

Study on the Obligation of Notification of Increased Risks in China's Insurance Law

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Abstract: *This article discusses the obligation of notification of an increase in risk and analyses its problems under the current legal framework, including the vague criterion of 'significant increase', the single subject of performance of the duty and the narrow scope of application. The article pointed out that the definition of increased risk should be clearer and the criteria for judgement should include factors such as seriousness, continuity and unpredictability; at the same time, it was suggested that the policyholder should also be included as a subject of the duty of notification, so as to enhance the flexibility and objectivity of the fulfilment of the obligation. In addition, it is proposed to extend this obligation to life insurance, in particular 'class III insurance', in order to restore the balance of consideration in insurance contracts. These improvements will better guarantee the fairness of insurance contracts.*

Keywords: *obligation of notification of increased risks, insured, contract*

1. Introduction

In order to study the obligation of notification the increase of danger, it is necessary to clarify the meaning of 'increase of danger'. However, the Insurance Law of the People's Republic of China does not provide a clear definition, nor do the relevant judicial interpretations. The concept is dispersed throughout the text, mainly in article 49, paragraph 3, which deals with the increase in risk resulting from the transfer of the subject matter of the insurance, and in article 52, which refers to the change in risk caused by factors internal to the subject matter of the insurance. Taken together, the obligation of notification an increase in risk means that if there is an unforeseeable and significant increase in the risk of the subject matter of the insurance during the validity period of the insurance contract, the policyholder or insured shall fulfil the obligation of notification in accordance with the contractual agreement. This obligation helps to safeguard information transparency, ensure fair contract enforcement and has a significant impact on insurers' risk assessment and rate adjustments. However, the current provisions of the Insurance Law on this obligation are rather broad, and there are problems such as vague standards, unclear subjects of fulfilment and narrow scope of application, which will be discussed in depth in this paper and suggestions for improvement will be made.

2. Problems in the notification obligation of increased risk

2.1. Significantly increased risk is vaguely defined

An agreed peril increase usually means that, when an insurer enters into a contract with a policyholder, it will expressly include in the terms of the contract circumstances that may lead to a significant increase in risk. However, in practice, there is often ambiguity in the definition of 'significant increase in risk', which makes it possible for some insurers to take advantage of this ambiguity to disguise certain situations as increased risk clauses in order to avoid due insurance liability.^[1] In practice, certain risk factors are difficult to predict accurately at the time of the conclusion of an insurance contract, and judgement on these factors often relies on subjective perceptions, creating difficulties in identification and determination. The criteria for defining the increase in danger have been the subject of extensive controversy in both theoretical and practical circles, and disputes arising from them have been on the rise year after year, making it particularly urgent to clearly define the specific criteria. Article 4 of Judicial Interpretation IV of the Insurance Law provides seven factors that can be taken into account in determining a significant increase in peril, including the use of the subject matter of the insurance, changes in the scope of use, changes in the environment in which it is located,

the impact of modifications, changes in the user or manager, and the duration of the increase in peril. Such factors play a critical role in determining whether an insurer will continue coverage or adjust rates. In fact, during the performance of an insurance contract, any change in the relevant factors may lead to an increase in risk. Therefore, when these factors change, it is important to carefully assess whether they are sufficient to trigger a significant increase in hazard and to make judgements accordingly. However, looking at the current legal framework, we can see that the existing legislation does not yet fully grasp the core meaning of the concept of 'increased risk' and, in particular, fails to accurately identify those risk factors that are sufficiently serious to upset the balance of consideration in an insurance contract. This neglect may affect the insurer's decision as to whether a premium adjustment, or even cancellation of the contract, is necessary. Although the Insurance Law has enumerated some specific situations of increased risk through judicial interpretations, these specific provisions are often too detailed and fail to adequately take into account the increasingly complex and volatile realities of the insurance market. Such overly specific provisions not only lack flexibility, but also fail to adapt to changing market needs, and may therefore be more difficult to apply in practice.

2.2. Single subject of obligation fulfilment

At present, there are three main situations in civil law systems regarding the division of the subject matter of the obligation of notification of the increased risk. Firstly, as represented by the Macao region of China, it only stipulates that the policyholder bears the obligation of notification. Secondly, as represented by Japan and Germany, the obligation of notification is shared by the policyholder and the insured. Thirdly, the current Insurance Law of China stipulates that the subject of the obligation of notification is only the insured. Normally, the insured, as the owner of the subject matter of the insurance, has the most direct knowledge of the actual situation and the degree of risk of the subject matter of the insurance, and therefore should be under an obligation of notification the increase in risk. As some scholars have pointed out, in the practice of insurance contracts, the policyholder and the insured are often not the same person, when the subject of the obligation of notification the increase in risk should be the insured, not the policyholder.^[2]

According to the current provisions of the Insurance Act, the subject of fulfilment of the obligation of notification an increase in risk is limited to the insured. This means that the insured is obliged to fulfil the obligation of notification to the insurer only if there is a significant increase in the risk of the subject matter of the insurance. However, this provision fails to adequately take into account the diversity and complexity that exist in insurance practice and lacks flexibility, which may affect the effective safeguarding of the balance of consideration. In a property insurance contract, the insured is usually the direct victim of the damage caused by the insurance accident and has the right to claim for compensation, while the policyholder is the party that enters into the contract with the insurer and pays the premium. In most cases, the policyholder and the insured are the same person, and the policyholder is usually also the owner of the subject matter of the insurance or a person with a close interest in the subject matter. As a result, the policyholder is usually more aware of the risk profile of the subject matter of the insurance than the insured, and has a greater ability to fulfil the notification obligation. However, with the development of the insurance market, the separation of the policyholder and the insured is becoming more and more common. In such cases, although the policyholder is usually better informed than the insured about the content of the insurance contract and the risk profile of the subject matter, there is no obligation of notification. This practice may result in the inability to adjust contracts in a timely manner to fix imbalances in consideration, affecting the fairness of insurance contracts, and is not conducive to improving the efficiency of the insurance industry. Therefore, the current provisions, which limit the obligation of notification to the insured, do not adequately reflect the actual situation in the developing market and need to be improved.

2.3. Excessively narrow scope of application of the obligation

Depending on the subject matter of the insurance, insurance contracts are usually divided into property insurance contracts and personal insurance contracts. In order to extend the scope of application of the obligation of notification the increase of risks, there is no uniform view in the academic community as to whether life insurance contracts should be included. Some scholars have argued that the application of the obligation cannot be ruled out in certain personal insurance contracts, where an increase in peril is equally likely to occur and where ignoring the obligation could undermine the principle of balance of consideration in insurance, while others have argued that most of the significant risks in personal insurance contracts are already excluded by exclusion clauses, so that there

is no need to create a further obligation of notification.

Although premiums in an insurance contract are not equivalent to an exchange of insurance liabilities, and on the face of it, the payment of lower premiums by the policyholder in exchange for higher compensation may seem to make the insurer bear the loss, this does not violate the principle of the balance of consideration when viewed as a whole. Insurance companies pay out from a 'pool' of funds shared by the entire policyholder community. If the insured's risk increases and the insurer continues to underwrite the policy according to the original contract, it may lead to a vicious overdraft of the 'pool of funds', thus undermining its risk diversification function. Therefore, in the author's opinion, if the obligation of notification the increase of danger is limited only to property insurance contracts, it will inevitably make the scope of its application too narrow, and it will be difficult to restore the balance of interests in the contract in a timely manner.

3. Refinement of the duty to notification of an increase in risk

3.1. Clarifying the criteria for determining the obligation of notification of increased risk

In practice, when applying the system of the obligation of notification of an increase in danger, it is first necessary to clarify what kind of situations are considered to be an increase in danger and to define the characteristics of those situations. Clarifying these criteria will not only help judges to make fair and reasonable judgements in judicial practice, but will also provide a theoretical basis for judgement.

Firstly, the increase in peril must be sufficiently serious to exceed the original scope of the risk set by the insurance contract, which is essential for the adjustment of the contract. Severity is the key criterion for rating increased risk and can be understood as a quantitative to qualitative transformation. When the risk reaches a certain level, the insurance contract will be exposed to more risk than its original underwriting capacity, and the further increase in risk will directly affect the stability and affordability of the contract. Therefore, severity is the criterion that must be focused on.

Secondly, the increase in risk must be of a continuing nature. The occurrence of a risk is not sufficient to constitute an increase in risk if it is temporary and can be eliminated. In other words, only risks that go beyond contractual expectations and are difficult to address in the short term should be taken into account. These risks must arise during the life of the contract and not be risks that already existed before the contract was signed. Only a continuing and unavoidable danger needs to trigger the obligation of notification.

Finally, the increase in risk should be unforeseeable by the policyholder or insurer at the time of the contract. If certain potential risks have been foreseen by the policyholder at the time the contract was concluded and have been accounted for in the premium accordingly, the risk should not be treated as an increase in risk. In other words, only those risks that could not have been foreseen at the time of the contract and were not included in the premium risk assessment fulfil the criteria for increased peril.

As to whether the obligation of notification the increase of risks should be applied in specific cases, I believe that there is no uniform criterion, but rather that the court should make a decision on a case-by-case basis. Premium adjustment or contract cancellation clauses should not be triggered if the increase in peril is due to an intentional act of the policyholder, the insured or the insurer. On the contrary, in the case of an increase in risk that was not foreseen at the time of the conclusion of the contract, the court should assess it on the basis of the above criteria, taking into account the specific circumstances. The current approach of relying on the criterion of 'significance' for determining increased risk is likely to be more difficult in practice. The vagueness of the existing legal framework regarding the criteria for making judgments makes it difficult to make accurate judgments in some complex situations. Therefore, it is necessary to further refine and clarify the criteria for increased risk, and introduce more factors of judgement in addition to significance, so as to ensure the fairness and reasonableness of the application of the law and to enhance its practicality in judicial practice.^[3]

3.2. Appropriate expansion of the subjects of obligation enforcement

Concentration of power often leads to loss of control and abuse. Similarly, if the obligation of notification of increased risk is too singularly limited to the insured, it may lead to ambiguous factual determinations, which in turn may lead to overly subjective judgments, affecting the fairness and reasonableness of the insurance contract. Therefore, in dealing with cases relating to the obligation of notification of an increased risk, it is not possible to treat the insured alone as the sole subject of the

enforcement of the obligation. The main reasons for this are: firstly, when there is an increase in danger, certain interests of the insured are often involved, so when fulfilling the obligation of notification, the insured may, out of consideration of its own interests, exaggerate or reduce the extent of the increase in danger, thus making it impossible for the implementation of the obligation of notification to be completely objective and fair, and thus affecting the insurer's judgement. Including the policyholder also as a subject of the obligation of notification can provide the insurer with more sources of information and help it to obtain more comprehensive and objective relevant reference facts. Secondly, there is often a closer relationship between the policyholder and the insured, and the policyholder is usually in a better position to keep track of the insured's situation. In practice, if the insured fails to fulfil the obligation of notification the increase in risk for some reason, the policyholder is usually able to detect the relevant changes in the first instance and take the initiative to fulfil the obligation of notification by reporting the risk information to the insurance company in a timely manner. This not only helps to ensure that insurers have access to timely and accurate information, but also enables them to quickly restore the contractual balance of consideration through measures such as adjusting the terms of the policy or cancelling the contract, so as to avoid imbalance of risk due to asymmetry of information. The policyholder has a greater ability and responsibility to fulfil its obligation of notification in such circumstances, which better protects the fairness and validity of the insurance contract. Therefore, recognising the policyholder as the subject of obligation performance under certain appropriate circumstances can effectively promote the smooth performance of the insurance contract and ensure the rights and interests of both parties to the contract. In addition, because of the information asymmetry that often exists between the parties to an insurance contract, especially between the insurer and the insured, the parties have opposing positions in terms of risk-taking capacity and contractual terms. Typically, the insurer charges higher premiums to take on a larger risk, while the insured passes on a larger percentage of the risk to the insurer by paying relatively low premiums. Although the Insurance Law has clearly required the insured to fulfil the obligation of notification of an increase in risk, many insured persons have failed to actively fulfil this obligation for their own reasons due to insufficient enforcement of the legal consequences. Such a situation often results in the balance of risks in an insurance contract being affected, with the insurer potentially facing an additional risk burden and the insured potentially avoiding liability for failure to fulfil its obligations. In addition, in many cases, the policyholder is more aware of the contents of the contract than the insured, especially in specific types of insurance where the policyholder may have taken out the policy for the sake of the insured, such as accident insurance. At this point, the policyholder is in an advantageous position and is in a better position to detect an increased risk in a timely manner. If the policyholder is also included as a subject for the fulfilment of the obligation of notification of an increase in risk, it will help to maintain the balance of consideration in the insurance contract more effectively, thus ensuring the fairness and integrity of the contract. In this way, the policyholder, as the main party to the contract, is able to identify and report changes in risk in a timely manner, which helps the insurer to more accurately assess the risk and make adjustments accordingly, thus avoiding any imbalance in contractual interests due to asymmetric information or untimely fulfilment of obligations.

To sum up, on the subject of the fulfilment of the obligation of notification the increase of danger, the provisions that only the insured bears the obligation should be changed in accordance with the actual situation of the specific case, and the policyholder and the beneficiary should be included appropriately, so as to protect the lawful rights and interests of both parties to the contract more effectively, and to ensure that the insurance contract maintains its balance and fairness in the process of dynamic changes.

3.3. Extension of the scope of application of the obligation

Some current theories suggest extending the obligation of notification of an increase in risk to the field of personal insurance, but at present China's Insurance Law expressly provides for such an obligation only in property insurance.^[4] With the continuous evolution of the insurance market, the variety of insurance products has become more and more diversified, in particular, the 'third type of insurance' (insurance that combines property and personal protection) has gradually come to the fore, and this type of insurance has a strong compensatory and predictable nature. In order to effectively maintain the balance of consideration in insurance contracts, it is necessary to extend the scope of application of the obligation of notification an increase in peril in due course, particularly in view of the unique risk characteristics that may be brought about by 'third type of insurance'.

The core purpose of the legislative creation of the obligation of notification is to maintain a balance of consideration between the parties to a contract. It is clear from international and regional legislative

practice that this obligation does not apply only to property insurance. For example, the insurance legislation of civil law countries such as Germany and Japan, as well as China's Taiwan, has expressly provided for this obligation in the general provisions of the insurance law. These legislative experiences show that the risk to which an insurance contract is exposed in the course of its performance always exists objectively, irrespective of the changes in the subject matter of the insurance, and that the specific manifestations of the increase in peril vary with the subject matter of the insurance. In life insurance, increased risk often results in a no longer balanced relationship of consideration between the parties to the contract. When the subject matter of an insurance policy involves a level of risk that exceeds the scope of the original contract, the risk borne by the insurer increases, which has a direct impact on the insurer's interests. Therefore, in order to restore fairness and balance of consideration in contracts, legislation should intervene appropriately in such changes. In both property and personal insurance, the insured should be obliged to notify the insurer in a timely manner if there is a significant increase in the risk of the subject matter of the insurance. This obligation of notification is not only a protection of the insurer's interests, but also an important measure to safeguard the stability of the insurance contract. In the future, with the further improvement of the insurance law, consideration should be given to expanding the scope of application of this obligation within the existing legal framework, in particular to cover the field of life insurance. It is possible to draw on the experience of Germany, Japan and other countries to specify the scope of application of the obligation of notification the increase of risk in the general provisions of the insurance law to ensure that it plays its proper role in all types of insurance contracts.

From a broader perspective, increased risk is an objectively existing circumstance in an insurance contract, and the parties to an insurance contract must maintain a reasonable balance of rights and obligations. If this balance is upset, it will inevitably have an adverse impact on the healthy development of the insurance market. Therefore, whenever there are factors that upset the balance of consideration, whether in property or life insurance, that balance should be restored in a timely manner by legal means. This is a consideration based on the nature of the insurance contract and its function. Combined with the actual situation in China, although life insurance is special and the full application of the obligation of notification the increase of risk may have certain operational challenges, with the gradual emergence of the 'third type of insurance', this type of insurance has property attributes as well as certain characteristics of personal protection, and it is possible to adjust the premiums to balance the contractual relationship of consideration. Therefore, in order to promote the stability and healthy development of the insurance market, it has become a non-negligible legislative need to reasonably expand the scope of application of the obligation of notification of increase in risk, especially in the field of life insurance. This is not only in line with the trend of the development of the insurance market, but also better reflects the core spirit of the principle of honesty and good faith in China's Insurance Law, and protects the fairness and effectiveness of insurance contracts.

4. Conclusions

In summary, the obligation of notification of an increase in peril is a crucial element of the insurance contract, centred on maintaining the balance of consideration in the insurance contract. However, there are still many deficiencies in the provisions of the existing Insurance Law regarding this obligation, including the vague definition of 'significant increase', a single subject for the fulfilment of the obligation, and an excessively narrow scope of application. In order to address these issues, there is an urgent need to further improve the relevant legal provisions. Specifically, the criteria for increased risk should be clarified, the scope of subjects subject to fulfilment of the obligation of notification should be broadened, and its application should be extended to more types of insurance contracts, including life insurance. In addition, taking into account the development and practical needs of the insurance market, the existing legal framework should be adjusted to give full consideration to the balance of interests between the two parties to the insurance contract, so as to ensure the fairness and adaptability of the insurance law. These improvements will help promote the healthy development of the insurance industry and safeguard the fairness and validity of insurance contracts, thereby better safeguarding the rights and interests of policyholders, insured persons and insurers.

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