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**Commentaries on the Recent Amendment of the
Insurance Law of the People's Republic of China
Regarding Insurance Contracts from the
Perspective of Comparative Law**

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COMMENTARIES ON THE RECENT AMENDMENT OF THE INSURANCE LAW OF THE PEOPLE'S REPUBLIC OF CHINA REGARDING INSURANCE CONTRACTS FROM THE PERSPECTIVE OF COMPARATIVE LAW

KUAN-CHUN CHANG*

ABSTRACT:

This paper, which begins with a brief history of the insurance industry and insurance law, discusses the recent amendments to the Insurance Law of the People's Republic of China. It focuses in particular on the amendments relating to insurable interest, the insured's duty of disclosure, the interpretation of contractual clauses, double insurance and insurance fraud. The paper concludes by considering areas with which the amendments have not dealt, and by suggesting ways in which the legislation could be improved.

I. INTRODUCTION

In February, 2009, the Insurance Law of The People's Republic of China (PRC) was amended, resulting in major changes to both substantive insurance contract law and insurance company regulations. At least 80% of the original articles were amended and the total number of articles increased from 159 to 187. Compared to the last change in insurance law, which focused on regulations pertaining to China's WTO commitments, this amendment placed more emphasis on settling insurance contract issues arising prior to the amendment, and on the prudential regulation of insurance companies. The primary source of reference for this amendment was American and British law;¹ this research will not only examine most of the newly-enacted articles in light of American and British law, but it will also provide critiques in accordance with the general principles of both insurance theory and law (i.e., principles of indemnity, consideration and utmost good faith). Part I of this paper will provide a brief history of modern Chinese insurance law. Part II will review the section of the amendment relating to insurable interest, the insured's duty of disclosure, the interpretation of contractual clauses, double insurances and insurance fraud. Part III will explore potential issues and problems not clarified in this amendment and propose suggestions for further amendments. Part VI will conclude the discussion with a commentary.

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¹ For examples, the incontestability clause and rules regarding waiver and estoppel have been introduced into the 2009 Amendment. See Xu Chongmiao & Li Li, *Zui Xin Bao Xian Fa Shi Yong Yu An Li* [Newly Amended Insurance Law – Application & Cases] (2009) at 14.

II. BRIEF HISTORY OF THE INSURANCE INDUSTRY AND REGULATIONS IN CHINA

A. Brief History of the Chinese Insurance Industry

1. Period before the Foundation of the People's Republic of China

Insurance in China has a long history. Thousands of years ago, businessmen traded food and goods between inland China and its coastal cities on the Yangtze River. This thousand-kilometer trek exposed small boats to risks such as bandits, rapids, and pilferage. To prevent the total loss of any one shipment, the businessmen established collective agreements to share the economic loss of any vessel.² For instance, a businessman who shipped five percent of the cargo on a vessel would absorb five percent of any loss or damage to that shipment.³ China's modern insurance industry, however, did not appear until the early 19th century. In 1805, the Guangzhou Insurance Firm was established by a British businessman in Guangzhou City.⁴ The first Chinese businessman's insurance company was founded in 1876, marking what most historians consider the beginning of China's insurance industry.⁵ However, from the end of the Opium War in 1842 until the beginning of the 20th century, foreign companies dominated the Chinese insurance market.⁶ Even after the collapse of the Qing dynasty in 1911, the Chinese conducted their insurance business primarily to support foreign trade.⁷ The industry retained this structure through World War II and the Civil War until the victory of the Communist Party and the establishment of the People's Republic of China (hereafter the PRC).

2. Period after the Foundation of the People's Republic of China

In October 1949, the Chinese government formed a state-owned enterprise, the People's Insurance Company of China (hereinafter the PICC) in Beijing.⁸ In its first decade of operation, the PICC made rapid and steady progress by setting up regional branches and offices in all of China's provinces, autonomous regions, and municipalities.⁹ At the same time, the Communist government interfered with the operation of private insurance companies, incorporating them one by one into the PICC, gradually causing private insurance companies to disappear from the market.¹⁰ Pursuant to the decision of the State Council, the PICC was designated in 1951 as the only institution to engage in mandatory insurance (i.e. mandatory insurance of state-owned enterprises).¹¹ In addition, the PRC government started imposing restrictions on foreign insurance institutions that had a presence in China. These restrictions included prohibitions on remitting foreign currency and severely penalized companies that violated the laws and regulations. As a

² Jennifer A. Meyer, Note, "Let the Buyer Beware: Economic Modernization, Insurance Reform, and Consumer Protection in China" (1994) 62 *Fordham L. Rev.* 2125 at 2136.

³ *Ibid.*

⁴ Linbo Fan, "The Insurance Market System" in Joseph J. Norton et al., eds., *Financial Regulation in the Greater China Area: Mainland China, Taiwan and Hong Kong* (Kluwer Law International) 158.

⁵ *Ibid.*

⁶ John J. Hampton, "Insurance in China" (1989) 42 *Chartered Property Casualty Underwriters* 106.

⁷ *Ibid.*

⁸ Hao-Min Zhu, *Da Lu Jin Rong Zhi Du Yu Shi Chang* [The Financial Regulation and Market in the Mainland China] (2002) at 124.

⁹ Alberto Monti, "The Insurance Contracts in the People's Republic of China - A Comparative Analysis of Policyholders' Rights" (2001) 3 *Global Jurists Topics* 1 at 4.

¹⁰ Zhu, *supra* note 8, at 124.

¹¹ *Ibid.*

result, all foreign insurance companies withdrew from the Chinese insurance market in early 1952.¹²

In 1959, the Great Leap Forward transformed the government's attitude toward insurance.¹³ Communist doctrine mandates that the government protect its organizations and citizens, so other means of security such as insurance becomes meaningless.¹⁴ Although the PICC maintained operations in the cities of Shanghai and Hangzhou, its businesses were limited to foreign trade activities, primarily insuring cargo and hull risks.¹⁵ The State subsequently assumed all damage claims and the domestic market nearly evaporated. Suspension of insurance continued for the next two decades.

Given that Chinese government could not entirely uphold its responsibility to assume insurance-type claims, it re-authorized the industry in 1979.¹⁶ In conjunction with the Four Modernizations and the Open Door Policy, China resumed its foreign trade and investment activities.¹⁷ To promote these policies and facilitate foreign investment, the National People's Congress passed "The Law of the People's Republic of China on Chinese Foreign Joint Ventures" which mandates that Chinese insurance companies serve all joint venture insurance needs.¹⁸ Since the PICC was the only authorized insurer at the time this law passed, this provision guaranteed a domestic monopoly. This monopoly, however, ended in 1985 with the passage of the Provisional Regulations Regarding the Administration of Insurance Enterprises (Regulations). The Regulations opened the domestic market to other Chinese insurers but still reserved certain lines of insurance, such as foreign business projects, for the PICC.¹⁹ In 1988, China Merchant Steam Navigation formed the Ping An Insurance Company, which was followed in 1990 by the China Pacific Insurance Company and the Xinjiang Agricultural Insurance Company.²⁰ In 1991, the China-Pacific Insurance Company was formed.²¹ Domestic competitors subsequently entered the marketplace, eroding the PICC monopoly. Rapid growth in foreign-related insurance business and foreign-owned insurance companies could also be observed during this period. Until 1995, the PICC owned nine foreign-related and overseas insurance institutions, some of which were holding companies or group companies.²² In October 1992, the American International Group (AIG) became the first foreign-owned insurance company permitted to offer both life and property insurance in China's largest city, Shanghai.²³ In 1994, the Tokyo Marine & Fire Insurance Company, Japan's biggest

¹² *Ibid.*

¹³ Liu Hongru, "Developments in the Reform of China's Banking and Financial System" (1988) 2 J. Chinese L. 323 at 356.

¹⁴ *Ibid.*

¹⁵ Zhu, *supra* note 8, at 125.

¹⁶ Meyer, *supra* note 2, at 2138.

¹⁷ Hampton, *supra* note 6, at 106.

¹⁸ See *The Law of the People's Republic of China on Chinese Foreign Joint Ventures* (1979), art. 8. "After payment out of the gross profit earned by the joint venture of the joint venture income tax, pursuant to the provisions of the tax laws of the People's Republic of China, and after deduction from the gross profit of a reserve fund, a bonus and welfare fund for staff and workers, and a venture expansion fund, as provided in the articles of association of the joint venture, the net profit shall be distributed to the parties to the joint venture in proportion to their respective contributions to the registered capital."

¹⁹ Fan, *supra* note 4, at 158.

²⁰ Wen-Hua Liu, *WTO Yu Zhong Guo Jin Rong Fa Lu Zhi Du De Chong Tu Yu Gui Bi* [WTO and its Conflicts with the Legal System of China's Financial Law and the Avoidance] (Beijing, 2001) at 373.

²¹ Zhu, *supra* note 8, at 125.

²² Fan, *supra* note 4, at 159.

²³ Zhu, *supra* note 8, at 125.

property and casualty insurance company, also initiated business in Shanghai.²⁴ Thereafter, foreign insurance business started returning to the Chinese market in the form of foreign-owned companies, representative offices or joint ventures with local companies. By the end of 1996, five foreign-owned insurance companies and some 126 representative and liaison offices from 77 foreign insurance companies were operating in China.²⁵

With continuing economic reform and removal of market restrictions, the climate of development accelerated the maturing of China's market. For example, the PICC became fully independent of the People's Bank of China (PBC), the central and former supervisory organ, while vastly expanding and developing its business to control almost 80% of the domestic insurance market.²⁶ In October 1998, the State Council restructured the former PICC Group, which had three subsidiaries and set up four independent, state-owned insurance companies: (i) the China Reinsurance Company (CRC); (ii) the China Life Insurance Company; (iii) the new People's Insurance Company of China (PICC); and (iv) the China Insurance Company Limited, which oversees the China Insurance Company Limited of Hong Kong.²⁷ At the same time, the total number of foreign insurance companies and Sino-foreign joint ventures grew. Insurance firms from Canada, Switzerland, Germany, Australia, and France entered the Chinese insurance market.²⁸

Another important feature of this period is the creation of the modern insurance regulation and supervision system. In October 1995, the Insurance Law of PRC (Insurance Law), the first comprehensive national legislation on insurance matters, which combined insurance contract law with laws on insurance supervision and administration.²⁹ For the purposes of strengthening insurance supervision and developing the Chinese insurance market, the amendment of the Insurance Law as a part of the post-WTO accession legislative renovation was completed in October 2002.³⁰ In addition, the structure and authority of financial supervisors were adjusted. In 1998, the authority over insurance supervision and regulation was transferred from the People's Bank of China to a newly established regulatory institution, the China Insurance Regulatory Commission (CIRC), which was formed because of the rapid growth in the Chinese insurance sector and the lack of sufficient industry oversight.³¹

B. Brief History of Chinese Insurance Legislation

China's insurance legislation dates back to the end of the Qing Dynasty. The Qing government drafted the Qing Commercial Law, which consisted of two chapters

²⁴ Yadong Luo, *China's Service Sector: A New Battlefield for International Corporations* (Copenhagen: Copenhagen Business School Press, 2001) at 159.

²⁵ Fan, *supra* note 4, at 159. Also see Guojian Xu et. al., *Insurance Law in China* (The Hague: Kluwer Law International, 2007) at 5.

²⁶ Before November 1998, China's insurance industry was regulated by the PBC. Now, the China Insurance Regulatory Commission (CIRC), a newly-established government agency, is charged with the supervision and administration of the insurance industry in China. Fan, *supra* note 4, at 159.

²⁷ See "China's Insurance Sector: Overview of Recent Changes" (1999) 21 E. Asian Executive Rep. 2 at 8 (Westlaw).

²⁸ Luo, *supra* note 24, at 159.

²⁹ Xu & Li, *supra* note 1, at 14.

³⁰ Xu Guojian & Richard L. Mertl, "Amending the Insurance Law: Long-Term Policy or Expedient Measures" (2003) 10 China L. & Prac. 21.

³¹ China's Insurance Sector, *supra* note 27, at 8.

concerning loss and life insurance.³² However, the Qing Dynasty collapsed before this law was implemented.³³ In 1929, the Guomintang (KMT) government drafted the Insurance Law, revised it in 1937, and promulgated the Maritime Law, which pertained to marine insurance in 1931.³⁴ After the foundation of the PRC in 1949, the State Council promulgated a series of insurance acts and regulations, consisting of rules, administrative decisions, ordinances, methods and notices.³⁵ Most of these acts and regulations focused on compulsory insurance, especially for the property of state institutions and for the property of ship, train, and airplane passengers.³⁶

The Insurance Law of 1995 was the first national legislation that provided a framework for understanding China's insurance regulations.³⁷ This legislation consisted of 152 articles in eight chapters.³⁸ The first chapter covered the purpose of the law, the definition of insurance, the scope of the law, and principles of the insurance industry.³⁹ Chapter Two, pertaining to insurance contracts, consisted of three sections: (1) the general rules of the formation, amendment, and performance of the insurance contract; (2) property insurance; and (3) life insurance contract.⁴⁰ Chapters Three through Five set forth the rules and requirements of insurance company administration and supervision, including licensing, scope of business management of premiums, liquidation, and continuous supervision.⁴¹ Chapter Six offered rules for supervision of insurance and related industries such as insurance agents and brokers.⁴² Finally, Chapters Seven and Eight included provisions regarding legal liabilities and sanctions.⁴³ As articles pertaining to the supervision and administration of insurance companies were still in the early stages of development, the CIRC promulgated the Regulation Regarding the Administration of Insurance Companies in 2000 and subsequently amended it in 2005. The Regulation now has seven chapters with 105 articles, which provide more detailed rules for supervising and administering insurance companies.⁴⁴

China's insurance industry changed drastically between 1995 and 2002. The number of insurance companies reached 53 by the end of 2002, and total annual premium income had risen from RMB 460 million in 1995 to RMB 226.3 billion through the first three quarters of 2002.⁴⁵ This growth resulted in an increasing number of insurance consumers and products, also generating demand for higher quality service and upgraded regulatory systems. With these changed objectives, several parts of the Insurance Law of 1995 ceased to be applicable to the market. Some original provisions even became obstacles to

³² Guanghua Yu & Minkang Gu, *Law Affecting Business Transactions in the PRC* (The Hague: Kluwer Law International, 2001) at 126.

³³ *Ibid.*

³⁴ Fan, *supra* note 4, at 158.

³⁵ *Ibid.*

³⁶ *Ibid.*

³⁷ Yu & Gu, *supra* note 32, at 126-127.

³⁸ *The Insurance Law of PRC 1995*, online: LawInfoChina <<http://www.lawinfochina.com/Law/list.asp>>.

³⁹ *Ibid.*

⁴⁰ *Ibid.*

⁴¹ *Ibid.*

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ *Regulation Administration of Insurance Companies*, online: China Insurance Regulatory Commission <<http://www.circ.gov.cn/web/site45/tab2746/i21575.htm>>.

⁴⁵ *China Insurance Regulatory Commission*, online: China Insurance Regulatory Commission <<http://www.circ.gov.cn/assay/index.htm>>.

reasonable operation in the altered environment.⁴⁶ Soon after its establishment, the CIRC placed amending the Insurance Law of 1995 at the top of its list of priorities. Eventually, the People's National Congress granted legislative approval to this amendment on October 28, 2002. This amendment was expected to accomplish four objectives: (i) to sustain the reform and development of China's insurance industry; (ii) to strengthen supervision and regulation of the industry; (iii) to standardize the regulation of insurance enterprises and business operations; and (iv) to fulfill pledges to adopt international practices made during the WTO accession negotiations.⁴⁷

For the purpose of balancing the rights and interests between the insured and the insurer, and facilitating prudential supervisions on insurance companies, on 28 February 2009, the Standing Committee of National People's Congress adopted the long-awaited amendments to the Insurance Law, which came into effect on October 1, 2009.⁴⁸ A number of new provisions were included and extensive amendments to existing provisions made. Compared to the Insurance Law 2002, the newly-amended version expands the rights of policyholders while imposing heavier duties on insurance companies.⁴⁹ Significant changes made in the 2009 Amendment include issues related to the insurance contract, the regulation of insurance companies, and the conduct of business. The former category includes articles pertaining to (1) the insurable interest, (2) applicants' duty to disclose misrepresentations, (3) interpretation of the policy, (4) timely notice of increased risks, (5) insurance fraud, and (6) double insurance.⁵⁰ In terms of the regulations to insurance companies, the 2009 Amendment established additional licensing criteria for the establishment of a new insurance company, and a process for the approval, fit, and requirements of directors. With respect to continuous supervision, although the list of permissible investment objects has been expanded, the CIRC has also been granted the authority to take prompt corrective action against insurance companies when necessary.⁵¹

Furthermore, Provisions on the Administration of Insurance Companies were deliberated and adopted at the chairman's executive meeting of the CIRC on September 18, 2009 to conform with and implement the newly enacted Insurance Law.⁵²

III. PRIMARY CHANGES TO INSURANCE CONTRACTS IN THE 2009 AMENDMENT

Although the 2009 Amendment retains the structure and organization of the Insurance Law of 2002 and Insurance Law of 1995, the number of articles has increased from 158 to 187 and several chapters have been renamed. This latest legislation consists of eight chapters. Chapter One covers general principles, including the purpose of the law,

⁴⁶ Guojin & Mertl, *supra* note 28, at 21.

⁴⁷ *Ibid.*

⁴⁸ *Insurance Law of PRC 2009*, online: China Insurance Regulatory Commission <<http://www.circ.gov.cn/web/site0/tab68/i94860.htm>>. Also see Xu & Li, *supra* note 1, at 22-23.

⁴⁹ Xu & Li, *ibid.*, at 24.

⁵⁰ Broad & Bright Attorney at Law, *The Second Amendment to China's Insurance Law (No. 11)*, online: Broad & Bright <[http://www.broadbright.com/en/up3/\(No.11\)The%202nd%20Amendment%20to%20China's%20Insurance%20Law.pdf](http://www.broadbright.com/en/up3/(No.11)The%202nd%20Amendment%20to%20China's%20Insurance%20Law.pdf)>.

⁵¹ Yujing Shu et. al., *Newly Amended Chinese Insurance Law*, online: K& L Gates <<http://www.klgates.com/newsstand/Detail.aspx?publication=6082>>.

⁵² *The CIRC Amended and Promulgated Provisions on the Administration of Insurance Companies*, online: China Insurance Regulatory Commission <<http://www.circ.gov.cn/web/site0/tab456/i112034.htm>>.

definitions, and the scope of the law and principles of the insurance industry.⁵³ Chapter Two provides the general rules of insurance contracts and specific rules for life insurance and property insurance contracts.⁵⁴ Chapters Three, Four and Six provide the rules and requirements of insurance company administration and supervision, including licensing, the scope of premium business management, liquidation, and continuous supervision.⁵⁵ Chapter Five gives rules for the supervision of insurance agents and brokers, while Chapter Seven describes the provisions on legal liabilities and sanctions.⁵⁶ Chapter Eight is comprised of miscellaneous provisions.⁵⁷ The following section will review the parts concerning the insurance contracts.

A. The Insurable Interest

1. The Insurable Interest Requirement

The Insurance Law of 2002 required an applicant to have an insurable interest in the insured subject matter as the prerequisite for an effective insurance contract.⁵⁸ Under it, therefore, if the applicant holds no insurable interest in the subject matter, the corresponding insurance contract will be deemed invalid.⁵⁹ Given that the old law did not distinguish insurable interest in property insurance from insurable interest in life insurance, Article 12 of the 2009 Amendment specifies that the applicant of a personal insurance⁶⁰ shall have an insurable interest in the person insured when entering into an insurance contract, and that the insured person with respect to property insurance shall have an insurable interest in the subject matter insured when the insured event occurs.⁶¹ Such a change has eliminated the confusion created by the old law according to which the party paying the premium and the party insured were not one and the same; only the contractual party who pays the premium is entitled to claim for proceeds.⁶² This argument tells only half of the story, as the original confusion should be traced back to the fundamental question – who should have the insurable interest? The purpose of property insurance is to provide no more than reimbursement for an insured because any net gain conferred by the insurer to the insured is against public policy.⁶³ This “principle of indemnity” is inseparable from the doctrine of insurable interest.⁶⁴ In property insurance, the level of the insured’s loss determines the amount of payment recoverable under the policy, so that the insured is required to have an insurable interest to prove and calculate his loss.⁶⁵ The old law requiring an applicant to have an insurable interest in the subject matter seemed to presume that the applicant bears the loss on occurrence of the risk insured. According to

⁵³ See Insurance Law of PRC 2009, *supra* note 48.

⁵⁴ *Ibid.*

⁵⁵ *Ibid.*

⁵⁶ *Ibid.*

⁵⁷ *Ibid.*

⁵⁸ *Insurance Law of PRC 2002*, art. 12 (1), online: LawInfoChina <<http://www.lawinfochina.com/Law/list.asp>>.

⁵⁹ *Ibid.*, art. 12(2).

⁶⁰ The term “personal insurance” is defined as “...[a] type of insurance which takes the life and body of human beings as the subject matter insured.” See Insurance Law of PRC 2009, *supra* note 47, art. 12(3).

⁶¹ Insurance Law of PRC 2009, *supra* note 48, art. 12 (1) & (2).

⁶² Monica Dang, *China’s new Insurance Law I* (2009), online: Lockton Inc <http://www.lockton.com/Resource/InsightPublication/976/China%20news_revised2.pdf>.

⁶³ Robert E. Keeton & Alan I. Widiss, *Insurance Law* (West Publishing Company, 1988) at 135.

⁶⁴ *Ibid.*

⁶⁵ John Lowry & Philip Rawlings, *Insurance Law: Doctrines and Principles* (Oxford: Hart Publishing, 2000) at 39.

the Insurance Law of 2002, the “applicant” is a person who signs the insurance contract with the insurer and pays the premiums.⁶⁶ The old law also regarded insurance as the payment of premiums by the applicant to the insurer; the insurer bears responsibility to indemnify the applicant in case of loss. These two definitions created an illusion that the person who signs the contract and pays the premium shall have legitimate right of insurance claim. However, under the old law, the applicant’s role was similar to that of the “insured,” because the applicant’s entitlement to claim for reimbursement was based not on his duty to pay the premium but on his possession of the insurable interest which made it possible for him to suffer the loss. The legislators attempted to solve this problem by clarifying the role of the applicant and the insured in property and life insurance respectively, and by determining who shall carry the insurable interest in both type of insurance.

Article 12 of the 2009 Amendment is similar to British and American common law, in which the insurable interest in property insurance refers to the insured’s economic relationship to the property including at least property rights,⁶⁷ contract rights,⁶⁸ and legal liabilities,⁶⁹ and insurable interest in life insurance is founded upon “the relations of parties to each other, either pecuniary or of blood or affinity, to expect some benefit or advantage from the continuance of the life of the assured.”⁷⁰ Although the 2009 Amendment’s definition of insurable interest in both property and life insurance appeared to supplant the common law definition, more problems are created by Section 5 of Article 12, which defines the insured as a person whose property, life or body is covered by an insurance contract and who is entitled to claim the insurance proceeds.⁷¹ First, the scope of insurable interest in property insurance is not sufficiently inclusive. “Property” is anything that is owned by a person or entity, including real property, which refers to any interest in land, real estate, growing plants or the improvements on it, and personal property which is everything else,⁷² the term in the 2009 Amendment does not cover property rights other than ownership, not to mention contractual rights and legal liabilities. Although scholarly writings acknowledge a variety of types of insurable interest in property insurance, given that courts in China, unlike those in common law countries, carry no law-making function, statutory laws and administrative rules serve as the source of law.⁷³ The narrowly defined insurable interest in property insurance leads to the possibility of questioning the legitimacy of using other property interests, contractual rights or liability even though nobody has yet done so. In addition, the subject matter of life insurance is unclear. The interest to be protected in a life insurance policy is the interest derived from the continuity of the life of the insured. The insured in life insurance, therefore, functions in a similar way to the subject matter in property insurance, in which the property is the object to

⁶⁶ Insurance Law of PRC 2002, *supra* note 58, art. 12 (1).

⁶⁷ *Brewster v. Michigan Millers Mutual Ins. Co.*, 274 So. 2d 213 (La. Ct. App. 1993) [stating that ownership qualifies an insurable interest].

⁶⁸ *Reid v. Hardware Mutual Ins. Co.*, 166 S.E. 2d 317 (S.C. 1969) [indicating that a mortgagor has an insurable interest on the property insured].

⁶⁹ *Clevenger v. Allstate Ins. Co.*, 505 N.W. 2d 533 (Mich. 1993) [affirming that personal pecuniary damaged caused by legal liability constitutes an insurable interest]. Also see Keeton & Widiss, *supra* note 63, at 164-167.

⁷⁰ *Warnock v. Davis*, 104 U.S. 775 at 779 (1881).

⁷¹ Insurance Law of PRC 2009, *supra* note 48, art. 12 (5).

⁷² *Law.Com Dictionary*, s.v. “property”, online: Law.Com <<http://dictionary.law.com/Default.aspx?selected=1645>>.

⁷³ Xu et. al., *supra* note 25, at 8-9.

which the insurable interest attaches.⁷⁴ For the reason that the applicant required to hold the insurable interest, pursuant to the 2009 Amendment, is the one who seeks insurance coverage against the loss of insured's life, he seems to be the person truly covered by the life insurance policy. In addition, no one expects to suffer pecuniary loss as a result of his or her own death.⁷⁵ Thus, Section 5 of Article 12 is problematic in two respects: (1) the insured having no insurable interest should not be the person "actually" covered under a life insurance policy; and (2) if the death of the insured is the risk covered by a life insurance policy, on what basis is a dead person, who by definition sustains no loss, entitled to insurance proceeds? Modern life insurance policies endow a policyholder (who could be the applicant) the right to name and change the beneficiary regardless of the identity of the primary beneficiary or the contingent beneficiary.⁷⁶ In the absence of a qualified designated beneficiary, the estate of the insured receives the proceeds.⁷⁷ At least in life insurance, the insured cannot and should not be the person to make the claim. Although Article 40 to 42 of the Insurance Law of 2009 explains that the applicant or the insured has the right to designate the beneficiary, and the entitlement of the insured's heir(s) to the insurance proceeds, there is undoubted conflict between Article 12 and these two articles.⁷⁸

2. The Time When an Insurable Interest Must Exist

While the old law was not explicit on this matter, the 2009 Amendment stipulates that the insured must have the insurable interest at the time of loss in property insurance while the applicant should have insurable interest at the time of the contract formation in life insurance.⁷⁹ Such an addition is consistent with the majority opinion in common law courts. The majority opinion of the American courts states that in order for insurance on property to be valid, an insurable interest in the property must exist at the time of the loss, since if there is no insurable interest in the property at the time of loss, then there would be no loss, due to the lack of a valid insurable interest in the property.⁸⁰ An incentive for the property's destruction would not be likely to exist if the person has an insurable interest at

⁷⁴ Keeton & Widiss, *supra* note 63, at 296.

⁷⁵ Robert Jerry II, *Understanding Insurance Law*, 2d ed. (New York: Lexis Publishing, 1996) at 250.

⁷⁶ *Ibid.* at 284.

⁷⁷ *Ibid.*

⁷⁸ See *Insurance Law of PRC 2009*, art. 40. "The insured or insurance applicant may designate one or more beneficiaries." & 42 ["After the death of the insured, under any of the following circumstances, the insurance money shall be deemed as the legacy of the insured, and the insurer shall perform the obligation of paying insurance money according to the Inheritance Law of the People's Republic of China".

⁷⁹ *Insurance Law of PRC 2009*, *supra* note 48, art. 12 (1) & (2).

⁸⁰ E.g., *Dairyland Ins. Co. v. Hawkins*, 292 F. Supp. 947 at 951 (S.D. Iowa 1968) [The court ruled that "informal arrangement between insured and his son-in-law whereby latter was to have use of insured's automobile until some future time when ownership would be transferred did not constitute a bona fide sale, and insurers could not, therefore, deny coverage on grounds that insured, who was listed as owner, had no insurable interest because automobile had been sold."]; *Ins. Co. of N. Am. v. Seaboard Homes, Inc.*, 273 N.Y.S.2d 470 at 472 (Sup. Ct. 1965) [The court pointed out that "where builder agreed with lessor that title to building which builder had constructed on lessor's land would vest in lessor if building was not removed by certain date and building was not removed by such date, title to property was in lessor and builder had no 'insurable interest' in house when house was destroyed by fire after agreed date for removal."]; *Stauder v. Associated Gen. Fire Ins. Co.*, 151 N.E.2d 583 at 585 (Ohio Ct. App. 1957)[The court ordered that "a father of minor children charged by court order with payment of money for their support subject to the further order of the court had an 'insurable interest' in the children's clothing as well as the furniture and household goods used by his divorced wife in the care, custody and control of the children so as to be entitled to maintain an action on a fire policy for the loss."].

the time of loss.⁸¹ In addition, the general rule, upheld by most American courts, declares that an insurable interest for all types of life insurance must exist only at the time the life insurance contract was formed, and the lack of any insurable interest at the time of the insured's death is irrelevant and immaterial in the absence of a contrary contractual provision or a state statute.⁸² This rule takes into consideration the possibility of the termination of the insurable interest in life insurance based either on the pecuniary interest (partnership) or family relationship (marriage).⁸³

Although the 2009 Amendment follows the majority rule of common law courts, neither section regarding the timing of the existence of the insurable is flawless. With respect to property insurance, the insurance interest must exist at the time of loss, but common law courts have never reached consensus on whether the insurable interest must exist at the time of insuring. In fact, numerous cases including the historic English case *Sadlers Company v. Badcock*,⁸⁴ have ruled that the insured must have an insurable interest in property both at the time of insuring and at the time of loss.⁸⁵ Arguments against the ruling in *Sadlers Co.* state that:

[in] most cases where the *Sadlers Co.* rule is applied, an insurable interest either exists both at the time of insuring and the time of loss, or at neither time. Thus, the confusion about the rule normally makes no practical difference in outcomes. In those cases where the rule matters, most courts have examined the rule carefully and decided only to require an insurable interest at the time of loss.⁸⁶

However, the rationale that the requirement of insurable interest in property insurance is to suppress the temptation to incur the loss insured against by using insurance as a method of wagering.⁸⁷ It seems to make more sense for the court to deny recovery to someone who has taken out a policy without interest or expectation of interest but has subsequently obtained one for the reason that the person started with wagering.⁸⁸ The

⁸¹ Jerry, *supra* note 75, at 255.

⁸² See *Conn. Mut. Life Ins. Co. v. Shaefer*, 94 U.S. 457 at 461 (1876) [“[A life insurance] policy formed in good faith, and valid at its inception, cannot not be avoided by the cessation of the insurable interest, unless such be the necessary effect of the provisions of the policy itself.”]; also see e.g. *Speroni v. Speroni*, 92 N.E.2d 63 at 66 (Ill. 1950) [“where the insurer recognizes the policy as valid and pays into court the proceeds thereof, a third person, such as the personal representative of the insured, cannot take advantage of the want of insurable interest.”]; *Secor v. Pioneer Foundry Co.*, 173 N.W.2d 780 at 782 (Mich. Ct. App. 1969) [“public policy against speculation on life of another did not prohibit husband's former employer, which had been applicant for, and owner and beneficiary of, ordinary life policy on husband, and which had paid premiums on such policy, from retaining insurance on husband after termination of employment or beyond date that first premium became due after such termination.”].

⁸³ Jerry, *supra* note 73, at 256.

⁸⁴ *Sadlers Co. v. Badcock* [1743] 26 All E.R. 733, 2 Atk. 544 [“Sadlers Co.”].

⁸⁵ Also see e.g. *Powell v. Ins. Co. of N. Am.*, 330 S.E.2d 550 at 552 (S.C. 1985) [The court ruled that “[i]n order to recover on a policy of insurance, the insured must prove an insurable interest in the property both at the time the policy is issued and becomes effective and at the time of the loss.”]; *Kingston v. Great Southwest Fire Ins. Co.*, 578 P.2d 1278 at 1279 (Utah 1978) [“The law requires an interest in insured property to exist both at the time of issuance and at the time of loss.”].

⁸⁶ Jerry, *supra* note 75, at 255.

⁸⁷ Malcom Clarke, *Policies and Perceptions of Insurance law in the Twenty-first Century* (New York: Oxford University Press, 2007) at 36; Keeton & Widiss, *supra* note 63, at 136.

⁸⁸ *Ibid.*, at 155 (quoting Edwin Patterson, *Essentials of Insurance Law*, 2d ed., (New York: McGraw-Hill, 1957) at 133.

majority rule fails to counter the danger generated from gambling and provides no additional protection for legitimate interests.⁸⁹

In addition, the premium is recognized as an insurer's consideration of taking the risk from the insured and paying the proceeds.⁹⁰ Policyholders are usually obligated to pay premiums prior the beginning of the period of coverage.⁹¹ The consideration may fail under the circumstances that the insurer assumes no risk at the time premiums are paid, because even though the insurer promised to insure against the risk of loss, the risk insured would not occur until the insured actually obtained the insurable interest which allowed him to suffer losses. Thus, during the period the insured holds no insurable interest, the insurer does not seem to have legitimate grounds to retain the premium because its promise is contingent upon the insured's acquisition of an insurable interest, which may not happen during the effective period of the contract.⁹² Given that the insurable interest is an essential element for the valuable consideration of an insured's payment of premium, requiring its existence only at the time of loss materially conflicts with the general principle of contract law.

As for life insurance, advocates of majority rule present four primary arguments. First, substantial amounts of life insurance have been marketed as investment contracts, rather than as contracts of indemnity, and the majority rule requiring an insurable interest for life insurance only at the formation of the contract facilitates the liquidity of such investments.⁹³ Second, "there apparently was, and perhaps continues to be, a strong sense of protecting the integrity of the life insurance transaction in terms of both preserving the contractual freedom of the parties and assuring the stability of the contractual commitment."⁹⁴ Third, life insurance is often purchased for the benefit of relatives and spouses, and familial relationships – such as those between parents and children – do not change with the passage of time.⁹⁵ Furthermore, though the spousal relationship may terminate in divorce, a pecuniary relationship usually survives the dissolution of the marriage, and this pecuniary relationship is sufficient to satisfy the insurable interest requirement.⁹⁶ Fourth, customarily, insurers continued to pay the full amount of the policy even when the interest had extinguished.⁹⁷ In short, life insurance "custom conquered the law," and the underlying reason for not requiring an insurable interest at the time of the insured's death was actually founded on a life insurance marketing scheme!⁹⁸

Several responses to these arguments have been presented by commentators who assert that an insurable interest in the life of another must exist both at the inception of the life insurance contract and at the time of the insured's death. First, various forms of life

⁸⁹ *Ibid.*

⁹⁰ Avery W. Katz, *Foundations of the Economic Approach to Law* (Foundation Pr, 1998) at 210. Also see Jerry, *supra* note 72, at 16.

⁹¹ Clarke, *supra* note 87, at 132; Jerry, *supra* note 75, at 510.

⁹² Clarke, *ibid.* at 133.

⁹³ Keeton & Widiss, *supra* note 63, at 152.

⁹⁴ *Ibid.*

⁹⁵ *Ibid.* at 151.

⁹⁶ Jerry, *supra* note 75, at 256.

⁹⁷ Peter N. Swisher, "The Insurable Interest Requirement for Life Insurance: A Critical Reassessment" (2005) 53 Drake L. Rev. 477 at 526 [quoting Edwin Patterson, *Essentials of Insurance Law*, 2d ed., Ralph H. Blanchard ed., (New York: McGraw-Hill Book Co., 1957) at 163.].

⁹⁸ *Ibid.*

insurance – including partnership life insurance policies, key employee life insurance policies, creditor-debtor life insurance policies, and other business-related life insurance policies – also possess important indemnity aspects.⁹⁹ Second, “a court generally does have the right, and the obligation, to review an insurance contract to determine whether or not such a contract is unconscionable or violates state public policy, including whether or not it constitutes an illegal wagering contract.”¹⁰⁰ Third, an absolute divorce generally terminates this love and affection insurable interest between ex-spouses absent other valid economic interests such as spousal support and child support obligations.¹⁰¹ In this case, the moral hazard significantly increases as the ex-spouse, who is the primary beneficiary in a pre-existing life insurance policy, may murder a former spouse in order to recover the insurance proceeds.¹⁰² This is an apparent wagering contract issue.¹⁰³

Indeed, where life insurance involves the function of indemnity, the insured can only be “put back to the position he or she would have been in had the loss not occurred.”¹⁰⁴ Since the insurable interest in indemnity insurance determines whether the insured has the expectation of loss,¹⁰⁵ it is required to exist at the time of loss, in the present case, the death of the insured. In addition, studies have revealed that being insured against the risk of being considered high risk reduces the incentive to exert preventive efforts to decrease the probability of greater risk.¹⁰⁶ A contract of wagering is unquestionably riskier than a contract with an insurable interest, the function of which is to discourage the use of insurance as a device of wagering, and to remove the incentive for the procurer of the insurance to destroy the subject matter of the insurance.¹⁰⁷ After the extinction of the insurable interest, allowing an insurance policy’s effect to continue is inconsistent the doctrine of insurable interest. In addition, the function of insurance, regardless of property or life, is risk financing through the application of the law of large numbers to achieve the goal of risk distribution.¹⁰⁸ Arguments that emphasize the petty function of investment in life insurance yet ignore the basic risk distribution function of insurance are merely confusing.

B. The Duty of Disclosure

The article governing an insured’s duty of disclosure, Article 16 of the 2009 Amendment, introduced several significant changes to the old law: (1) the scope of the duty, (2) elements of breach of the duty, (3) the incontestability provision, and (4) the return of premium after the rescission of contract.

1. The Scope of the Duty of Disclosure

⁹⁹ *Ibid.* at 525.

¹⁰⁰ *Ibid.* at 526.

¹⁰¹ *Ibid.* at 525.

¹⁰² *Ibid.*

¹⁰³ *Ibid.*

¹⁰⁴ Lawry & Rawlings, *supra* note 65, at 179.

¹⁰⁵ Clarke, *supra* note 87, at 32.

¹⁰⁶ Renaud Bourles, *Moral Hazard in Dynamic Insurance, Classification and Prepayment 2* (2009), online: European Center for Advanced Research in Economics and Statistics <<http://www.ecares.org/ecaresdocuments/ws/summerschool2009/papers/bourles.pdf>>.

¹⁰⁷ Jerry, *supra* note 75, at 236.

¹⁰⁸ Emmett J. Vaughan & Therese Vaughan, *Fundamentals of Risk and Insurance*, 9th ed. (Hoboken, New Jersey: Wiley, 2003).

With regard to the scope of the duty, the old law provided that the insurer may raise inquiries on matters concerning the subject matter of insurance or the insured, and the insured is obliged to make true representations.¹⁰⁹ The 2009 Amendment limited the scope of insured's duty by stating that "where the insurer makes any inquiry about the subject matter or about the insured when entering into an insurance contract, the insurance applicant shall tell the truth."¹¹⁰ The amendment unequivocally confined the insured's duty of making true representation to the inquiries posed by the insurer, and the insured bore the duty only until the formation of contract.¹¹¹

The new law imposing only the duty of true representation per the insurer's questions omitted the insured's duty to disclose facts material to the determination of the insurability and the risk. In fact, the terms "non-disclosure" and "misrepresentation" are distinguishable under British and American common law. While the former usually refers to situations where incorrect and misleading answers have been given to questions posed of the applicant for insurance, the latter describes a situation where no answer has been volunteered to the insurer because no specific question was asked.¹¹² Considering that the purpose of the duty of disclosure, based on the implied duty of utmost good faith, is to assist the insurer in its risk assessment, the duty of disclosure should continue throughout the negotiation, at least until the contract has been completed.¹¹³ To illustrate, the duty of disclosure applies to negotiations proceeding conclusion of the contract, and full disclosure of any material fact affecting the risk in question should be made up to the time when a binding contract is concluded.¹¹⁴ Therefore, an insured is required to advise the insurer of such matters that he knows might influence the insurer in accepting or declining the risk, at least where such facts are not a matter of record and not discoverable by the insurer.¹¹⁵ Even though a true representation is made in an application, it is the insured's duty to maintain its truthfulness until the delivery of the policy, and he must therefore use due diligence to communicate to the insurer facts materially affecting the risk which arise after the application has been made but before the contract is formed.¹¹⁶ Hence, the 2009 Amendment, which lightened an insured's duty of disclosure, may result in an insurer's poor risk classification, ultimately leading to adverse selection.¹¹⁷ It also creates the possibility that, once the truth is exposed, an applicant might conceal or misrepresent material risks at the time of application and contend that risks at issue arose only after the application. Such a scenario is inconsistent with the principle of utmost good faith.¹¹⁸

¹⁰⁹ Insurance Law of PRC 2002, *supra* note 58, art. 17 (1).

¹¹⁰ Insurance Law of PRC 2009, *supra* note 48, art. 16 (1).

¹¹¹ Dingfu Wu, *Zhonghua Renminggoheguo Baoxianfa Shiyi* [The Explanation of the Insurance Law of the People's Republic of China] (2009) at 44.

¹¹² Ray Hodgkin, *Insurance Law* (Oxon: Routledge-Cavendish, 1998) at 173.

¹¹³ Semin Park, *The Duty of Disclosure in Insurance Contract* (Boston: Dartmouth Publishing Group, 1996) at 59.

¹¹⁴ *Ibid.*

¹¹⁵ *Pioneer Nat'l Title Ins. Co. v. Lucas*, 382 A.2d. 933 at 936 (N.J. Super. 1978).

¹¹⁶ E.g. *United Saving Life Ins. Co. v. Coulson*, 560 S.W. 2d. 211, 215 (Tex. Civ. App. 1977); *MacKenize v. Prudential Ins. Co. of Am.* 411 F.2d 781 (6th Cir. 1969).

¹¹⁷ For details, see Scott E. Harrington & Gregory R. Niehaus, *Risk Management and Insurance* (New York: McGraw-Hill, 1999) at 115-119.

¹¹⁸ The rationale of the application of the doctrine of utmost good faith is that "[i]nsurance is a contract of speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the assured only; the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge to mislead the underwriter into a belief that the circumstance does not exist... Good faith forbids either party, by concealing what he privately knows, to draw the other into a bargain from his ignorance of the fact, and his believing the

2. Elements of Breach of the Duty

The old law was clear on the elements of breach of the duty of disclosure. According to the old law, three situations that constituted breach are: (1) the insured intentionally concealing facts; (2) the insured refusing to perform the duty of true representations; or (3) the insured failing to fulfill the duty of true representations due to negligence.¹¹⁹ The Insurance Law of 2002 also specified that breach can only be sustained where the violation is sufficient to affect the insurer from making the decision of whether or not to agree to insure or increase the premium.¹²⁰ Although the 2009 Amendment retains most parts of this section, it further restricts breaches to failing to make true representations “intentionally or [through] gross negligence.”¹²¹ It also explicitly restricts the insurer’s right to rescind the contract should the insurer be aware of the truth of the insured’s misrepresentation.¹²²

In the U.S., three conditions must be met to constitute misrepresentation: (1) the representation must be untrue; (2) the information is material either to the insurer’s decision to insure or to the terms of the insurance contract; and (3) the insurer actually relies on the incorrect information.¹²³ Compared to the 2009 Amendment, except for the similarity in defining materiality, the U.S. does not regard the insured’s intention as irrelevant in sustaining the misrepresentation. For the purpose of reducing the insured’s burden of disclosure, the 2009 Amendment excludes the untrue statement made due to negligence from the scope of “misrepresentation” regardless of the materiality of the statement to the risk assessment.¹²⁴ Such an arrangement is not entirely without grounds, as in the U.S. a few courts have ruled that an applicant for insurance cannot willfully intend to deceive a potential insurer unless it actually, not constructively, knows that what it misrepresents is untrue.¹²⁵ However, most courts still approve insurers’ defense to coverage if the misrepresentation is material despite the intention of the insured or the applicant.¹²⁶ Given that the purpose of imposing upon the insured the duty of disclosure is

contrary.” Lawry & Rawlings, *supra* note 65, at 73-74 [quoting *Carter v. Boehm* (1766), 3 Burr 1905 at 1909].

¹¹⁹ Insurance Law of PRC 2002, *supra* note 58, art. 17 (2).

¹²⁰ *Ibid.*

¹²¹ Insurance Law of PRC 2009, *supra* note 48, art. 16 (2).

¹²² Insurance Law of PRC 2009, *supra* note 48, art. 16 (6).

¹²³ See e.g. *Crawford v. Standard Ins. Co.*, 621 P.2d 583, 586 (Or. App. 1980) [“An insurer may show it approved the policy in the ordinary course of business which, when coupled with proof that the application contains false representations but for which the insurer would not have issued the policy and the insurer’s legal right to rely on the application information, is sufficient to make out prima facie the element of reasonable reliance.”] Also see Jerry, *supra* note 73, at 682.

¹²⁴ Wu, *supra* note 111, at 45.

¹²⁵ E.g. *Parsaie v. United Olympic Life Ins. Co.* 29 F3d 219 at 221 (5th Cir. 1994) [“a cause of action for breach of the duty of good faith and fair dealing exists when the insurer wrongfully cancels an insurance policy without a reasonable basis.”]; *Kuhns v. N.Y. Life Ins. Co.* 147 A. 76, 77 (Pa. 1929) [“[A] forfeiture [of insurance contract] does not follow where there has been no deliberate intent to deceive, and the known falsity of the answer is not affirmatively shown.”]. Also see Keeton & Widiss, *supra* note 63, at 573.

¹²⁶ See e.g. *Bankers Life & Cas. Co. v. Long*, 266 S.2d 780 at 782 (La. Ct. App. 1972) [“Insurance companies are entitled to candid and truthful answers, and when such candor is withheld and involves matters material to the risk, no just complaint can be raised, when, in after investigations, the falsity is discovered and the policies issued in reliance upon the truthfulness of the statements, are avoided.”]; *Elfstrom v. N.Y. Life Ins. Co.*, 432 P.2d 731 at 739 (Cal. 1967) [An insurer of a group insurance, despite the knowledge of the employer may avoid a policy where the employee misrepresents material facts in the application to the employer acting as the agent of the insurer.]

to ensure the accuracy of a prudent insurer's decision in computing the risk to be undertaken, information pertaining to a proposed risk must be disclosed by an insured to allow an insurer to assess the risk properly.¹²⁷ Therefore, so long as the information is sufficient to affect the insurer's decision in the existence of insurability, the risk classification and the premium associated with the level of risk, the untruth of such information will result in adverse selection and subsidization which may ultimately discourage ordinary people from using insurance as a tool of risk management.¹²⁸ Whether the misrepresentation is intentional or unintentional makes no difference in the potentiality of this negative effect.

If the central philosophy of the 2009 Amendment on the insured's duty of disclosure is to mitigate the insured's responsibility in misrepresentation, it makes sense that the 2009 Amendment includes a section regarding the insurer's waiver of the right to rescind the contract. For the insurer to avoid the coverage, courts in the U.S. require the insurer to prove that its reliance was reasonable.¹²⁹ Where an insurer investigates and learns the true facts before issuing the policy, there will obviously be no reliance on the original information in issuing the policy.¹³⁰ It is not uncommon for the insured to be urged to undergo a medical examination by a physician designated by the insurer in applying for life insurance, in particular so that health conditions inconsistent with insured's disclosure may be discovered. Not all insured persons are medical professionals. The addition of the "reliance" element eliminates the possibility of an insurer relying on misrepresentation if he knows the truth of the misrepresented statement.¹³¹ Section 6 of new Article 16, which serves the same function as the reliance element, is therefore admirable.

3. The Incontestability Provision

The third change the 2009 Amendment made to the duty of disclosure is the addition of the incontestability provision. The new Section 3 of Article 16 provides that the insurer's right to rescind the contract upon an insured's misrepresentation shall be cancelled at least 30 days from the day when the insurer knows the cause of rescission, or at least two years from the day when an insurance contract is formed.¹³² In the U.S., the incontestability clause is acknowledged:

[to] give the insurance company an adequate window of time in which to investigate an application for life insurance so as to discover any material misrepresentation on the part of the applicant. It also protects the insured from having to defend against a possibly specious challenge long after acquisition of the policy. Thus, by requiring prompt investigation of statements made in an insurance application, the clause furthers the public policy of denying protection to those who make fraudulent claims. The "during the lifetime" wording is part of that public policy. If the insured dies of a

¹²⁷ Poh Chu Chai, *General Insurance Law* (Singapore: LexisNexis, 2009) at 68.

¹²⁸ Harrington & Niehaus, *supra* note 117, at 118.

¹²⁹ See e.g. *State Farm Auto. Ins. Co. v. Price*, 396 N.E.2d 134, 136 (Ind. 1979) [The court held that "[The insurer] had no notice that the information obtained from the insured was false; therefore it was entitled to rely on this information in issuing its policy and had no duty to investigate the truthfulness of the application. Only where the insurer has sufficient information to give rise to a reason to doubt the representations made is there an obligation to investigate or make further inquiry."]

¹³⁰ Jerry, *supra* note 73, at 690.

¹³¹ *Ibid.* at 691.

¹³² Insurance Law of PRC 2009, *supra* note 48, art. 16 (3).

serious illness a short time after obtaining a life insurance policy, the insurance company should be permitted to investigate in contemplation of a challenge.¹³³

The 2009 Amendment prevents the insurer from lulling the insured into a false sense of security for the purpose of receiving premiums and postponing the issue, possibly until after the death of the insured.

4. Return of Premium After the Rescission of Contract

Both the 2009 amendment and the Insurance Law of 2002 endowed the insurer with the right to rescind the contract when the applicant makes an untrue misrepresentation, either intentionally or as a result of gross negligence. Sections 3 and 4 of the 2009 Amendment set out the insurer's right to retain insurance premiums after rescission. The new law mandates that the insurer shall not refund the insurance premium, where the insurance applicant intentionally failed to perform the obligation of making true representations, but shall refund the insurance premium where the applicant violated his obligation due to gross negligence.¹³⁴ As for the rationale of not returning the premiums, commentators in China explain that the purpose of withholding the refund is to punish the dishonest applicant, which resembles punitive damages.¹³⁵ This argument is completely unpersuasive. First, "punitive damages are money damages awarded to a plaintiff in a private civil action, in addition to and apart from compensatory damages, assessed against a defendant guilty of flagrantly violating the plaintiff's rights."¹³⁶ They are most commonly awarded in tort litigation, particularly in product liability litigation.¹³⁷ As punitive damages are, in a real sense, "quasi-criminal"¹³⁸, and are imposed mostly upon enterprises, it is a false analogy to make a comparison to the "confiscated premium" resulting from the insured's misrepresentation to an insurer's single inquiry. Second, if the insured's misrepresentation of material facts, either intentionally or through gross negligence, has an equally adverse impact on the insurer's risk assessment, what is the rationale for permitting the refund under the gross-negligence circumstance? The argument praising this provision has failed to answer this question.

In fact, "an insured is basically entitled to a return of premium where there has been a total failure of consideration."¹³⁹ The common law rule required a refund of the insurance premium in the event of prospective cancellation and of the entire policy in the event of rescission.¹⁴⁰ As rescinding a contract renders a contract void *ab initio*,¹⁴¹ the

¹³³ *Crow v. Capitol Bankers Life Ins. Co.*, 891 P.2d 1206 at 1212 (N.M. 1995).

¹³⁴ Insurance Law of PRC 2009, *supra* note 48, art. 16 (3) & (4).

¹³⁵ Xu & Li, *supra* note 1, at 103.

¹³⁶ David G. Owen, "Punitive Damages Overview: Functions, Problems and Reform" (1994) 39 Vill. L. Rev. 363 at 364.

¹³⁷ *Ibid.* at 371.

¹³⁸ *Ibid.* at 366.

¹³⁹ John Birds, *Modern Insurance Law*, 7th ed. (UK: Sweet & Maxwell, 2007) [citing *Tyrie v. Fletcher* (1777) 2 Cowp 666].

¹⁴⁰ See e.g. *Dairyland Ins. Co. v. Kammerer*, 327 N.W.2d 618, 620 (Neb. 1982) ["An insurer is precluded from asserting a forfeiture where, after acquiring knowledge of the facts constituting a breach of condition, it has retained the unearned portion of the premium or has failed to return or tender it back with reasonable promptness, especially where the nature of the breach or ground for forfeiture is of such character as to render the policy void from its inception."].

¹⁴¹ *FindLaw Legal Dictionary*, s.v. "rescind", online: FindLaw <<http://dictionary.lp.findlaw.com/scripts/results.pl?co=dictionary.lp.findlaw.com&topic=df/df4db4a79b5c7693653a03843f012af6>>.

insurer would assume no obligation for paying the proceeds as if the contract was never formed. The insurer suffers no detriment for retaining the premiums and the consideration, therefore, fails. The 2009 Amendment's permission for the insurer to "confiscate" the premiums after the rescission of contract violates the general rule of contract law.

C. The Interpretation of Contract

1. Interpretation in Favour of the Insured

Before the enactment of the 2009 Amendment, in interpreting insurance contracts, Article 31 of the Insurance Law of 2002 provided that disputes as to the meaning of terms or clauses should be construed in favor of the insured and beneficiary.¹⁴² Although Article 31 appears to conform to the principles of the ambiguity doctrine¹⁴³ in spirit, the legislation proves problematic. Article 31, sweeping in scope, grants uniformly favorable interpretation to insured persons or beneficiaries without recognizing that ambiguity exists. As a result, a clause or term is automatically construed against the insurer in situations where no ambiguity exists. Certainly, Article 31 is to the advantage of the insured or the beneficiary. However, where the insured or beneficiary is obviously in the wrong, this law is applied, appearing unfair to the insurer while granting a windfall to the insured. Having noticed such a loophole, legislators, in drafting the 2009 Amendment, attempted to seal it by imposing the conditions under which it could be applied, by giving the clear definitions of the term "ambiguity." Article 30 of the new law states that where there is any dispute between the insurer and the applicant, the insured or the beneficiary, over any clause of an insurance contract entered into by using the standard clauses of the insurer, the clause shall be interpreted as commonly understood.¹⁴⁴ Furthermore, where two parties attach different interpretations to a clause, it should be interpreted in favor of the insured and the beneficiary.¹⁴⁵

Both limiting the application of the ambiguity rule to the standardized policy form (adhesion contract) and defining the ambiguity by providing a literal description¹⁴⁶ undoubtedly made the interpretation rule in the Insurance Law of 2009 more reasonable and consistent with the international standards.¹⁴⁷ However, the 2009 Amendment fails to address the insured's reasonable expectation. Although in some cases, the reasonable expectation doctrine applies when an ambiguity exists,¹⁴⁸ the doctrine also functions as a

¹⁴² Insurance Law of PRC 2002, *supra* note 58, art. 31.

¹⁴³ When a contract is deemed "adhesive," courts are more active in policing the bargain to counterbalance the potential detriment to the weaker parties so that all ambiguities should be construed against the insurer. Insurers who tailor sophisticated wordings in the policy must bear the burden of any resulting confusion. See *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599 at 602 (2nd Cir. 1947). Also see Keeton & Widiss, *supra* note 62, at 628; Birds, *supra* note 138, at 228 [citing *English v. Western* [1940] 2 K.B. 156].

¹⁴⁴ Insurance Law of PRC 2009, *supra* note 48, art. 30 (1).

¹⁴⁵ Insurance Law of PRC 2009, *supra* note 48, art. 30 (2).

¹⁴⁶ The term "ambiguity" in contract law is generally defined as "an expression has been used in an instrument of writing which may be understood in more than one sense." See *The Lectric Law Library*, s.v. "ambiguity", online: The Lectric Law Library <<http://www.lectlaw.com/def/a188.htm>>.

¹⁴⁷ Wu, *supra* note 111, at 80-81.

¹⁴⁸ See e.g. *Allstate Ins. Co. v. Ellison*, 757 F.2d. 1042 at 1044 (9th Cir. 1985) ["The court will not artificially create ambiguity where none exists. *Id.* (applying California law). If a reasonable interpretation favors the insurer and any other interpretation would be strained, no compulsion exists to torture or twist the language of the policy...Coverage will also be found if the insured can demonstrate

rule of interpretation where the principle of resolving ambiguities in a contract against the drafter is not an adequate explanation for the coverage issues in which there is no ambiguity.¹⁴⁹ Insurance contracts should provide the coverage that either the insured reasonably believed was being purchased or that a reasonable person in the place of the insured would expect after reading the policy.¹⁵⁰ Once the doctrine is applied, (1) an insurer will be denied any unconscionable advantage in an insurance transaction; and (2) the objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.¹⁵¹ Commentators have provided three solid bases in support of the application of reasonable expectation:

[T]he marketing approaches employed for most kinds of insurance ordinarily do not even allow a purchaser to examine a copy of an insurance policy until after the contract has been completed. In life insurance transaction, for example, the purchaser usually does not see the insurance policy terms until after the application has been submitted, the first premium has been paid, the insurance company has decided to approve the application, and the company has issued the policy... It is appropriate to protect expectations which result from the marketing practices of the insurer – that is, actual or reasonable expectations which differ from the coverage provisions – that are derived from events or acts which were attributable either to the actions of persons in the field representing the insurer in the marketing transaction or persons at a management center that directs the operations of the insurance company.¹⁵²

Therefore, to correct the unequal bargaining power between the insurer and the individual insured, it is suggested that the doctrine of reasonable expectation should be introduced.

Furthermore, as indicated in Article 30 of the 2009 Amendment, when disputes not involving ambiguity occur, the clause shall be interpreted as “commonly understood.”¹⁵³ What exactly is “common understanding”? Whose common understanding is it? The insurer’s or the insured’s? If it refers to the insured’s common understanding, is it based on the particular insured’s subjective standard or reasonable insured’s objective standard? If it means the insurer’s common understanding, how can its contradiction with the ambiguity rule be reconciled? All these questions remain unanswered even by commentators in China.¹⁵⁴ The following rules apply to the interpretation of an insurance contract:

Rule1: Words are to be understood in their ordinary sense as they would be understood by ordinary people...Rule 2: In the event of inconsistency in the ordinary

through extrinsic evidence that its expectation of coverage was based on specific facts which make its expectations reasonable.”]; *Auto-Owners Ins. Co. v. Jensen*, 667 F.2d 714 at 721 (8th Cir. 1981) [“The doctrine [of reasonable expectation] only applies to situations where an ambiguity exists in the insurance policy.”].

¹⁴⁹ Keeton & Widiss, *supra* note 63, at 630-631.

¹⁵⁰ Jerry, *supra* note 75, at 141-142.

¹⁵¹ Robert E. Keeton, “Insurance Law Rights At Variance With Policy Provisions” (1970) 83 Harv. L. Rev. 961 at 967.

¹⁵² Keeton & Widiss, *supra* note 63, at 634-635.

¹⁵³ Insurance Law of PRC 2009, *supra* note 48, art. 30 (1).

¹⁵⁴ See Wu, *supra* note 111, at 79; Xu & Li, *supra* note 1, at 103.

meaning of words in different parts of the contract, the court prefers the meaning that best reflects the intention of the parties... Rule 3: If it appears that the words have been used in a special sense...the words will be interpreted in that special sense. Rule 4: If, in spite of the application of Rule 1 and 2, the meaning of the words is not clear, and Rule 3 is of no assistance...the words will be construed *contra proferentem*, that is, against the insurer and liberally in favor of policyholders.¹⁵⁵

Besides the ambiguity rule, incorporating these rules into Article 30 of the current Insurance Law would establish a more unequivocal, systematic and complete interpretation of the insurance contract in comparison to the present “common understanding” rule.

2. The “Control of Content” Rule

The 2009 Amendment also received the rule commonly applied in Civil Law countries called “the control of the contractual content.”¹⁵⁶ The newly promulgated Article 19 provides that “the following clauses in an insurance contract using the standard clauses of the insurer shall be null and void: (1) a clause exempting the insurer from any legal obligation or aggravating the liability of the insurance applicant or insurant; and (2) a clause excluding any legal right of the insurance applicant, insurant or beneficiary.”¹⁵⁷ This article resembles Germany’s *Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen, AGB-Gesetz* (Standard Contract Terms Act), Section 9 of which provides that:

(1) Provisions in standard contract terms are void if they unreasonably disadvantage the contractual partner of the user contrary to the requirements of good faith. (2) In case of doubt, a provision is unreasonably disadvantageous if (i) this provision is irreconcilable with essential basic principles of the statutory provisions from which the terms deviate, or (2) essential rights or duties arising from the nature of the contract are restricted to a degree which jeopardizes the purpose of the contract being attained.¹⁵⁸

While this paper is not a critique of German law, the issue associated with the addition of Article 19 in the Insurance Law of 2009 is the harmonization between Article 19 and Article 30, that is to say, the harmonization between the Common Law and Civil Law. It is possible that a term may be deemed ambiguous and simultaneously place the insured in an unreasonably disadvantageous position. In that case, if the court follows the ambiguity rule, it is the court’s duty to interpret the contractual terms in favor of the insured, but if the court simply applies the “control of the contractual content rule,” no further interpretation seems to be necessary. This trick incurs the possibility of the regulatory arbitrage within the court system. Thus, further rules clarifying the conditions under which an article applies are needed.

3. The Insurer’s Duty to Explain the Contract

¹⁵⁵ Clarke, *supra* note 87, at 140.

¹⁵⁶ Chao-Guo Jiang, *Bao Xian Fa Gi Chu Li Lun* [The Fundamental Theories of Insurance Law] (1996) at 39.

¹⁵⁷ Insurance Law of PRC 2009, *supra* note 48, art. 19.

¹⁵⁸ *German Standard Contract Terms Act*, Sec. 9, online: IUSCOMP <<http://www.iuscomp.org/gla/statutes/AGBG.htm>>.

The insurer's duty to explain the contract was also included in the 2009 Amendment. The new law requires the insurer to explain the contents of the contract to the applicant if standard clauses are used.¹⁵⁹ For those clauses exempting the insurer from liability in the insurance contract, the insurer shall sufficiently warn the applicant of clauses relieving the insurer's obligations in the application form, the insurance policy or any other insurance certificate, and expressly explain the contents of such clauses to the applicant in writing or verbally.¹⁶⁰ The insurer's failure to make such warning or explanation will invalidate those clauses.¹⁶¹

In the U.S., the majority of courts have ruled that the insurer bears no affirmative duty to explain the policy or its exclusions to the insured if the terms in an insurance policy are clear, unambiguous, and explicit.¹⁶² Arguments affirming the insurer's duty to explain the policy reason that the doctrine of reasonable expectations can operate to impose *de facto* a duty on the insurer to explain the policy's coverage to the insured.¹⁶³ In *Bowler v. Fidelity and Casualty Co. of New York*,¹⁶⁴ the court ruled that:

Insurance policies are contracts of the utmost good faith and must be administered and performed as such by the insurer. Good faith 'demands that the insurer deal with laymen as laymen and not as experts in the subtleties of law and underwriting. In all insurance contracts, particularly where the language expressing the extent of the coverage may be deceptive to the ordinary layman, there is an implied covenant of good faith and fair dealing that the insurer will not do anything to injure the right of its policyholder to receive the benefits of his contract. This covenant goes deeper than the mere surface of the writing. When a loss occurs which because of its expertise the insurer knows or should know is within the coverage, and the dealings between the parties reasonably put the company on notice that the insured relies upon its integrity, fairness and honesty of purpose, and expects his right to payment to be considered, the obligation to deal with him takes on the highest burden of good faith. In situations where a layman might give the controlling language of the policy a more restrictive interpretation than the insurer knows the courts have given it and as a result the uninformed insured might be inclined to be quiescent about the disregard or non-payment of his claim and not to press it in timely fashion, the company cannot ignore its obligation. It cannot hide behind the insured's ignorance of the law; it cannot conceal its liability. In these circumstances it has the duty to speak and disclose, and to act in accordance with its contractual undertaking. The slightest evidence of deception or overreaching will bar reliance upon time limitations for prosecution of the claim.¹⁶⁵

¹⁵⁹ Insurance Law of PRC 2009, *supra* note 48, art. 17(1).

¹⁶⁰ Insurance Law of PRC 2009, *supra* note 48, art. 17(2).

¹⁶¹ *Ibid.*

¹⁶² See e.g. *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563 at 567 (Pa. 1983) ["where policy limitation relied upon by insurer to deny coverage under a policy of liability insurance was clearly worded and conspicuously displayed, insured could not avoid consequences of that limitation by proof that it failed to read the limitation or that it did not understand it."]; *Realin v. State Farm Fire and Cas. Co.*, 418 So.2d 431 at 432 (Fla. Dist. Ct. App. 1982) ["An insurer has no duty to explain uninsured motorist coverage to an insurance applicant unless asked"].

¹⁶³ Jerry, *supra* note 75, at 185.

¹⁶⁴ 250 A.2d. 580 (1969).

¹⁶⁵ *Ibid.* at 587-588.

Observing the practice, insurance policies are typically long and complicated documents which insurers realize most policyholders will not even read, much less study.¹⁶⁶ In addition, numerous insurance policies cannot be understood without detailed analysis, and often not even an extended consideration of terms would fully reveal to an insured the precise scope of coverage and meaning of the limitations or restrictions embedded in a particular policy.¹⁶⁷ Even in the case where the insured does attempt to analyze the policy, and has only limited expertise of law and insurance theory, it is very likely that the insured will become frustrated. For these reasons, in China's relatively young insurance market, where insurance purchasers do not have extensive experience in this matter, it is better to retain the insurer's duty to explain the policy in its insurance law. The 2009 Amendment is a step in the right direction.

D. Double Insurance

Double insurance used to be governed by Article 41 of the Insurance Law of 2002. When the insured insures the same subject matter with two or more insurers, and with the same insurable interest and the same risks, the insured is carrying double insurance.¹⁶⁸ The insured is obligated to notify each insurer of the other insurance policies.¹⁶⁹ If the sum of the amount insured under all contracts exceeds the value of the subject matter, the sum of proceeds paid by all insurers shall not exceed such value.¹⁷⁰ Unless otherwise provided, each insurer shall only share the loss on a pro-rata basis.¹⁷¹ The 2009 Amendment has two additions: (1) it limits the application of double insurance provision only to the situation where the sum of the amount insured exceed the value of the subject matter; and (2), based on the pro-rata contribution provision, the insured is entitled to claim from each insurer the refund of premiums paid in exchange for the protection exceeding the value of the subject matter.¹⁷²

While the second change meets the doctrine of consideration, the first change is not consistent with the principle of indemnity, which indicates that the amount recovered be commensurate with the amount lost.¹⁷³ Even in the case of underinsurance, when the insured suffers only a partial loss, unjust enrichment may still occur. For example, suppose that insurance companies A, B and C insure Mr. X's sedan, valued at \$10,000, for \$3,000, \$2,000, and \$1,000, respectively. If the car is damaged in an accident and the repairs cost \$1,000, without Mr. X notifying all the insurers, he might successfully claim \$1,000 compensation from each insurer, because insurers A, B and C have no knowledge of existence of the other policies insuring the same car, not to mention the fact that Mr. X might have intentionally damaged the car.

If, pursuant to the new law, the insured still bore the duty of notification, what would be the consequence of violation? The imposition of this duty would be a deterrent to people who overinsure their property in order to destroy or damage it, and then collect on each of the insurance policies.¹⁷⁴ Under British law, courts tended to approve the

¹⁶⁶ Keeton & Widiss, *supra* note 63, at 634.

¹⁶⁷ *Ibid.*

¹⁶⁸ Insurance Law of PRC 2002, *supra* note 58, art. 41(3).

¹⁶⁹ *Ibid.* art. 41(1).

¹⁷⁰ *Ibid.* art. 41(2).

¹⁷¹ *Ibid.*

¹⁷² Insurance Law of PRC 2009, *supra* note 48, art. 56 (3) & (4).

¹⁷³ Hodgin, *supra* note 111, at 28.

¹⁷⁴ Keeton & Widiss, *supra* note 63, at 259.

forfeiture clause which requires the insured to notify the insurer if he is carrying double insurance during the life of a policy, and the sanction for non-disclosure will be forfeiture or cancellation of the policy.¹⁷⁵ In the U.S., courts generally agree with insurers that when additional insurance is purchased for an insured property without permission from the insurer who has already insured the property, it increases the likelihood that such property might be intentionally destroyed, especially when the property is over-insured, in order to recover the proceeds.¹⁷⁶ The drafters of insurance policies have designed an “escape clause” with the goal of eliminating all liability under the insurance policy when the insured has purchased additional insurance policies without the permission of the first insurer.¹⁷⁷ Escape clauses in property insurance policies are often upheld.¹⁷⁸ Without the legal consequence imposed on the person breaching his duty, it seems unlikely that the article will effectively implement the principle of indemnity and thus prevent unjust enrichment. Thus, it is suggested that insured’s right to forfeit the insurance policy be added to future amendments of Article 56 of the Insurance Law of 2009.

E. Insurance Fraud

The 2009 Amendment retained most of the old law’s provisions related to insurance fraud, including the section regulating the insurer’s immunity from paying the proceeds when, after the occurrence of an insured incident, the applicant, the insured or the beneficiary fabricated the cause of incident or overstated the amount of losses by forging or altering the certificates, materials or other evidence.¹⁷⁹ It also elaborated the fraud provision by providing that where the insured or the beneficiary files a claim by intentionally deceiving the insurer about the occurrence, the insurer shall have the right to rescind the contract and keep the premiums.¹⁸⁰ Despite the objective of this article – to penalize the insured or the beneficiaries who have used deception to claim for payments from the insurer¹⁸¹ – it is flawed in two respects. First, in the case of life insurance where only one of the several designated primary beneficiaries committed fraud, conferring upon the insurer the right to rescind the contract violates the rule that where the beneficiary intentionally caused the death of the insured, regardless of his disqualification, “the proceeds go to any remaining primary beneficiaries, or, if there are none, to designated contingent beneficiaries.”¹⁸² Second, in phrasing this article, legislators failed to consider the divisibility of the insurance coverage. Under the general rule of contract law,

¹⁷⁵ E.g. *Steadfast Ins. Co. Ltd. v. F & B Trading Co. Pty. Ltd.* (1972), 46 A.L.J.R. 10. Also see *Birds*, *supra* note 138, at 345-346.

¹⁷⁶ Keeton & Widiss, *supra* note 63, at 259-260.

¹⁷⁷ *Ibid.* at 259.

¹⁷⁸ See e.g. *O’Leary v. Merchants’ & Bankers Mutual Ins. Co.*, 66 N.W. 175 at 176 (Iowa 1898) [holding that an insurance company has the right to write in the contract the escape clause as that its liability consequent upon a change in the contract, shall be in writing.]; *Zimmerman v. Insurance Co.*, 42 N.W. 462 (Iowa 1889); *Kirkman v. Insurance Co.*, 57 N.W. 952 (Iowa 1894); *Hankins v. Insurance Co.*, 35 N.W. 34 (Wis. 1887) [“When the assured has accepted a policy containing a clause prohibiting the waiver of any of its provisions [including the escape clause] by the local agent, he is bound by such inhibition, and that any subsequently attempted waiver, merely by virtue of such agency, is a nullity.”]; *Cleaver v. Trader’s Insurance Co.* 32 N.W. 660 at 663 (Mich. 1887) [“The holder of the policy is estopped, by accepting the policy, from setting up or relying upon powers in the agent in opposition to limitations and restrictions in the policy”].

¹⁷⁹ Insurance Law of PRC 2009, *supra* note 48, art. 27 (3); Insurance Law of PRC 2002, *supra* note 58, art. 28 (3).

¹⁸⁰ Insurance Law of PRC 2009, *supra* note 48, art. 27 (1).

¹⁸¹ Wu, *supra* note 111, at 70-71.

¹⁸² Jerry, *supra* note 75, at 297 [citing *Lee v. Aylward*, 790 S.W.2d 462 (Mo. 1990)].

If the performances to be exchanged under an exchange of promises can be apportioned into corresponding pairs of part performances so that the parts of each pair are properly regarded as agreed equivalents, a party's performance of his part of such a pair has the same effect on the other's duties to render performance of the agreed equivalent as it would have if only that pair of performances had been promised.¹⁸³

Under this logic, the insured's breach of one portion of an insurance contract will not deprive the insured of the full measure of the insurer's promised performance unless the contract is indivisible.¹⁸⁴ Thus, if, for example, a policy covers three perils and collects three premiums (e.g. an automobile policy that has collision, comprehensive loss, and the liability coverage), "the insured is considered to own three different policies for three different perils even though the coverage is stated within the parameters of one written contract."¹⁸⁵ Therefore, under the premise that multiple perils contained in the single contract in issue are divisible, the insurer's right to rescind the contract, voiding the entire contract, is more properly restricted only to the part of the coverage directly related to the fraud; otherwise there might not be grounds to invalidate the untainted part of the contract.

IV. UNFINISHED BUSINESS – WHAT STILL REMAINS TO BE DONE?

The 2009 Amendment has addressed many issues that the Insurance Law of 2002 ignored, especially the efforts to achieve a higher level of consumer protection and a more solid corporate governance mechanism of insurance companies. Nevertheless, some problems associated with the Insurance Law of 2002 were not dealt with in the 2009 Amendment. The discussion in the next section will reveal these shortcomings.

A. The Structure of Legislation

The Insurance Law of 2002 and the 2009 Amendment combine two types of law: insurance contract law (civil legislation), and the laws regarding insurance supervision and administration (administrative law). "In the societies that obey the notion of the rule of law, it is theoretically and conceptually necessary to maintain a distinct separation between civil and administrative legislation."¹⁸⁶ In fact, many of the world's leading insurance markets, such as Germany and Japan, utilize dual statutes: one regulates contractual transactions and the other regulates government administration in the marketplace.¹⁸⁷ Under insurance law, "the issue is to clearly and carefully separate matters better dealt with through contractual agreements of mutual consensus from matters appropriately governed by administrative mediation."¹⁸⁸ Separate "legislation will [serve to] protect insurance participants' rights from being arbitrarily subjected to inappropriate administrative power."¹⁸⁹ Furthermore, the use of separate statutes to address contractual and administrative aspects functions such that an amendment made to one part may not affect the other. "This practice maintains the continuity and stability of the law as a whole,

¹⁸³ *Restatement of the Law, Second, Contracts*, § 240 (1981).

¹⁸⁴ Jerry, *supra* note 75, at 714.

¹⁸⁵ *Id.*, at 714-715.

¹⁸⁶ Guojin & Mertl, *supra* note 30, at 23.

¹⁸⁷ For details, see online: Financial Services Agency <<http://www.fsa.go.jp/common/about/syosyou.pdf>>.

¹⁸⁸ Guojin & Mertl, *supra* note 30, at 23.

¹⁸⁹ *Ibid.*

and minimizes disruption to the balance between flexibility and consistency built into the overall regulatory system."¹⁹⁰

B. Insurance Contract

1. Classification of Insurance Contracts

The 2009 Amendment retains the structure of the old law, which categorized insurance contracts into property insurance and personal insurance.¹⁹¹ While such a classification is not technically wrong, it is inaccurate under the principle of indemnity. Generally, in an insurance contract in which the principle of indemnity applies, the insurer agrees to indemnify the insured for the actual loss suffered on the occurrence of a particular incident. This is recognized as a “contract of indemnity.”¹⁹² Conversely, a contingency policy refers to an insurance contract in which the insurer, on the occurrence of a particular incident, promises to pay a fixed sum determined not by an estimate of the loss suffered but by the amount of cover agreed in the insurance contract.¹⁹³ An indemnity policy that also includes the insurer’s promise to pay hospital bills in a personal accident policy or a health insurance policy is still considered personal insurance, according to the Insurance Law of PRC.¹⁹⁴ Pursuant to the present Insurance Law, rules derived from the principle of indemnity, namely the rule regulating double insurance, the insurer’s right of subrogation and the rule banning overinsurance, are all applicable only to “property insurance policies.”¹⁹⁵ The confusion arises when determining whether such rules apply to policies of personal insurance which, in fact, are indemnity contracts. If the answer is negative, the principle of indemnity does not seem to have been completely executed, and such a problem could lead to cases of unjust enrichment by taking advantage of this loophole. In order to extinguish the insured’s incentive to take advantage of such a legislative flaw, insurance contracts must be re-categorized as indemnity contracts and contingency contracts in a timely manner.

2. The Insurer’s Right of Subrogation

With regard to the insurer’s right of subrogation, both the Insurance Law of 2002 and the 2009 Amendment grant the insurer a right, after having indemnified the insured, to subrogate the insured’s claim for indemnity against the third party who incurred the loss, up to the amount of the amount of proceeds paid.¹⁹⁶ The insurer’s right of subrogation, under the Insurance Law, shall not prejudice the insured’s claim against the third party for the portion of losses not indemnified by the insurer.¹⁹⁷ Compared to the British or American Common Law, Chinese law should be supplemented in at least three respects.

First, because subrogation rights are not independent rights which insurers can exercise against the wrongdoer, the insurer, after making the indemnity, is entitled only to

¹⁹⁰ *Ibid.*

¹⁹¹ See generally Insurance Law of PRC 2009, *supra* note 47.

¹⁹² Lowry & Rawlings, *supra* note 65, at 14-15.

¹⁹³ Clarke, *supra* note 87, at 140.

¹⁹⁴ Insurance Law of PRC 2009, *supra* note 48, art. 46.

¹⁹⁵ See Insurance Law of PRC 2009, *supra* note 47, art. 55, 56 & 60.

¹⁹⁶ Insurance Law of PRC 2009, *supra* note 48, art. 60 (1); Insurance Law of PRC 2002, *supra* note 58, art. 45 (1).

¹⁹⁷ Insurance Law of PRC 2009, *supra* note 48, art. 60 (3); Insurance Law of PRC 2002, *supra* note 58, art. 45 (3).

use the means by which the insured might have protected himself against or reimbursed himself for the loss.¹⁹⁸ That means the insurer who steps into the shoes of the insured has no more rights than the insured, and cannot take actions which the insured could not have undertaken.¹⁹⁹ Thus, subrogation comes into operation when the insured has a legally enforceable right against a party who caused the loss, including any tortfeasors and the party breaching the contract, and the law gives the insured rights of compensation.²⁰⁰ The insurer generally is not entitled to be subrogated to rights that may exist as a consequence of a liability claim against its own insured person.²⁰¹ Article 59 has expanded the scope of insurer's right of subrogation to every "third party who incurred the loss" regardless of whether those third parties are liable for the insured's damage or are involved due to their relationship with the insured (i.e. employer-employee, spouse). Confusion may arise because of its overly broad reach.

Second, although the current law prohibits the insurer, in executing his right of subrogation, from interfering with the insured's claim against the third party for the portion of losses not indemnified, it remains unclear whether the insurer's right of subrogation can only be activated after the insured's indemnification is completed. In the U.S, if the insurer has paid only a portion of the amount that it is required to pay in accordance with the policy, the insured has not been indemnified in full for the loss and the insurer is not entitled to be subrogated to the insurer's rights.²⁰² Even when the insurer pays the insured the full amount under the insurance contract, if the sum paid is insufficient to indemnify the insured for his losses, the insurer may still have no right of subrogation.²⁰³ The rationale for such rules is simple – a subrogation right before the insured's receipt of full indemnification would make the insurer a competitor with the insured for the remainder of the tortfeasor's payment.²⁰⁴ Therefore, it is necessary to clarify this wording.

Finally, nothing in the current law deals with the insured's interference with an insurer's right of subrogation, especially when a settlement between the third party and the insured has prejudiced that right.²⁰⁵ Common law rules indicate that the insured's act of releasing the third party after a loss without the insurer's consent, though effective to the insurer, is an interference with the insurer's right of subrogation.²⁰⁶ Therefore, any compromise between the insured and the tortfeasor will discharge the insured's obligations to the insured under the contract and the insurer is entitled to the return of any payments already made to the insured.²⁰⁷ This rule should also be added to the subrogation clause.

3. Issues Associated with Various Types of Insurance

The 2009 Amendment concerning the insurance contract concentrates only on general principle. Except for two simple articles dealing specially with issues in liability insurance contracts – the third party's right to file a direct claim against the liability insurer

¹⁹⁸ *Simpson v. Thomson* (1877) 3 App. Cas. 279 at 284.

¹⁹⁹ Hodgin, *supra* note 112, at 563-564.

²⁰⁰ *Ibid.* at 564.

²⁰¹ Keeton & Widiss, *supra* note 63, at 221; Birds, *supra* note 139, at 321.

²⁰² E.g. *Baillio v. Western Cas. & Sur. Co.*, 189 So. 2d 605 (La. Ct. App. 1966).

²⁰³ E.g. *Capps v. Klebs*, 382 N.E. 2d 947 (Ind. Ct. App. 1978).

²⁰⁴ Jerry, *supra* note 75, at 606.

²⁰⁵ Poh, *supra* note 127, at 580.

²⁰⁶ Birds, *supra* note 139, at 319.

²⁰⁷ Compare *Ankney v. Franch*, 652 A.2d 1138 at 1145 (Md. Ct. App. 1995).

and insurer's duty to defense – no other parts of the current law arose from a particular type of contract, such as accident policies, auto insurance, annuities, surety bonds, fidelity bonds, or group insurance. In a civil law country like China, the primary source of law is the legal code.²⁰⁸ The fact that most laws are codified in statutory form is considered the most significant distinction between a civil law and a common law system, in which judge-made law established in court decisions predominates.²⁰⁹ Hence, incorporating issues associated with different types of insurance contract into the statutory law is another essential step toward a perfect insurance code in China.

V. CONCLUSION

With respect to the portion related to insurance contracts, the 2009 Amendment has improved the protection of policyholders while stressing the obligations of both parties derived from the duty of utmost good faith.²¹⁰ The Amendment has also strengthened the risk management mechanism and reinforced the safety and soundness associated with insurance. Through changes to almost every article in the Insurance Law of 2002, the new law has not only clarified several questions associated with insurance contracts under the old law – such as issues related to insurable interests, the insured's duty of disclosure and double insurance – but has also established a more solid system for prudential supervision.

Since the modern insurance law regime of PRC was not established until 1995, expecting the Insurance Law of PRC and related regulations to be perfected through the addition of two amendments in 2002 and 2009 is unrealistic. This paper has tried to suggest ways in which the Insurance Law of PRC could be further improved by offering critiques of the present law and proposing future amendments with respect to insurance contracts and insurance regulations. The current Insurance Law of PRC still needs to address several issues related to insurance contracts, including the definition and status of the insured in the life insurance; the time when a insurable interest must exist; the scope of the insured's duty of disclosure, the return of premium issue associated with the rescission of the contract; the divisibility issue in the case of insurance fraud; the categorization of insurance contracts in accordance with the principle of indemnity; and the "full indemnity" standard in insurer's right of subrogation.

²⁰⁸ Von B. Sharon Byrd, *Einführung in die anglo-amerikanische Rechtssprache [Introduction to Anglo-American Law and Language]* (Auflage, 1997) at 3.

²⁰⁹ For details, see Alan B. Morrison et. al., *Fundamentals of American law* (Oxford: Oxford University Press, 1999) at 10-14.

²¹⁰ Wu, *supra* note 111, at 2.