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Legislative Council
Panel on Financial Affairs

Minutes of special meeting held on
Thursday, 20 December 2001 at 10:45 am
In the Chamber of the Legislative Council Building

Members present	:	Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman) Hon James TIEN Pei-chun, GBS, JP Hon LEE Cheuk-yan Hon Eric LI Ka-cheung, JP Hon NG Leung-sing, JP Hon James TO Kun-sun Hon Bernard CHAN Hon SIN Chung-kai Dr Hon Philip WONG Yu-hong Hon Jasper TSANG Yok-sing, JP Hon Emily LAU Wai-hing, JP
Non-Panel members attending	:	Hon Margaret NG Hon CHAN Yuen-han, JP Hon Andrew CHENG Kar-foo Hon LI Fung-ying, JP Hon Audrey EU Yuet-mee, SC, JP
Members absent	:	Hon Henry WU King-cheong, BBS (Deputy Chairman) Hon Albert HO Chun-yan Dr Hon David LI Kwok-po, GBS, JP Hon CHAN Kam-lam Hon MA Fung-kwok

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Public officers attending	:	Mr Stephen IP Secretary for Financial Services Mr Philip CHOK Deputy Secretary for Education and Manpower Mr Benjamin TANG Commissioner of Insurance Miss Susie HO Deputy Secretary for Financial Services Mrs Jenny CHAN Assistant Commissioner for Labour Mr H Y MOK Assistant Commissioner of Insurance
Clerk in attendance	:	Ms Anita SIT Chief Assistant Secretary (1)6
Staff in attendance	:	Ms Pauline NG Assistant Secretary General 1 Mr WONG Tin-yau, Anthony Senior Assistant Secretary (1)8

I Reinsurance cover for employee compensation insurance policies

CB(1)662/01-02(01) - Press release

CB(1)662/01-02(02) - LegCo Brief on employees' compensation and motor vehicle (third party risks) insurance coverage for terrorist activities

The Chairman thanked members for attending the special meeting at short notice. He said that the meeting was convened at the request of the Administration to brief members on the proposed measures to tackle the problem of impending absence of reinsurance coverage on terrorist activities on treaty arrangements in the wake of the 9-11 incident.

2. At the invitation of the Chairman, the Secretary for Financial Services (SFS) advised that since the 9-11 incident, re-insurers worldwide had indicated

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that, with effect from 1 January 2002, they would cease offering reinsurance coverage for terrorist activities on treaty arrangements in Hong Kong when the current reinsurance contracts expired. SFS explained that in the light of the requirements under the Employee Compensation Ordinance and the Insurance Companies Ordinance, there would be severe implications for the relevant stakeholders. He highlighted the following -

Direct Insurers

(a) Without reinsurance coverage, direct insurers would not be able to limit their financial exposure and spread out their risks. Due to increased exposure to insolvency as a result, they would stop underwriting employee compensation (EC) insurance policies covering, inter alia, damages resulting from terrorist activities.

Employers

(b) Employers would not be able to find insurance companies which would be willing to provide insurance coverage against terrorist activities in the EC policies for employees, and hence employers would become fully responsible for compensating employees against death or personal injury caused by such terrorist activities. Most employers however would be unlikely to have the financial means to take on such a responsibility. Without insurance cover, employers would be unable to comply with the Employee Compensation Ordinance (Cap. 282) (EC Ordinance), which provided that they should purchase EC insurance for their employees, and that they were liable to compensate their employees suffering from personal injuries arising from accidents in the course of employment.

Employees

(c) In the light of the above, employees would ultimately be left without coverage for personal injuries suffered due to terrorist activities in the course of their employment.

3. SFS said that while the risk of Hong Kong suffering from terrorist activities was low compared to other countries, it could not be said with absolute certainty that such activities would not occur. In the event of such terrorist activities, it would be debilitating to all stakeholders if there were no reinsurance coverage. To tackle the problem, the Administration proposed to put in place a system to protect the interests of the stakeholders by providing a facility of up to HK$10 billion in aggregate to cover the EC liabilities of direct insurers caused by terrorist activities. With the provision of the facility, direct insurers would be able to continue to write EC insurance policies and pay compensation to employees suffering from death or injury caused by terrorist activities by

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resorting to the proposed facility for funding such payment. Employers would be able to obtain insurance policies to cover their EC liabilities under the law. Most importantly, the protection currently rendered to Hong Kong's three million employees would not be eroded as a result of the absence of the reinsurance market on terrorist activities.

4. SFS advised that the proposed facility would be funded under the Government's General Revenue Account, and the Administration proposed a charge of 3% on the gross premium of EC policies for providing the facility. The Administration planned to seek approval of the Finance Committee (FC) on 11 January 2002 for its proposal to provide the facility.

5. In response to Miss Emily LAU's enquiry, SFS confirmed that the discontinuation of reinsurance coverage for terrorist activities on treaty arrangements was not unique to Hong Kong, and was a global phenomena, since reinsurers had become highly apprehensive of the high stakes of providing reinsurance coverage for terrorist activities after the 9-11 incident. To address this issue, governments of other jurisdictions such as the United Kingdom, France, South Africa and the United States (US) made similar proposals for their countries to provide some form of reinsurance coverage against terrorism risks. In the US, a bill aiming to ensure the continued financial capacity of insurers to provide coverage for terrorism risks was being considered by the Congress. The facility proposed by the US Government in this case was US$100 billion with a charge ranging from 3% to 10% on the gross premium of EC insurance policies.

Discussion with members

6. Members in general supported in principle the provision of a facility that there was an adequate level of protection for employees and employers. Dr Philip WONG declared that as Chairman of the Finance Committee, his position was neutral on the Administration's proposal.

Time gap between the discontinuation of reinsurance coverage and approval for the proposed facility

7. Mr Bernard CHAN noted that there was a time gap between the cessation of reinsurance coverage for terrorist activities on treaty arrangements by reinsurance companies from 1 January 2002 onwards and the seeking of the Finance Committee's approval for providing the facility on 11 January 2002. He thus enquired about the arrangements to cover this hiatus. Miss CHAN Yuen-han queried why the Administration had not submitted the proposal to the Panel and FC at an earlier time.

8. SFS advised that the Administration had been discussing with reinsurance companies to work out feasible arrangements in respect of the time gap. Hopefully, the companies would agree to extend their provision of

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reinsurance coverage up to 11 January 2002. As regards the timing of putting up the present proposal, SFS said that in this regard, the Administration was already ahead of many other countries which were still deliberating on the options to provide reinsurance coverage for terrorist activities.

Proposed charge of 3% on EC premium

9. Mr James TIEN said that employers were already substantially burdened by hefty EC payments, having to pay 5.3% for the EC insurance premium, plus 1% contribution to the Employees Compensation Assistance Fund (ECAF). He expressed concern that the proposed 3% charge for the provision of the facility would be ultimately borne by employers and thus increasing the total cost of EC insurance to employers to 9.3%. He also considered that the proposed 3% charge was on the high side, in consideration that Hong Kong faced a much lower level of terrorism risks than the US and many other countries as pointed out by the Administration. He sought explanation on how the Administration had arrived at the proposed 3 % charge. He stated that while Members of the Liberal Party supported the proposed facility, they considered that the 3% charge was excessive. Miss CHAN Yuen-han and Miss Emily LAU also requested the Administration to elaborate on the basis of the proposed 3% charge. Miss Emily LAU added that as a matter of principle, the cost of providing the reinsurance facility should not be borne by taxpayers.

10. In response, SFS advised that the extent to which the proposed 3% charge would ultimately be shouldered by employers would be a matter of commercial negotiations between individual insurers and employers. The Administration had consulted the General Insurance Council which represented all major insurers in Hong Kong, and obtained an indication that a charge of 3% on EC insurance premium for provision of the facility was considered reasonable by the industry. The Administration was not seeking to generate a profit by providing the reinsurance facility. However, as the Government would be undertaking a risk in providing the facility, it was reasonable for the Government to levy a charge payable by direct insurers. He emphasized that the 3% charge was proposed in the light of professional actuaries' estimation of Hong Kong's risk exposure to terrorist activities, and the views of the insurance industry. He added that the Administration hoped that the 3% charge would act as an incentive to encourage re-insurance market to come back so that Government could withdraw the facility.

11. SFS and the Commissioner of Insurance (C of I) further explained that insurance premium was normally determined by estimating the probability of occurrence and the extent of losses based on historical data. There was a lack of historical information on terrorist activities in Hong Kong. It was therefore difficult to determine scientifically whether 3% or otherwise was the optimal level of charge to cover the cost of providing the facility. Indeed, for the same reason, re-insurers had yet to determine the level of premium for reinsurance coverage for terrorist activities. In deciding the proposed 3% charge, the

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Administration had taken into account the affordability of the charge to direct insurers and employers at large, and the projected period of time it would require to recoup the cost of the facility should it be drawn down due to damages caused by terrorist activities in the worst case scenario. SFS also advised that that the proposed 3% charge would generate an annual income of about HK$ 90 million for the Government.

Future adjustment of the charge on insurers for provision of reinsurance coverage

12. Mr James TO said that he appreciated the problem of the absence of a reinsurance market on terrorist activities under the present-day circumstances and hence the need for the Government to take action to tackle the problem. He however questioned under what circumstances the Administration would withdraw the facility or adjust the charge of 3% if reinsurance coverage was available in the market but at a substantially higher percentage of premium. He also enquired whether the Administration had laid down any objective criteria for the future review of the 3% charge.

13. Mr Ng leung-sing also referred to the Legislative Council Brief which stated that the 3% charge could be increased in future, if necessary, to recoup the cost of providing the facility. He enquired about the criteria for determining whether the charge should be increased and the extent of such increase. In this connection, he also asked if the Administration would reduce the charge if there was no need to resort to the facility to fund insurance payment for damages caused by terrorist activities after the facility had been in operation for a period of time.

14. In response SFS reiterated that in determining the proposed 3% charge, the Administration had consulted professional actuaries and the insurance industry, and had given regard to the financial capacity of employers and direct insurers at large. While currently, the reinsurers were not prepared to put up with the risk of providing reinsurance coverage against terrorist activities, the terrorism risks in Hong Kong as perceived by reinsurers might reduce after some time. When there were indications that reinsurers were prepared to re-enter the market, the Administration could seek Members' advice on whether it should continue to provide the facility and the main consideration would be whether there was adequate reinsurance capacity in the market to safeguard Hong Kong's three million workforce.

15. At Mr TO's request, the Administration agreed to provide quarterly reports for the Panel on the proposed facility, with information on the up-to-date market situation of reinsurance coverage for terrorist activities on treaty arrangement and the Administration's assessment of the need to continue to provide the proposed reinsurance facility.

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Re-insurers re-entering the market

16. Regarding the estimated time frame for reinsurance companies to re-enter the market in the provision of reinsurance coverage for terrorist activities, SFS stressed that it was difficult to give an assessment given the present-day situation. Reinsurance companies would consider the risk involved, the financial returns and the market conditions. These companies might regain confidence in the market after a few months when events related to recent terrorist activities stabilised in the international environment. SFS re-iterated that the main incentive for re-insurance companies to re-enter the market was commercial gains. A reasonable level of charge by the Government for provision of the re-insurance facility would serve to induce these companies to re-enter the market.

17. Mr SIN Chung-kai said that the risk of employees being exposed to terrorist activities should not be underestimated as there were many local employees who went abroad to work, and might fall victim to such activities. He observed that some countries established specific funds for their re-insurance facilities, implying their expectation that these facilities would be required in the long term. He suggested that if the reinsurance market did not come back for say five to 10 years, the Administration should consider establishing a specific fund to enable more effective management of the income and expenditure of the proposed facility.

18. SFS replied that it might be overly pessimistic to anticipate that it would take five to 10 years before re-insurers would re-enter the market. He said that Hong Kong's situation was different from that of many other countries. For example, there had been occasions of terrorist activities in the United Kingdom prior to the 9-11 incident, and due to re-insurer’s perception of a high risk exposure to terrorist activities in the country and hence their reluctance to provide re-insurance coverage for terrorism risks, the UK government had to establish a long-term facility to provide re-insurance coverage for terrorism risks. SFS affirmed that the proposed facility was not intended to operate on a permanent basis. The Administration was only temporarily shouldering the risk and hopefully, the latter would find it commercially viable to provide the re-insurance coverage shortly in the future.

Definition of terrorist activities

19. Dr Philip WONG enquired about the definition of "terrorist activity" for the purposes of the proposed facility. The Deputy Secretary for Financial Services (DS/FS) advised that according to the United Nations Sanctions (Federal Republic of Yugoslavia) (Prohibition on Terrorist Activity) Regulation, the definition of terrorist activity read "any activity involving the unlawful use of force or violence against persons or property to intimidate or coerce a government, the civilian population, or any segment thereof, in furtherance of political or social objectives." DS/FS informed the Panel that the definition was

under review by the Administration in the light of the 9-11 incident, with the Secretary for Security taking the lead. If and when there was any change to the definition in the law, the new definition would be adopted for the purposes of the proposed facility.

Monitoring of claims

20. In response to Mr Andrew CHENG's concern about possible abuse of the facility, SFS explained that what constituted terrorist activities was clearly defined. There were also established procedures to process claims for death and injury incurred in the course of employment. The Administration did not envisage that with a robust system in place, the proposed facility would be susceptible to abuses. In the event that there were different opinions as to whether the death or injury sustained by an employee did arise from a terrorist activity, the Administration would seek legal opinion for dispute cases according to the normal procedures for insurance claims, i.e. any compensation would be subject to, and conditional upon, satisfactory investigation. The Administration assured members that it would vet every claim diligently.

The HK$10 billion facility and maximum liability

21. Ms Margaret NG referred to the statement in paragraph 14 of the Legislative Council Brief that "Government will provide a facility of up to $10 billion in aggregate to general insurers writing EC insurance policies". She expressed doubt on whether $10 billion would be the maximum liability of the Government as stated. She said that it was still unclear as to how the Government, in providing the facility, could effectively limit its liability to settle valid claims against the facility to $10 billion. Without a clear explanation on these issues, it would be impossible to judge whether the proposed facility would provide adequate protection for employees, and whether the financial commitment sought could be accurately conceived as the maximum liability of the Government in operating the facility.

22. Mr James TO, Mr Eric LI, Miss Emily LAU and Mr LEE Cheuk-yan shared the concern of Ms Margaret NG. They pointed out that although under the Employment Compensation Ordinance, there was a limit to the required coverage per event ($100 million per event when the number of employees did not exceed 200, or $200 million per event when the number of employees exceeded 200). But in the event that several events occurred at the same time or within a short period of time, it was possible that the proposed $10 billion facility would not be adequate to meet all valid claims. They therefore sought confirmation on whether it was Government policy to limit its liability up to a maximum of $ 10 billion in aggregate in providing the proposed facility, and how far this understanding would be implemented in the agreements between insurance companies and the Government.

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23. SFS explained that while there was no relevant historical insurance data based on which the Administration could scientifically establish an optimal amount for the proposed facility, the $10 billion facility was calculated on the basis that it would be adequate to cover the EC liabilities of direct insurers in the worst scenario arising from a single event of terrorism reminiscent of a skyscraper being destroyed at a terrorist attack. He acknowledged that there was the possibility that the sum of claims arising from an event or events exceeded the amount available under the proposed facility. In this unlikely event, the Administration would seek advice from Members as to whether more funds should be allocated to settle the relevant outstanding claims. SFS noted Members' concern regarding the Administration's legal liabilities under the future agreements with direct insurers and assured members that it would seek advice from the Department of Justice in this regard.

24. Mr Eric LI pointed out that if the Government was the legal entity to operate the facility, and given that a government would not wind up in any case, there might be practical difficulties to effectively limit the Government’s liability in respect of claims against the facility. He suggested that the Administration consider the option of establishing a limited liability company with an injection of HK$ 10 billion to provide for the facility, in which case the company, rather than the Administration, would shoulder the liabilities involved.

25. The Administration noted Miss LI Fung-ying's comment that if a ceiling was imposed on the Government's liability to provide the facility up to HK$10 billion, this might give rise to a problem of some employees suffering damages caused by terrorist activities not being able to obtain the statutory employee compensation.

26. Mr LEE Cheuk-yan agreed that there was a practical need to limit liability of the Government. He suggested that should a single event of terrorism cause damages that required a sum exceeding the amount available under the proposed facility to settle claims, affected employees should be compensated on a 'pro-rata' basis. If the amount available under the facility was totally drawn down, the Administration should revert to LegCo and propose the way forward.

27. Miss Emily LAU urged the Administration to clearly explain to FC the Government policy regarding the limit of its liability in the provision of the facility and the relevant concrete arrangements.

28. The Panel noted that the Administration would seek approval for provision of the HK$ 10 billion facility and the related proposed 3% charge from the Finance Committee at its meeting on 11 January 2002.

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II Any other business

29. There being no other business, the meeting ended at 1:00 pm.

Legislative Council Secretariat
25 January 2002