

**Legislative Council Panel on Manpower
Meeting on 18 January 2001**

The Employees' Compensation System in Hong Kong

Introduction

In late November 2000, the Hong Kong Federation of Insurers (HKFI) released a report (the Report) by consultants who were commissioned to review the performance of Hong Kong's employees' compensation (EC) insurance business and to come up with possible measures for reform.

2. In preparing the Report, the consultants had conducted extensive discussions with insurers, as well as its own investigations and analyses. The Report notes that as a result of escalation in compensation and related payments in the last decade, currently the EC business is under-funded by around \$2 billion per annum. The consultants examined causes for under-funding, and proposed possible measures for reform. The executive summary of the Report is at **Annex**.

3. On the basis of the Report's findings and proposals, HKFI announced publicly that they would follow up some proposals pertaining to the operation of insurers underwriting the EC business. HKFI also called on the Government to consider making improvements to the EC system.

4. This paper provides the Administration's response to the proposals contained in the Report.

Relevant Legislative Provisions

5. The Report makes references to the EC system as prescribed by the Employees' Compensation Ordinance (ECO), the common law damages awarded by the court in employment-related injuries as well as the operation of the insurance industry in underwriting EC insurance. It is therefore relevant to provide background information in relation to these aspects.

6. The ECO provides for the payment of compensation by individual employers to employees and family members of deceased employees for injuries and fatalities caused by employment-related accidents or for specified occupational diseases. It operates on the basis of a 'no-fault' system. The ECO does not limit the right of injured employees to claim common law

damages against the employer if the latter has been at fault in respect of the accident. If employers' negligence is proven, the amount of compensation payable under the ECO is set off from the amount of damages awarded by the court.

7. Since liability to pay compensation and damages rests with individual employers, the ECO requires employers to take out insurance to cover liabilities under the ECO and in respect of common law damages, to ensure that they would be able to discharge such liabilities as and when required to do so.

8. As regards the under-funding situation, the Insurance Companies Ordinance (ICO) requires insurers to submit annually their financial statements to the Commissioner of Insurance for examination, including a review of their compliance with the solvency margin requirement. Where there are areas of concern, an insurer will be required by the Commissioner to submit its financial statements more frequently, for example on a quarterly basis. Early remedial actions, such as requirement for capital injection to address any solvency deficiency, will be taken against the insurer concerned in order to protect policyholders. In respect of each line of business of an insurer, including EC, the Commissioner also requires the insurer to hold a reserve to cover future liabilities in that particular line of business.

The Administration's Response

Proposed measures relating to the operation of the insurance industry

9. According to the Report, the total amount of EC doubled over the past six years but the amount of premium collected decreased by half, resulting in serious under-funding of the EC insurance business. The consultants note that keen competition in the market has driven down the premium income to a level which could not adequately match the liabilities that insurers are exposed to.

10. The Report proposes a number of remedial measures such as reformulating the premium-fixing strategy, enhancing information management and data collection on occupational safety records, and introducing insurer-sponsored anti-fraud initiatives. The Administration considers that these proposals constructive and urges the insurance industry to make concerted efforts to put them into practice.

11. The consultants note that commission paid to intermediaries accounts for as much as 23% of premiums, which is excessively high, and propose to introduce statutory limit on commission levels. In a free market environment,

however, the fixing of premium rates, of which commission payable to intermediaries is an integral part, is a commercial decision for insurers. The Administration does not consider it appropriate to intervene. Indeed, the Administration is debarred from doing so under section 26(3A) of the ICO. The Administration notes that the consultants have also proposed an alternative for insurers to introduce a more structured method of premium calculation, such that commission costs are accurately and effectively factored into the calculation.

12. Nothing that a lack of quality data concerning scheme performance and a lack of pricing disciplines have also contributed to variability in premiums and current under-funding, the consultants propose that the industry should commence collecting extensive premium and claims data. The Office of the Commissioner of Insurance acknowledges the importance of transparency and will explore this proposal further with HKFI.

13. To reduce management expenses, the consultants propose that consideration should be given to limiting the number of insurers to those which would satisfy licensing conditions, such as market share and the provision of statistical data for the purpose of monitoring scheme performance and pricing. The Administration considers that it is not appropriate to limit the number of insurers that can carry on EC insurance business as long as an insurer has the financial resources and expertise required by the ICO. The Administration believes that competition brings with it improved services to the public.

Proposed measures relating to the employees compensation system

14. The Administration agrees with paragraph 5 of Part II of the Report, which states that the existing employees' compensation system has been able to provide fair and equitable compensation to employees injured at work as well as family members of deceased employees. The Administration has regularly reviewed the provisions of the ECO to improve employees' benefits. In formulating any improvements to compensation benefits, it is our practice to consult the insurance industry on the premium impact. Therefore, insurers are fully aware of their exposure arising from improvements to the statutory compensation and should make provisions to meet the additional liabilities.

A tiered or step-down approach to the entitlement of statutory compensation

15. The consultants believe that the existing rate of periodical payments payable at four-fifths of pre-injury earnings to an injured employee during sick leave would induce him or her to stay on sick leave rather than to return to work early. They therefore propose to reduce periodical payments to 67% of pre-

injury earnings for injured employees who have been receiving benefits for more than six months. In this regard, it should be noted that the length of sick leave is decided by a registered medical practitioner or the Employees' Compensation Assessment Board after taking into account the medical conditions of the injured employee. There is no reason to believe that these independent professionals would make biased and unfair decisions. Moreover, according to the Labour Department's statistics, for all compensation claims with sick leave of more than three days and settled in 1999, 75% were granted sick leave of less than 30 days and 95% less than six months. Therefore, we do not believe that the existing benefits in respect of sick leave for employment-related injury have been abused. Unless there is sufficient evidence that the existing employees compensation system is being abused, we do not see justification to reduce in any way the legitimate and reasonable compensation provided to injured employees.

Compulsory rehabilitation programme

16. The consultants point out that the ECO and its regime is one exclusively of compensation, rather than one of rehabilitation and return to work, with compensation to provide support during incapacity. They assess that there is currently negligible provision for effective occupational rehabilitation of injured employees, and consider that early intervention should be a key factor for facilitating early return to work and therefore provides cost-effective outcome. Drawing on the practices in a few countries, they suggest for consideration a measure whereby the injured employee will be encouraged to return to work even though not fully recovered. Basing on an objective assessment, the EC system will make up most of the shortfall in earning capacity.

17. The Administration notes that compulsory rehabilitation programme is not a common international practice and the consultants have not comprehensively assessed its effectiveness. At present, there are agencies providing rehabilitation services to employees who suffer permanent or temporary incapacity as a result of a employment-related injuries, to enable them to recover as soon as possible and re-enter the labour market. We consider it inappropriate to introduce legislation requiring employers to offer jobs to employees who have not yet fully recovered. Such compulsory requirement will also create practical problems for small and medium sized enterprises which make up 98% of our establishments and do not have the capability to design and implement such programmes.

Restricting access to common law damages

18. To address the lack of stability in claims costs, which are on a rising trend, the consultants recommend to restrict access to common law damages only to those employees who have suffered serious injury, such as by introducing an impairment threshold, or alternatively, to require, as in the case of Singapore, injured employees to elect pursuing either statutory benefits or common law damages.

19. The right of a party to claim common law damages against another party for negligence has been an integral part of Hong Kong's legal system and involves important principles in law. According to the consultants, common law claims only accounted for about 35% of total claims payments. The figures do not provide sufficient justification to deviate from the established practice and widely accepted legal principles.

Limiting the right to appeal against the determination of the Employees' Compensation Assessment Boards

20. Under existing provisions, the Employees' Compensation Assessment Board assesses the permanent loss of earning capacity suffered by the employee as a result of injuries sustained in employment-related accidents. Appeals could be made in court by the employer or employee against the Board's assessments. The consultants note that it has become a course of action for injured employees to appeal in court seeking upward revision of the Board's assessment. They therefore propose that the circumstances for allowing such appeals should be restricted.

21. According to Labour Department's statistics, only 70 out of some 20 000 assessments made in 1999 were referred to the Legal Aid Department for appeal against the Board's assessments. The Administration does not consider there is a case for qualifying the right of employers and injured employees to seek redress in court, with the purpose of discouraging review of assessments.

The Way Forward

22. The EC system is reviewed regularly, and the insurance industry would be consulted in the process as in the past. As part of this review process, we will also consult relevant parties for their views.

Hong Kong Federation of InsurersAnnex**Part I Executive Summary**Page
Reference**1 Background**

In April 2000 Trowbridge Consulting ("Trowbridge") and Deacons were jointly engaged by the Hong Kong Federation of Insurers (HKFI). Our brief was to review the performance of the employees' compensation system and come up with possible measures for reform.

Our appointment reflected that HKFI members, who distribute most of the compensation entitlements under the current system and collect contributions towards their cost, had noted the considerable escalation in compensation and related payments over the past decade, and were concerned the viability of the system may be in question.

This summary is to be interpreted in the context of the remainder of the report, which should be read in full. In particular, the readers' attention is drawn to the full list of reliances and limitations contained in Section 2.

2 Scheme Finances

The Hong Kong system appears on the face of it to be working well in terms of providing benefits to injured workers at reasonable levels. However, there is currently a serious under-funding, estimated at around HK\$2 billion per annum (gross). We estimate net claim reserves for direct insurers are currently around \$1 billion under-funded. We estimate both statutory benefits and common law damages are increasing at about 5% to 8% per annum over inflation. A considerable part of the cost of the scheme is directed towards compensating employees with relatively minor injuries.

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3 Causes

We consider the under-funding of the current scheme is due to six main reasons.

- (i.) The intensely competitive and fragmented insurance market. 54
- (ii.) Excessive leakage from the system, including generous intermediary commissions, which are substantially greater than rates in other countries, and high legal and other experts' costs associated with the resolution of disputed claims. 35
- (iii.) Common law damages and statutory benefits have been increasing and continue to increase beyond the usual rate of inflation by reason of changes in legislation and judicial attitudes. 26-28

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(iv.) The limited industry data on scheme costs and the ad hoc and unfocused nature of its collection and analysis.	36
(v.) There is no emphasis on rehabilitation and early return to work, resulting in some workers remaining on prolonged sick leave.	9-11
(vi.) There are no effective measures in place to remove employees from compensation until the expiry of the statutory period of limitation.	9-11

4 Possible measures for Reform (FOR FURTHER CONSIDERATION)

Reform measures include the introduction/implementation of:-

(i.) a tiered step-down approach after six months to the entitlement of statutory benefits for loss of earnings, which would provide clearer incentives to return to work;	49
(ii.) provisions for compulsory rehabilitation programmes involving employers, the medical profession and the injured employees;	48
(iii.) restricting access to common law to the seriously injured, removing access altogether or alternatively an elective procedure whereby injured employees can opt either for statutory benefits <u>OR</u> common law damages <u>BUT NOT BOTH</u> ;	50
(iv.) limiting the number of insurers to those which satisfy certain licensing conditions;	54
(v.) imposing statutory requirements for insurers to provide data for monitoring scheme performance and pricing;	52
(vi.) implementing statutory limits on commission levels;	54
(vii.) the creation of an industry group whose purpose is specifically to press for procedural reforms of the dispute resolution process, albeit litigation, mediation or other process;	
viii.) limited circumstances upon which the assessment of LOEC made by the Ordinary or Special Assessment Boards may be appealed against; and	
(ix.) imposing restrictions on access to common law (see measure iii above) would cause a direct impact on the level of legal/expert fees. Further reduction in legal and expert fees may be achieved by introducing a tender system to all assignments from the Legal Aid Department, and, depending on the nature of the claim, a fixed fee system whereby legal or expert fees are fixed or capped at an appropriate level having regard to the circumstances/size of the claim.	53

5 Conclusion

The current system as it is presently funded is unsustainable in the longer term and reforms should be augmented urgently, failing which a withdrawal of underwriters and their re-insurers from this sector of the market is inevitable, and insurer insolvencies are likely.

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