

The Essential Provisions in the PRC Reinsurance Contract

It is often puzzling and difficult for foreign reinsurers to navigate through Chinese legal frameworks on reinsurance contracts, especially since there are relatively fewer regulations to offer guidance on reinsurance contracts compared to the extensive regulations on direct insurance.

Moreover, since the reinsurance business often involves small groups of close acquaintances, it is often the case that the parties neglect the wording of reinsurance contracts.

During the past five years, the Chinese courts and arbitration institutions handled massive disputes related to reinsurance contracts. Those cases facilitated legislation in the reinsurance sector and aroused attention towards more careful wording of reinsurance contracts.

Based on our practice and experience, we list several essential provisions of reinsurance contracts under PRC law as follows.

- Conditions Clause

In some jurisdictions, a party in breach of the conditions clause of a reinsurance contract shall be liable for the relevant risks caused therefrom and the other party shall have the right to cancel or terminate the contract. However, such conditions clauses are not commonly used in PRC reinsurance practice, which means a party's breach of the condition clause does not necessarily mean that the other party can refuse to assume responsibility or terminate the contract, unless such a breach constitutes a fundamental breach of contract or a special remedy is stipulated for such a scenario. To avoid a potential dispute, further clarification should be made in the reinsurance contract, especially to stipulate a remedy for such a violation. An example of how a clause might operate is as follows:

The parties shall abide by the clauses hereunder. Failure of any party to comply with any of the provisions of the Conditions, regardless of the severity of the failure, constitutes a substantial breach of this reinsurance contract and the other non-breaching party has the right to terminate this reinsurance contract.

- Addendum Correspondence Clause

A typical wording of the Addendum Correspondence Clause is similar to as follows:

All mutually agreed alterations to the terms and conditions of this reinsurance contract shall be binding upon both parties and be deemed to form an integral part hereof.

In addition to the wording above, it would be better to further clarify that all the subsequent documents that forms a part of the reinsurance contract shall be duly signed by the reinsured and the reinsurer to avoid potential legal disputes. In PRC practice, there were some disputes in which reinsurers refused to cover the subsequent risks because the relevant amendments and documents were not signed by the reinsurers.

- Intermediary Clause

Brokers play a critical role in the placement of reinsurance. Thus, the broker is mentioned in the reinsurance contract to clarify the broker's responsibilities despite the fact that the broker is not a party to the contract.

According to the provisions of Article 117 of Insurance Law of PRC, *an insurance agent is "an organization or individual that is entrusted by an insurer to handle insurance businesses within the scope authorized by the insurer and collects commissions from the insurer."* As per the provisions of Article 118, *an insurance brokerage is "an organization that provides intermediary services for conclusion of an insurance contract between a policyholder and an insurer for the benefit of the policyholder, and collects commissions pursuant to the law."* Thus, under PRC law, the broker is deemed to be the representative of the reinsured instead of the reinsurer in a reinsurance relationship, unless otherwise stated.

Generally speaking, brokers handle the business under the authorization of the reinsured or reinsurers. However, to avoid potential misunderstandings and ambiguity under PRC law, amendments should be made to clarify the legal relations between the reinsured, reinsurer and the broker in the reinsurance contract.

- Arbitration Clause

In PRC, most reinsurance parties prefer to select arbitration, rather than litigation, as the means to resolve disputes.

According to the provisions of Article 16 of PRC Arbitration Law, an arbitration agreement shall include the following: (1) an expression of intent for an arbitration, (2) the subject matter of arbitration, and (3) the chosen arbitration institution.

The exact location of the arbitration, the arbitration rules, and the arbitration language are not requisite information for the arbitration clause. In PRC, it is beneficial for the reinsurance parties to describe the arbitrators' background in the reinsurance contract because only a few arbitrators have reinsurance backgrounds and could better understand the reinsurance business.

- Offset/Set-off Clause

Offset Clauses are common in PRC reinsurance contracts.

An example of the Offset Clause is as follows:

Either party may at its discretion offset against any amounts advised to and due from the other party hereunder any amounts which have been previously advised and are due at that time under this or other Agreement.

However, this clause may bring out many questions on ascertainment of basic facts if it includes the underlined words because other agreements, other parties and/or other legal relationships may be involved.

Furthermore, according to the Management Rules for Reinsurance of Property Insurance Companies/《财产保险公司再保险管理规范》, the Notice on Strengthening Financial Fund Management/《关于加强财务资金管理的通知》, the Basic Guidelines for Internal Controls in Insurance Company/《保险公司内部控制基本准则》 and the Standards for the Financial and Accounting Work of Insurance Companies/《保险公司财会工作规范》, the premium income and commissions of insurance companies shall be managed in accordance with the rule of “two lines of revenue and expenditure.” That means, when business is carried out, it is necessary to calculate and manage the commission account and premium account separately. As such, the current wording and implementation of common offset clauses might breach the financial and accounting regulations of PRC insurance companies.

- Line Slip

“A line slip is an authority given in writing by a number of underwriters which enable the leading underwriter(s) to agree to proposals for (re)insurance of risks within a prescribed class on behalf of all underwriters subscribing to the line slip provided that the proposed (re)insurance is within the scope of the terms of the authority” (Balfour v. Beaumont (1982) 2 Lloyd’s Rep. 493).

A line slip is seen as giving a market-delegating authority to the leading reinsurer(s), creating an agency relationship between the lead reinsurer(s) and following reinsurers. Despite the fact line slip is common practice in the reinsurance market, the PRC laws and regulations have not set out special rules for the relations between the lead reinsurer and following reinsurers.

Another common source of dispute is vague language in the reinsurance contract regarding each party’s role, which has resulted in litigations and arbitrations. We would

recommend a clear scope of authorization of the leading reinsurer (what kind of risks can the reinsurer underwrite, whether separate signatures of the following reinsurers are required for special risk acceptance) in the reinsurance contracts governed by PRC law.

The utmost good faith is also the most essential doctrine in PRC insurance and reinsurance law. If there are no clear or specific legal provisions in the reinsurance contract, the reinsurer and reinsured would unsurprisingly use the utmost good faith to interpretate the reinsurance contract. However, to avoid any vagueness and ambiguity, it would be wise to stipulate the aforementioned provisions in the reinsurance contract.