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An Introduction to China's New Insurance Law

On 28 February this year the Standing Committee of the National People's Congress passed the second major amendment to the 1995 Insurance Law of the People's Republic of China. The amended law comes into force from 1 October 2009.

In the following article we outline some of the property insurance changes in the new law.

Insured's lack of insurable interest in the insured subject matter will not invalidate a property insurance contract

The new law overturns the old law's stipulation that an insurance contract will be held invalid if the insured party has no insurable interest in the insured subject matter. The new law specifies that in order to claim indemnification, the insured party in a property insurance contract must have an insurable interest in the insured subject matter at the time when the insured event occurs.

This should put an end to the considerable judicial confusion caused by one of the old law's most unreasonable stipulations. The law previously held that where the party paying the premium and the party insured were not one and the same, only the party who signed the contract and pays the premium is entitled to claim from the insurer.

Clearly, if a policyholder has no insurable interest when the insured risk occurs they will not suffer any loss. Indemnification without loss is inconsistent with a fundamental principle of insurance – compensation for loss – and creates the potential for moral hazard.

Insurer's duty to explain exclusion clauses

The original law stated that an exclusion clause is only valid if the insurer has clearly explained it to the insured. The amended law now specifies exactly what the insurer must do to satisfy this obligation. Insurers must highlight exclusion clauses on application forms, policies and other insurance certificates in such a way as to be sure of attracting the insured's attention. Failure to explain its contents clearly, either orally or in written form, will bar insurers from relying on a particular clause. From the insurer's point of view, this is a relatively onerous amendment. It leaves open the question of how insurers can improve their processes and documentation so as to demonstrate having satisfied their obligation to explain exclusions.

Insurers required to settle claims promptly – with just one opportunity to request additional evidence, and 30 days in which to assess this

Insurers' tardiness in assessing and paying claims has been widely criticized in China, and the amended law imposes tough new requirements on claims settlement timescales. Once an insured event occurs and the insured or beneficiary has provided evidence to support its claim, the insurer has a limited period of time – and a single opportunity – to request any and all additional materials or evidence it requires. Thereafter the insurer has 30 days within which to assess the claim – regardless of its complexity.

If it feels there are grounds for rejecting the claim, the insurer must inform the insured or beneficiary in writing – clearly stating the reasons for its decision – within three days. If the claim is accepted, the insurer must satisfy its obligation to pay compensation within ten days. Failure to comply with these tight deadlines will leave the insurer legally liable to pay claims in full and indemnify the insured or beneficiary for any losses consequent upon the delay in settling their claim.

Disclosure only required in response to insurers' inquiries

The current law stipulates that insurers have the right to make inquiries on matters concerning the insured subject matter or the insured, and that the insured must make true representations. It is a moot point, both in theory and in judicial practice, whether this imposes an "unlimited disclosure obligation" on the policyholder or simply "the obligation of disclosure upon inquiry."

The amended law clearly states that the insured must make true representations if the insurer inquires about matters concerning the insured subject matter or the insured in the process of concluding an insurance contract. From this, it seems clear that the insured has no obligation to disclose matters about which the insurer does not inquire. It seems equally clear that the insurer should inquire about all material consideration when concluding insurance contract – or risk losing the right to terminate the insurance contract on the basis of the insured have failed in their duty of disclosure.

The insurer's right to terminate a contract on the basis of non-disclosure will expire 30 days following the discovery of non-disclosure or two years following conclusion of the contract

One new stipulation contained within the amended law is that the insurer enjoys the right to terminate a contract based on the insured's failure to disclose relevant information. This right expires 30 days following the identification of grounds for termination. The right to terminate based on non-disclosure is limited to the first two years of the contract.

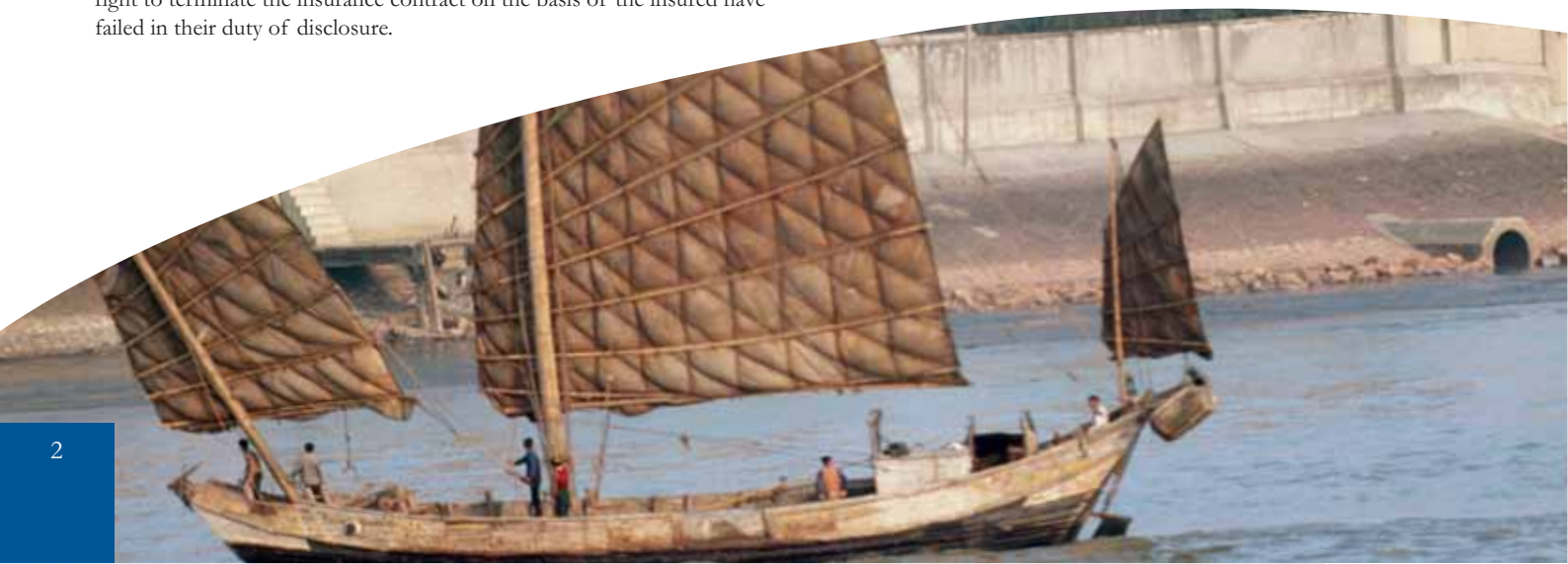
This amendment puts the onus on the insurer to take action as soon as it becomes aware of a potential issue of non-disclosure. It mitigates the potentially negative consequences arising – for insurer and insured alike – from the latter's failure to disclose material information at the contract's outset.

The compensation object under liability insurance is conditionally extended to third-party victims

The current law stipulates that the insurer may, in accordance with the relevant legal and contract provisions, pay compensation directly to a third party who has suffered loss or injury due to the actions of an insured party for whom that insurer provides liability coverage.

The new law supplements this stipulation with the provision that, once the amount of compensation to be paid by the insured to the third party is confirmed, the insured may ask the insurer to pay the third party directly. If the insured is slow to request this, the third party may now claim payment directly from the insurer.

This amendment represents a significant breakthrough for the principle of relativity in insurance contracts, thereby extending the protection afforded to third party victims. It allows liability insurance to function as a more efficient economic mechanism. At the same time, of course, it presents an additional challenge to insurers who may now face claims from third parties from time to time.



Transferee of the insured subject matter will succeed to the rights and obligations under the policy

China's current insurance law stipulates that insurers must be notified when the insured subject matter is transferred, and that the insurer must consent to the alteration of the insurance contract if they are to continue providing cover. In other words it is at the insurer's discretion whether or not they chose to continue underwriting the policy.

The amended law alters this stipulation with the effect that the party to whom the insured subject matter is transferred succeeds to the rights and obligations under the policy. Although the new law requires the insured or the transferee to notify the insurer of the transfer in a timely fashion, the insurer enjoys only restricted rights upon notification. Only where the risk "obviously increases" as a result of the insured subject matter being transferred, does the insurer have the right to increase the premium or terminate the contract within 30 days of notification.

Exactly how "obviously increases" should be defined will clearly be a topic of dispute in practice. This amendment is particularly helpful to original insureds and transferees of cars sold second hand who are looking to pass a policy from vendor to purchaser. It does however present a clear and open-ended challenge to the claims departments of motor insurers in terms of how they identify "obviously increased" risks and how they can be sure of exercising whatever rights they may have to alter policy terms subject to the 30-day restriction.

Important points to note for policyholders

1. Obligation to notify an insurance incident

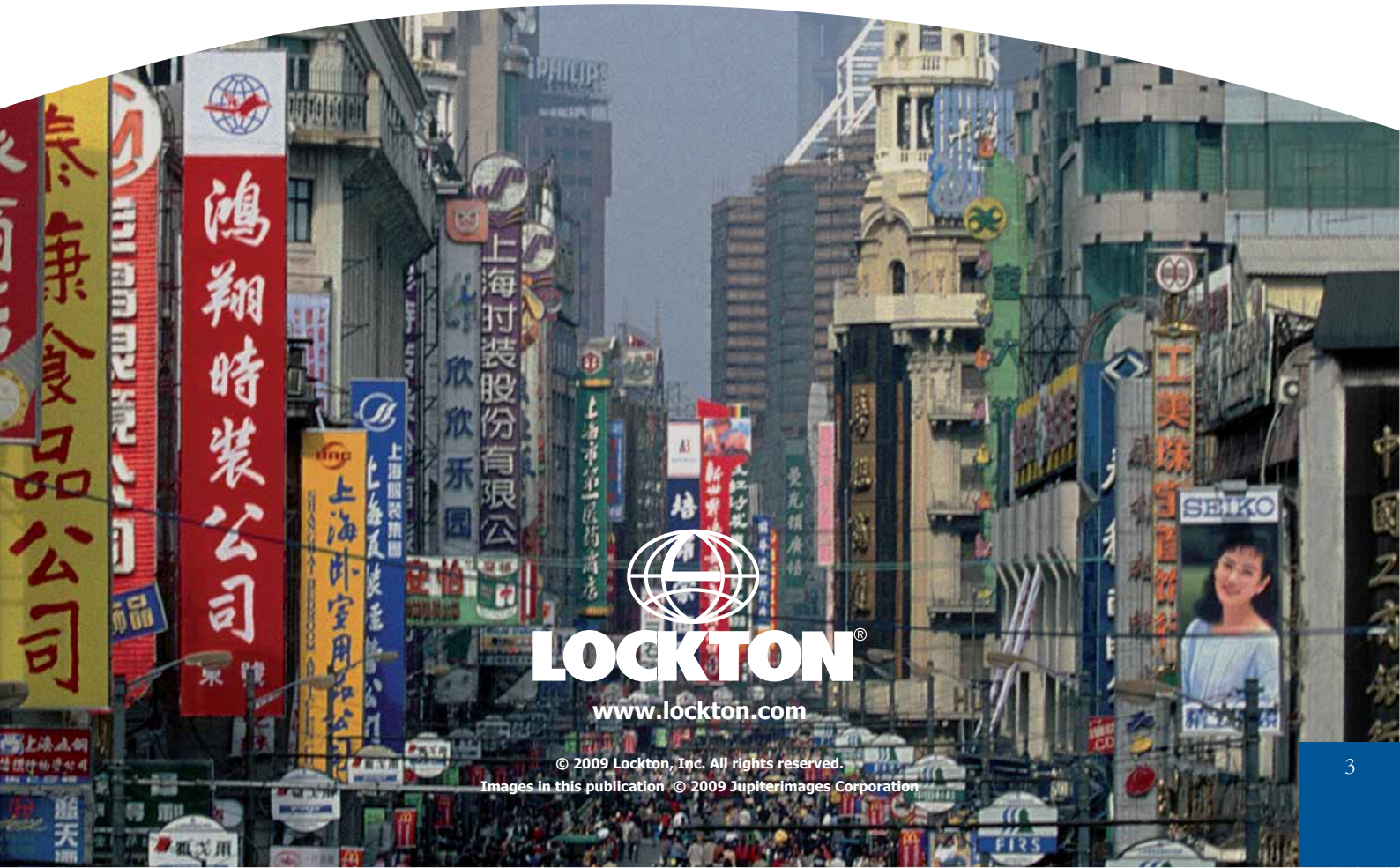
The revised law emphasizes the obligation for policyholders, insureds and/or beneficiaries to notify insurers promptly of any incident. Failure to do so may, under certain circumstances, relieve insurers of their obligation to pay compensation. The existing law is unclear on the legal consequences of such failure, so policyholders need to be vigilant on this issue.

2. Failure to pay premium installments

In the section on life insurance contracts, the revised law grants insurance companies the right to provide insureds with a reminder in respect of any missed premium installments. If the policyholder fails to pay within 30 days of receiving such a request for payment, the contract will be considered suspended. Again, policyholders need to be vigilant on the payment deadlines.

Tighter regulation of insurance companies

The revised law provides for firmer regulation of insurance companies in terms of the criteria for company setup, new branch office approval, employment approval for senior management, compliance requirements and solvency issues. The intention is to minimize risks, enhance the stable operation of insurance companies, and safeguard the interests of policyholders and insureds.



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