

ITEM FOR FINANCE COMMITTEE

HEAD 148 - FINANCIAL SERVICES BUREAU

Subhead 700 General other non-recurrent

New Item “Facility to cover direct insurers’ liability arising from employees’ compensation for death or injury caused by terrorist activities”

Members are invited to approve a commitment of \$10,000,000,000 for the Government to undertake to provide a Facility to cover direct insurers’ liability arising from employees’ compensation for death or injury caused by terrorist activities.

PROBLEM

2. As a result of the 11 September (“9-11”) 2001 incident in the United States, reinsurers will stop offering reinsurance coverage for terrorist activities in Hong Kong with effect from 11 January 2002. The lack of such reinsurance coverage in the market will render direct insurers unable to offer employees’ compensation (EC) insurance policies, and as a result employees will lose the protection against death or injury provided under the Employees’ Compensation Ordinance (referred to as “the EC Ordinance” hereunder) (Cap. 282).

PROPOSAL

3. The Secretary for Financial Services proposes to create a commitment of \$10,000,000,000 to undertake to provide a Facility so that direct insurers can continue to write EC insurance policies in the absence of the reinsurance market on terrorist activities.

/JUSTIFICATION

JUSTIFICATION

Insurance for Employees' Compensation

4. Section 5 of the EC Ordinance provides that an employer is liable to pay compensation to his employees who suffered death or injury in an accident arising out of and in the course of employment. To ensure that employees will be able to receive adequate compensation and to protect employers when they become so liable, section 40 of the EC Ordinance requires employers to purchase EC insurance. The required coverage is \$100 million per event when the number of employees does not exceed 200, or \$200 million per event when the number of employees exceeds 200.

Exclusion of Terrorist Activities in Treaty Arrangements

5. The EC Ordinance requirements apply to accidents caused by terrorist activities. Existing EC insurance policies also cover death or injury caused by terrorist activities, and in turn direct insurers arrange reinsurance cover to limit their exposure in case of terrorist activities. Reinsurers have provided such coverage in the past as they considered the occurrence of terrorist activities highly unlikely.

6. However, with the "9-11" incident causing unprecedented losses, the insurance industry world-wide has become alerted to the severe damages that terrorist activities may cause. Reinsurers world-wide are therefore excluding coverage for terrorist activities from new treaty arrangements (which refer to standing facilities for reinsurance coverage on all businesses accepted by direct insurers during the year without individual assessment of the risks), when reinsurance contracts expired on 31 December 2001¹. Such exclusion, coupled with the requirement of the EC Ordinance that insurers have to pay EC up-front, will render direct insurers unable to write EC insurance policies in Hong Kong.

The Proposed Facility

7. The proposed Facility will be available to every direct insurer writing EC insurance policies providing coverage that includes accidents caused by terrorist activities. The salient features of the Facility are set out below.

/Amount

¹ In late December 2001, having learnt of Government's decision to seek Finance Committee's approval to provide a Facility of up to \$10 billion in aggregate, reinsurers in Hong Kong agreed to extend a 10 days terrorism cover to direct insurers. The cover will expire on 11 January 2002.

Amount committed under the Facility

8. The total amount of Facility to be made available to participating insurers is \$10 billion. A charge of 3% on the gross EC premium² will be levied on insurers for the provision of such a Facility. Hong Kong is regarded as a low risk territory in terms of terrorist activities, and there is no historical insurance data such as the severity of losses and the claim frequency. The \$10 billion Facility is calculated on the basis that it would be adequate to cover the EC liabilities of direct insurers in the worst case scenario arising from one event of terrorism. We consider that a \$10 billion Facility is reasonable in the present circumstances. There must be a limit to the amount of the Facility and to provide for a larger Facility would inevitably attract a higher charge.

9. The Facility will be provided on a per claim first come first served basis and participating direct insurers will only be allowed to draw down from the Facility immediately before they settle the claims against them. In the unlikely event that the sum of claims arising from an event or events exceeds the amount available under the proposed Facility, direct insurers will be allowed to draw down from the Facility until it is totally exhausted. Allocating the Facility on a per claim first come first served basis will also encourage early settlement of claims and hence better protection for claimants, namely employers and employees.

10. The amount of the Facility and the level of charge are determined on the basis that Hong Kong is a low risk area and there is no relevant historical insurance data. In the unlikely event of death or injury in employment caused by terrorist activity, we shall review the need for revising the amount and level of charge. Should there be a need to raise the limit of the Facility, we shall seek the necessary approval from the Finance Committee.

Coverage

11. The Facility will only cover the statutory minimum level of EC insurance cover stipulated in the EC Ordinance as stated in paragraph 4. As it is Government's policy to encourage reinsurers to return to the market to provide reinsurance coverage, we shall closely monitor the market situation and consider

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² Gross EC premium in this context is the premium paid to the direct insurer in respect of the EC insurance policies which are covered by the Facility before deducting commission of agents or brokers but after deducting any discounts specified in policies or refunds of premium made in respect of any termination or reduction of risks. This definition carries the same meaning as that in the Insurance Companies Ordinance.

terminating the Facility when the reinsurance market has re-emerged. We also understand that there may be instances whereby reinsurers are prepared to provide reinsurance cover for terrorist activities to individual entities on a case by case basis. To ensure that the Facility will not impede reinsurers from offering such facultative reinsurance to individual entities, the Facility will not cover insurance policies whose risks are already covered by facultative reinsurance.

Commencement

12. Subject to members' approval of this proposal, the proposed Facility will be made available to insurers from 11 January 2002.

Entry and Exit

13. Participation in the Facility is voluntary. Direct insurers who decide not to participate but continue to write EC insurance policies will have to satisfy the Commissioner of Insurance that they have proper reinsurance arrangement in accordance with the provisions of the Insurance Companies Ordinance (Cap. 41)

14. The Government will enter into an Agreement with participating insurers on the proposed Facility. The Agreement will allow both Government and participating insurers to terminate the Facility arrangement by tendering one month's written notice. Such exit clause is necessary. For the Government, we do not intend (as stated in para.11 above) to compete for business in the market and the exit clause will enable us to withdraw the Facility once there is evidence of adequate reinsurance cover in the market.

The Draw Down Mechanism

15. The Facility will only be invoked in the event of an insurer settling a claim for EC caused by terrorist activities. Two issues will need to be resolved before such a claim can be settled -

- (a) that the employer is liable to pay compensation in accordance with the EC insurance policy taken out in compliance with the EC Ordinance, in the amount as determined by Commissioner for Labour or the court; and
- (b) that the relevant death or injury is caused by terrorist activities within the scope of the Government's Agreement with the relevant direct insurer.

16. In relation to para.15(a) above, there already exists well established procedures within the Labour Department (LD) to process any claim after receiving the notification of the accident by the employer and for the Department to issue a Certificate of Compensation Assessment stating the amount of compensation payable. If the claim cannot be settled by LD, it will be referred to the Court for determination. A description of the present arrangement is set out in Encl. Enclosure. Safeguards are built into the present system to avoid abuses.

17. As regards para.15(b) above, namely, whether the relevant death or injury is caused by terrorist activity, we shall require direct insurers not to settle any claims without obtaining the prior consent of the Government. We shall require insurers to notify the Government immediately after they have received claims arising from terrorist activities, to vet all claims diligently and to provide all relevant information to the Government. Taking into account the facts of the case, the Commissioner of Insurance will determine, in consultation with the Department of Justice, whether the claim falls within the ambit of terrorism under the Agreement. Together with the information provided by LD as set out in para.16 above, the Commissioner will give consent to the insurer to settle the claims. The insurers will then draw from the Facility in accordance with the terms of the Agreement to settle such claims.

The 3% Charge

18. Participating direct insurers will be required to pay a charge to the Government at 3% of its gross EC premium. The level of this charge can be revised with one month's notice. Payment will be made to the Government on a monthly basis.

FINANCIAL IMPLICATIONS

19. The proposal requires the creation of a commitment of \$10 billion to support the Facility. Actual expenditure will only be incurred when there is a validated claim in accordance with the above draw down mechanism. The relevant bureaux and departments will absorb the additional workload arising from the proposal using their existing resources.

20. The proposal will generate revenue for the Government in the form of 3% charge on gross premium levied on direct insurers carrying on EC insurance business and participating in the proposed Facility. Since participation in the

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proposed Facility will be on a voluntary basis and since it is difficult to predict future developments in the insurance market, it is hard to estimate the amount of receipt from this source with any degree of certainty. Assuming all EC direct insurers would participate, the expected revenue to Government could be up to \$90,000,000 a year, based on the latest statistics on the level of gross EC premium.

BACKGROUND INFORMATION

21. We briefed Members of the Legislative Council on our proposal on 20 December 2001. We informed Members that we have considered other options to tackle the problem. Amending the law to remove employers' duty to compensate employees for injury caused by terrorist activities or to remove direct insurers' duty to pay EC up-front will undermine protection for employers and employees. Setting up a fund financed by a levy will not provide adequate cover for such risks for many years. None of these options is considered viable.

22. Our proposal represents the joint efforts of the Government, employers and insurers. The Government will provide a Facility at a charge, insurers will continue to provide cover for death or injury caused by terrorist activities by paying a charge to Government, and employers will continue to be able to enjoy insurance protection. Most important of all, the protection rendered to employees will not be eroded.

23. At the time of issuing this paper, the Agreement between the Government and direct insurers is being finalised. A copy of the Agreement will be provided to Members once it is available.

Financial Services Bureau
January 2002

**Existing Arrangements under
the Employees' Compensation Ordinance**

- Under the Employees' Compensation Ordinance (ECO), an employer must notify the Commissioner for Labour of any employment-related accidents within 14 days for non-fatal cases and 7 days for fatal cases. Upon receiving such a notification, the Employees' Compensation Division (ECD) of the Labour Department (LD) will conduct an initial vetting on the basic facts as reported to check for conformity with the requirements of the ECO. If there is any doubt over whether the accident is employment-related, the ECD will take action to clarify. Unresolved disputes over an employer's liability will be determined by the District Court.
- After the injured employee has recovered from the injury or has been assessed of the degree of permanent incapacity, the ECD of LD will issue to the employer and the employee a Certificate of Compensation Assessment stating the amount of compensation payable. Any objection to the assessment by either party may be made within 14 days after the issue of the certificate. On receipt of the objection notice, the ECD will review the assessment and issue a Certificate of Review of Compensation Assessment to both parties. Further appeal may be made to the District Court.
- For accidents causing death, the ECD may determine the claims with the consent of the employer and the family members of the deceased employee. Having made a determination the ECD will issue the Certificate of Compensation Assessment for Fatal Case, stating the amount of compensation payable and the apportionment to the respective family members of the deceased employee. Like the case of Certificate of Compensation Assessment, a review and appeal procedure is also provided if any party is not satisfied with the determination by the ECD.
- For injured employees (or their representatives, including those on behalf of the deceased employees) who wish to claim for common law damages, they have to prove both liabilities of the employers concerned and the quantum of damages.
- Thus, safeguards have been built in for either the ECD or the Court to determine the liability of the employer in paying EC and the amount of EC to be paid.