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Dr Wang Feng

Post-Doctoral Fellow, Centre for Maritime Law, Faculty of Law, NUS

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The Insured's Duty of Disclosure under Chinese Insurance Law

Dr Wang Feng^{*}

Two and a half centuries ago, Lord Mansfield delivered the judgment of *Carter v Boehm*, which is one of the most well-known cases in English law. Since then, the duty of disclosure has become one of the most significant obligations of the insured. During the past 250 years, the development of English law on this particular issue has been truly extraordinary. Various kinds of detailed and practical principles have been laid down by the English courts. In addition, most recently, after a thorough review progress undertaken by the English and Scottish Law Commissions, the Insurance Act 2015 (UK) came into force in August 2016, and parts of the outdated duty of disclosure principles have been replaced by this new Act.

As the origin of modern insurance law, it is an undebatable fact that English law has also had an influence on Chinese law that cannot be ignored. This paper will first explore the insured's duty of disclosure under Chinese law in detail. Secondly, the criticisms of current Chinese insurance law will be discussed. In particular, in light of the reforms in English law, what are our reasonable expectations of new developments in Chinese insurance law?

Keywords: insurance law, China, duty of disclosure, good faith.

^{*} Post-Doctoral Fellow, Centre for Maritime Law, Faculty of Law, National University of Singapore.

A contract of insurance is a contract based on utmost good faith, and this principle is not unique to English law. In Chinese law, there are basically two statutes which impose the duty of good faith on the insured. Article 6 of the Contract Law of the People's Republic of China (PRC) ('PRC Contract Law') states: 'The parties shall observe the principle of honesty and good faith in exercising their rights and performing their obligations.'¹ Article 5 of the Insurance Law of the PRC ('PRC Insurance Law') further emphasizes: 'The parties to insurance activities shall follow the principle of good faith in their exercise of rights and performance of obligations.'²

However, both of these regulations are fundamental principles in Chinese law. This means that they are basically guiding principles, making it difficult for a judge to come to a judgment based solely upon them. Moreover, these two principles can only be used when more detailed regulations are unavailable. Therefore, in this paper, the more detailed regulations of the insured's pre-contractual duty will be introduced and discussion will be confined to the duty of disclosure only.

1 Duty of disclosure: an introduction to Chinese law

The duty of disclosure (or the informative obligation) is the foundation of an insurance contract. This is one of the most important pre-contractual duties of the insured. The informative obligation in Chinese law can generally be summarized as follows: the person who should perform this obligation shall disclose details which relate to the subject matter of the insured to the insurer.

The meaning of this legal provision is not completely clear. The main question it presents is, who will be responsible for disclosure to the insurer? This issue is currently under debate in China. In English insurance law, there is no such concept. According to Article 16 of the PRC Insurance Law, this obligation only applies to the insurance applicant. The meaning of

¹ Contract Law of the People's Republic of China (Promulgated by Order No 15 of the President of the People's Republic of China on 15 March 1999, in force 1 October 1999), art 6.

² Insurance Law of the People's Republic of China (2015 Amendment) (Promulgated by Order no 26 of the President of the People's Republic of China on 24 April 2015), art 5.

‘insurance applicant’ according to Chinese law is ‘a person who enters into an insurance contract with an insurer and performs the obligation of paying an insurance premium under the insurance contract’.³ Therefore, according to this explanation, an insurance applicant can be a broker (as in English law); it also can be a relative of the insured (as in the situation of personal or death insurance); and, according to Article 12 of the PRC Insurance Law, the applicant can be the insured itself.⁴ Therefore, the parameters of the duty of disclosure would definitely extend to the insured, although the law itself seems ambiguous on this.

The main law of the insured’s pre-contractual duty can be found in Article 16 of the PRC Insurance Law. Paragraph 1 of this Article states: ‘Where the insurer inquires about the subject matter insured or about the insured when entering into an insurance contract, the insurance applicant shall tell the truth.’⁵ It can easily be concluded that the insurance applicant’s obligation of disclosure is only confined to the facts that the insurer would like to know. Interpretation II of the Supreme People’s Court on Several Issues concerning the Application of the Insurance Law of the PRC (‘Interpretation II’) further clarifies: ‘An insurance applicant’s obligation of disclosure is limited to the extent and content of inquiries from the insurer’.⁶ In English law, the insured has two obligations. The first is the representation duty, and the second is the duty of disclosure. The representation duty is similar to the informative obligation in Chinese law; however, there is no initiative duty of disclosure in Chinese law, even though the information may be clearly known by the insurance applicants.⁷

However, these rules are different for marine insurance. In marine insurance cases, the insurance contract is concluded between the insured and the insurer. This means there are no insurance applicants in Chinese marine insurance law. Furthermore, according to Chinese

³ PRC Insurance Law (n 2) art 10.

⁴ Ibid, art 12 which states that: ‘An “insured” means a person whose property, life or body is covered by an insurance contract and who is entitled to claim the insurance money. An insurance applicant may be the insured.’

⁵ Ibid, art 16 para 1.

⁶ Interpretation II of the Supreme People’s Court on Several Issues concerning the Application of the Insurance Law of the People’s Republic of China (Adopted at the 1577th Session of the Judicial Committee of the Supreme People’s Court on 6 May 2013, issued on 31 May 2013, in force 8 June 2013), art 6.

⁷ Ibid, art 5.

maritime law, the insured shall truthfully inform the insurer about material circumstances (which the insured has knowledge of, or ought to have knowledge of) in its ordinary business practices that may have a bearing on the insurer's decisions regarding the premium or the decision whether to insure. The insured need not inform the insurer of facts (which the insurer has knowledge of, or ought to have knowledge of, in ordinary business practice) if the insurer makes no inquiry.⁸ Thus, the duty of the contractual parties for an insurance contract is reversed in marine insurance cases.

The reason behind this difference is that people who purchase ordinary insurance (such as life insurance or health insurance) are not experts in this field. As such, it can be quite difficult for them to determine what kind of information is most relevant to the insurer. Rather, it would be more just for the burden to fall to insurers to ask those questions that most concern them.⁹ In the case of business insurance (such as marine insurance), the insured normally participates in the practice and is readily aware of the details of its business. The insurer cannot fully know and understand every single ship that will be insured. Therefore, the insured bears the burden of disclosure in this case.

In contrast, under general insurance law, not only are the insured's obligations delimited by the insurer's questions, but the insurer also has the obligation to explain any general terms and conditions in the questionnaire of the insurance application form to the insured (or the insurer should insert specific information to explain general terms and conditions). Otherwise, the insurer cannot request rescission of a contract on the ground that the insurance applicant has breached the obligation of faithful disclosure.¹⁰

The purpose of this legal provision is quite clear: to prevent the insurer from shifting its obligation to the insured. In the case of non-business insurance, it is the insurer who has the professional knowledge to decide which information the insurance company needs to know. Therefore, a general term without any specific information requires that the insured decides

⁸ Maritime Law of the People's Republic of China (Promulgated by Order No 64 of the President of the People's Republic of China on 7 November 1992, in force 1 July 1993), art 222.

⁹ This scenario is similar to consumer insurance in English law; however, there is no such concept in Chinese law.

¹⁰ Interpretation II (n 6), art 6.

which information it should disclose. For example, a contract term in a life insurance questionnaire that states: 'Please disclose any other diseases you have' places the burden on the insured to determine which types of diseases the insurer would care about the most. This undermines the intent of Article 16 of the PRC Insurance Law, which states that, in a non-business insurance contract, it is the insurer rather than the insured who must decide which information to ask.

However, one important issue stems from Article 6 of Interpretation II: how broad will the specific information in the general terms be? Will the insured be responsible for any questions in the general terms which may not even relate to the insured's risk? In addition, will the insurer successfully fulfil the obligation to ask for disclosure by inserting any kinds of specific terms?

Currently, academics in China hold the view that Interpretation II may, in fact, not serve its intended function. This legal provision was supposed to protect the legislative intent of Article 16 of the PRC Insurance Law, but it may entitle the insurer to abuse this right when asking questions. However, the specific information cannot be random information; it must relate to the risk of the insurance policy, and the insured's liability will be restricted only to the answers of the questions under the general term. Therefore, the insurer cannot discharge its liability based on any information beyond the questionnaire.¹¹ From a practical point of view, Chinese courts will not exempt the insurer's obligation simply because specific terms have been inserted. In most cases, Chinese courts will still require the insurer to explain any specific terms that have been inserted, or at least require that these terms have been brought to the insured's attention. For that reason, very few insurers have relied on Article 6 of Interpretation II to exclude their responsibility to pay.¹²

¹¹ Ma Ning, 'The Reconstruction of the Duty of Disclosure in Insurance Law' (2014) 1 Political Science and Law 58.

¹² According to 15 recent cases, which were decided in 2015, not a single insurance company has successfully relied upon art 6 of Interpretation II (n 6) to exclude its liability. See <http://www.pkulaw.cn.libproxy1.nus.edu.sg/CLink_form.aspx?Gid=202336&Tiao=6&km=pfnl&subkm=0&db=pfnl> accessed 10 March 2017.

2 Parameters of the informative obligation

As in English law, insurance applicants in Chinese law need only to disclose material facts. However, there is no clear definition of 'material facts' in Chinese insurance law. Article 16 paragraph 2 of the PRC Insurance Law states: 'Where the insurance applicant fails to perform the obligation of telling the truth as prescribed in the preceding paragraph intentionally or for gross negligence, affecting the insurer's decision on whether to underwrite the insurance or raise the insurance premium, the insurer shall have the right to rescind the insurance contract.'¹³ Therefore, according to this legal principle, material facts should be considered information that may affect the insurer's decision to underwrite the insurance or raise the insurance premium.

There are three issues that arise from Article 16 paragraph 2. First, the insured is not liable to disclose every material fact that may influence the insurer's decision. The insured is only responsible for any non-disclosure which is either intentional or which results from gross negligence. Second, the phrase 'gross negligence' indicates that the insured needs to disclose those facts which a normal and reasonable person ought to know.¹⁴ The third issue regards the criteria for determining whether a fact is material. In other words, how does the court decide whether an insurer would have accepted the insurance risk upon another condition if the truth had been told? This question has also been a subject of debate in English law.

Clearly, Chinese law governing this issue does not follow the position of English law as evidenced in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*. In this case, it was held that 'the appropriate test is whether the matter would have been taken into account by the prudent insurer when assessing the risk; it is not necessary to show that the matter would have had a decisive influence on the prudent insurer'.¹⁵ With regard to the

¹³ PRC Insurance Law (n 2), art 16 para 2.

¹⁴ Normally, in Chinese law, gross negligence by the insured leading to the omission of facts in its insurance application is taken legally to be equivalent to the intentional omission of facts. However, there is a debate in academia that these two scenarios should be distinguished. See also Cai Dashun, 'Reconstruction of the Legal Duty of Gross Negligence on Insurance Law' [2016] 3 Political Science and Law 116.

¹⁵ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501.

materiality test, English law does not require a decisive influence on the insurer. However, under Chinese law, material facts need to influence the insurer's decision. Moreover, in English law, there is also a requirement that the underwriter should have been induced to make the contract by the material non-disclosure or misrepresentation. In contrast, there is no test of inducement in Chinese insurance law. The insurer does not need to prove that it has taken the risk based on the insured's false statements. Under Chinese law, the insurer only needs to prove that it would not have taken the risk — or that it would have taken the risk, but on different terms — had the truth been told by the insured.

Thus, Chinese law with regard to this issue is more problematic than English law and is clearly more subjective.¹⁶ However, academic articles as well as judicial reports and statutory instruments indicate that no inducement test is required under Chinese insurance law. The reason for this position is that the insured does not have the duty to initiate the disclosure of material facts. The insured only needs to disclose material facts based on the insurer's inquiries.¹⁷ As such, the inquiries of the insurer are vital to the formation of the insurance contract. So, if the insured intentionally or negligently misrepresents material facts, the insurer's right to form a contract has been repudiated at the moment that the insured filled in the form with the concealment, and there is no need to wait for the insurer to enter into the contract.

Clearly, not all information known by the insured needs to be disclosed to the insurer. Therefore, the parameters of disclosure under Chinese insurance law are worthy of discussion.

The first issue for consideration (as mentioned above) is that the insured does not need to disclose all facts that may influence the insurer's decision. The insured is only responsible for intentional and grossly negligent non-disclosure.

¹⁶ Under English law, the inducement test is seen as a protection to the assured. See *Arnould's Law of Marine Insurance and Average* (18th edn, Sweet and Maxwell 2013) para 15-66.

¹⁷ This is not the case in marine insurance. The position in marine insurance law has been discussed above. The position in English consumer insurance law has also been changed, which will be discussed below.

The second issue is that the insured also needs to disclose those facts which a reasonable insured should know. According to Article 5 of Interpretation II, '[w]hen an insurance contract is entered into, the information known by the insurance applicant regarding the subject matter of insurance or the insured shall be the information that the insurance applicant "shall truthfully disclose" as mentioned in paragraph 1 of Article 16 of the Insurance Law'.¹⁸ However, the facts known to the insured should be construed as to include that knowledge which can easily be acquired by the insured. There are no clear authorities on this; however, it is evident that, if the insured is allowed to ignore facts which can easily be ascertained, that would undermine the foundation of the insurance contract, which is a contract of good faith. In addition, this imbalance of information between the insurer and the insured still exists today. Under Chinese law, the insurer can acquire the insured's information through the use of inquiry forms. However, this does not justify an argument that, in circumstances where the inquiry forms fail to ask certain questions, the insured is entitled to conceal material facts which can easily be acquired by the insured, especially information that is unfavourable to the insured.

The third issue is what should be the guiding principle when determining whether a fact is material. The traditional position in English law regarding material facts is evident in *Pan Atlantic*. The difficulty, as has been observed by the English Law Commission, is that of 'an insured who gave incomplete or inaccurate information having their policy avoided even though they honestly and reasonably believed that the information omitted or mis-stated was of no importance to the insurer'.¹⁹ Therefore, in order to deal with this ambiguity, in the Consumer Insurance (Disclosure and Representations) Act 2012 (UK), English law adopted the same test as in the Australian Insurance Contracts Act 1984 (Cth), which is known as a reasonable insured test. According to this test, the insured has a duty to make certain disclosures to the insurer before the relevant contract of insurance is entered into. The insured must disclose every matter that is known to the insured that might be relevant to the insurer's decision regarding whether to accept the risk, and if so, on what terms, and

¹⁸ Interpretation II (n 6), art 5.

¹⁹ Law Commission and Scottish Law Commission, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (Law Com CP No 182, Scot Law Com CP No 134, 2007) para 2.31.

also must disclose matters which a reasonable person in the circumstances is expected to know to be a matter relevant to the risk.²⁰

However, this test does not deal with the basic principles of Chinese insurance law. As can be seen from the analysis above, under current English and Australian law, the insured has the obligation to voluntarily disclose. However, under Chinese law, the insured has no such duty. Furthermore, under Chinese law, the insured is only liable for non-disclosure based on intentional or gross negligence. Therefore, if the insured has reason to believe that the undisclosed fact is not important to the insurer, it would be very difficult for the insurer to prove that the insured's decision was intentionally made to conceal material facts from the insurer. As such, under current circumstances, Chinese law should still follow English law (prior to 2012): that is, the principle to decide material fact should be an objective one and it is not for the insured to decide whether the undisclosed fact is relevant to the decision of insurer. Moreover, this is also the position of the Principles of European Insurance Contract Law ('PEICL').²¹ Under Article 2:103(b) of the PEICL, the insured shall not be liable for 'information which should have been disclosed or information inaccurately supplied, which was not material to a reasonable insurer's decision to enter into the contract at all, or to do so on the agreed terms'. Therefore, the position of Chinese law on this issue is quite clear.

The last point under discussion regarding the issue of material facts is that there are some facts that do not need to be disclosed by the insured under Chinese law. Article 16 paragraph 6 of the PRC Insurance Law states: 'Where the insurer knows the truth which the insurance applicant fails to tell when they enter into an insurance contract, the insurer shall not rescind the contract.' This rule is obviously a general one; however, more specific rules can be deduced from it. The first exception scenario is where the insurer fails to ask questions which are material. Clearly, according to the fundamental principles of Chinese insurance law, the insured cannot be liable for the insurer's omission. The second scenario is a fact which the insurer knows or should have known. The purpose of the duty of disclosure is to help the insurer to assess the risk of the subject matter that is being insured due to the

²⁰ Insurance Contracts Act 1984 (Cth), s 21(1).

²¹ For the authorised English text of the PEICL, see <<https://www.uibk.ac.at/zivilrecht/forschung/evip/restatement/sprachfassungen/peicl-en.pdf>> accessed 11 March 2017.

information imbalance between the insured and the insurer. If the insurer already knows the information regarding subject matter about the insured, then there is no need for the insured to disclose additional information to the insurer. This also includes information that the insurer should have known.

A possible problem may arise in this scenario: if the insurer asks questions which relate to the information which should have been known by the insurer, does the insured still need to respond? There are currently two arguments on this point. The first argument is based on the wording of the statute and holds that the insured should still answer the questions which should have been known by the insurer. However, the second argument holds that the aim of the statute is to assist insurers, so that they have the information they need to assess risk. Therefore, there is no need for the insured to disclose more than the insurer's demands. In light of this purposive interpretation, the second argument is more reasonable. The intent of the statute needs to be protected. Furthermore, if the first argument was valid, it would entitle the insurer to abuse its right by asking questions that do not relate to the insured's risk.

The third exception of the disclosure rule is as follows: where the insured fails to answer particular questions, which are raised by the insurer clearly or in sufficient detail, and the insurer fails to make further enquires on such particular issues, the insurer cannot later raise the failure of disclosure by the insured as a defence. This is a common rule in countries governed by Civil Law and Common Law. For instance, the Australian Insurance Contract Act 1984 (Cth) states that '[w]here a person: (a) failed to answer; or (b) gave an obviously incomplete or irrelevant answer to; a question included in a proposal form about a matter, the insurer shall be deemed to have waived compliance with the duty of disclosure in relation to the matter'.²² The rationale for such a legal provision is that, in today's insurance industry, the insurer mainly relies on the standard form insurance contract, and it is clear that the questions on the standard form contract are the same regardless of the insured seeking to insure its unique risk. Therefore, if the insurer fails to ask particular questions with regard to the insured's particular interest, it should be considered that the insurer has

²² Insurance Contracts Act 1984 (Cth), s 21(3).

waived its right to ask for further information that could be material to the insurer, and not blame the insured for this. Furthermore, standard insurance policies may fail to cover unique questions for a particular insured, and may also include questions which the insured is unable to answer, or questions which have no relation to the insured's risk. Then, similarly, the insured would not be responsible for this information either.

The last exception is as follows: if the insurer waives its right to obtain more information from the insured, then clearly the insured will be relieved from its duty to make further disclosure. The insurer can expressly waive its right to do so. Scenarios such as the insurer's agency filling in the form wrongfully for the insured or falsely inducing the insured into non-disclosure will also amount to such waiver.

3 Consequences of the insured's violation of its responsibility of disclosure

The consequences of the insured's violation of its duty of disclosure can be found in paragraphs 4 and 5 of Article 16 of the PRC Insurance Law, which provide as follows: 'Where the insurance applicant intentionally fails to perform the obligation of telling the truth, the insurer shall not be liable for paying indemnity or insurance benefits for an insured incident which occurs before the contract is rescinded, and shall not refund the insurance premium';²³ and 'Where the insurance applicant fails to perform the obligation of telling the truth for gross negligence, materially affecting the occurrence of an insured incident, the insurer shall not be liable for paying indemnity or insurance benefits for an insured incident which occurs before the contract is rescinded, but shall refund the insurance premium.'²⁴ As can be seen from these two paragraphs and also from the earlier analysis, there are three kinds of violations under Chinese law: the first violation results from the insured's gross negligence, the second violation is when the insured commits non-disclosure intentionally, and the third violation occurs in circumstances due to the insured's general negligence and for non-blameworthy reasons.

²³ PRC Insurance Law (n 2), art 16 para 4.

²⁴ Ibid, art 16 para 5.

In order to understand these two legal provisions more clearly, the first thing which needs to be defined is what amounts to gross negligence. What are the differences between gross negligence and general negligence under Chinese law? Under Chinese statutes, there is no clear definition of gross negligence. There is no clear definition of gross negligence in academic research. In Civil Law, general negligence means that the tortfeasor has no intention to commit such tortious actions; the tortfeasor only fails to exercise due care as required by the statute. However, gross negligence means that the tortfeasor knows, or should have known, that its actions could be harmful to others and nevertheless continues on that path. Therefore, compared to general negligence, gross negligence is closer to intentionality. Hence the punishment of the insured under gross negligence is more severe.²⁵

However, one aspect that can be distinguished from intentionality is that the grossly negligent tortfeasor does not have the intention to achieve the consequence of deceiving the insurer. Another point of difference between intentionality and gross negligence is that, in order to sustain an intentional breach, no serious consequence would be needed. Proof of the insured's intention alone is enough. However, for a cause of action based on gross negligence to be sustained, guilty intention alone is not enough. A serious consequence must result from such negligence.

Therefore, accordingly, gross negligence under insurance law can be defined as occurring when the insured fails, due to its negligence, to disclose material facts that it should disclose to the insurer, when the facts are known or should have been known by the insured, despite having no intention of fraud. Intentionality under insurance law occurs when the insured intentionally conceals facts which should be disclosed to the insurer, or the insured deliberately makes false statements to mislead the insurer.

The difference between intentional non-disclosure and fraud is quite blurred. Under Civil Law, the notion of fraud is clear; fraud occurs when, subjectively, the insured intentionally

²⁵ See *ibid*, art 16: gross negligence entitles the insurer to rescind the contract, the same consequence as attaches to intentionality.

commits a fraudulent action and induces the insurer to act on such fraudulent information. The scenario of intentional non-disclosure is that, subjectively, the insured has the intention to conceal material facts from the insurer in order to obtain the insurance policy or to enter into the policy on better terms. Therefore, it is clear that, in both circumstances the insured has committed an action without good faith and the insurer has acted accordingly. Thus, from this point of view, intentional non-disclosure by the insured should be considered as fraud under Chinese law.

Regarding intentional violations of disclosure rules, there is general agreement in both Civil Law and Common Law countries that the insurer will be entitled to rescind the contract, while not being liable for any losses under the insurance policy and being entitled to keep the premium.²⁶ It is clear that Chinese law has similar rules. There was an academic debate in Chinese law regarding whether a causal link was required between non-disclosure and its corresponding loss. However, the majority view is that no such link would be needed in the circumstances of non-disclosure.²⁷ It is commonly agreed that this rule exists for the purpose of deterrence.

Due to the severe consequences of breaching the duty of disclosure, two issues may arise. The first issue is whether the insurer can vary the terms of contract after the insurer discovers the non-disclosure of the insured, instead of just rescinding the contract. For this question, there is no clear indication in Chinese insurance law as to whether this is possible. However, according to the principle of free construction of contract, the insurer clearly has the right to do so, provided that the contract is neither a non-revocable contract according to Article 54 of the PRC Contract Law,²⁸ nor a null and void contract under Article 52.²⁹ Moreover, in circumstances where the non-disclosure of the insured only affects the

²⁶ PRC Insurance Law (n 2), art 16 para 2.

²⁷ Ma Ning (n 11).

²⁸ 'A party shall have the right to request the people's court or an arbitration institution to modify or revoke the following contracts: (1) those concluded as a result of significant misconception; (2) those that are obviously unfair at the time the contract was concluded.'

²⁹ 'A contract shall be null and void under any of the following circumstances: (1) a contract is concluded through the use of fraud or coercion by one party to damage the interests of the State; (2) malicious collusion is conducted to damage the interests of the State, a collective or a third party; (3) an illegitimate purpose is concealed under the guise of legitimate acts; (4) damaging the public interests; (5) violating the compulsory provisions of laws and administrative regulations.'

premium of the insurance policy, it would seem too severe for the insured to allow the insurer to terminate the insurance contract solely because of this. Hence, the insurer may choose not to terminate the contract. The first reason for such a scenario is that, as a known general rule, the insurer can only collect its premium until the termination of the contract; the insurer cannot collect its premium for the unperformed part of contract.³⁰ Therefore, after assessing the risk after full disclosure by the insured, the insurer might prefer to take the risk on different terms in order to obtain the premium. Secondly, according to the freedom of construction of contract, the law should not prohibit an insurer from making a decision that may favour the insured. Therefore, Chinese law should adopt the principle described in Article 2:102(1) of the PEICL, which states that, '[w]hen the policyholder is in breach of Article 2:101, subject to paras. 2 to 5, the insurer shall be entitled to propose a reasonable variation of the contract or to terminate the contract'.³¹ Currently, there is no equivalent in Chinese law; however, Article 8 of Interpretation II states that, '[w]here an insurer does not exercise its right to rescind a contract, and directly refuses to make compensation on the ground that there exists any of the circumstances as prescribed in paragraphs 4 and 5 of Article 16 of the Insurance Law, the people's court shall not support such a refusal'.³² Therefore, clearly, the violation of the rule of disclosure by the insured in Chinese law cannot automatically result in the termination of contract by the insurer. It only means that the contractual parties have the option to vary the contract.

The second issue is whether the insurer can choose to revoke the contract by alleging that the insured is in violation of Article 54 of the PRC Contract Law³³ rather than rely on the remedies that have been provided in the PRC Insurance Law. There are currently two arguments that can be made regarding this. The first argument is that the constitutive requirements, namely, the intention of the law and the consequences of violation of the

³⁰ Which is known as no risk no premium, as indicated by PRC Insurance Law (n 2), art 54: 'Where the insurance applicant requires rescission of the contract before the insurance liability commences, it shall pay a commission charge to the insurer as agreed upon in the contract, and the insurer shall refund the insurance premium. Where the insurance applicant requires rescission of the contract after the insurance liability commences, the insurer shall refund the insurance premium to the insurance applicant after deducting the receivable part from the day of commencement of insurance liability to the day of contract rescission, as agreed upon in the contract.'

³¹ PEICL, art 2:102(b).

³² Interpretation II (n 6), art 8.

³³ See n 28 above.

rule of disclosure in the insurance contract and the misrepresentation rule in contract law are distinct. Therefore, there is no contradiction between these two rules. Therefore, the insurer can rely on both principles to justify rescinding the contract or terminating the contract. The second argument is that the rule of disclosure in insurance law is the application of general contract law rules in an insurance contract. Therefore, according to the general principle that the application of particular rules should enjoy priority over general rules, the insurer can only rely on the remedies that have been provided in insurance law. However, bizarre consequences may result if the second argument is used. The reason for these bizarre consequences is that paragraph 3 of Article 16 of the PRC Insurance Law states that '[t]he right to rescind an insurance contract as prescribed in the preceding paragraph shall be annulled 30 days after the insurer knows the cause of rescission. Two years after an insurance contract is concluded, the insurer may not rescind the contract; and where an insured incident occurs, the insurer shall pay indemnity or insurance benefits'.³⁴ Therefore, if the insurer can only rely on remedies under insurance law to rescind the contract, the insured may abuse its right under paragraph 3 of Article 16. For instance, if the insured commits a fraud and induces the insurer to enter into a contract, and if the insurer can find out the fraud promptly and terminate the contract, the insured will lose its right to claim back the premiums that have been paid to the insurer. However, if the insurer only discovers the fraud two years later, the insurer is still liable for the payment of losses. Therefore, clearly the second argument is not appropriate, as it will undermine the deterrence of fraud in insurance law.

Thus, the first argument should be used, and under the circumstances where the insurer cannot rely on Article 16 of the PRC Insurance Law to terminate the contract, the insurer should be entitled to use Article 54 of the PRC Contract Law to revoke the contract. In addition, there is no need to worry that the insurer may abuse its right under Article 54 of the PRC Contract Law, because according to Article 7 of Interpretation II, '[w]here, after an insurance contract is established, an insurer knows or should have known that the insurance applicant fails to perform the obligation of truthful disclosure, but still collects premiums, if

³⁴ PRC Insurance Law (n 2), art 16 para 3.

it claims rescission of the contract in accordance with paragraph 2 of Article 16 of the Insurance Law, the people's court shall not support such a claim'.³⁵

4 Criticisms of the current law

According to paragraph 5 of Article 16 of the PRC Insurance Law, '[w]here the insurance applicant fails to perform the obligation of telling the truth out of gross negligence, materially affecting the occurrence of an insured incident, the insurer shall not be liable for paying indemnity or insurance benefits for an insured incident which occurs before the contract is rescinded'.³⁶ Therefore, it can be seen that Chinese law adopts the all-or-nothing principle.

There is common agreement that the all-or-nothing principle operates too harshly on the insured and over-protects the insurer. Such a legal doctrine does not reflect the realities in the current trends of development of insurance law in the world.

There are two main criticisms of the current position in Chinese law on this matter, which can be summarized as follows.

Firstly, in the circumstance where the non-disclosure occurs because of the insured's gross negligence rather than its actual intention, the right to rescind the contract will entitle the insurer to obtain a windfall. The act of rescission is retroactive and the contract can be taken as never having existed, and this is the reason the insurer can deny its responsibility and return the premium. Furthermore, it is a common practice under insurance industry that the insurer always undertakes the necessary research to check for non-disclosure after the commencement of a claim. According to insurance law, under such circumstances, the insured will be required to provide evidence to prove its losses which will reveal more information to the insurer. This characteristic of insurance law and the right to rescind the contract would result in the insurer taking an unfair gamble. Clearly, non-disclosure by the

³⁵ Interpretation II (n 6), art 7.

³⁶ PRC Insurance Law (n 2), art 16 para 5.

insured may make it difficult for the insurer to assess the risk accurately, but this does not mean that every non-disclosure will result in the risk becoming uninsurable. In scenarios where the insured has no intention to commit fraud, the mere fact that the insured negligently failed to disclose does not indicate that the insured intends to benefit from such act. The insured will normally not raise a claim until there is an actual loss. Therefore, if it is impossible for the insurer to ascertain, in the event of non-disclosure, whether the insured will suffer a loss, the insurer can keep the premium from the insured until there is an insurance accident. In the meantime, the insurer can also deny its liability to the insured, who will suffer losses. The insurer will thus gain a benefit that exceeds the extent of the actual loss.

Secondly, there are no instruments in Chinese law that are effective enough to balance the negative impact of the right of rescission. This is a common issue in other countries as well, and various kinds of instruments have been applied to attempt to resolve this problem. For example, paragraph 3 of Article 16 of the PRC Insurance Law restricts the timeframe during which the insurer can exercise such a right; or requires a causal link to be shown between the insured's non-disclosure and the insurance accident in order for the insurer to rescind the contract. Although under Chinese law there are some restrictions on the insurer, the situation cannot be fundamentally changed. For instance, paragraph 3 of Article 16 of the PRC Insurance Law provides for two years as the period for the insurer to exercise its right of rescission; however, the paragraph normally applies to life insurance only.³⁷ Furthermore, under Article 7 of Interpretation II, if after an insurance contract is established, an insurer knows or should have known that the insurance applicant failed to perform its obligation of truthful disclosure, but the insurer nonetheless collects premiums, and subsequently claims rescission of the contract in accordance with paragraph 2 of Article 16 of the PRC Insurance Law, the People's Court will not support such a claim.³⁸ The aim of this Article is to protect the interest of insured. However, in the event of a rescission claim by the insurer, it is very hard for the insured to prove that the insurer knew, or ought to have known, about the non-disclosure of the insured. Therefore, this Article can only provide limited protection to the

³⁷ This is because, in property and liability insurance, the insured period will normally be shorter than two years. Therefore, such a period is of less importance to the insured under these two kinds of insurance contracts.

³⁸ Ma Ning (n 11).

insured. In addition, even after confirmation of the causal link, the courts will have to decide upon the issue on a case-by-case basis without a set of universal criteria, and this means a significant increase in the legal costs involved. Moreover, under the all-or-nothing principle, if the courts choose to protect the insured's interests, the insurer will also lose everything under the current law.

There is growing agreement that proportionate remedies are a better substitute for the all-or-nothing principle. Under the proportionate principle, the insurer's liability under the insurance contract will be reduced according to the seriousness of the insured's violation of the duty of disclosure and its impact on the insurer's assessment of the risk.

Proportionate remedies were recently adopted in English law after a long period of debate. In Schedule 1, Part 1, Sections 2, 4, and 5 of the Insurance Act 2015 (UK), the consequences of a breach of duty of disclosure by the insured have been classified into three categories. The first is where the breach was deliberate or reckless. In this case, the insurer may void the contract and refuse all claims, and need not return any of the premiums paid. The second is when, in the absence of the qualifying breach, the insurer would not have entered into the contract on any terms. If this is true, the insurer may void the contract and refuse all claims, but must in this scenario return the premiums paid. The third is if the insurer would still have entered into the contract in the absence of the qualifying breach, but on different terms (other than terms relating to the premium). The contract is then to be treated as if it had been entered into on those different terms, if the insurer so requires.

The basic principles of proportionate remedies could be seen as a proper method to resolve current difficulties in Chinese insurance law. Firstly, in cases of non-disclosure which arise due to the insured's gross negligence, the insurer should have the right to reconstruct the contract with the insured. If there are no agreements between the insured and the insurer, the insurer is still entitled to rescind the contract and return the premium. Secondly, if the insurer can prove that, had it known the undisclosed facts earlier on, it would not have entered into the insurance contract with the insured, the insurer is still entitled to discharge its liability under the insurance contract and refuse to pay the claim, but should return the premium. Thirdly, if the insurer can prove that, had it known the undisclosed facts, it would

have entered into the contract on different terms, the insurer's liability will be ascertained based on the new terms. Fourthly, if the insurer can prove that, had it known the undisclosed facts, it would have charged the insured a higher premium, the insurer's liability will be adjusted proportionately based on the premium that the insurer has actually received and that which the insurer should receive under the new contract. Finally, if the insurer cannot prove any of these circumstances, it will need to take full responsibility under the existing contract.

The merits of such proportionate remedies are clear. Such remedies can allow the courts to ascertain the insurer's responsibility based on the real risk that the insurer undertakes; and the insured can also claim back part of the damages suffered, provided that there was no fraud. In addition, judges also do not need to make difficult decisions between the insurer who profits from the insured's non-disclosure, and the insured who intends to transfer its risk to the insurer by non-disclosure. Injecting such proportionate remedies would promote the normal operation of the insurance industry. Therefore, proportionate remedies should be adopted by Chinese law and modified to meet the demands of the Chinese insurance market.

The final question is whether the insured should be responsible for non-disclosure when it results from general or common negligence, as opposed to gross negligence or fraud. Currently, no clear answers can be found in Chinese insurance law regarding such a scenario. There was an argument regarding the law as it stood prior to 2009 stating that, based on the basic principle of good faith in insurance law, the insurer should have the right to claim higher premiums from the insured in scenarios where the non-disclosure arose from the insured's general negligence.³⁹ However, such arguments cannot be used under the current PRC Insurance Law. According to that law, the insured is only liable for non-disclosure caused by intentionality or gross negligence. It is therefore implied that general negligence on the part of the insured will not be punished under the current law. It has been argued that making the insured liable for general negligence could cause more problems. For

³⁹ This is because, under insurance law prior to 2009, the assured was liable for non-disclosure which is caused by intentionality and negligence, rather than by gross negligence under the current PRC Insurance Law as amended.

example, the insured can be in a position whereby it cannot be aware of the subject matter for physical or mental reasons. In such a scenario, it cannot be said that the insured was blameworthy in its omission of facts. Therefore, under such circumstances, the risk of the insured should be transferred onto the shoulders of the insurer, who normally can endure the losses. This cannot be seen as a violation of the principle of good faith. However, even if such an argument is accepted, it still does not follow that the general negligence of the insured should be ignored by the court. It is vital to bear in mind that the insurer and insured should have the freedom to construct their own insurance contract. Further, if the concealment of facts because of general negligence or gross negligence had influenced the insurer's decision to accept or reject the risk, the insurer should still have the liberty to terminate the contract accordingly. There is a difference between termination of contract and rescission of contract: termination only relieves the insurer from future performance under the contract, but the insurer is still liable for the insurance accidents which have occurred before the termination. Furthermore, the insurer must return the premium which the insurer has charged the insured in advance. Similar rules can be found in Article 19(3) of the German Insurance Contract Act 2008⁴⁰ and in Article 2:102(3) of the PEICL.⁴¹

5 Conclusion

The insured's responsibility under Chinese law is not a rigid concept but one which is ever-changing. There are some unreasonable requirements and unclear points in Chinese law regarding this matter. Clearly, Chinese law still follows some of the old positions in English law. However, the positions adopted by Chinese law in this area have stayed the same for several years. Interpretation III on Chinese Insurance Law was recently published by the

⁴⁰ Versicherungsvertragsgesetz (Gesetzes vom 23.11.2007 (BGBl I S 2631), in force 1 January 2008). Art 19(3) states as follows: 'The insurer's right to withdraw from the contract shall be ruled out if the policyholder breached its duty of disclosure neither intentionally nor by acting with gross negligence. In such cases, the insurer shall have the right to terminate the contract subject to a notice period of one month.'

⁴¹ Which states that '[t]he insurer shall not be entitled to terminate the contract if the policyholder is in innocent breach of Article 2:101, unless the insurer proves that it would not have concluded the contract, had it known the information concerned.'

Supreme People's Court.⁴² However, no provisions in this Interpretation dealt with these questionable principles in Article 16 of the PRC Insurance Law. Therefore, it can be said that Chinese law still has a long way to go before arriving at a fairer position on the insured's responsibility regarding the duty of disclosure.

⁴² Interpretation III of the Supreme People's Court on Several Issues concerning the Application of the Insurance Law of the People's Republic of China (Adopted at the 1661th Session of the Judicial Committee of the Supreme People's Court on 21 September 2015, issued on 25 November 2015, in force 1 December 2015).