj.at).

Endnotes

(1) Judgment of July 21 2011, 1 Ob 115/11 k.

(2) 7 Ob 226/09 z.

Authors

Felix Hörlsberger

Marguerita Sedrati-Müller