

## Exclusion Clauses and Disclosure Obligations in Insurance Policies Clarification from China's Supreme People's Court

July 2013

The Supreme People's Court in China periodically issues judicial interpretations of Chinese laws. It does so either in response to enquiries from lower courts or on its own initiative in response to issues that have arisen in cases that have been heard. Although China is not a common law jurisdiction, its interpretations have *de facto* binding legal effect on lower courts in China.

In May 2013, the SPC issued an interpretation (the "**Interpretation**") of certain provisions of the *People's Republic of China Insurance Law* (the "**PRC Insurance Law**"). The Interpretation deals with several points, but focusses mainly on the disclosure obligations of parties entering into insurance contracts and exemption clauses in those contracts.

### Utmost good faith?

The common law principle of "utmost good faith" or *uberrimae fidei* does not apply in China. That is, there is no general obligation upon policy holders to submit to the insurer any and all information that is relevant to the insured subject. Instead, the PRC Insurance Law sets out the specific obligations of policy holders in this regard.

The relevant provisions in the PRC Insurance Law state that the policy holder must make "honest disclosure" in response to the insurer's enquiries about the insured and/or the insured subject matter and, where it has taken out duplicate insurance coverage for a risk, it must notify all the underwriting insurers. The Interpretation has clarified that the obligation to make honest disclosure relates to information of which the policy holder is aware when the contract is entered into, and is limited to the scope and content of the insurer's enquiries.

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Furthermore, those enquiries must be specific: general provisions in the proposal form that require general information will not suffice to oblige the policy holder to provide all relevant information.

Where the policy holder fails to make the requisite honest disclosure, the insurer's remedy under the PRC Insurance Law differs depending on whether that failure was intentional or a result of gross negligence. Where the failure was intentional, the insurer may rescind the contract, refuse to pay benefits and claims, and is not required to refund premiums paid. Where the failure results from gross negligence and has a material impact on the occurrence of the risk, the insurer may rescind the contract and refuse to pay benefits and claims, but must refund premiums already paid. In other words, the insured or policy holder is subject to greater or lesser protection based on the perceived level of fault.

The insurer's right to rescind is subject to a time limit of 30 days from the date on which it learns of the failure to disclose, and that, in turn, is subject to a long-stop time limit of 2 years from the date of the contract. The right is also lost if the insurer knew, when it entered into the contract, about the policy holder's failure to disclose.

The Interpretation has further limited the insurer's rights in this respect by providing that the insurer's right to rescind is lost where the insurer knew or ought to have known (i.e. constructive knowledge), about the failure to disclose at the time the contract was entered into but nevertheless accepted premium payments. Furthermore, where an insurer does not rescind the contract on the basis of non-disclosure, it may not refuse to pay claims under that contract.

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The Interpretation does not clarify the position in relation to failures to disclose that arise from fault that falls below the standard for gross negligence nor where the information which the policy holder failed to disclose has a major connection with the insured incident. Accordingly, we understand the position to be that the insurer has no right to rescind or refuse to pay claims in such circumstances. This is in line with the analysis in some court rulings. For example, in one case, an insured (an infant) under a life insurance policy died from a particular condition. The insurer refused to pay under the policy, claiming that the policy holder (the insured's mother) failed to disclose on the proposal form that the insured was born prematurely. The court ruled that even though the policy holder had failed to perform her obligations, there was no evidence showing that the condition which led to the infant's death was caused by or linked to the premature delivery, and the insurer was required to pay the claim.

The practical impact of these provisions of the Interpretation is to put the onus on insurers in China to make sure that policy proposal documents expressly require any proposed insured to truthfully and accurately answer sufficient specific questions in order to generate the information needed to assess the risk and to set the appropriate premium level.

### **Exclusions and interpretation**

The PRC Insurance Law requires that insurers' standard contracts and provisions must be explained to policy holders. The insurer must warn policy holders about any clauses that exempt the insurer from liability and must explain the effect of those clauses to the policy holder. Any failure in this regard will render the clauses ineffective. This is simply an extension of the requirement under the *People's Republic of China Contract Law* (the "**PRC Contract Law**") that exclusion or limitation of liability clauses in standard form contracts must be explained to the counterparty on request (see below). The PRC Insurance Law further provides that any clauses that

attempt to exclude any of its statutory obligations, or expand the insured's statutory obligations, in relation to the contract will be void.

The Interpretation clarifies that an exemption clause in the context of a standard form insurance contract means a clause providing for any exclusion or mitigation of the insurer's liability, including deductible/excess provisions and prorated indemnities or benefits, but it does not include provisions that allow the insurer to terminate on the grounds of the policy holder or insured's breach of law or contract.

The Interpretation provides that an exclusion based on "prohibitive provisions" of laws and regulations will be valid if the insurer has notified the policy holder of that exclusion. There is no obligation to explain such exclusion to the policy holder. An example of a prohibitive provision is Article 22 of the *PRC Law on Road Transportation Safety*, which provides that a person must not drive if he or she is under the influence of alcohol. It is not necessary for an insurer to explain to a policy holder an exclusion of liability for accidents involving the insured driving when drunk.

The Interpretation also provides that the obligation to notify the policyholder of the existence of exclusion clauses will be satisfied if measures are taken to draw the policy holder's attention to them – including by way of "words, characters, symbols or other clear indicators" (which is similar to the wording used in a Supreme Court Interpretation of the PRC Contract Law which requires a party to use some form of special mark in order to draw attention to the exclusion or limitation of liability clause). Explanations must be in terms that "an ordinary person" can understand. Subject to the requirements above, notifications and explanations given over the telephone or on a web page or through audio, visual or other channels are acceptable. However, unless the policyholder has confirmed that an explanation was given to him, either by signing or sealing the

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relevant documentation, the burden of proof is on the insurer to show that it discharged its obligation to explain.

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All standard terms in insurance contracts, whether or not they seek to exempt a party from liability, are subject to the general *contra proferentem*-type rule set out in the PRC Contract Law. That is, where there is more than one way of interpreting the clause, in the event of a dispute, it will be construed in favour of the party that did not draft the clause. The Interpretation also sets out some bases upon which courts should interpret any inconsistent provisions in insurance contracts. That includes a rule similar to the above (which is also based on the PRC Contract Law provisions): in the event of any conflict between a standard term and any non-standard term in a contract, the non-standard term shall prevail.

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The Interpretation deals with several other matters, but in less detail than the above issues. We have prepared our own, unofficial, translation of the Interpretation. If you would like a copy of that, please contact Anna Elshafei at the email address below.

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