

ITEM FOR FINANCE COMMITTEE

LOAN FUND

NEW HEAD “EMPLOYEES COMPENSATION ASSISTANCE FUND”

New Subhead “Bridging loan to Employees Compensation Assistance Fund Board”

Members are invited to approve the creation of a new commitment of \$60 million under a new Head “Employees Compensation Assistance Fund” and Subhead “Bridging loan to Employees Compensation Assistance Fund Board” of the Loan Fund, to provide a bridging loan to the Employees Compensation Assistance Fund Board.

PROBLEM

The Employees Compensation Assistance Fund Board (ECAFB) has been operating on annual deficits since 1996-97. Although a reform of the Employees Compensation Assistance Scheme (ECAS) is being devised to improve ECAFB’s financial position, we expect that all of ECAFB’s reserves would be depleted before the reform package can be put in place.

PROPOSAL

2. We propose to provide a bridging loan of \$60 million to ECAFB to help it tide over its cash flow problem until end-July 2001 when the reform package of ECAS is expected to take effect.

/JUSTIFICATION

JUSTIFICATION

Financial position of ECAFB

3. ECAFB is financed by a levy on the premium of employees' compensation insurance policies. At present, a levy at 5.3% of the premium of employees' compensation insurance is collected by the Employees' Compensation Insurance Levies Management Board for distribution to ECAFB (1%) and two other statutory bodies, namely, the Occupational Safety and Health Council (2%) and the Occupational Deafness Compensation Board (2.3%). The levy rate for ECAFB has been maintained at 1% since its inception in 1991. The amount of levy distributed to ECAFB reached the peak of \$31.3 million in 1994-95. However, due to a number of factors including the completion of the new airport projects, the levy income has stabilised at around \$20 million a year since 1996-97. In 1999-2000, ECAFB received \$19.8 million as levy income. It is expected that the levy income will remain at this level in the foreseeable future.

4. In recent years, ECAFB has faced an increasing number of huge claims and escalating amount of common law damages awarded by the court¹. In each of the three financial years from 1995-96 to 1997-98, there was one major claim exceeding \$10 million. These three cases alone accounted for 25% of the total amount of assistance for 181 cases (\$186 million) paid by the Fund between 1 July 1991 and 30 November 1999. Since 1996-97, ECAFB has been operating on annual deficits. In 1999-2000, the expenditure (\$40.5 million) of ECAFB was nearly two times of its income (\$21.5 million). A summary of ECAFB's financial position since 1991-92 is at the Enclosure.

Encl.

5. As at 12 May 2000, the Fund's accumulated reserves stood at \$6.5 million. Based on the experience of ECAFB in the first half of 1999-2000, it is expected that the reserves would be depleted by the second quarter of the 2000-01 financial year. If there are any large common law claims requiring payment by ECAFB, the reserves may be depleted at an even faster pace.

Reform of the Scheme

6. Given the financial difficulties of ECAFB, we commissioned a consultancy review of ECAS. The review, which was completed in December 1999, has examined ways of addressing the significant imbalance between the

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¹ When an employee is injured or dies in an accident arising out of and in the course of employment, his employer will be liable to pay him or his dependants statutory compensation under the Employees' Compensation Ordinance (ECO). ECO does not limit the right of an injured employee or the dependants to take civil action to claim common law damages against the employer at court. However, the amount of damages shall be reduced by the amount of statutory compensation payable under ECO.

estimated income and expenditure of the Scheme. The consultant concluded that the amount of levy collected has never been adequate to cover the potential liabilities accepted by ECAFB, despite the fact that ECAFB has only recently experienced operating deficits. The consultant has looked at three strategic options for reforming ECAS –

- (a) retaining the existing coverage of ECAS;
- (b) introducing a maximum payment limit of \$4 million for each individual case, which would cover statutory compensation in full with the remaining amount used to cover common law damages; and
- (c) removing common law payment altogether.

7. In addition, the consultant proposed other measures that would help ECAFB better manage its resources –

- (a) reducing or removing the payment of interest to the claimants;
- (b) reducing or removing the payment of legal costs; and
- (c) empowering ECAFB to take a more active role in the legal proceedings where it is known that the employer is likely to default in the payment of compensation.

8. In view of the imbalance of ECAFB's income and expenditure, the consultant considered that the levy rate has to be increased from 1% to a level ranging from 2.9% to 4.4%, depending on which of the above strategic options will be adopted.

9. We are consulting various parties on the various options and proposals but it is clear that maintaining the status quo will not sustain the continued operation of the Scheme. Depending on which options to pursue in the light of those consultations, we aim to introduce into the Legislative Council necessary amendments to legislation during the 2000-01 legislative session to give effect to the recommendations of the review and expect their enactment by the second quarter of 2001.

Need for a bridging loan

10. Given its current financial position, we doubt if ECAFB could continue to meet its liabilities up to 2001. In the event of insufficient funds to meet its liabilities, ECAFB would be required to make payments in accordance with a queuing mechanism as laid down in section 26 of the Employees Compensation Assistance Ordinance (ECAO). Under such a scenario, ECAFB would need to pay interest at 11.54%² to eligible claimants until the date of actual payment. This statutory arrangement is designed to enable ECAFB to tide over short-term cash flow problems. However, as the imbalance in ECAFB's income and expenditure is unlikely to be redressed under the current system, the queuing mechanism will not resolve ECAFB's financial problem. The payment of hefty interest will only aggravate the problem. Moreover, invoking the queuing mechanism would jeopardise the interests of eligible claimants. In order to help ECAFB tide over its financial difficulties pending reform without compromising Government's policy on employees compensation matters (see paragraph 17 below), a bridging loan from Government is considered appropriate.

Proposed terms of the loan

11. In determining the quantum of the bridging loan, we have assumed that measures to restore the financial viability of ECAS, which are likely to include capping the maximum payment by the Scheme and increasing the levy income, will be put in place in the 2000-01 legislative session. We expect that the effects of these measures would be fully realised in one to two years' time. Accordingly, based on ECAFB's operating deficit of about \$20 million in 1999-2000, a bridging loan of \$60 million will be adequate to ensure that ECAFB will have sufficient funds to meet its statutory responsibilities during the interim period.

12. It is proposed that the bridging loan of \$60 million to ECAFB will be subject to the following terms –

- (a) the loan would be drawn down in a lump sum or by instalments as and when necessary until 31 July 2001;
- (b) interest will be charged against the loan from the date of drawdown at Government's "no-gain-no-loss" interest rate³. The interest payable may be capitalised; and

/(c)

² Under section 22(2) of the Employees Compensation Assistance Ordinance (Cap. 365), any outstanding amount unpaid by the Board following the Board's determination on an application shall carry simple interest at the rate determined from time to time by the Chief Justice for the purpose of section 49(1)(b) of the High Court Ordinance. This interest rate is commonly known as the "judgement rate". For the past three years, the judgement rate ranged from 11% to 13%. The prevailing judgement rate is 11.54%.

³ The Government's "no-gain-no-loss" interest rate is set at 2% below the average best lending rate of the note-issuing banks. This formula ensures that the interest rate will move in tandem with the market lending rate and is applied for certain Government loans granted on the principle that there should be "no gain" and also "no loss" to the Government. The prevailing "no-gain-no-loss" interest rate is 7.5%.

- (c) the loan will be repaid in six equal annual instalments starting from 1 August 2001.

13. We propose that the interest rate for the loan should be set at the Government's "no-gain-no-loss" interest rate because the responsibility to pay compensation should rest with employers. To minimise interest payment, ECAFB would no doubt draw down the loan only when necessary.

FINANCIAL IMPLICATIONS

14. The proposal to grant a one-off bridging loan at Government's "no-gain-no-loss" interest rate will not have additional financial implications for Government.

URGENCY

15. As at 12 May 2000, the reserve of the Fund stood at \$6.5 million. There will be a forthcoming levy income of about \$4 million at the end of June. Based on the payment pattern in the past, it is anticipated that the reserves is likely to be depleted in the second quarter of the 2000-01 financial year. If the proposal for a bridging loan cannot be approved before the closing of the current legislative session, ECAFB would probably run out of cash to meet its statutory responsibility to make payments to the eligible applicants. As a result, it will be necessary to invoke the queuing mechanism in making payment. This would not be in the interests of injured employees and will further aggravate the financial difficulties of ECAFB.

BACKGROUND INFORMATION

16. ECAFB was established on 1 July 1991 under ECAO to provide benefits to persons eligible for payment under ECAO. Under the Ordinance, employees or dependants of deceased employees who are unable to receive employees' compensation or damages from their employer or insurer after exhausting legal and financially viable means of recovery may apply to ECAFB for assistance. Apart from statutory compensation payable under ECO, ECAS also covers common law damages. ECAO also protects employers against default of their insurers who become insolvent.

17. From the inception of ECAS, we have made it clear that the primary responsibility to pay compensation to employees injured or died in work-related accident should remain with employers as provided for under ECO. In order to

ensure that employers are financially capable of paying the compensation, ECO requires employers to take out employees' compensation insurance to cover their liabilities. The objective of ECAS is to provide a safety net for those employees who fail to receive compensation from their employers after exhausting all existing means of recovery.

Education and Manpower Bureau
June 2000

Employees Compensation Assistance Fund Board
Income and expenditure account

	1991-92 (1.7.91 - 31.3.92)	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
Number of assisted cases	27	12	12	20	18 {1}*	19 {1}*	22 {1}*	28	35
Total income	\$16.7m	\$15.7m	\$21.8m	\$33.8m	\$31.7m	\$23.9m	\$28.5m	\$22.4m	\$21.5m
<i>levy income</i>	\$16.5m	\$15m	\$20.6m	\$31.3m	\$27.8m	\$20.9m	\$23.7m	\$20m	\$19.8m
<i>interest and other income</i>	\$0.2m	\$0.7m	\$1.2m	\$2.5m	\$3.9m	\$3m	\$4.8m	\$2.4m	\$1.7m
Total expenditure#	\$2.6m	\$4.5m	\$23.8m	\$10.8m	\$11.2m	\$35.4m	\$49.7m	\$29.1m	\$40.5m
<i>claims</i>									
- statutory	\$1.39m	\$0.48m	\$1.57m	\$0.86m	\$4.68m	\$2.08m	\$0.96m	\$7.93m	\$6m
- common law	\$0.78 m	\$2.15m	\$3.88m	\$6m	\$15.4m {\$13.9m}*	\$25.6m {\$16.4m}*	\$33.8m {\$15.3m}*	\$10.03m	\$18.9m
<i>interest</i>	\$0.71m	\$0.97m	\$1.65m	\$2.06m	\$1.82m	\$2.36m	\$3.58m	\$4.32m	\$5.4m
<i>legal cost</i>	\$0.49m	\$0.69m	\$1.57m	\$1.5m	\$2.51m	\$4.12m	\$9.72m	\$4.23m	\$7.6m
<i>operating expense</i>	\$0.16m	\$0.4m	\$0.23m	\$0.43m	\$0.74m	\$1.2m	\$2.4m	\$2.55m	\$2.6m
Surplus/Deficit	\$14.1m	\$11.2m	-\$2m	\$23m	\$20.5m	-\$11.5m	-\$21.2m	-\$6.7m	-\$19m
Retained surplus	\$14.1m	\$25.3m	\$23.3m	\$46.3m	\$66.8m	\$55.3m	\$34.1m	\$27.4m	\$8.4m

Notes:

The total expenditure does not necessarily represent the sum of statutory award, common law damages, interest and legal cost in the ensuing columns as the amount paid in a specific year may cover the balance of unpaid items of cases assisted in the previous year(s).

* Figures in { } denote the number of/amount paid for major common law cases with settlement exceeding HK\$10 million.

