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# Misleading Conduct by Insurers in Sales of Insurance Policies in China

Dr Zhen Jing\*

*This paper considers the insurers' pre-contractual misleading conduct and the legal consequences for such misconduct under the Insurance Law, examines possible private right of action available to the insureds in the case of the insurers' misleading misrepresentation and intentional concealment of material information under the Chinese Contract Law, and puts forward recommendations, with reference to approaches in some states of the United States of America, for effective remedies to the insureds where the insurers' misleading misrepresentation or intentional concealment of material information has induced him to enter into the insurance contract.*

## I. Introduction

Misleading conducts in sales of insurance policies can often be observed in China's insurance market; these misconducts prejudice the consumers' interest, give rise to distrust of insurers by the general public, and seriously affect the development of insurance industry.

The Insurance Law of the People's Republic of China 2015 (hereafter the Insurance Law)<sup>1</sup> prohibits insurers from practising misconducts<sup>2</sup> and also provides rules for penalising the insurers for misconducts.<sup>3</sup> The China Insurance Regulatory Commission (CIRC)<sup>4</sup> has published a series of regulatory measures in order to control the misconducts in sales of insurance policies and protect the interest of insurance consumers.<sup>5</sup> Where an insurer commits a pre-contractual (or post-contractual) misconduct, the insurer will be imposed a

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<sup>1</sup> The Insurance Law of the People's Republic of China was enacted by the National People's Congress on 30 June 1995 and amended in October 2002, February 2009 and April 2015. It is a comprehensive insurance legislation, consisting of insurance contract law and insurance company law.

<sup>2</sup> The Insurance Law, articles 116 and 131.

<sup>3</sup> The Insurance Law, articles 161 and 165.

<sup>4</sup> The China Insurance Regulatory Commission, established on November 18, 1998, is authorized by the State Council to conduct administration, supervision and regulation of the Chinese insurance market, and to ensure that the insurance industry operates stably in compliance with law.

<sup>5</sup> Notice of China Insurance Regulatory Commission on issues concerning comprehensive control of misleading conducts in sales of life insurance policies, Bao Jian Fa [2012] No. 14.

fine, a restriction on the scope of business, and even a revocation of business licence.<sup>6</sup> However, these remedies for the insurer's pre-contractual misconducts are inadequate to the grieved insured when a loss has occurred, as the Insurance Law does not provide any private right of action to the insured to claim actual damages in the case of the insurer's pre-contractual misconducts, such as intentional misrepresentation or non-disclosure of material facts to the insured. On the other side of the story, however, where the insured's intentional or grossly negligent misrepresentation or nondisclosure of material facts has induced the insurer into the contract, the insurer is entitled to rescind the contract and reject claims.<sup>7</sup> So the lack of an effective remedy available to the grieved insured for the insurer's misleading conducts is a serious deficiency in the Insurance Law.

The aims of this article are therefore to consider the insurers' pre-contractual misleading conducts and the legal consequences for such misconducts under the Insurance Law (the part on insurance company), to examine possible private right of action available to the insureds in the case of the insurers' misleading misrepresentation and intentional concealment of material information under the Contract Law 1999,<sup>8</sup> and to put forward recommendations, with reference to approaches in some states of the United States of America, for effective remedies to the grieved insureds where the insurers' intentional misleading misrepresentation or concealment of material information has induced the insured to enter into the contract.

## **II. The Insurers' Misleading Conducts in China**

The CIRC describes misleading conducts in sales of insurance policies as those conducts by insurers, their agents, brokers or employees in advertising and selling insurance products by way of deception, concealment of material information of the insurance products, or inducing intending insureds to purchase the insurance products using misleading information and explanations about the products and those conducts which are in violation of relative provisions of the Insurance Law, the State Council administrative regulations and the

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<sup>6</sup> Insurance Law, art.161.

<sup>7</sup> The Insurance Law, art.16. For more on the insured's pre-contract duty of disclosure and remedies for breach of the duty in Chinese law, see Z. Jing, "Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China" (2006) J.B.L.,681; Z. Jing and L. Zhu, "Restrictions on the insurer's defence of nondisclosure or misrepresentation in Chinese Insurance Law" (2015) I.L.J., 26(2), 145; Z. Jing and M. Zhong, "Limitations on the insured's duty of disclosure in Chinese law: a comparative analysis with English, Australian and German laws (2015) I.C.C.L.R., 26(7), 224.

<sup>8</sup> The Contract Law of the People's Republic of China was enacted on 15 March 1999.

CIRC regulations.<sup>9</sup> Deception here refers to false and misleading representation and concealment means intentional nondisclosure of material information.<sup>10</sup>

The insurers are refrained by the Insurance Law from conducting fraudulent and misleading acts in the sales of insurance policies. Articles 116 and 131 of the Insurance Law set forth instances of the insurer's pre- and post-contractual misconducts. Some guidelines for determining these misconducts are provided by the CIRC.<sup>11</sup> Where an insurer commits a pre-contractual (or post-contractual) misconduct, the insurer will be sanctioned according to article 161 and 165 of the Insurance Law.

Art.116 of the Insurance Law provides: "An insurance company and its employees shall not have any of the following acts in the course of conducting business:

- (1) cheating the proposers, the insureds or the beneficiaries;
- (2) concealing from the proposers material information relevant to the insurance contracts;
- (3) preventing the proposers from fulfilling their obligation of making truthful disclosure provided under this Law or inducing them not to fulfil such an obligation;
- (4) giving or promising premium rebates or other benefits other than those provided for in the contracts to the proposers, the insureds or the beneficiaries;
- (5) refusing to fulfilling the obligation of paying indemnity or insurance benefits agreed upon in an insurance contract according to law;
- (6) deliberately fabricating insured events that have never occurred, making up insurance contracts or deliberately exaggerating insured events that have occurred to make false indemnities and defrauding the company of insurance benefits or seeking other illegitimate gains;
- (7) diverting, retaining or encroaching on premium;
- (8) entrusting agencies or individuals that have not obtained lawful qualifications to engage in activities of insurance sales;
- (9) seeking illegitimate gains for other organisations or individuals by taking advantage of the insurance business;

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<sup>9</sup> Notice of China Insurance Regulation Commission on Issuing "the Guidance on Accountability of Misleading Conducts of Life Insurance Companies in Sales of Policies", Bao Jian Fa [2012] No. 99, art.2.

<sup>10</sup> The guidance of identification of misleading conducts in sales of life insurance policies, Bao Jian Fa [2012] No 87, art.3. In Californian Insurance Code, concealment is defined as "Neglect to communicate that which a party knows, and ought to communicate", (CA Ins Code § 330 (2014) ).

<sup>11</sup> The China Insurance Regulatory Commission, established on November 18, 1998, is authorized by the State Council to conduct administration, supervision and regulation of the Chinese insurance market, and to ensure that the insurance industry operates stably in compliance with law.

- (10) using insurance agencies, insurance brokers or insurance adjusting firms to engage in illegal activities such as siphoning off commission by making up insurance agency business or fabricating surrender of policies;
- (11) damaging the commercial reputation of its rivals by fabricating and disseminating false facts or other acts of unfair competition, disturbing the order of the insurance market by other acts of unfair competition;
- (12) divulging the business secrets of the proposers or the insured that they become known in their business activities;
- (13) other acts violating laws, administrative regulations and provisions of the insurance supervision and regulation authority of the State Council.

Art.131 of the Insurance Law provides a similar provision to art.116 of the Insurance Law, which concerns the misconducts of insurance agents and insurance brokers.<sup>12</sup>

While art.116(1) to (12) of the Insurance Law set forth specific instances of misconducts by the insurers, art.116(13) provides a catchall rule that may encompass other misconducts. The insurer's pre-contractual misconducts are listed in art.116(1) to (4). The CIRC has formulated some guidelines for determining misleading conducts in sales of life insurance policies which are in violation of articles 116 and 131 of the Insurance Law (hereafter the Guidance).<sup>13</sup>

In determining whether an insurer's pre-contractual behaviour can be identified as a misconduct as specified by articles 116 and 131 of the Insurance Law, the following guidelines shall be followed:

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<sup>12</sup> Art.131 of the Insurance Law provides "In handling insurance business, insurance agents and insurance brokers and their practitioners are not allowed to conduct any of the following acts in the course of conducting business:

- (1) cheating the insurers, the proposers, the insureds or the beneficiaries;
- (2) concealing from the proposers material information relevant to the insurance contracts;
- (3) preventing the proposers from fulfilling their obligation of making truthful disclosure provided under this Law or inducing them not to fulfil such an obligation;
- (4) giving or promising any interests other than those provided for in the contracts to the proposers, the insureds or the beneficiaries;
- (5) using their administrative power, position or the advantage of their profession or any other illicit means to force, induce or restrict the insured to sign insurance contracts;
- (6) forging or altering an insurance contract arbitrarily, or providing false certification materials to the parties to an insurance contract;
- (7) diverting, retaining or encroaching on premium or insurance benefits;
- (8) seeking illegitimate gains for other organisations or individuals by taking advantage of the business;
- (9) defrauding the insurer of insurance benefits by colluding with the proposers, the insureds or the beneficiaries;
- (10) divulging the business secrets of the proposers or the insured that they become known in their business activities.

<sup>13</sup> The guidance of identification of misleading conducts in sales of life insurance policies, Bao Jian Fa [2012] No 87.

(1) Where life insurance companies, insurance agents or insurance sales staff commit one of the acts listed in articles 5 and 6 of the Guidance, the act can be determined as an act of “cheating the proposers, the insureds or the beneficiaries” as stipulated in articles 116(1) and 131(1) of the Insurance Law.<sup>14</sup>

Art.5 of the Guidance stipulates that life insurance companies, insurance agencies and insurance sales staff shall not make false propaganda about the insurance products at the sites of business network, public places and other areas, or using product introduction meeting, news media, company websites, and other media.

Art.6 of the Guidance prohibits life insurance companies, insurance agencies and insurance sales staff from committing the following kinds of deception:

- (A) Exaggerate scope of the insurance or the benefits of insurance products;
- (B) Make false propaganda about relevant laws, regulations, policies in relation to insurance business;
- (C) Advertise or sell insurance products under the pretext of giving gifts to the insureds, but in fact no gifts are given;
- (D) Advertise or sell insurance products on the false grounds that the sales of the insurance products will soon be suspended, but in fact the sales of the same products are not suspended;
- (E) Make false propaganda about the shareholders, business operation or business achievements in the past;
- (F) Advertise or sell insurance products under the pretext of financial products, bank deposits, securities investment fund shares and other financial products;
- (G) Sell insurance products of the particular insurance company in the name of other insurance company or financial institution, or in the name of the sale-man of other insurance company or financial institution;
- (H) Other deceptive conducts.

(2) Where life insurance companies, insurance agents or insurance sales staff commits one of the acts listed in art.7 of the Guidance, the act can be determined as an act of “concealing from the proposers material information relevant to the insurance contracts” as stipulated in articles 116(2) and 131(2) of the Insurance Law.<sup>15</sup>

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<sup>14</sup> Notice of China Insurance Regulation Commission on Issuing “the Guidance of identification of misleading conducts in sales of life insurance policies”, Bao Jian Fa [2012] No 87.

<sup>15</sup> Ibid.

Art.7 of the Guidance provides that life insurance companies, insurance agencies and insurance sales staff must not conceal the following material information relevant to the insurance contracts:

- (A) Clauses exempting the insurer's liability;
- (B) The losses which may be incurred by premature termination of life insurance contracts;
- (C) The expense deducting circumstances for universal life insurance and investment-based insurance;
- (D) The uncertainties about the benefits of new life insurance policies;
- (E) Duration of the life insurance policies, payment period, and the consequences of not paying the premium on time;
- (F) The starting time for the "probation period" in life insurance policy and the impact on the interests of the insureds;<sup>16</sup>
- (G) The starting time and duration of the "cooling off period" in life policies, and the insured's rights in the "cooling off period";<sup>17</sup>
- (H) Other material information.

(3) Where life insurance companies, insurance agents or insurance sales staff commits any act mentioned in art.8 of the Guidance, the act can be identified as an act of "preventing the proposers from fulfilling their obligation of making truthful disclosure provided under this Law or inducing them not to fulfil such an obligation" as stipulated in articles 116(3) and 131(3) of the Insurance Law.<sup>18</sup>

Art.8 of the Guidance provides that life insurance companies, insurance agencies and insurance sales staff must not impede the insureds to perform the duty of disclosure, and shall not induce, instigate or in other improper ways to induce the insureds not to perform the duty of disclosure.

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<sup>16</sup> For health insurance policies, there is usually a probation clause in the policies. During the probation period, the insurer is not liable for payment of medical expenses or death of the life insured. The length of the probation period varies from 30-90 days from the date of conclusion of the contracts for short-term health insurance, usually 180 days for long-term health insurance.

<sup>17</sup> For life insurance policies with the insurance period of more than one years, there is usually a clause of cooling off period of 10 days in the policy, which means that within the 10 days from the date of receiving the insurance policy, the insured is free to cancel the contract and request repayment of the full premium paid without penalty.

<sup>18</sup> Notice of China Insurance Regulation Commission on Issuing "the Guidance of identification of misleading conducts in sales of life insurance policies", Bao Jian Fa [2012] No 87.

(4) Where life insurance companies, insurance agents or insurance sales staff commits one of the acts listed in art.9 of the Guidance, the sanction for the acts according to law should be based on the specific circumstances of the case and the nature of the offence.<sup>19</sup>

Art.9 of the Guidance prevents the insurers from engaging in the following misleading conducts in the sales of life insurance policies:

- (A) Promise to pay guaranteed benefits of the insurance products for uncertain benefits of the same products;
- (B) Induce or instigate the insureds to terminate other insurance contracts for the purpose of purchasing the new insurance products, and damage the legitimate rights and interests of the insureds, the life insureds or the beneficiaries;
- (C) Make simple comparisons of dividend rate or settlement rate or other ratio indicators with bank deposit interest rates or bond interest rates or other financial product yields;
- (D) Obstruct the insured to accept return visits, induce the insureds to refuse return visits or to answer questions untruthfully in return visits;
- (E) Other misleading conducts in the sales of insurance products.

### **III. Legal Consequences for the Insurers' Misleading Conducts under the Insurance Law**

Articles 161 and 165 of the Insurance Law set forth rules for punishing the insurers, their agents, brokers or employees who have committed misconducts as prohibited in articles 116 and 131 of the Insurance Law.

Where an insurance company commits any of the acts provided in article 116 of this Law, the insurance supervision and regulation authority<sup>20</sup> shall order it to make corrections and impose a fine of not less than fifty thousand Renminbi yuan (¥50,000), nor more than three hundred thousand Renminbi yuan (¥300,000); where the circumstances are severe, the insurance supervision and regulation authority may restrict the scope of business, order the company to cease accepting new business or revoke the business licence.<sup>21</sup>

Similarly, where an insurance agent or an insurance broker commits any of the acts provided in article 131 of this Law, the insurance supervision and regulation authority shall order it to make corrections and impose a fine of not less than fifty thousand Renminbi yuan

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<sup>19</sup> Ibid.

<sup>20</sup> The CIRC.

<sup>21</sup> Insurance Law, art.161.



(¥50,000), nor more than three hundred thousand Renminbi yuan (¥300,000); where the circumstances are severe, the business licence shall be revoked.<sup>22</sup>

In accordance with articles 161 and 165 of the Insurance Law, the CIRC punishes insurers, insurance agents or brokers that are in breach of articles 116 and 131 of the Insurance Law. For examples, the Kunlun Health Insurance Company Ltd deceived proposers in many cases. The CIRC investigated the misconducts of the insurer and found that in 25 sales (of 33 telephone sales), the insurer deceived the proposers by using untrue and misleading information for advertising its insurance products. The CIRC held that the insurer committed acts prohibited by art.116 of the Insurance Law.<sup>23</sup> The insurer was imposed a fine of ¥200,000 according to art. 161 of the Insurance Law and the Manager of the Company was fined ¥20,000 according to art.171 of the Insurance Law.<sup>24</sup>

In another case, the Xingfu Life Insurance Company Ltd and its branches paid extra surrender fees of ¥1.9 million for group life policies by agreements during the period of 18 months from January 2011 to June 2012, thus was in breach of art. 116(4) of the Insurance Law.<sup>25</sup> The CIRC imposed on the insurer a fine of ¥50,000.<sup>26</sup>

While the Insurance Law imposes penalty on the insurers, their agents and brokers for breach of articles 116 and 131 of the Insurance Law in order to deter the insurers from practising the misconducts, it does not provide remedies to a grieved insured in the case of the insurer's pre-contractual misconducts, in other word, there is no private right of action for the grieved insured to claim compensation for his loss.

In Chinese legal system, special law prevails over general law, for matters the special law does not cover, general law operates. It is therefore necessary to look for solution from the Contract Law which is the general law of contracts in China.

#### **IV. Remedies Available to the Grieved Insureds Under the Contract Law**

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<sup>22</sup> Insurance Law, art.165.

<sup>23</sup> The China Insurance Regulation Commission administrative punishment decision No.15, 2013 ([www.circ.gov.cn/web/site0/tab5240/info3895156.htm](http://www.circ.gov.cn/web/site0/tab5240/info3895156.htm), accessed in July 2015)

<sup>24</sup> Art.171 of the Insurance Law provides "Where an insurance company, an insurance asset management company, a professional insurance agency or an insurance broker violates the provisions of this Law, the insurance supervision and regulation authority shall, besides punishing the unit according to the provisions of art.160 to art.170 of this Law, give warnings to the personnel in charge and other personnel directly liable, and impose a fine of not less than ten thousand Renminbi yuan (¥10,000) nor more than one hundred thousand Renminbi (¥100,000) concurrently. Where the circumstances are severe, their qualifications for holding a position or practising the profession shall be revoked."

<sup>25</sup> Art.116(4) of the Insurance Law provides "...giving or promising premium rebates or other benefits other than those provided for in the contracts to the proposers, the insureds or the beneficiaries...".

<sup>26</sup> The China Insurance Regulation Commission administrative punishment decision No.8, 2013 ([www.circ.gov.cn/web/site0/tab5240/info3891531.htm](http://www.circ.gov.cn/web/site0/tab5240/info3891531.htm), accessed in July 2015)

In the Contract Law and Insurance Law as well, the parties must observe the principle of good faith in the exercise of their rights and performance of their duties.<sup>27</sup> It is generally agreed that when the parties enter into a negotiation, their relationship is no longer one of strangers, and they owe to each other such duties of care as are deemed applicable under the prevailing standards of conduct in the relevant community. Those duties are imposed by law and generally include those of mutual co-operation, assistance, notice, protection, care and confidentiality.<sup>28</sup> The content and scope of those pre-contractual duties may vary, depending on the particular transaction, parties and community concerned. Where a party acts in violation of a pre-contractual duty, causing loss to the other party, the law of pre-contractual liability allows the aggrieved party to claim compensation for the loss.<sup>29</sup> The party who has contravened its pre-contractual duties is deemed to have committed a fault or *culpa in contrahendo* (fault in conclusion of a contract) and shall be liable therefor.<sup>30</sup>

Pre-contractual liability is recognised by the Contract Law. Art.42 of the Contract Law spells out the general rule on pre-contractual liability, which provides “A party shall be liable for compensation if he, in the course of concluding the contract, causes damage to the other party in one of the following situations:

- (1) He negotiates in bad faith under the pretext of concluding a contract;
- (2) He intentionally conceals a material fact relevant to the conclusion of the contract or gives false information; or
- (3) He engages in other acts that violate the principle of good faith.”

Art.42(1) and (2) describe two specific instances of *culpa in contrahendo*, while art.42(3) is a catchall provision which intends to cover any other kinds of pre-contractual bad faith acts.

According to art.42 of the Contract Law, to determine whether a party has incurred pre-contractual liability, two questions must be considered. First, whether the defaulting party has breached the pre-contractual duty of good faith. It would be difficult to draw an exhaustive list of acts which are in violation of the principles of good faith. The key test of requirement of good faith is whether the defrauding party’s act falls below what is expected of a reasonable person on the basis of moral, social and commercial standards of conduct prevailing in the community in which the transaction takes place.<sup>31</sup> Pre-contractual liability is

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<sup>27</sup> The Contract Law 1999, art.6. The Insurance Law, art.5.

<sup>28</sup> B. Ling, *Contract Law in China* (Sweet & Maxwell Asia, 2002), p213, (hereafter Ling’s book)

<sup>29</sup> The Contract Law, art.42.

<sup>30</sup> The Contract Law, articles 42 and 58

<sup>31</sup> Ling’s book, p214

not limited to liability for an unconcluded or invalid contract. A claim for pre-contractual liability is tenable even though a valid contract has been concluded.<sup>32</sup> Secondly, whether the injured party has suffered loss as a result of the defaulting party's breach of the pre-contractual duty of good faith. It is generally accepted that recoverable loss should be limited to reasonable reliance, i.e. such reliance that a reasonable and prudent person would place on the conduct of the other party in a way that is foreseeable to the defaulting party. Whether or not the injured party's reliance is reasonable and foreseeable should depend on the circumstances of the case, including the nature and purpose of the transaction, the usage of the transaction and the relationship of the parties.<sup>33</sup>

If the defrauding party breaches his pre-contractual duty of good faith and the breach has given rise to damage to the other party, the defendant is liable to compensate the injured party.<sup>34</sup> Two kinds of remedies may be available to the injured party. First, where the defrauding party's misconduct has caused failure of conclusion or effectiveness of the contract, the grieved party is entitled to claim for compensation for his reliance on the contract being concluded or effective, which should include actual expenditure incurred in the negotiation and preparation for the performance of the contract and loss of opportunities of alternative contracts with other persons.<sup>35</sup> So liability for a void or rescinded contract is in principle limited to the loss suffered by the injured party owing to his reliance on the validity of the contract. The general idea is to put the injured party in the same position that he would have been in had he not concluded the contract.<sup>36</sup> By virtues of art.58 of the Contract Law, "if a contract is void or rescinded, property obtained under that contract shall be returned; where it is impossible or unnecessary to return it, its value shall be made good. The party who was at fault shall compensate the other party for the loss caused thereby; where both parties were at fault each party shall bear his corresponding liability". Fault here refers to the wilfulness or negligence of the conduct of the party in causing the invalidity of the contract.

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<sup>32</sup> Art.43 of the Contract Law, by referring to "whether or not the contract is concluded", makes it clear that the breach of good faith under art.42 of the Contract Law does not have to cause the failure of conclusion of the contract.

<sup>33</sup> Ling's book, p216.

<sup>34</sup> The Contract Law, art.42.

<sup>35</sup> Ling's book, p215.

<sup>36</sup> UNITROIT principles 2010, art.3.2.16 provides "Irrespective of whether or not the contract has been avoided, the party who knew or ought to have known of the ground for avoidance is liable for damages so as to put the other party in the same position in which it would have been if it had not concluded the contract." For more, see Ling's book, p223.

The party at fault is the one who, at the time the contract is concluded, knows or ought to know the cause of invalidity of the contract.<sup>37</sup>

Secondly, where a party has induced the other party to enter into the contract by fraud or intentional concealment of a material fact relevant to the conclusion of the contract or intentional misrepresentation of information, the injured party is entitled to apply to a people's court or arbitral institution for modification or rescission of the contract under art.54 of the Contract Law.<sup>38</sup> Although art.42(2) of the Contract Law specifically sets forth the actionable misconduct of fraudulent misrepresentation or concealment of material information, it do not say that the injured party should be entitled to rescind the contract by reason of the fraudulent misrepresentation. However, art.54 of the Contract Law vests in the injured party the right of rescission of the contract by reason of the defendant's fraud.<sup>39</sup>

In the context of insurance, the insurer's pre-contractual liability is not provided in the Insurance Law, the most relevant provision to an insurance contract with regard to an insurer's pre-contractual liability is art.42(2) of the Contract Law, from which, it can infer that if an insurer intentionally conceals a material fact relevant to the conclusion of the contract or gives false information about the insurance product, the insurer should be made liable to compensate the insured for his loss due to the insurer's breach of the pre-contractual duty of disclosure or misrepresentation. It should be noted here that intentional nondisclosure of only "*material facts* relevant to the conclusion of the contract" would make the defendant liable, while provision of false information is in all cases actionable (i.e. whether the false information is material or not). Because an insurance contract is different from a sale or other kinds of contract in that under an insurance contract, the insured pays premium to the insurer in return for insurance payment when the insured risk occurs and causes a loss. The insured's reliance on and expectation of the insurance contract is that he will be paid by the insurer when the insured event occurs. The remedies of avoidance of the contract and recovery of the premium paid may be adequate redress for the insured where the insured has not suffered any loss when he discovers the insurer's breach of duty. For example, in *Mr Li v the Life Insurance Company*,<sup>40</sup> the insurer's agent induced Mr Li to purchase five life policies

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<sup>37</sup> UNITROIT principles 2010, art.3.2.16.

<sup>38</sup> Art. 54 of the Contract Law provides "... in regard to a contract concluded under circumstances where a party uses fraud, duress or exploits the other party's distress thereby causing the other party to act contrary to his true intention, the injured party has the right to apply to a people's court or arbitral institution for modification or rescission."

<sup>39</sup> Ibid.

<sup>40</sup> This case was decided by the People's Court, City District, Chang Zhi City, Shanxi Province, Civil Court Judgement (2009) No. 445, and is reported in *the Annual Report of the Typical Insurance Cases* (Law Press China, 2010) Vol 2, 201.

by giving false information to the insured about the benefits of the life policy (i.e. the insured can get a loan from the insurer of 80% of the premium paid), and also promised other benefits other than those provided for in the policy to the insured (i.e. the insured can receive a discount card from the insurer for payment of tolls on three motorways). After Mr Li effected five life policies, he did not received the discount card. Three years later, he got a loan from the insurer which was less than 50% of the premium he paid. It was held that the insurer's agent fraudulent misstatement of the insured benefits constituted a fraud. The Insurance contracts were entered into on the basis of the fraudulent misstatement, so the contracts were voidable. The insured's claim for avoidance of the contracts and recovery of the premium paid were upheld.

On the other hand, avoidance of the contract and recovery of the premium paid are not effective remedies to the insured where the insured event has occurred and he has suffered a loss which is covered by the contract.<sup>41</sup> Effective remedies should be available to compensate the insured for his loss due to the insurer's pre-contractual *culpa in contrahendo*. If the insurer's pre-contractual fault results in the invalidity of the insurance, the insurer must be liable for its fault and pay the insurance benefits. For example, in *Mr Xu v the life insurance company*,<sup>42</sup> the employer effected a comprehensive accident insurance policy with the insurer on the lives of their employees (including Mr Xu) for the benefits of the employees' family. The employer paid half of the premium and each life insured paid another half. Mr Xu presented his ID card and other relevant documents to the insurer's agent. The insurer would pay ¥60,000 for accidental death of the life insured under the policy. The insurer's agent did not ask the life insured to sign the proposal form but signed for the life insureds without being asked by the life insureds. Mr Xu was injured by a motor car and died as a result of the accident. His beneficiary claimed for the insurance benefits but was turned down by the insurer on the grounds that the insurance policy was void because Mr Xu did not give his consent to the policy as he did not sign the proposal form. According to the Insurance Law, a contract with death as the condition for payment of insurance benefits is invalid without the insured's consent thereto and acceptance of the sum insured in writing.<sup>43</sup> It was held that the

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<sup>41</sup> See R Merkin, *Colinvaux's Law of Insurance* (9<sup>th</sup> edn., Sweet & Maxwell, 2010) para. 6-124.

<sup>42</sup> This case is reported in the book of *Insurance Cases* by Z.J. Li, published by China Modern Economic Publishing House in 2007, p208.

<sup>43</sup> The Insurance Law 2002, art.56; The Insurance Law 2009, art.34. For more on insurable interest in life insurance in China, see Z. Jing, "Insurable interest in life insurance: a Chinese perspective" (2014) J.B.J.,337.

invalidity of the contract was due to the insurer's fault, so the insurer was liable for paying the insured amount (¥60,000) as a compensation.<sup>44</sup>

The remedies available to the grieved insured in the case of the insurer's breach of pre-contractual duty of good faith has been discussed for two situations. For the situation where the insurance contract is valid (but voidable) and the insured suffers no loss, the appropriate remedy to the insured is for him to avoid the contract and recover the premium paid. Alternatively, the insured may choose not to avoid the contract but affirm it. For the situation where the insurance contract is invalid, and the insured event has occurred and caused a loss, the insurer is liable to pay the insured's loss as a compensation for his pre-contractual fault.

There may be other situations where effective remedies are needed to the grieved insured. Where the insurer's intentional nondisclosure or misrepresentation does not affect the overall validity of the contract but recoverability of a claim under the contract, the insured should be entitled to the payment of the claim as a compensation for the insurer's intentional concealment of material facts or misrepresentation of information about the recoverability of the claim.<sup>45</sup> The recoverability of the claim mentioned here may relate to three elements: the coverage of the risk (i.e. whether or not the risk is covered under the policy), or the cause of the occurrence of the insured risk (i.e. whether or not the cause of the insured risk is covered), or the extent of the insurer's liability to the loss caused by the insured risk (i.e. whether or not the loss is fully or partly covered). All these three elements can affect the recoverability of a claim, so the insurer's intentional nondisclosure or misrepresentation of material facts about these three elements should be actionable and the insured' claim should be paid.

Another situation is that if the insurer prevents the insured from performing his duty to disclose material information, or induces the insured not to disclose material facts at the time of the contract,<sup>46</sup> the insurer should not be allowed to take the defence of the insured's nondisclosure or misrepresentation of the material information to avoid the contract and reject claims.

In certain situations, an insurer may not be required by the pre-contractual duty of good faith to disclose to an insured all material information relevant to the conclusion of the

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<sup>44</sup> According to art.58 of the Contract Law.

<sup>45</sup> In *Banque Financiere de la Cite SA v Westgate Insurance Co*, [1990] 1 QB 665 at 772, Slade LJ, speaking for the Court of Appeal, said the duty requires an insurer to disclose all facts known to it which are material to the nature of the risk sought to be covered, or the recoverability of a claim under the policy, which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer.

<sup>46</sup> The Insurance Law, art.116(3), and art.131(3).

contract. For instance, an insurer owes no duty to inform the insured of the current market price of the similar insurance policy, however material or important as the information may be to the insured's decision to enter into the contract. The duty of good faith owed by an insurer should not be extended to convert the insurer into some form of adviser.<sup>47</sup>

Art.42(2) of the Contract Law covers intentional nondisclosure (concealment) of material facts relevant to the conclusion of the contract or provision of false information, but does not cover negligent nondisclosure or misrepresentation. In other words, if nondisclosure or misrepresentation is a negligent one, it is then not governed by art.42(2). Under art.58 of the Contract Law, the party who was at fault shall compensate the other party for the loss caused thereby. Fault refers to the wilfulness or negligence of the conduct of the party in causing the invalidity of the contract. So the case of negligent nondisclosure or misrepresentation could be covered by art.58 of the Contract Law. However, art.58 deals with damages only for void or rescinded contracts. If an insurer's negligent nondisclosure or misrepresentation does not affect the validity of the insurance policy, but the recoverability of claims under the policy, there is no rules of law to follow for this situation either in the Contract Law or in the Insurance Law. Thus remedies provided by the Contract Law are inadequate for the grieved insured in the case of the insurer's breach of the pre-contractual duty of good faith. A new provision on remedies available to the insureds in this regard should be introduced to the Insurance Law.

Before attempting to make any suggestion and recommendation for introducing a new provision to the Insurance Law with respect to remedies available to the insured who has suffered loss due to the insurer's pre-contractual misleading conducts, it would be helpful and beneficial to take a look at the approaches taken in the United States in combating insurers' pre-contractual misconducts and remedies to the injured insured, as American law has developed effective approaches in handling unfair, deceptive or misleading acts and practices in the business of insurance.<sup>48</sup>

## **V. The Insurers' Pre-contractual Misleading Conducts and Remedies in American Law**

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<sup>47</sup> See R Merkin, *Colinvaux's Law of Insurance* (9<sup>th</sup> edn., Sweet & Maxwell, 2010) para. 6-124.

<sup>48</sup> For more on the regulation of insurer's misconducts in the USA, see M. Davies, "Insurer's pre-contractual disclosure obligations: The position in the United States of America" (2012) I.L.J., 23, p70, (hereafter Davies' paper).

In the United States, regulation of insurance practices is a matter of state law, with minimal federal intervention. The McCarran-Ferguson Act gives supremacy to state regulation of the business of insurance to the extent that the states choose to occupy the regulatory field.<sup>49</sup> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance unless such Act specifically relates to the business of insurance.<sup>50</sup> As a result, there is a wide variety of practices in controlling insurers' unfair or deceptive acts or practices in the business of insurance in the 50 states and other US jurisdictions.<sup>51</sup>

The insurer's pre-contractual misleading conducts are forbidden by specific statutes relating to insurance practices, or by general consumer protection legislation. In the state of New Mexico, art.16 (Trade Practices and Fraud) of the Insurance Code prohibits "unfair or deceptive act or practice" by insurers,<sup>52</sup> or the publication of "any estimate illustration, circular, statement, sales presentation or comparison" that misrepresents the benefits, advantages, conditions, terms, effects, or premium of an insurance policy,<sup>53</sup> or "untrue, deceptive or misleading" advertising.<sup>54</sup> If an insurer is in violation of these statutory restrictions, he will be imposed a penalty<sup>55</sup> and the grieved insured is granted a right to bring an action to recover actual damages caused by the insurer's violation of the statutory rules.<sup>56</sup> In *Azar v Prudential Insurance Co of America*,<sup>57</sup> the policyholders' claim was for failure by a life insurer to disclose the additional cost of paying premiums in instalments. The Court of Appeal of New Mexico held that the policyholders could rely on a statutory duty to disclose imposed by the Unfair Insurance Practice Act.<sup>58</sup>

Similarly, Pennsylvania's Unfair Insurance Practice Act (PUIPA) prohibits an insurer from engaging in any practices which is unfair or deceptive.<sup>59</sup> The PUIPA proscribes many unfair or deceptive acts or practices in the business of insurance at pre- and post-contractual stages. An insurer is prevented from making and publishing any estimate, illustration, circular, statement, sales presentation that misrepresents the benefits, advantages, conditions or terms

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<sup>49</sup> 15 USC §1012.

<sup>50</sup> 15 USC §1012(b).

<sup>51</sup> Davies' paper, p70.

<sup>52</sup> New Mex Stat §§ 59A-16-1, 59A-16-3(2014).

<sup>53</sup> New Mex Stat § 59A-16-4 (2014).

<sup>54</sup> New Mex Stat § 59A-16-5 (2014).

<sup>55</sup> New Mex Stat § 59A-16-29 (2014).

<sup>56</sup> New Mex Stat § 59A-16-30 (2014).

<sup>57</sup> 68 P 3d 909 (NM App, 2003).

<sup>58</sup> For more, see Davies' paper, p72.

<sup>59</sup> Unfair Insurance Practice Act, Act of July 22 1974, P.L.589, No.205, S.4 and S.5.



of any insurance policy,<sup>60</sup> and that makes false or misleading statement as to the circumstances relating to the insurance products.<sup>61</sup> The insurers shall not make and publish an advertisement, announcement or statement containing any representation or statement with respect to the business of insurance or to any person in the conduct of his insurance business which is untrue, deceptive or misleading.<sup>62</sup> The PUIPA also provides administrative penalty and civil penalties for any violation of the provisions of the Act. If the insurer commits any unfair or deceptive acts or practices, the Commissioner may suspend or revoke the insurer's licence,<sup>63</sup> and also impose a fine as a civil penalty.<sup>64</sup> However, the PUIPA does not provide the grieved insured with a private right of action against the defendant insurer.

California's Unfair Insurance Practice Act (CUIPA) proscribes many different kinds of deceptive acts or practices in the business of insurance, including misleading statements about the contents, benefits or advantages of policies, or misleading advertising.<sup>65</sup> The Supreme Court of California has held that CUIPA itself does not create a private right of action,<sup>66</sup> but CUIPA is used by the insureds in conjunction with California's general Unfair Competition Law<sup>67</sup> as the basis for statutory action against insurers.

In some other states (such as Colorado, Delaware and Massachusetts), where there is no unfair insurance practice legislation, or where the unfair insurance practice legislation does not confer a private right of action, plaintiffs have turned to their states' general consumer protection statutes,<sup>68</sup> which usually protect consumers against misleading or deceptive conduct and other predatory business behaviour.<sup>69</sup> Most state courts have held that the sale of insurance is the sale of a service,<sup>70</sup> or property,<sup>71</sup> or both,<sup>72</sup> and thus is caught by the general consumer protection legislation. In contrast, in those states (such as Georgia and

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<sup>60</sup> PUIPA, S.5(1).

<sup>61</sup> Ibid.

<sup>62</sup> PUIPA, S.5(2).

<sup>63</sup> PUIPA, S.9.

<sup>64</sup> PUIPA, S.11. S.11(1) provides that for each unfair or deceptive acts which the insurer knew or reasonably should have known to be in violation of the PUIPA, a penalty of not more than five thousand dollars (\$5,000) for each violation but not to exceed an aggregate penalty of fifty thousand dollars (\$50,000) in any six month shall be imposed on the insurer. S.11(2) provides that for each unfair or deceptive acts which the insurer did not know nor reasonably should have known to be in violation of the PUIPA, a penalty of not more than one thousand dollars (\$1,000) for each violation but not to exceed an aggregate penalty of ten thousand dollars (\$10,000) in any six month shall be imposed on the insurer.

<sup>65</sup> Cal Ins Code § 790.03.

<sup>66</sup> *Moradi-Shalal v Fireman's Fund Insurance Co* 759 P 2d 58 (Cal, 1988).

<sup>67</sup> Cal Bus & Prof Code § 17200.

<sup>68</sup> *Dodd v Commercial Union Insurance Co* 365 NE 2d 802 (Mass, 1977); *Showpiece Home Corp v Assurance Co of America* 38 P 3d 47 (Colo, 2001); *Grand Ventures Inc v Whaley* 622 A 2d 655 (Del Supeer, 1992).

<sup>69</sup> For more, see Davies' paper, p74.

<sup>70</sup> *Wagner v Travelers Property Casualty Co of America* 209 P 3d 1119 at 1129 (Colo App, 2008).

<sup>71</sup> *Showpiece Home Corp v Assurance Co of America* 38 P 3d 47 (Colo, 2001).

<sup>72</sup> *Dodd v Commercial Union Insurance Co* (1977) 365 NE 2d 802 (Mass, 1977).

New Hampshire) where the specific legislation relating to unfair insurance practices does not provide a private right of action for the grieved insured, an action may not be brought under general consumer protection legislation.<sup>73</sup>

In summary, American law in relation to the insurer's pre-contractual misleading conducts varies from state to state. Some states combat insurers' misconducts by unfair insurance practice legislation which punishes the defendant insurers by penalties, and at the same time may (or may not) confer a private right of action upon the injured insureds to claim actual damages as a result of the insurer's unfair or deceptive acts or practices. Some other states prohibits the insurers' misconducts by way of consumer protection legislation. So there are many different types of provision prohibiting the insurers from committing unfair and deceptive acts or practices in the business of insurance.

## **VI. Recommendations for Effective Remedies**

The Insurance Law imposes on an insured a statutory duty of truthfully disclosing material facts to the insurer before concluding the contract.<sup>74</sup> If the insured failed to comply with the duty of disclosure, the insurer has different remedies depending on the insured's state of mind and consequences of the breach.<sup>75</sup> Only for intentional or grossly negligent nondisclosure or misrepresentation of material facts by the insured, the insurer is entitled to set aside the contract,<sup>76</sup> while negligent or innocent nondisclosure or misrepresentation is not actionable.

The insurance Law does impose on an insurer a pre-contractual duty to explain the content of the insurance contract to the insured, but does not provide any remedy for the insurer's breach of the duty.<sup>77</sup> Art.17(2) of the Insurance Law also requires the insurer to make specific and clear explanation of the clauses which exclude the insurer's liability, the remedy for the insurer's failure to comply with the duty is that the exclusion clauses are not effective.

There is no provision in the Insurance Law relating to the insurer's pre-contractual liability. It is suggested that it is necessary to add one provision into the Insurance Law to impose on the insurers the pre-contractual liability and also to set forth remedy available to

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<sup>73</sup> *Bell v Liberty Mutual Insurance Co* 676 SE 2d 428 at 434 (Ga App, 2009); *Northeast Georgia Cancer Care LLC v Blue Cross & Blue Shield of Georgia Inc* 766 A 2d 1260 (NH, 2001).

<sup>74</sup> The Insurance Contract Law, art.16(1).

<sup>75</sup> The Insurance Law, art.16(4) and (5). For more, see Z. Jing "Remedies for breach of the pre-contract duty of disclosure in Chinese Insurance Law" [2015] B.L.I (forthcoming), and H.Y.Yeo, Z. Yu and J. Chen, "Of remedies and non-disclosure in the insurance law of the People's Republic of China" [2011] J.B.L. 566.

<sup>76</sup> The Insurance Law, art.16(2).

<sup>77</sup> Insurance Law, art.17(1).

the insureds in the case of the insurers' breach of pre-contractual duty as provided in article 116(1) to (3) of the Insurance Law. This new provision could be phrased as follows:

*“An insurer shall be liable for compensation if he, in the course of concluding the contract, causes damage to the insureds in one of the following situations:<sup>78</sup>*

- (1) Cheating the insured, the life insured or the beneficiary;*
- (2) Concealing from the insured material information relevant to the insurance contract or giving false information about the insurance product;*
- (3) Preventing the insured from fulfilling his obligation of making truthful disclosure of material facts or inducing them not to fulfil such an obligation;*

*Where the insurer's fraud, intentional or unintentional (negligent or innocent) nondisclosure or misrepresentation of material facts has induced the insured to enter into the contract, (i) the insured may avoid the contract and recover the premium paid before the insured's event occurs; (ii) the insured is entitled to claim for insurance payment if the insured event occurs and causes losses; or (iii) if the insurance contract is void due to the insurer's fault, and the insured event has occurred and caused loss, the insurer is liable to pay the insured's loss as a compensation for his pre-contractual fault.*

*Where the insurer prevents the insured from performing his duty to disclose material facts, or induces the insured not to disclose material facts, the insurer shall not take the defence of insured's nondisclosure or misrepresentation to avoid the contract and reject claims.”*

In addition to the remedies proposed above specifically for the insurer's breach of pre-contractual duties, and in order to provide an aggrieved insured with an effective remedy for all misconducts (pre- and post-contractual) as proscribed in articles 116 and 131 of the Insurance Law, it is suggested that a private right of action be conferred upon the insured as follows:

*“An insured who has suffered damages as a result of a violation of articles 116 and 131 of the Insurance Law by an insurer or agent or broker is granted a right to bring an action against the defendant to recover actual damages.”<sup>79</sup>*

## **VII. Conclusion**

The Insurance law prohibits an insurer's from practising misleading conducts in advertising and sales of insurance policies, and also other misconducts as provided in article 116 and 131

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<sup>78</sup> This is referred to art.42 of the Contract Law.

<sup>79</sup> This is referred to S.59A-16-30 of New Mexico's Insurance Code.

of the Law. The CIRC has provided some guidelines for determination of the insurer's misconducts. When an insurer is in violation of the provisions, the Insurance Law provides administrative and civil penalties to punish the defendant insurer, but does not provide a private right of action to the grieved insured who has suffered loss as a result of the insurer's misconducts. It is suggested that the insured should be entitled to claim damages from the defendant insurer for his misleading conducts. Some effective remedies for the insurer's breach of the pre-contractual duty of disclosure and misrepresentation have been proposed with reference to the Contract Law and the approach taken in the New Mexico' Insurance Code. These remedies should be introduced into the Insurance Law in the future reform of the Law.