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THE HONG KONG FEDERATION OF INSURERS

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21 March 2002

Mrs Sharon Tong Lee Yin Ping
Clerk
Bills Committee on
Employees Compensation Assistance (Amendment) Bill 2002
Legislative Council Secretariat
3rd Floor, Citibank Tower
3 Garden Road
Central
Hong Kong

Dear Mrs Tong

Bills Committee on
Employees Compensation Assistance (Amendment) Bill 2002

On behalf of the General Insurance Council (GIC) of the Hong Kong Federation of Insurers, which is the representative body of underwriters engaging in employees' compensation business, I am writing to you to register our interest in the proposed Bill and should be most grateful if you would draw to the attention of Members of the Bills Committee the following issues:

1. The following statement on page 53 of the draft Bill gazetted on 15 February 2002 was incorrect:

   > *"…the insurance industry in Hong Kong is in the process of establishing of a scheme which will in effect replace the present provisions of the principal Ordinance relating to applications by employers for payment from the Fund where their insurers are insolvent…"*

   As far as we understand, the insurance industry in Hong Kong was not and is not in the process of establishing such a scheme.

2. Whilst the GIC is in favour of most of the suggestions made in the proposed Bill which would result in the better management of the Employees Compensation Assistance Scheme, we strongly object to the proposal to split the insolvency element from the current scheme.

3. The position of the GIC had already been relayed to the Insurance Authority on 6 November 2001 (annex 1).

4. The stance of the GIC has remained unchanged. Enclosed please find our industry position paper dated 18 March 2002 (annex 2).

Since underwriters of employee' compensation insurance business is a major stakeholder of the proposed Bill, we would appreciate your letting Members of the Bills Committee have this letter together with enclosures for their consideration at the next meeting to be held on 3 April 2002.

The GIC would also appreciate your relaying our request to the Bills Committee that we would like to make a representation for and on behalf of the insurance industry to the Bills Committee in due course.

Please feel free to contact Mr David Hui of our secretariat by phone on 2861 9377 or via fax on 2520 1967.

Yours sincerely

K P Chan
Chairman
General Insurance Council

Encls.

c.c. The Hon. Mr Bernard Chan (w/ position paper dated 18/3/2002)
Mr Benjamin Tang, JP, Commissioner of Insurance (w/ position paper dated 18/3/2002)

6 November 2001

Mr Benjamin Tang, JP
Commissioner of Insurance
Office of The Commissioner of Insurance
21/F Queensway Government Offices
66 Queensway
Hong Kong

Dear Benjamin

EMPLOYEES' COMPENSATION (EC)

In reply to your letter dated 19 October 2001 and further to our meeting yesterday afternoon, I would like to recap the following:

1. **The proposal to Split Insurer Insolvency from the Employees Compensation Assistance Scheme (ECAS)**

The General Insurance Council unanimously objects to the proposal in splitting insurer insolvency from the ECAS because:

(i) A separation of the insolvency element from the uninsured assistance fund may result in having two different standards of claims assessment, which is unfair to the claimants. It would also be difficult for the manager of the insolvency fund to evaluate an adequate level of levy in order to run the operation on a financially sound basis.

(ii) The Motor Insurers' Bureau of Hong Kong clearly demonstrates the success of a combined fund which compliments and supports each other under the roof of one prudent and responsible management.

(iii) Setting up a separate EC insolvency scheme would not resolve the problem. From the cost and efficiency perspective, it would create less flexibility in distributing current resources and would incur duplication of resources on administration, claims settlement, etc. The additional fund required in establishing and maintaining a separate fund will eventually be borne by employers leading to an escalation of operating cost across Hong Kong.

(iv) Market dynamics should encourage policyholders to choose the most competitive product available by reference to solvency, service to customers and risk management. A separate fund for insolvency would likely distort this important mechanism.

(v) The present funding issues are referable to numerous matters including:

- the back dating of fund coverage from 1991 to 1984 ("retrospective liabilities");
- the absence of any funding for retrospective liabilities.

(vi) The separation of funding now without any capital contribution will include a levy for retrospective liabilities and other risks that pre-date the separation.

(vii) Any attempt to levy solvent insurers for insolvent insurers would likely lead additionally to withdrawal of insurance capacity.

Since the GIC disagrees with the proposal, we must make it clear that we also reject the suggestion that insurers should contribute to such an insolvency fund.

2. **Proposed Amendments to the EC & Motor Ordinances**

We would kindly request your bringing to the attention of the appropriate authorities the need to consider making due amendments to the Employees' Compensation Ordinance and the Motor Vehicle Insurance (Third Party Risks) Ordinance to allow certain liabilities to be excluded.

As you are aware that political related risks are usually beyond the capability of the general insurance industry. This explains why war or warlike operations, nuclear and similar contamination exposure are standard exclusions in all insurance and reinsurance contracts. Likewise, terrorism protection will soon be totally removed from the market. However under the both the Motor and EC Ordinances, the said risks are not exempted from coverage and insurers are obliged to pay for compensation or damages irrespective of policy exceptions although we are provided with the right of recovery against the insureds. Such recovery rights may well be academic as policyholders could be totally destroyed in the disastrous events or the recoverable sum is simply unaffordable to them. If the above said scenarios do happen, we afraid that most, if not all, direct insurers may be forced into liquidation as they have to pay all the claims according to legislations but without any reinsurance support nor having the prospect of recovery.

In light of the serious financial implications, the Council suggests that it is imperative for the Government to prevent the exposure by excluding War, Terrorism and other similar risks from the Motor and EC Ordinances. Otherwise, insurers may be prohibitive to write the businesses.

In order to expedite the process of making such amendments, the GIC is more than happy to present our proposal to relevant authorities.

Yours sincerely

K P Chan
Chairman
General Insurance Council

cc The Hon Mr Bernard Chan
Mr M K Cheng

<u>Annex 2</u>

THE HONG KONG FEDERATION OF INSURERS

RESPONSE OF THE GENERAL INSURANCE COUNCIL TO THE PROPOSAL OF THE GOVERNMENT TO SPLIT THE INSOLVENCY FUND FROM THE CURRENT EMPLOYEES COMPENSATION ASSISTANCE SCHEME

1. Introduction

The General Insurance Council (GIC) established under the Hong Kong Federation of Insurers (HKFI) responsible for dealing with industry matters concerning general insurance, is pleased to submit its views on the proposal of the Government to split the insolvency fund from the current Employees Compensation Assistance Scheme (ECAS).

2. GIC Response

2.1 The GIC welcomes the Education and Manpower Bureau's initiative to review the current ECAS in the light of the funds under the management of the Employees Compensation Assistance Fund had been completely depleted in the last two years.

2.2 The GIC is in favour of the objectives of the ECAS to provide compensation to injured employees who are not covered under effective Insurance policies and to provide for the protection of injured employees and employers in the event of insolvency of insurance companies. The insurance industry has been a staunch advocator and supporter of effective consumer protection schemes, the most successful one being the Motor Insurers' Bureau of Hong Kong (MIB) run by the industry itself. The MIB provides protection to victims of motor accidents through its First Fund Scheme resulting from a hit-and-run accident or accident involving a non-insured vehicle and to insureds through its Insolvency Fund Scheme. Since its inception in December 1980, the MIB, through prudent management, has accumulated a surplus of $170 million for the First Fund Scheme and $1.1 billion for the Insolvency Fund Scheme. The level of funding has been maintained at low levels throughout the existence of the MIB.

2.3 The GIC would highlight that the 2001 insolvency of three insurance companies belonging to the same Group was a single incident. Whilst the GIC fully supports a review of the ECAS, it is not prepared to jump to the conclusion that the current ECAS should be abandoned. We believe this should only be done after a thorough and detailed consideration and that all means have been exhausted to improve the current establishment that has been in place since 1 July 1991.

2.4 The financial difficulties and problems recently encountered by the ECAS are, we believe, a fund management problem as well as a claim management problem. Both can be fixed through effective and prudent means, and should not be used as the reason to create another vehicle with new structure, organization and operation. There can be no guarantee of its future performance and may impact upon the interests of insured employers who are currently well protected by the ECAS.

2.5 It was suggested that the cost for the establishment of a separate Employees Compensation Insurance Insolvency Scheme (Insolvency Scheme) could be transferred to end user customers. The GIC, who knows the EC mechanism thoroughly, feels obliged to give input now in order to ensure that the cost of this consumer protection fund would be minimized through sound and cost effective management. Otherwise, the insuring public will end up paying further extra levies for no real added value and protection.

3. Issues for Further Consideration

3.1 Improvement to the Current ECAS

The GIC opines that if the following two areas are properly dealt with, the ECAS may operate on a sound basis in the future **WITHOUT** having to increase any levy charges at all:

i. Introducing widely accepted and adopted standards to objectively evaluate and assess claim amounts instead of taking a passive role.

ii. Re-allocating the share of the levy income among the three recipient funds namely, the Employees Compensation Assistance Fund, the Occupational Deafness Compensation Board and the Occupational Safety and Health Council in order to reflect the needs of the real situation. Since 1995 to date, the Employees Compensation Insurance levy has been increased from 2% to 5.3%, i.e. 165%. The current allocation and changes are as follows:
   - To the Employees Compensation Assistance Fund - remained unchanged at 1%,
   - To the Occupational Deafness Compensation Board - increased to 2.3% from the original 1.5%. The Board is now enjoying a surplus of around $180 million and,
   - To the Occupational Safety and Health Council - increased from 1% to 2%. The Council has accumulated a surplus of $29 million.

It is further recommended that the Government should review the allocation on a regular basis and be flexible to respond to and cater for the actual needs of employees and employers at large instead of select groups:

- * The Employees Compensation Assistance Scheme should receive a bigger share of the levy income; and
- * Under the Employees Compensation Assistance Scheme, the two sub-funds, i.e. one for uninsured employees and the other for insolvency, should be clearly identified and should receive separate allocation of funding from the Employees Compensation Insurance levy.

3.2 The Government's proposal does not address the challenges of the initial setting-up of any new fund, and the potential levels of levy required to support the early days of build –up.

3.3 A separation of the insolvency element from the Employees Compensation Assistance Fund is likely to result in having two different standards of claims assessment, which is unfair to the claimants.

3.4 Setting up a separate Insolvency Scheme would not solve the above problems. From the cost and efficiency perspective, it would create less flexibility in distributing current resources and would incur duplication of resources on administration, claims settlement etc. The additional costs of the funding required to establish and maintain a separate fund will eventually be borne by employers leading to a further escalation of operating costs across Hong Kong.

3.5 In the Policy Address of the Chief Executive, the Government will in 2002-2003 study the feasibility of setting up a comprehensive policyholders protection fund. Since the Insolvency Scheme is in itself a policyholder protection scheme, the Government should incorporate this into the study rather than dealing with it on a piece meal basis.

18 March 2002