

**Information Paper for
the Legislative Council Panel on Manpower**

Review of the Employees Compensation Assistance Scheme

INTRODUCTION

This paper seeks to inform Members of the result of the consultancy review of the Employees Compensation Assistance Scheme (ECAS).

BACKGROUND

2. The Employees Compensation Assistance Scheme (ECAS) was set up on 1 July 1991 under the Employees Compensation Assistance Ordinance (ECAO) for the protection of employees to compensation or damages in employment-related injury or death against defaulting employers. It also indemnifies employers against default of insurers who become insolvent.

3. The ECAS is financed by a levy on the premium of employees' compensation insurance which employers are required to take out under the Employees' Compensation Ordinance (ECO). The Employees' Compensation Insurance Levies Management Board (ECILMB) serves as the central agent to collect the levy. At present, a total levy amounting to 5.3% of the premium is collected by ECILMB for distribution to the Employees Compensation Assistance Fund Board (ECAFB) (1%), the Occupational Deafness Compensation Fund Board (2.3%) and the Occupational Safety and Health Council (2%).

UNDERLYING FINANCIAL PROBLEMS OF THE SCHEME

4. Between 1 July 1991 and 30 November 1999, the ECAFB assisted 181 claims involving a total payment of \$186 million. The distribution of payment is as follows –

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|---|-----|
| • Common law award for damages ¹ | 59% |
| • Legal cost | 15% |
| • Statutory employees' compensation | 14% |
| • Interest | 12% |

¹ In each of the 1995/96, 1996/97 and 1997/98 financial year, there was one major claim for damages exceeding \$10 million. The amount paid in these three cases accounted for 25% of the total amount of assistance.

5. Since 1996/97, the ECAFB has been operating on annual deficits. It has been facing a rising number of large claims and escalating amounts of damages awarded by the court. As at the end of March 2000, the accumulated reserves of the Board stood at \$8.4 million only. Based on the experience in 1999/2000, it is expected that all the reserves would be depleted by the second quarter of 2000/01. However, if there were any large common law claims requiring payment from the Board, the reserves would be depleted at an even faster pace. A cumulative income and expenditure account of the ECAFB is given in the **Appendix**.

6. There is no provision under the ECAO to allow the ECAFB to make partial payment or to pay by instalments. In the event of insufficient funds to pay applicants as their entitlements are due, the Board shall make payments in accordance with a priority mechanism as laid down in section 26 of the Ordinance. It shall also pay interest on any amount that remains unpaid.

7. The financial difficulties confronting the Scheme are attributable to a number of factors. They are discussed below.

Liabilities for accidents since 1984

8. When the Scheme was established in 1991, it assumed the liabilities in respect of all accidents that occurred after 1984 when compulsory employees' compensation insurance was first introduced. This means that the Scheme has taken up a substantial number of "backlog" cases.

Comprehensive scope of coverage

9. The Scheme accepted unlimited liabilities for both the statutory compensation and common law damages arising from work injuries. Whilst the payout for statutory employees' compensation has remained manageable with the highest total payment for a year amounting to \$8 million, the amount of payment for common law damages has escalated significantly in the past few years. Since 1995/96, there were three major common law cases each of which applied for assistance exceeding \$10 million. These three claims have consumed a large proportion of the reserve of the ECAFB. With these precedents, it is likely that the awards for future serious common law cases would probably continue to remain at a high level.

Low levy income

10. The levy rate of the Scheme has been maintained at a rate of 1% since its inception in 1991. The amount of levy income depends on the growth of the premium of employees' compensation insurance policies and the

employment size in Hong Kong. It reached a peak at around \$30 million a year in 1994/95 and 1995/96 owing to the boom in the construction industry as well as the new airport-related projects. With the completion of a number of large-scale construction projects, the levy income has stabilised at around \$20 million a year since 1996/97. Coupled with the slow growth in premium due to competition within the insurance industry, the existing levy income is not sufficient to cover the liabilities implicit in the Scheme.

THE CONSULTANCY REVIEW

11. Against the above background, the Education and Manpower Bureau (EMB) commissioned a consultancy review to study the scope and extent of coverage of the ECAS, the financing arrangements and the operational procedures of the ECAFB. In particular, the consultancy review looked into ways to address the significant imbalance between the estimated income and expenditure of the Scheme.

12. To address this problem, the Consultant has put forward three strategic options which would make the ECAS financially viable in the long term. They are discussed in the ensuing paragraphs.

Option A - Retaining the existing scheme

13. This option will preserve the existing scope and coverage of the scheme. On the expenditure side, the inherent volatility of the Scheme could still not be addressed. In order to alleviate the funding problem, the levy rate for the ECAS may need to be substantially increased from the present 1% to 4.4%. In other words, the total employees' compensation insurance levy would need to be increased from the present 5.3% to 8.7%. By doing so, the Board would receive an additional \$64 million per annum. This would enable it to build up its assets to about four times of its annual expenditure to cushion against the Scheme's volatility. The Consultant considered that the Scheme should not adopt a funding principle to hold a low level of assets (say less than 2 or 3 times estimated expenditure) without access to short-term finance to smooth out volatile cash flows. The Consultant has advised that the higher the level of assets held, the greater the buffer that the Scheme has against volatility of expenditure. Conversely, the lower the level of assets held, the greater the risk of insufficient assets to make claim payments as they fall due.

Option B - Capping the payment to each applicant at \$4 million

14. Under this option, the extent of coverage is limited to a maximum of \$4 million per applicant in respect of any single accident. Through imposing a

cap on the payment, the inherent volatile element of the existing Scheme would be largely removed. The proposed payment limit of \$4 million should fully cover the statutory compensation that an injured employee or dependants of a deceased employee would be entitled to under the ECO². According to past statistics, if a \$4 million cap were adopted, the Consultant estimated that around 15% to 20% of future claimants would not be able to receive their entitlements awarded by the court in full³.

15. There could be three ‘cut-off’ points for implementing the “capped” scheme:

- (a) ***Accident date***: the payment limit would be applicable to those applicants whose accidents occur on or after the date when the legislative change comes into effect;
- (b) ***Lodgment date***: the payment limit would be applicable to those applicants who have not lodged their claims at court prior to the effective date of the legislative change;
- (c) ***Judgement date***: the payment limit would be applicable to those applicants whose claims have not been adjudicated by the court prior to the effective date of the legislative change.

16. If the judgement date is adopted to be the cut-off point for implementing the “capped” scheme, i.e. the payment limit would be applicable to applicants whose claims have not yet been adjudicated by the court when the legislative changes come into effect, the ECAS would gain the greatest savings. According to past statistics, the average time lag between the accident date and judgment date in respect of common law claims was about six years. To finance the “capped” scheme with judgement date as the cut-off point, the levy rate for ECAS will need to be increased from the present 1% to 3%. In other words, the total employees’ compensation insurance levy will be increased from the present 5.3% to 7.3%.

17. If the “accident date” or the “lodgment date” are used as cut-off point, the levy increase would be higher. For the “accident date” scenario, the levy

² Under the ECO, the ^{maximum} amounts of compensation for permanent loss of earning capacity and death are \$2,016,000 and \$1,764,000 respectively.

³ According to past statistics, if the cap were set at \$4 million, only 7 out the 151 applicants to date (or 5%) would not be able to receive their entitlement in full. However, having considered the inflationary effect, the Consultant estimates that around 15% to 20% future claimants would not be able to receive their entitlements in full if a cap were set at \$4 million.

rate would need to be raised from 1% to 3.6%, whereas that for the “lodgment date” scenario is 3.5%.

18. The above scenarios have assumed that the Board would hold a stable level of long-term assets equivalent to four times of its annual expenditure. If we target at a lower asset to expenditure ratio, the corresponding levy rate would be lower. However, as noted in paragraph 9, the certainty in the financial viability of the Scheme might be compromised.

Option C - Remove common law payment

19. This is the other extreme on the spectrum of options discussed above. Under this option, the extent of coverage is restricted to payments in respect of statutory compensation entitlements. To cater for potential liability arising from past cases, the levy rate will still need to be increased from the present 1% to 2.9%, **in the first 10 years**, in order to clear the backlog cases. After that, the levy rate could be reduced to 0.9%. In other words, the total employees’ compensation insurance levy will be increased from the present 5.3% to 7.2% in the first 10 years, and then reduced to 5.2% thereafter. The Consultant estimated that more than 50% of the applicants to date would not be able to receive their entitlements in full by the removal of common law payment. By doing so, the Board would be able to hold a stable level of assets equivalent to four times of its annual expenditure.

Insurer Insolvency

20. It should be noted that the above three options have not provided any cushion against the financial impact of cases of insurer insolvency. This is because it is difficult to predict the financial impact and magnitude of possible cases of insurer insolvency.

Other options for change

21. The Consultant has also discussed other options for change, even though acknowledging that savings from these options would be in second order, particularly if measures were introduced to restrict the coverage of the Scheme. The key suggestions are set out below.

Removal or reduction of entitlement to interest

22. Interest is provided to applicants in order to compensate them for forgone interest whilst waiting to receive their entitlement. Past statistics showed that about 12% of the payment of ECAS are related to interest payment.

Given the very favourable interest rate (currently at 11.5% per annum from the date of judgment onwards) and the absence of any time limit for making an application, there is little incentive for an applicant (save for the need to obtain early payment) to make prompt application to the ECAFB for payment.

23. To plug this loophole, consideration could be given to removing or reducing the interest rate applicable from the date of judgment (or the date of default by employer's insurer) to the date of application to the ECAFB. One implication of this proposal is that applicants under ECAS may receive lower benefits (i.e. difference in interest payment) than their insured counterpart. However, ECAS is by nature a safety net scheme and the ECAFB should not be penalised for the delay on the part of the applicants in making applications.

Removal of entitlement to legal costs

24. Another suggestion floated by the consultant is to abolish payment of legal costs. At present, the ECAFB pays legal costs to claimants in addition to compensation awards. The gross legal costs paid represented 15% of the total amount of assistance paid by the ECAFB.

25. If this change is pursued, the amount of legal costs would have to be deducted by the Legal Aid Department from the amount of damages awarded to the applicant. This would mean that the actual sum in the hands of the claimant would be reduced. If a cap on the maximum amount of payment to individual applicant is introduced, it might be undesirable to further remove the payment of legal costs.

Role of the ECAFB

26. The Consultant recommended that the ECAFB should be managed more along the lines of an insurance company by taking a more active role in claims estimation, financial monitoring, claims negotiation as well as in actual court proceedings. These issues are connected - if the Fund Board were to take an active role in early claim settlement and court proceedings, it must possess expertise in claims estimation and investigation. One of the problems faced by the Board is that in some common law cases, the employers defaulted before the initiating of court proceedings and the ECAFB was not in the position to contest the case, resulting in very large amount of common law damages being awarded to the applicant.

27. The Consultant estimated that the hiring of loss adjusters to handle claims management could result in additional costs of up to \$1 million per annum (which is equivalent to the current administrative costs of the scheme). The Consultant could not quantify the amount of savings that can be achieved

by empowering the Board to take a more active role in managing the claims, particularly if a payment limit is imposed. However, it would be beneficial to help settle earlier the applications made to the Board for payment by giving the Board discretion to take a more active role in claim negotiation and court proceedings.

CONSULTATION

28. After the completion of the Consultancy Review in December 1999, the Administration has consulted the ECAFB and the Labour Advisory Board (LAB) on the findings of the consultancy review.

29. Members of the ECAFB shared the view that there should be a more equitable arrangement whereby payments should be made available to a greater number of applicants instead of those few persons who had been awarded huge sums by the Court.

30. The LAB was consulted on the findings of the Consultancy Review at its meeting on 28 March 2000. Members supported the principle of the Scheme in assisting injured employees to obtain compensation in cases of defaulting payment by their employers, but employers representatives present did not favour any increase in the levy rate as it would impose extra financial burden on employers.

THE WAY FORWARD

31. We shall continue our consultation with the relevant parties on the proposals of the review. Depending on the outcome of the consultation, we shall initiate action to prepare the necessary legislative amendments with a view to introducing them into the Legislative Council in the 2000/01 session. If necessary, the Government is prepared to support a bridging loan, subject to Finance Committee's approval, to tide the Fund over to end July 2001 while the improvement measures for the Scheme are being implemented.