

**Bills Committee on
Employees Compensation Assistance (Amendment) Bill 2002**

LC Paper No. CB(2)1682/01-02(01)

The Administration's Response to Submissions by Organisations

Introduction

This paper sets out the responses of the Administration to the written submissions made by the following organisations to the Bills Committee on Employees Compensation Assistance (Amendment) Bill 2002:

- (a) General Insurance Council (GIC) of the Hong Kong Federation of Insurers;
- (b) Employers' Federation of Hong Kong (EFHK); and
- (c) The Hong Kong Construction Association Ltd. (HKCA).

Responses to submissions

2. In their submissions, the three organizations have made references to the proposed employees compensation insurer insolvency scheme (ECIIS). The Administration recalls that it has submitted a paper to the Bills Committee on the main features of the ECIIS and the compensation schemes for insurance policyholders in other places. As explained at the last Bills Committee meeting on 3 April 2002, employees compensation insurer insolvency, by its very nature and as demonstrated by the HIH incident, would inevitably create sudden and substantial strain on the resources of the Employees Compensation Assistance Fund (the Fund). To avoid creating such a sudden and substantial strain, we consider it appropriate to excise insurer insolvency from the scope of the Employees Compensation Assistance Scheme (ECAS) and establish a separate ECIIS. Towards this end, the Office of the Commissioner of Insurance (OCI) is discussing the matter with the GIC.

3. Responses to submissions by the three organizations are given in paragraphs 4 to 20 below.

(A) Submission made by the GIC

Protection of ECIIS for policy holders

4. GIC has made a second submission to the Bills Committee on 16 April 2002. In the submission, GIC has expressed concern over the adequacy of the start up fund under the proposed ECIIS, and cast doubts over the protection rendered to policyholders and employees during the start up period of ECIIS.

5. As explained at the last Bills Committee meeting on 3 April 2002, the OCI has put in place an effective system for regulating and supervising insurers authorised in Hong Kong, which is in line with the international standards. Under the Insurance Companies Ordinance, all insurers carrying on general insurance business, including employees' compensation (EC) business, in Hong Kong must be authorised by the Insurance Authority (IA). They are subject to the regulatory requirements including those on minimum paid-up capital, solvency margin, fit & proper management, adequacy of reinsurance arrangements and annual reporting of financial information. The OCI (in the capacity of IA) assesses on a regular basis whether these requirements are complied with, based on periodic returns submitted by insurers and on-site inspections by the OCI. Where there is any cause for concern, more frequent assessment would be conducted and where the situation warrants, the OCI would invoke the power of intervention provided for in the Insurance Companies Ordinance, such as restricting an insurer to take on new businesses.

6. As a matter of fact, insolvency of EC insurers has been uncommon and the HIH Group is the only incident in which there were EC insurers in Hong Kong becoming insolvent in the past 10 years. As such, we believe that there would be adequate time for the proposed ECIIS to accumulate funds to render adequate protection for policyholders (i.e. employers) and employees. In the interim, the proposed ECIIS could also protect its solvency position by taking reinsurance cover.

7. In the very unlikely event of depletion of funds under the ECIIS during the start up stage (a situation which is analogous to the present position of the Fund), other appropriate options could be explored, e.g. seeking bridging loans from banks. In this regard, it should be noted that the Government does not play the role of "the lender of last resort" for ECAS as suggested by GIC. The Government has taken into account various factors before considering any loan for ECAS.

8. In any case, the earlier the proposed ECIIS is established, the earlier funds start to accumulate. We therefore hope that the ECIIS could be established as soon as possible.

9. GIC also sets out in its submission a comparison between the existing Fund and the proposed ECIIS, such as the levels of funds available for settling claims. Such a comparison is not entirely appropriate. For example, the existing Fund covers both uninsured and insurer insolvency cases, while the proposed ECIIS would cover only the latter. The levels of funds available (and their adequacy) should be considered in the light of the difference in the scheme coverage.

10. Maintaining the existing coverage of ECAS would **not** help lower the level of levy, nor would it provide better protection to employers and employees. As demonstrated by the HIH incident, mixing insurer insolvency with uninsured EC claims would result in sudden and undesirable volatility in the financial position of the Fund. The proposed ECIIS, with a *dedicated* and *clear* objective, would render better protection for employers and employees. ECAS would also be able to enjoy a more stable cash flow and would not suffer from sudden strains brought about by insolvency of EC insurers. The OCI will continue to discuss with the GIC matters relating to the ECIIS, such as the administration of the fund and the level of levy, with a view to establishing the new scheme as soon as possible.

Waiting period for assistance to employers and employees

11. In the submission, GIC has suggested that applicants are not required to wait for assistance under ECAS in case of insufficient funds as the Government would act as a lender of the last resort.

12. As pointed out above, the Government is not taking any role as a lender of the last resort. In fact, section 26 of the Employees Compensation Assistance Ordinance (ECAO) provides for a queuing mechanism whereby the Employees Compensation Assistance Board (the Board) makes payment in accordance with the priority set out in the section in case of insufficient funds. In other words, if there is insufficient funds to meet the liabilities, the Board would have to invoke section 26 to make payment. As a result, some eligible applicants would have to queue for some time before they can obtain payment from the Board.

Coverage between ECAS and ECIIS

13. GIC has also pointed out in its submission that after the establishment of the ECIIS, disputes as to whether a claim should be covered by ECAS or the new ECIIS may arise.

14. We have already considered this issue and made the necessary transitional arrangement in the Amendment Bill to address the concern. As stated in the speech by the Secretary for Education and Manpower when moving the Employees Compensation Assistance (Amendment) Bill 2002 (the Amendment Bill) on 27 February 2002, the current protection accorded to employers against insurer insolvency under the ECAO will only be excised upon the establishment of the ECIIS. By then, the new section 46A(2) to (6) will come into operation so that the relevant sections relating to the protection against insurer insolvency under the ECAO will be repealed.

15. At the same time, the new section 46A(7) and (8) on the transitional arrangement will also come into effect. By the operation of the new section 46A(7), the protection against insurer insolvency under the existing ECAS would continue to apply to cases for which the Board has published a notice of insolvency of insurers in the Gazette and the notice is still valid before the establishment of ECIIS. Employers covered by such a notice will continue to be entitled to make applications for assistance under the ECAO. Section 46A(8) further provides that no person shall be entitled to apply under the Ordinance as a result of insurer insolvency after the ECIIS is established. With these transitional arrangements provided by the Amendment Bill, there should not be any overlap in the protection between ECAS and the proposed ECIIS.

(B) Submission made by EFHK

16. We also note that the EFHK has made a submission to the Bills Committee. In the submission, the Federation has recommended that more stringent authorisation requirements should be imposed on EC insurers, including a higher solvency margin and higher reserve requirement. As mentioned in paragraphs 5 to 6 above, the existing regulatory system in Hong Kong is effective and in line with the international standards. Having said so, the OCI is mindful of the need to regularly review the system, in the light of developments in the industry. As discussed at the last Bills Committee meeting on 3 April 2002, the OCI has introduced from January 2002 the requirement for actuarial review of the reserves for EC business. The OCI is also

considering to set an admissibility limit to the amount of reinsurance recoverable from the parent company of general insurers (including EC insurers).

17. An effective regulatory system is one which would protect the interests of the insuring public and at the same time provide latitude for the market to develop. Our present system has served us well and we will continue to strive for upgrading the regulatory regime in line with developments in the industry (whether overseas or local).

(C) Submission made by HKCA

18. HKCA has made a submission to the Bills Committee on 19 April 2002. As we have mentioned in paragraph 2 above, the establishment of the proposed ECIIS would avoid a sudden and substantial strain on the resources of ECAS arising from the insolvency of EC insurers. We also believe that there would be adequate time for the proposed ECIIS to accumulate funds to render adequate protection for employers and employees. There will be no gap in the cover for both employers and employees.

19. As regards the handling of applications arising from the HIH insolvencies by the Board, we would like to point out that the Board could only consider an application for assistance when the relevant injury has stabilised and the amount of compensation or damages is being determined. Therefore, we expect that it would take several years to settle all the liabilities arising from the HIH insolvencies. Nevertheless, the Board is proactive in processing applications. Where appropriate, it would negotiate with the relevant parties with a view to bringing about an earlier settlement.

20. However, in view of the substantial liabilities arising from the HIH insolvencies, it is imperative that the necessary financial arrangements, which include the proposed increase in the levy rate for the Board and a further government loan, would be in place in time so that the Board could have sufficient funds to meet its statutory responsibilities.

21. This is a co-ordinated response of the Financial Services Bureau, Office of the Commissioner of Insurance and the Labour Department.

Labour Department
April 2002