For discussion on
19 May 2005

LegCo Panel on Manpower

Proposed Measures to Improve the Employees' Compensation Insurance System in Hong Kong

Purpose

This paper seeks Members' views on the proposed measures to improve the employees' compensation insurance (ECI) system in Hong Kong, having regard to the experience in overseas jurisdictions, local circumstances and submissions from relevant bodies.

Background

2. It is Government policy to require all employers to take out insurance cover from authorised insurers so as to ensure their ability to compensate their employees injured at work both under the Employees' Compensation Ordinance (ECO), Cap. 282, and common law. This policy is enshrined in Part IV of the ECO which came into effect in 1984. Since then, the private ECI market has been underpinning the operation of the mandatory requirement. At present, some 70 insurers are authorised by the Insurance Authority to write ECI policies.

3. Following the "911" terrorist attack in 2001 and the outbreak of Severe Acute Respiratory Syndrome (SARS) in 2003, Legislative Council (LegCo) members as well as employer and employee groups expressed concern over the potential non-availability of ECI cover for certain risks e.g. infectious diseases. LegCo carried a motion on 10 December 2003 urging the Administration to study the desirability and feasibility of establishing a central employees' compensation scheme.

4. Against this background, the Labour Department (LD), together with the Office of the Commissioner of Insurance (OCI), sent two separate missions in February 2004 to study the operation of the central employees' compensation schemes in Australia and Canada and the 'residual market' mechanism in the USA.

Key Findings of Study Missions

(A) Central employees' compensation insurance scheme

5. The study missions examined the workers compensation systems in Victoria, Queensland and New South Wales in Australia and that of British Columbia in Canada. In these jurisdictions, a central agency set up by statute is the sole insurer providing ECI cover to employers. All risks due to work injuries or occupational diseases, subject to certain degree of limitation on common law damages, are covered.

6. A summary of the central ECI schemes in these jurisdictions is given in **Appendix 1**. The positive features and risk factors of these schemes are outlined below.

Positive Features

7. Drawing on the experience of Australia and Canada, it would appear that a central ECI scheme has the following positive features :

- Ensure the availability of ECI cover for every employer.
- Facilitate the detection of incidents of non-insurance.
- Reduce commission payment to insurance intermediaries.
- Facilitate the basing of premium rate on an employer's claims records kept in a central claims database.
- Avoid wide fluctuations in premium rates by amortising any substantial surplus or deficit over several years.
- Facilitate the management of work injuries claims.

Risk Factors

8. While a central ECI scheme has its merits and can address the problem of non-availability of insurance coverage for certain employers, there are obvious risk factors :

- Without risk-diversification and cross-subsidisation through other lines of business, the scheme may experience financial difficulties if it comes across unexpected risks e.g. SARS. This would lead to pressure to increase premium.

- Create expectation for the Government to act as a guarantor to provide financial support if the central scheme faces financial difficulties, thereby shifting the burden of paying compensation from employers to taxpayers.

- Fuel demands for enhancement in compensation benefits and reduction in premium rates which, taken together, would undermine the financial viability of the scheme.

- Subject the setting of premium rates to economic and political considerations, thus affecting the financial viability of the scheme.

- The impact on ECI premium and the cost-effectiveness of establishing a central ECI scheme in Hong Kong is not known.

- The impact on the general insurance industry by taking away ECI business and intensifying competition in the remaining lines of general insurance business could be serious, thereby jeopardising a sizable number of jobs in the industry.

(B) 'Residual Market' Mechanism

9. The study missions also covered the 'residual market' mechanism in the USA. They studied the 'assigned risk pool' in Massachusetts and the 'state fund' operated by California.

10. All states in the United States impose a mandatory requirement for employers to have ECI cover to provide compensation on a 'no fault' principle to workers injured at work. In the great majority of the states, employers obtain such insurance cover from private insurers in the 'voluntary market'.

11. To ensure the availability of insurance cover for those employers who could not obtain it from the 'voluntary market', many states also set up a 'residual market' mechanism as part and parcel of the mandatory insurance requirement. The 'residual market' must provide cover to such employers if

they fulfil the relevant conditions. A detailed description of the 'residual market' mechanism in USA is provided in **Appendix 2**. The positive features and risk factors of the 'residual market' mechanism are set out below.

<u>Positive Features</u>

12. The positive features of a 'residual market' mechanism are :

- Ensure availability of ECI cover for employers who are denied ECI cover from the 'voluntary market'.

- Maintain competition in the ECI market. Employers can have more choices of insurers that offer different types of services to suit their individual needs.

- Milder impact on the insurance industry as compared to the central scheme since insurers in the 'voluntary market' can continue to underwrite ECI.

<u>Risk Factors</u>

13. The risk factors of the 'residual market' mechanism are :

- If some insurers decide to exclude certain risks e.g. infectious disease, from the 'voluntary market', then employers with these risks would turn to the 'residual market'. This would increase the financial burden of the 'residual market'.

- Unfavourable experience in certain types of ECI business will increase demand for insurance to be taken out with the 'residual scheme' which would expand at the expense of the shrinking of the 'voluntary market'. If this happens, residual scheme members would share higher risks.

Submissions Received

14. In the course of studying ways to improve the ECI system in Hong Kong, the Government received 13 written submissions from nine parties on the subject. A list of these parties is at **Appendix 3**.

15. Nine submissions from predominantly labour groups support the establishment of a central ECI scheme in Hong Kong. The major reasons advanced by them are:

- A central ECI scheme could solve the problems of non-availability of insurance cover and escalating premium faced by high-risk occupations.

- Self-employed persons and casual workers such as part-time domestic helpers would be able to obtain ECI cover.

- ECI should aim at protecting employees instead of making profits.

- Savings from commissions charged by intermediaries, insurers' profits and management expenses could be used to increase employees' compensation and for work injury prevention and rehabilitation purposes.

- It would be easier for part-time domestic helpers who serve several employers concurrently to claim compensation for occupational diseases.

16. On the other hand, the submissions from four associations of the insurance industry are against replacing the private ECI market with a central scheme. In essence, their arguments are:

- A competitive private insurance market ensures that premium is controlled and promotes innovations and continuous improvements. The private ECI market in Hong Kong has improved considerably in terms of efficiency over the years as evidenced by the continued reduction in the overall running costs. For the period 1999 to 2003, gross commission payable declined from 23.0% to 15.5% and management expenses also dropped from 19.3% to 10.5%.

- In the absence of competition and other incentives to reduce cost, a central ECI scheme would not be cost effective. Employers and taxpayers could end up footing the bill.

- Although Hong Kong employees have unrestricted access to claims for damages under the common law, the premium paid by Hong Kong employers amounts on average to 1% of the payroll.

This is lower than the premium rate in Queensland (1.55%) and British Columbia (1.92%) which operate central ECI schemes and have restricted or abolished employees' right to claim common law damages.

- As most of the employees' compensation insurers would underwrite other lines of business, if they experience loss in ECI business for any specific period of time, they could afford not to increase the premium immediately. A central ECI scheme would not have such an advantage.

- The success of Hong Kong as a major financial and economic centre owes much to the adoption of a "big-market-small-government" policy. The replacement of private ECI market by a central scheme would undermine investor confidence in Hong Kong. It would also militate against the Government's effort to develop Hong Kong into an international insurance centre.

- The livelihood of a sizable number of people associated with the ECI business would be jeopardised if a central scheme were to be introduced. Thousands of jobs would disappear.

- Insurance brokers perform a valuable role both in the development of the market and in individual transactions. Elimination of the brokers would not reduce premium as the administration, management and overhead costs of insurers would need to be increased to cover the functions currently performed by brokers.

Improvement proposals from the Hong Kong Federation of Insurers (HKFI)

17. The Hong Kong Federation of Insurers (HKFI) has made a submission to the Government on improving the existing ECI system, including a proposal for setting up a residual market mechanism to cater for the problems faced by high-risk industries in taking out ECI. Details are at **Appendix 4**. The major points in the submission are highlighted below.

(A) Residual Scheme

18. To address the availability, affordability, accessibility and transparency issues in the ECI market, HKFI proposes the setting up of a

residual scheme. It points out that the important principle of ensuring the sustainability of any proposed scheme structure should not be ignored. The major features of the scheme are as follows -

- The residual scheme would provide ECI cover for those who cannot purchase cover from the market.

- The insurance policy issued under the residual scheme would cover every risk including known infectious diseases other than the normal exclusions set out in current ECI policy (e.g. war, strike, riot and radiation, etc).

- The insurance policy will provide up to the minimum insurance cover specified in the Fourth Schedule of the Employees' Compensation Ordinance (ECO) for the purpose of section 40[1].

- All licensed employees' compensation insurers in Hong Kong would be required to participate in the residual scheme. The scheme would be administered in the form of co-insurance by an Administrative Representative who will handle claims under the scheme.

- An employer who is refused cover by at least three employees' compensation insurers or one broker could apply to join the scheme. The risk and relevant information would be circulated to all employees' compensation insurers to see if any insurer is willing to take up the risk. If no feedback is received within a certain period of time e.g. one week, the residual scheme would provide cover to the employer concerned.

- The HKFI would work out the benchmark premium rate for high-risk groups by actuaries. A premium loading mechanism will be set to apply to those employers with a history of poor claims experience. The premium rating system will be made

---

[1] Section 40(1) of the ECO provides that no employer shall employ any employee in any employment unless there is in force in relation to such employee a policy of insurance issued by an insurer for an amount not less than the applicable amount specified in the Fourth Schedule in respect of the liability of the employer. Section 40(1F) stipulates that the reference to the liability of a person is a reference to the liability of the person under this Ordinance and independently of this Ordinance for any injury to his employee by accident arising out of and in the course of the employee's employment.

transparent to the public. A proper mechanism would be put in place to prevent insurers quoting rates which are way above the benchmark.

- Like any ECI cover, the premium level could always be lowered accordingly to reflect favourable experience of claims as a result of proper risks mitigation.

(B) Other improvement measures

19. In addition to the proposed residual scheme, HKFI indicates that it has continued, and will continue, to take the following steps to improve the existing ECI system -

- HKFI has been promoting the Voluntary Rehabilitation Programme and Early Work Injury Management Facilitation Scheme to its members. These programmes aim at facilitating insurers in managing claims early and providing assistance and timely rehabilitation services to injured workers. In this connection, the Labour Department received a submission from the Alliance of Professionals for Rehabilitation of Workers with Occupational Injuries. HKFI is considering a funding proposal from a non-government member organization of the Alliance for assisting injured workers for early return to work.

- It supports the Occupational Safety and Health Council in educating workers on safety issues and encouraging employers to improve safety and health as well as rehabilitation of their workers.

- It is liaising with relevant parties to promote mediation of work injuries claims. Mediation may shorten the time of claim and reduce legal fee so that the injured can get higher and earlier payment.

Consultation

20. The Labour Advisory Board (LAB) was briefed in October 2004 on the key findings of the study missions. The LAB was subsequently consulted on 20 April 2005 on ways to improve the ECI system in Hong Kong. Having considered the overseas experience in running ECI schemes, the positive features and risks associated with a central ECI system vis-à-vis

those of a residual scheme, and the views of relevant bodies, the LAB agreed to test run the proposed residual scheme. However, the LAB made it clear that if the proposed residual scheme did not live up to public expectation and failed to address the major concerns, it would revive discussion on a central scheme. The LAB considered it necessary that a mechanism be put in place to monitor the effectiveness of the residual scheme, the transparency in premium setting for high-risk occupations, and the difficulties for small and medium enterprises in taking out ECI cover.

21. HKFI agreed to take all these into account in working out the operational details of the residual scheme. HKFI intends to implement the scheme in the first half of 2006 at the latest. In the meantime, it will continue with other improvement initiatives including supporting the promotion of occupational safety and health, facilitating the early rehabilitation of injured workers and mediation of work injuries claims.

Way Forward

22. The study missions show that the experiences of central ECI schemes in overseas jurisdictions are diverse. The cost-effectiveness of setting up a central ECI scheme in Hong Kong and the resultant benefit to employers in terms of more affordable premium are uncertain. At present, EC business accounts for about one-quarter of the general insurance market business. Replacing a private market by a central scheme would have significant impact on all general insurers and EC insurers. The disappearance of one-quarter of the general insurance business would inevitably intensify competition in the remaining lines of general insurance business. Those insurers hitherto relying on EC business may have difficulty continuing to operate. There would also be impact on insurance intermediaries: employees in the industry would lose their jobs.

23. It is vitally important that any changes to the ECI system be considered in the context of local circumstances. If HKFI’s proposed residual scheme could fulfill the cardinal principle of availability, accessibility, affordability, transparency with sustainability, it would appear reasonable and pragmatic to allow the industry to improve its services for employers and injured workers than to bring about a drastic change by introducing a central system. It is noteworthy that the industry has cooperated fully with the Administration over the past year in identifying areas for improvement in the operation of the ECI system and developing viable measures to address public concern.

24. In the circumstances, the Administration considers it appropriate for the HKFI to take forward the proposed residual scheme as soon as possible and implement all the other proposed improvement measures.

Advice Sought

25. We would welcome Members' views on the way forward.

Economic Development and Labour Bureau
Labour Department
Financial Services and the Treasury Bureau
Office of the Commissioner of Insurance
May 2005

A Comparison of the Employees' Compensation Insurance Scheme in Selected Jurisdictions in Australia and Canada

Items for Comparison	Australia			Canada
	Victoria (est. in 1992)	**New South Wales (est. in 1987)**	**Queensland (est. in 1916)**	**British Columbia (est. in 1917)**
Authority Administering the Scheme	• Victoria WorkCover Authority (VWA), a statutory body reporting to the Minister for WorkCover	• NSW WorkCover Authority, a statutory body responsible to the Minister for WorkCover.	• WorkCover Queensland (WCQ), a statutory body reporting to the Minister for Industrial Relations	• Workers Compensation Board (WCB), a statutory body reporting to Minister of Labour
Objectives / Responsibilities of Authority	• Provide compensation insurance • Administering the compensation scheme • Overseeing and enforcing the occupational safety and health standards • Implementing rehabilitation and return-to-work programmes for the injured workers. • Setting investment guidelines.	• Provide compensation insurance • Administering the compensation scheme • Promoting occupational safety and health standards • Implementing rehabilitation and return-to-work programmes for the injured workers. • Setting investment guidelines.	• Provide compensation insurance • Administering the compensation scheme • Implementing rehabilitation and return-to-work programmes for the injured workers. • Setting investment guidelines.	• Provide compensation insurance • Administering the compensation scheme • Overseeing and enforcing the occupational safety and health standards • Implementing rehabilitation and return-to-work programmes for the injured workers. • Setting investment guidelines
Government Involvement	• Government is involved in determining the policies of the VWA. • In principle, compensation is employers' responsibility and the government is not a guarantor, nor is it an insurer of last resort. • No start-up fund was injected by the government. • While the Board of Management decides on the investment guidelines, VWA's assets are managed by the Victorian Management Fund, which is a government body.	• The Government is involved in determining the policies of the WorkCover Scheme. • Clearly stated in the law that compensation is employers' responsibility and employers are the ultimate owners of the WorkCover Scheme. The government is <u>not</u> a back up guarantor, nor an insurer of last resort. • No start-up fund was injected by the government	• Compensation is employers' responsibility and the government is not a guarantor, nor is it an insurer of last resort. • When WCQ was set up, it received a government loan of A$169 million as a start-up fund. The loan had already been repaid in a lump sum.	• Government involvement is minimal. • In principle, compensation is employers' responsibility and the government is not a guarantor, nor is it an insurer of last resort. • The Board receives no funding from the Government.
Coverage of Scheme	• All employers, except for those allowed to be self-insured, are required to take out the WorkCover Policy. • Employees earning less than A$7,500 a year are entitled to compensation, but their employers are not required to take out insurance cover. • No exclusion of risks. • Certain self-employed persons or contractors are deemed as employees.	• All employers, except for those allowed to be self-insured and some special sectors, are required to take out the WorkCover Policy. • Some sectors with special risks like coal mining are covered by special industry insurers. • No exclusion of risks. • Certain self-employed persons or contractors are deemed as employees.	• All employers, except for those allowed to be self-insured, are required to take out the WorkCover Policy. • No exclusion of sectors or risks. • Self-employed persons may take a personal accident policy with WCQ, but the benefits are made in accordance with the policy rather than the compensation legislation.	• All employers, except for those allowed to be self-insured and some special sectors, are required to register with WCB. • No exclusion of sectors or risks. • Self-employed persons may take a personal accident policy with WCB, but the benefits are made in accordance with the policy rather than the compensation legislation.

Items for Comparison	Australia			Canada
	Victoria (est. in 1992)	**New South Wales (est. in 1987)**	**Queensland (est. in 1916)**	**British Columbia (est. in 1917)**
Interface with insurers in private market	• 6 authorized agents administer the WorkCover Scheme on behalf of VWA under fixed term agreement which is subject to renewal. • The functions of the authorized agents broadly encompass premium collection, administration of insurance policies, debts recovery, claims management and rehabilitation. • Authorised agents are paid fees for their services based on premiums. In 2002/03, fees paid to authorized agent represented 7.4% of the premium revenue.	• 6 licensed agents administer the WorkCover Scheme on behalf of NSW WorkCover Authority under open-end agreement. • The functions of the licensed agents broadly encompass premium collection, administration of insurance policies, debts recovery, claims management and rehabilitation, and investment of funds. • NSW WorkCover regulates the licensed insurers through an agreement entered with them which sets out all the requirements to be complied with by the licensed insurers. • Licensed insurers are remunerated according to their performance as set out in the agreement. In 2002/03, insurers' management fess represented about 9% of the net earned premium.	• No involvement of any private insurer.	• No involvement of any private insurer.
Setting of Premium Rate	• Premium rates have to be approved by the government in the form of a Premium Order upon recommendation by VWA. • Premium rates set by reference to the industry experience in claims costs, the employers' total remuneration and the employers' claims experience. • For 2003/04, the average premium rate is 2.22% of total remuneration, which has remained unchanged since 2000/01. • Increase in premium rate for an employer is subject to capping (between 19% and 20%) in order to avoid drastic fluctuation of rates.	• Premium rates have to be approved by the government through the Insurance Premiums Order upon recommendation by the NSW WorkCover Authority which is also advised by outside actuaries. • Premium rates are set by reference to the industry experience in claims costs, the employers' total remuneration and the employers' claims experience. • For 2003/04, the average premium rate is 2.57% of total remuneration. • Increase in premium rate for an employer is capped at 15% per year.	• The Government has the final say in the setting of the premium rates. • Premium rates are set by reference to the industry experience in claims costs, the employers' total remuneration and the employers' claims experience. • The average premium rate for the year of 2003/04 was 1.55%. • As investment returns can fluctuate from year to year, WCQ has created an Investment Fluctuation Reserve to reduce premium volatility.	• WCB determines premium rates on its own without the need for approval by the government. • Premium rates are set by reference to the industry experience in claims costs, the employers' total remuneration and the employers' claims experience. • Industries with similar risk level are pooled together for the assessment of premium rate. This is to avoid cross-subsidy between industries of different levels of risk. • For 2003, the average premium rate is 2.06% of assessable payroll. • Increase in premium rate for an employer is subject to a cap at not more than 20% to avoid drastic fluctuation of rates.

Items for Comparison	Australia			Canada
	Victoria (est. in 1992)	**New South Wales (est. in 1987)**	**Queensland (est. in 1916)**	**British Columbia (est. in 1917)**
Financial Position	• For 2002/03, the net loss of VWA was A$316 million. • This was due to: ✧ previous mismanagement of claims; ✧ escalating common law liabilities before the capping of common law damages in 1999; ✧ poor investment performance; and ✧ unfavourable changes in economic assumptions used to determine the net claims liability. • The financial position of VWA improved in 2003/04 with a net operating surplus of A$1.2 billion. This is due mainly to the favourable investment return of A$815 million in the year. • The substantial surplus in 2003/04 helps VWA achieve a funding ratio (i.e. percentage of total asset over its total liabilities) of 102% as at 30 June 2004 (compared with 83% in 2003).	• For 2002/03, NSW WorkCover recorded a deficit of A$181 million from its ordinary activities. • This was due to: ✧ inadequate claims management ✧ poor investment performance ✧ difference between actual and long term expected returns on its assets and change in discount rates used to determine the net claims liability. • The A$444 million higher than expected investment return helped NSW WorkCover to achieve a surplus of A$629 million from its ordinary activities in 2003-04. • As at 30.6.2004, the funding ratio of the Scheme was 73%, up from 66% a year ago. • It was NSW WorkCover's target of achieving a funding ratio of 90% by 2008.	• For 2002/03, WCQ experienced an operating loss of A$22 million. • Due to favourable investment return of A$279 million (or a return rate of 13.5%), WCQ recorded an operating surplus of A$193 million in 2003/04. • WCQ has achieved full funding of its liabilities. For five consecutive years, WCQ has maintained the required solvency rate (i.e. net assets in excess of outstanding claims liability) by 20% and is projected to be able to remain so by independent actuary.	• For 2003, WCB recorded an operating surplus of C$154 million. • As at 31 December 2003, WCB's funding ratio (i.e. percentage of liabilities funded with assets) was 100.1%. • From 1993-2002, the funding ratio averaged 99% with the lowest of 87% in 1994 and the highest of 109% in 1999 and 2000.

Residual Market Mechanism in the USA

1. What is Residual Market Mechanism

1.1 Residual market mechanism was established in the states of the USA along with the introduction of the compulsory requirement for workers compensation insurance in the early 1900s. It serves as "an insurer of last resort", providing cover to those employers who cannot obtain workers compensation insurance in the voluntary market.

1.2 Each state would establish its own residual market mechanism which, in practice, operates in one of the two main modes:

- Assigned Risk Pool
- State Fund

2. Assigned Risk Pool

2.1 An Assigned Risk Pool operates as a reinsurance pool formed by all insurers who are licensed to write workers compensation insurance in a particular state. Employers who are rejected by insurers in the voluntary market can apply to the Pool for coverage.

2.2 All insurers who are licensed by the state government to underwrite such insurance are required to join the Pool. The Pool will be administered by an authority, which is appointed by the state government, through servicing carriers. The servicing carriers, who are appointed by the Pool administrator through a set of established procedures, shall carry out all the functions[1] that an insurer in the voluntary market would have to perform.

2.3 All the premiums collected, after deducting the service charge of the servicing carriers, will be shared by the participating insurers according to their respective market share in terms of premium underwritten in the voluntary market. The payouts from the Pool will also be shared among all the participating insurers according to the proportion of their market share of the workers compensation insurance in terms of premiums.

2.4 In this way, all the workers compensation insurers share the risks of those employers who could not obtain insurance cover for various reasons[2]. Insurers will have to leave the workers compensation insurance market if they choose not to share

[1] These functions include the issue of policy, collection of premium, handling claims and making payment of benefits to the injured workers.

[2] Employers who could not obtain insurance cover are not necessarily of particularly high-risk. Some of them may be new enterprises without claims history for reference by insurers. Some others are small enterprises which could only generate a very small sum of premium so that the insurers are not interested in writing the policy.

the risk. No government funding is involved in the operation of the Assigned Risk Pools.

2.5 It is noted that in the past few years, the Assigned Risk Pools experienced re-populations with a growing market share. The different Pools also run with operating deficits.

3. State Fund

3.1 Some states in the USA set up a "state fund" as an insurer of last resort to assure that all employers would be able to obtain insurance cover. State funds are, by law, designed to be self-supporting from their premium and investment revenue. They will be either run as a non-profit making state department or as an independent non-profit making company set up by law.

3.2 Some state, such as California, will allow the state fund to compete in the workers compensation insurance market. Such competitive state funds, for the most part, are subject to the same regulatory requirements as private insurance companies.

3.3 In California, employers may also choose to purchase insurance from the State Compensation Insurance Fund which is an enterprise operated by the state government to provide workers compensation insurance on a non-profit making basis. Operating on a mutual insurance basis, the California State Compensation Insurance Fund returns unused premium (which is in excess of operating expenses, claims costs and expenses, and necessary reserves) to policyholders in the form of dividends.

3.4 In 1995, California deregulated the setting of premium rates for workers compensation insurance to allow insurers to set their own rates. This has led to drastic cut in the premium rates. As a result, the capacity of the workers compensation insurance market contracted as a number of insurers became insolvent or withdrew from the market.

3.5 As at the end of 2003, the State Compensation Insurance Fund took about 60% of the market share of the workers compensation insurance in California. It is now the single largest workers compensation insurer for the state.

Appendix 3

List of submissions on the employees' compensation insurance system received by the Government

1. Alliance for the Establishment of Central Compensation Fund
2. Hong Kong Confederation of Trade Unions with ten other organisations as joint-signatories
3. Federation of Hong Kong and Kowloon Labour Unions
4. First Step Association
5. Hong Kong Domestic Workers General Union with 31 other organisations as joint-signatories
6. Hong Kong General Insurance Agents Associations Ltd
7. Hong Kong Chamber of Insurance Intermediaries
8. Hong Kong Federation of Insurers
9. Hong Kong Confederation of Insurance Brokers

PROVISION OF EMPLOYEES COMPENSATION INSURANCE FOR HIGH RISK GROUPS: RESIDUAL SCHEME AS A PROPER WAY FORWARD

Background

1. Following the incidence of 911 terrorist attack and the outbreak of Severe Acute Respiratory Syndrome (SARS), there has been increased public concern about the perceived unavailability of employees compensation insurance cover and the issue of premium costs for certain high risk occupational groups. At a Legislative Council motion debate in December 2003, the HKSAR Government undertook to study the feasibility and desirability of establishing a centralized Employees Compensation Insurance (ECI) system to help address these issues.

2. The Hong Kong Federation of Insurers (HKFI) was invited in that context to consult its member companies and comment on the proposed way forward. An in-depth study by HKFI was then conducted, and in the light of extensive consultation with its member companies, a paper was presented to the Government in November 2004 explaining why we at HKFI are of the view that:

（a）the proposed centralized ECI system does not offer the right kind of solution to the problems we are trying to tackle and instead, it could end up undermining the ultimate interests of employees and employers; and

（b）a better way forward woud be to keep improving the operation of the existing ECI system and proceed to consider establishing a practical Residual Scheme (RS) to ensure a proper and sufficient provision of EC cover for those high risk groups.

3. As referred to in our position paper, the long-established philosophy of "big business, small government" has served Hong Kong well over the years. Hong Kong is well recognized as a premiere international insurance centre in the Asia Pacific region, and this has been achieved essentially through the enterprising spirit and substantial investments of the private sector and without any Government subsidies or public funding support apart from a fair and effective regulatory framework provided by Government. Compared with many overseas jurisdictions, employers in Hong Kong are paying considerably much less EC insurance premiums overall whereas employees are being provided with one of the most comprehensive EC protection and benefit schemes in the world.

4. In aftermath of the 911 terrorist attacks, Governments around the world have provided various schemes, as in the case of Hong Kong, to support and enable the private insurance market to continue to operate. The taking of this extraordinary step is guided by consideration of the fact that terrorist attacks are intended to inflict pains and damages on the Government or sovereign power and, as such, it would be neither possible nor reasonable for such kind of risks to be shouldered by a private industry.

5. The outbreak of (SARS) was an unprecedented crisis for everybody including the insurance industry. Working closely with the Government and the public and private health care sectors, our industry was able eventually to come up with practical solutions acceptable to all parties concerned. The experience showed once again the merit of allowing the market to respond accordingly and operate in a way that is free from any unnecessary Government intervention.

6. No system is perfect. We at HKFI firmly believe that a proper way to address public concerns over the current ECI system is to identify effective ways to improve its operation and, at the same time, establish a workable, transparent residual scheme to provide the necessary EC cover for high risk groups.

Present Position

7. As explained in our position paper, HKFI has taken the initiative to approach the relevant parties concerned including Government officials, Legislative Councillors, trade unions, employers groups and insurance brokers & agents associations to present the key points of the paper and solicit their views on the areas for improving the existing EC insurance scheme. These meetings proved to be very useful and constructive. There is general consensus that we need to work harder to upgrade the efficiency and transparency of the present ECI system. In particular, ways should also be found to ensure that high-risk groups are not, by default, excluded from EC cover and proper consideration should be given to the issue of pricing of premiums. We believe the existing private sector operated EC insurance scheme, coupled with a Residual Scheme (RS) operated in many other similarly privately run EC insurance schemes overseas, should be able to deliver the desired results.

8. Based on the experience of similar schemes operating in USA and taken into account the unique market conditions in Hong Kong, HKFI have come up with a preliminary proposal on the structure of a RS. The proposal has been endorsed in principle by the Insurance Authority and has had full support of the great majority of insurance companies providing EC cover in the territory.

Guiding Principles

9. We understand that the Government considers that with the experience of the operation of the existing EC scheme, it is absolutely essential that the RS should meet the basic criteria of Affordability, Availability, Accessibility and Transparency.

10. HKFI agrees entirely with these suggested principles. We find them not only relevant but also inspiring in terms of providing a sound and clear framework for taking forward this exercise. We would like to add, however, that in highlighting affordability as one of the basic elements of a RS, we cannot choose to ignore the equally important principle of ensuring the sustainability of any proposed scheme structure. This is based on a simple but crucial fact that any form of insurance is all about risk sharing and the true claim cost of a risk has to be fully recoverable so that the RS is financially solvent ultimately to meet any potential claims associated with the risks accepted.

11. The relevant rates, of course, will have to be made transparent and calculated on actuarial basis. Like any EC cover, the premium level can always be lowered accordingly to reflect favourable experience of claims as a result of proper risks mitigation.

Proposed Structure of RS

Modes

12. The proposed RS would be made mandatory. With Insurance Authority's endorsement, every licensed EC insurer is required to participate in the scheme and sign a market agreement modelled on the Employees Compensation Insurer Insolvency Bureau. The reinsurance arrangement of the scheme will be similar to the model of Motor Insurers Bureau. The RS is to be managed by a panel comprising members to be elected by RS members. The management panel will be responsible for decision making including appointment of the Administrative Representative (AR) i.e. the insurers responsible for the operation of the RS.

13. As with any ordinary commercial policy, the policy issued under the RS will cover every risk including known infectious diseases other than the normal exclusions set out in the current EC policy (e.g. war, strike, riot and radiation, etc).

Mechanism

14. The HKFI will bear the initial setting-up cost of the RS. The RS will be administered in the form of co-insurance by an Administrative Representative elected from the participating members. The AR must have professional knowledge and experience in the insurance field and will issue cover on behalf of all participating members who will bear a share of every risk by reference either to:

（a）their respective share of market size in the existing ECI business; or

（b）premium bands based on each insurer's percentage of the total gross written premium in ECI in the preceding year (market share) for Hong Kong business, for example 3% each for the first ten leading EC insurers, and 1.5% each for the next 40 EC insurers and 1% for the remaining.

The AR will handle claims under the scheme as well.

Eligibility requirements for employers to obtain coverage

15. The RS will be open for application only to those who cannot purchase cover from the market. An applicant who is refused cover by at least three EC Insurers or one Broker can apply to the RS. Insurers will be required to provide their reason for not giving the quote. The AR will then circulate the risk and the relevant information to all its members. If no feedback is received within a certain period of time e.g. one week, then it will go to this RS. Every cover provided by the RS must offer back into the market upon expiry. It will remain in the RS as long as there is no cover available in the market.

Premium rates

16. Our initial assessment is that for the insurance market of Hong Kong, there would be no more than 20 genuine high risk groups experiencing difficulties in obtaining EC cover (see Annex I for examples of such groups of employees). The HKFI will work closely with the Labour Department as well as labour unions and employers associations to try to define and identify this particular category of occupational groups on an ongoing basis. The HKFI will then seek to provide benchmark rates of ECI for the high risk occupational groups so identified. These rates will be worked out by actuaries based on past experience, risk exposure, annual review and update of the relevant actuarial statistics. These rates will be made transparent and available to the public. We will also put in place a proper mechanism to prevent insurers quoting rates which are way above the benchmark set for any particular high risk group. In situation where the rate quoted exceeds a certain percentage above the established benchmark, for example, the case in question will automatically go into the residual scheme for proper assessment. A premium loading mechanism will be set to apply to those applicants with a history of poor claims experience. The Insurance Authority will be invited to assist in the collection of the required market data.

17. Payment terms for the premium will be "Cash On Delivery". There might be a minimum premium for mid-term cancellation, to be considered on a case-by-case basis.

Coverage provided by the scheme

18. The RS will provide cover up to the required statutory limit.

<u>Way Forward</u>

19. The success of the proposed RS would depend largely on establishing:

(a) a transparent system of setting the relevant premium rates;

(b) an effective mechanism of ensuring that all high risk groups have access to the RS;

(c) a good framework of scheme administration whereby all participating member companies are willing and ready to take part in sharing the risks and assuming the related liabilities; and

(d) a proper way to ensure the solvency of the RS to protect the interests of the insured. Policies issued under the scheme will be subject to the same levies as other EC policies and protected under the Employees Compensation Insurer Insolvency Scheme.

20. All these would require further in-depth study and consultation with the relevant parties including the Insurance Authority and the Labour Department. At the same time, we at HKFI will take pro-active steps to strenghten co-operation with the Government and all interested business and community groups in areas of injury management, early-return-to-work, claims mediation with the objective of containing and reducing the costs of ECI in the long term (see Annex II for details). On the other hand, HKFI will continue to strengthen the Code of Best Practice to be followed by EC Insurers and to annually update the EC burning cost for reference of member companies.

21. As and when the proposed structure and operation of the RS are accepted by the Government and the related stakeholders (including employees and employers representative bodies) the HKFI will proceed to form a working group with the Insurance Authority and the Labour Department to oversee the setting up and initial operation of the proposed RS. We would need to work out, for instance, the categories of 20 high risk groups and their ECI pricing benchmarks.

22. It is our intention to complete the necessary consultation and bring the proposed scheme into operation as soon as practicable. All things considered and barring any unforeseen circumstances, the proposed scheme is expected to be up and running in the first half of 2006.

The Hong Kong Federation of Insurers
18 March 2005

Examples of high risk groups

1 Blasting
2 Demolition Work
3 Diving
4 Earth Removal
5 Excavation
6 Filling & Reclamation
7 Gondola Worker
8 Scaffording
9 Ship Repairer
10 Steel Bending & Erection
11 Stevedores
12 Stuntman
13 Tunnelling
14 Well Sinkers and Borers
15 Window Cleaner
16 Worker on board Launch/ River Trade Vessel
17 Elderly Watchman/ elderly Domestic Helper
18 Professional Athlete/ Footballer
19 Drain Repairer
20 Air Conditioner Installation Worker/ Repairer
21 Neon Light Signboard Installation Worker/ Repairer
22 Crane Operator

Annex II

Pro-active steps taken by HKFI with the relevant parties to improve the existing EC System

1 Labour Department

(a) Voluntary Rehabilitation Programmes

(b) Early Work Injury Management Facilitation Scheme

- to facilitate insurers in managing claims early and providing assistance and timely rehabilitation services to injured workers.

  HKFI have been promoting the schemes to its members. For Rehabilitation Scheme, the number of participating members has been increased from the beginning 8 to 14 members at present whereas the number of members in the Management Facilitation Scheme is 47.

2 Occupational Safety & Health Council

(a) Safety Promotion Campaign for construction, catering, transportation industry etc

- to educate workers on safety issues so that accident rate can be reduced

  Members have been invited to nominate their clients in the catering industry to participate. The nominated clients will join the enhancement programs to improve their working environment and to raise their productivity and competitiveness.

(b) HKFI Award of Excellence in Occupational Safety & Health

This award will go to the employers who have good achievement in the Voluntary Rehabilitation Programme.

3 Hong Kong Mediation Council

(a) Promotion Seminar by the Council

- to shorten the time of claim and reduce legal fee so that the injured can get higher and earlier payment

  HKFI is at present liaising with relevant parties to promote mediation.