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France adopts favourable amendment of cooling-off and cancellation rights in life insurance

On 31 December 2014, Law No. 2014-1662 of 30 December 2014 "*portant diverses dispositions d'adaptation de la législation au droit de l'Union européenne en matière économique et financière*"[1] (the 2014 Law) was published in the Official Journal. Article 5 of the 2014 Law significantly amends cooling-off and cancellation rights under French insurance law. The amendment is favourable to insurers.

This briefing summarises the relevant rules and the amendment made by Article 5 and comments on the amendment from the perspective of unit-linked life insurers.

EU and French legislation on cooling-off, cancellation rights and pre-contractual disclosures in life insurance

EU law introduced cooling-off and cancellation rights under the 1990 "second generation" EU Life Insurance Directive[2]. The 1992 "third generation" Directive introduced certain pre-contractual information requirements[3]. The EU law provisions were a minimum harmonisation of rules in relation to pre-contractual disclosures. Member States remained free to impose more stringent requirements. France implemented the EU law provisions by amending its Insurance Code (IC), in particular Articles L 132-5-1 (cooling-off and cancellation rights) and L 132-5-2 (pre-contractual disclosures).

Implementation in France was more stringent than the minimum harmonisation contemplated by the Directives[4]:

- Article L 132-5-1, IC enshrines the policyholder's 30-day cancellation right. In the event of cancellation, the insurer must return the gross premium paid (*restitution du versement*) – whatever the policy value (higher or lower) on cancellation.

- Article L 132-5-2, IC provides for pre-contractual disclosures (IC regulations and orders add highly detailed and prescriptive requirements). This Article also expressly provided that, in the event of failure by the insurer to provide all the pre-contractual information, the 30-day cooling-off period was extended "by operation of law" (*de plein droit*), *i.e.* automatically, until such time as the full information had been provided. Originally, the extension was, in theory, for an unlimited period. A 2006 legislative amendment restricted the extension to a maximum of eight years from the date when the policyholder was informed of conclusion of the contract. This meant that, if the policyholder cancelled during such extension, they were entitled to repayment of the gross premium – again, even if the policy value were lower.

A sword of Damocles for insurers

This extension and right to full repayment of premium created a sword of Damocles over insurers, in particular in unit-linked contracts, where policy values may fall because of poor investment performance of the underlying assets of the policy. Thus, if the policyholder could prove that they had

[1] *i.e.* Law No. 2014-1662 of 30 December 2014 on "various provisions to adapt legislation to economic and financial law of the European Union."
[2] Directive 90/619/EEC introduced a 15 to 30-day cooling-off period for contracts of life insurance. The Solvency II Directive, which applies from 1 January 2016, maintains this period.
[3] See Article 30 and Annex II, Directive 92/96/EEC, subsequently "recast" in the Consolidated Life Directive, Directive 2002/83/EEC. Once again, the Solvency II Directive consolidates these rules without amending their terms.
[4] Initial implementation was through Law No. 92-665 of 16 July 1992 "to adapt insurance and credit legislation to the Single European market." Law No. 2005-1564 of 15 December 2005 on "various provisions to adapt legislation to Community law in the insurance area" significantly amended – and clarified – the text, in particular by limiting the cancellation right to a maximum of eight years.

not received full pre-contractual information – even for arguably immaterial omissions or inadequate information – they could reclaim premium[5].

Needless to say, certain policyholders chose to take advantage of this rule, in particular following a 2006 Court of Cassation judgment in which a policyholder successfully reclaimed a premium of about €690,000. In that case, the Court held that, "…*whereas, however, it follows from Article L 132-5-1 of the Insurance Code, which is* ordre public*, ……., that it is within the insured's discretion whether to exercise the extended right to cancel applied by operation of law in order to sanction the failure to provide the insured with the documents and information listed in this text and that there is no good faith requirement* [imposed on the insured]…[6]"

Since then, the Courts have been regularly requested to interpret the scope of the above rules, for example:

- Cancellation rights pre-suppose that the contract is still in force. If there has been a full surrender, or the insurer has terminated the contract (for failure by the policyholder to pay premiums), the policyholder will not, in principle, be able to rely on cancellation rights[7].

- Since the extension applies by operation of law, it is *ordre public* (*cf.* cancellation rights during the initial 30-day cooling-off period). This means that the parties cannot "contract out" of the rule and it is not, therefore, possible for the policyholder to waive their extended rights[8], whether by endorsement or, even, through performance of the contract. By way of example, the policyholder may – in principle - grant a charge (*nantissement*) over the policy without waiving cancellation rights[9].

- Where the policyholder has validly exercised cancellation rights, it may then still be possible for the policyholder subsequently to exercise contractual rights such as granting a charge[10]. If the policyholder were to part surrender, the cancellation might still be valid, where the policyholder could prove that the part surrender had been carried out to meet specific needs (such as a creditor's claims) and so was not an unambiguous reversal of the cancellation[11].

- Where: (i) a finance company makes a loan to a customer; (ii) the customer uses the loan to pay the premium for a contract of life insurance taken out with an insurer in the same group; (iii) the gains on the policy are then used to repay the loan; and (iv) the policy has been secured (*gagé*) in favour of the lender, cancellation rights may also have the effect of terminating the loan contract – even where the loan agreement expressly excludes any interdependence and non-severability between the loan and the life insurance. The two contracts were held to be non-severable – cancellation of the insurance terminated the loan - and the borrower was able to avoid certain duties under the loan agreement[12].

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[5] For a recent example of a judgment upholding the insurer's defence: 2nd Civil Chamber, Court of Cassation, No. 13-16540 of 12 June 2014.
[6] In French: *Mais attendu qu'il résulte de l'article L. 132-5-1 du Code des assurances, d'ordre public, et conforme à la directive 2002/83/CEE du 5 novembre 2002, que l'exercice de la faculté de renonciation prorogée ouverte de plein droit pour sanctionner le défaut de remise à l'assuré des documents et informations énumérés par ce texte est discrétionnaire pour l'assuré dont la bonne foi n'est pas requise*; 2nd Civil Chamber, Court of Cassation, No. 05-12.338 of 7 March 2006.
[7] For an interesting example where the insurer "surrendered" the contract: 2nd Civil Chamber, Court of Cassation, No. 13-20.358 of 12 June 2014.
[8] In French, the right to cancel is *faculté de renonciation*; a waiver of rights is also *renonciation*. This leads to the curious terminology applicable if a policyholder were to waive cancellation rights – *renonciation à la renonciation*.
[9] For a recent example: 1st Civil Chamber, Court of Cassation, No. 11-28.183 of 16 January 2013.
[10] For an example of *renonciation à la renonciation*: 2nd Civil Chamber, Court of Cassation, No. 11-26043 of 4 October 2012.
[11] For example: 2nd Civil Chamber, Court of Cassation, No. 11-18.207 of 28 June 2012.
[12] 1st Civil Chamber, Court of Cassation, No. 13-21.362 of 1 October 2014.

In numerous cases, the Courts have upheld the public policy basis of the rules and allowed the policyholder to recover premium. This has been a costly and time-consuming exercise for insurers offering unit-linked contracts on the French market. The sector and legal commentaries have noted that a strict interpretation of the rules has the effect of removing the financial risk assumed by policyholders in unit-linked contracts: it is sufficient for a policyholder to set up a claim based on failure in pre-contractual disclosures to enjoy "guaranteed" return of premium for up to eight years.

The amendment under Article 5 of the 2014 Law

In order to protect insurers from excessive recourse by policyholders to cancellation rights, Article L 132-5-2, IC needed amendment to enable insurers to challenge a policyholder that he is acting in bad faith. Bad faith arises, for example, where the policy has been in force some years, and the policyholder has manifestly understood how it works notwithstanding an omission or inadequate pre-contractual disclosure. In such circumstances, the policyholder should not enjoy the automatic extension of the cooling-off period in order to recover their initial investment in the policy.

Article 5 of the 2014 Law therefore deletes the terms "by operation of law" / *de plein droit* in Article L 132-5-2, IC and inserts a requirement for the policyholder to be in good faith / *de bonne foi* in order to be able to extend the cooling-off period of 30 days and recover their premium.

In order to see this amendment in context, the Annex to this briefing sets out the French text of Article L 132-5-2, IC before and after amendment by Article 5 of the 2014 Law.

Comment

The 2014 Law was published on 31 December 2014. Absent specific provision to the contrary, for example where implementing measures are required, a law enters into force on the day following its publication[13]. There are no specific provisions regarding entry into force of the amendment under Article 5. The 2014 Law is, furthermore, silent as to its applicability to in-force contracts[14]. The amendment therefore entered into force on New Year's Day and applies to contracts concluded from that date.

This means that existing portfolios remain vulnerable to challenge by policyholders under the rules in force until 31 December 2014: in the event of a claim, insurers need to check case law closely to identify any circumstances where the Courts have held that the policyholder has unambiguously waived cancellation rights. Note that Article L 132-5-1, IC refers to policyholders who are natural persons; corporate person policyholders do not enjoy these cancellation rights.

Views on the proposed amendment within the legislature conflicted. The Article 5 amendment only surfaced late in the legislative process, namely in the *commission mixte paritaire* (the joint committee of representatives of the National Assembly and the Senate – the CMP). Christophe Caresche, a socialist CMP member, who was *rapporteur* on the text, commented to the National Assembly on the work of the CMP as follows, "*Je terminerai en citant deux apports issus des travaux de la CMP. Tout d'abord, l'article 3 bis* [5] *modifie le code des assurances afin de réserver aux souscripteurs de bonne foi la prorogation du délai de renonciation aux contrats d'assurance-vie en cas de manquement de l'assureur à son obligation d'information précontractuelle.*

Il s'agit d'éviter le détournement de la procédure de renonciation par des souscripteurs de mauvaise foi, souvent de gros investisseurs avertis et qualifiés qui bénéficient de l'aide d'avocats spécialisés,

[13] Article 1, Civil Code.

[14] Article 2, Civil Code: in principle, laws are not retroactive. Cancellation rights are public policy and so an amendment of their terms is also public policy. Arguably, such an amendment should apply to in-force contracts, *i.e.* be retroactive, but we doubt such an argument can override the express rule in Article 2, Civil Code. At best, an insurer could, in the course of proceedings, point to the legislative amendment under Article 5 of the 2014 Law as additional evidence to deny a claim for repayment of premium.

pour faire annuler leurs pertes éventuelles. La notion de « bonne foi », notion classique de notre droit civil, sera un outil à la disposition des magistrats pour apprécier concrètement les litiges.[15]" – in short, this commentary reflects the insurers' concerns in recent years.

A member of the opposition (*UMP*), Marie-Christine Dalloz, took the contrary view, "*L'article 3 bis* [5]*, pour sa part, remet en cause la protection des souscripteurs de contrats d'assurance vie. En effet, les compagnies d'assurances devaient, jusqu'à présent, délivrer une information précontractuelle conforme, faute de quoi elles s'exposaient de plein droit à une sanction, à savoir la restitution des primes versées. Or, ce texte modifie les termes de l'application de la sanction de plein droit pour les souscripteurs de bonne foi. C'est un recul du droit des souscripteurs. J'ai tenté en commission mixte paritaire de faire entendre cet argument. Je n'y suis pas parvenue, ce que je regrette, car nous risquons d'affaiblir le droit des souscripteurs.*[16]"

As for the criteria of good faith and an extension of cancellation rights, one approach might be to consider which transactions under the contract demonstrate that the policyholder has understood that they bear financial risk and so should not be "guaranteed" against poor investment performance. Under this approach, a policyholder who has made part surrenders or who switches between assets available under the policy may struggle to argue that they should still be able to cancel their contract and recover premium. Conversely, a top-up, especially when made into a less risky investment choice or subject to maintenance of cancellation rights, may not be sufficient evidence of bad faith. Likewise, other transactions, such as a change in beneficiary, may be insufficient.

In sum, while the amendment requiring good faith is welcome, insurers should not presume that they will now always have a defence against a policyholder who has suffered losses and seeks return of premium. The insurer will doubtless still need to prove that: (i) it provided full pre-contractual disclosures[17]; and (ii) the policyholder is acting in bad faith. The existing corpus of case law will continue to provide guidance.

Postscript

The 2014 Law has another distinguishing feature of interest to the insurance sector: its Article 4 authorises the government to adopt ordinances required to implement the Solvency II Directive, including its delegated and implementing acts, as well as other major EU financial services texts.

[15] *i.e. "I shall conclude by citing two additions which have come out of the work of the CMP. First, Article 3bis* [5] *amends the Insurance Code in order to restrict to policyholders who act in good faith the extension of the cooling-off period for contracts of life insurance in the event of failure by the insurer to meet its duty of pre-contractual disclosure.*

The purpose is to avoid a misuse of the cancelation procedure by policyholders acting in bad faith, who are often significant, informed and qualified investors who enjoy the assistance of specialised lawyers in order to wipe out their losses. The notion of "good faith" is a classic notion of our civil law and will be a tool for judges to use in order to assess disputes specifically."

[16] *i.e. "As for Article 3bis* [5]*, it calls into question the protection of policyholders of contracts of life insurance. Indeed, until now, insurance companies had to provide pre-contractual information which was conform, failing which they were by operation of law subject to a sanction, namely return of premiums paid. Now, this text amends the terms for application of the sanction by operation of law in favour of policyholders who are in good faith. This is a setback for the policyholder's rights. In the joint committee, I tried to put forward this argument. I did not manage and regret this, since we are likely to weaken policyholders' rights*."

[17] In this respect, note that the IC provisions are already extremely onerous and will likely only become more so with the entry into force from 31 December 2016 of the PRIIPs regulation, Regulation (EU) No. 1286/2014 "on key information documents for packaged retail and insurance-based investment products"

Annex: text of Article L 132-5-2, IC before and after amendment by Article 5 of the 2014 Law

Article 5 of the 2014 Law provides:

> *«Au sixième alinéa de l'article L. 132-5-2 du code des assurances, les mots: «de plein droit» sont remplacés par les mots: «, pour les souscripteurs de bonne foi,».*[18] »

Herewith the former and amended versions of Article L 132-5-2, IC (French text only with the amendment in red overleaf):

Former version	Amended version
Avant la conclusion d'un contrat d'assurance sur la vie ou d'un contrat de capitalisation, par une personne physique, l'assureur remet à celle-ci, contre récépissé, une note d'information sur les conditions d'exercice de la faculté de renonciation et sur les dispositions essentielles du contrat. Un arrêté fixe les informations qui doivent figurer dans cette note, notamment en ce qui concerne les garanties exprimées en unités de compte. Toutefois, la proposition d'assurance ou le projet de contrat vaut note d'information, pour les contrats d'assurance ou de capitalisation comportant une valeur de rachat ou de transfert, lorsqu'un encadré, inséré en début de proposition d'assurance ou de projet de contrat, indique en caractères très apparents la nature du contrat. L'encadré comporte en particulier le regroupement des frais dans une même rubrique, les garanties offertes et la disponibilité des sommes en cas de rachat, la participation aux bénéfices, ainsi que les modalités de désignation des bénéficiaires. Un arrêté du ministre chargé de l'économie, pris après avis de l'Autorité de contrôle prudentiel et de résolution, fixe le format de cet encadré ainsi que, de façon limitative, son contenu. La proposition ou le contrat d'assurance ou de capitalisation comprend : 1° Un modèle de lettre destiné à faciliter l'exercice de la faculté de renonciation ; 2° Une mention dont les termes sont fixés par arrêté du ministre chargé de l'économie, précisant les modalités de renonciation. La proposition ou le projet de contrat d'assurance ou de capitalisation indique, pour les contrats qui	Avant la conclusion d'un contrat d'assurance sur la vie ou d'un contrat de capitalisation, par une personne physique, l'assureur remet à celle-ci, contre récépissé, une note d'information sur les conditions d'exercice de la faculté de renonciation et sur les dispositions essentielles du contrat. Un arrêté fixe les informations qui doivent figurer dans cette note, notamment en ce qui concerne les garanties exprimées en unités de compte. Toutefois, la proposition d'assurance ou le projet de contrat vaut note d'information, pour les contrats d'assurance ou de capitalisation comportant une valeur de rachat ou de transfert, lorsqu'un encadré, inséré en début de proposition d'assurance ou de projet de contrat, indique en caractères très apparents la nature du contrat. L'encadré comporte en particulier le regroupement des frais dans une même rubrique, les garanties offertes et la disponibilité des sommes en cas de rachat, la participation aux bénéfices, ainsi que les modalités de désignation des bénéficiaires. Un arrêté du ministre chargé de l'économie, pris après avis de l'Autorité de contrôle prudentiel et de résolution, fixe le format de cet encadré ainsi que, de façon limitative, son contenu. La proposition ou le contrat d'assurance ou de capitalisation comprend : 1° Un modèle de lettre destiné à faciliter l'exercice de la faculté de renonciation ; 2° Une mention dont les termes sont fixés par arrêté du ministre chargé de l'économie, précisant les modalités de renonciation. La proposition ou le projet de contrat d'assurance ou de capitalisation indique, pour les contrats qui

[18] In English, "*In the sixth paragraph of Article L 132-5-2 of the Insurance Code, the words 'by operation of law' are replaced by the words 'for policyholders in good faith'*."

en comportent, les valeurs de rachat au terme de chacune des huit premières années du contrat au moins, ainsi que, dans le même tableau, la somme des primes ou cotisations versées au terme de chacune des mêmes années. Toutefois, pour les contrats mentionnés au deuxième alinéa de l'article L. 132-23, l'entreprise indique les valeurs de transfert au lieu des valeurs de rachat. La proposition ou le projet de contrat d'assurance ou de capitalisation indique les valeurs minimales et explique le mécanisme de calcul des valeurs de rachat ou de transfert lorsque celles-ci ne peuvent être établies.	en comportent, les valeurs de rachat au terme de chacune des huit premières années du contrat au moins, ainsi que, dans le même tableau, la somme des primes ou cotisations versées au terme de chacune des mêmes années. Toutefois, pour les contrats mentionnés au deuxième alinéa de l'article L. 132-23, l'entreprise indique les valeurs de transfert au lieu des valeurs de rachat. La proposition ou le projet de contrat d'assurance ou de capitalisation indique les valeurs minimales et explique le mécanisme de calcul des valeurs de rachat ou de transfert lorsque celles-ci ne peuvent être établies.
Le défaut de remise des documents et informations prévus au présent article entraîne **de plein droit** la prorogation du délai de renonciation prévu à l'article L. 132-5-1 jusqu'au trentième jour calendaire révolu suivant la date de remise effective de ces documents, dans la limite de huit ans à compter de la date où le souscripteur est informé que le contrat est conclu.	Le défaut de remise des documents et informations prévus au présent article entraîne, **pour les souscripteurs de bonne foi**, la prorogation du délai de renonciation prévu à l'article L. 132-5-1 jusqu'au trentième jour calendaire révolu suivant la date de remise effective de ces documents, dans la limite de huit ans à compter de la date où le souscripteur est informé que le contrat est conclu.
Les dispositions du présent article sont précisées, en tant que de besoin, par arrêté ministériel.	Les dispositions du présent article sont précisées, en tant que de besoin, par arrêté ministériel.
Elles ne s'appliquent pas aux contrats d'une durée maximale de deux mois.	Elles ne s'appliquent pas aux contrats d'une durée maximale de deux mois.

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If you have any questions concerning this briefing, please contact Philip Woolfson or Guy Soussan (contact details below). This briefing should not be treated as a substitute for specific legal advice on individual situations.

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