

For information
on 15 March 2003

Legislative Council Panel on Financial Affairs
Meeting on 15 March 2003

Insurance Coverage for Various Business Sectors

Introduction

At the meeting of the LegCo Panel on Financial Affairs held on 16 January 2003, Members considered the Information Paper entitled “Business environment of the Hong Kong insurance industry and the difficulties encountered by some professional and business sectors in obtaining insurance coverage”. This paper updates the position in respect of matters mentioned in that Information Paper.

Background

2. There are two major types of mandatory insurance in Hong Kong: insurance in respect of employees’ compensation (EC) and motor vehicle third party risk in relation to death or bodily injury. The requirements in respect of these two types of compulsory insurance are set out in the relevant Ordinances. All employers, except for the Government, are required to obtain EC insurance cover for their employees. Depending on the nature of business activities, employers may need to obtain additional types of insurance cover. For example, employers in the transport business using motor vehicles would need to obtain cover for their motor vehicle third party risk. EC and motor insurance together takes up a significant portion of the general insurance market in Hong Kong for

they amount to some 22% and 16% of the market in 2002.

3. Hong Kong has one of the most open insurance markets in the world. As at the end of January 2003, there were 194 insurers authorized to carry on insurance business in Hong Kong. Among these, 148 were authorized to carry on general insurance business.

4. The Hong Kong general insurance industry, similar to that in many other places, has been hit by the sluggish economy, shrinkage of investment returns and keen competition. The hardening of the market has led to increase in premium level, around 20% in 2002 in terms of total gross premium. Hong Kong's situation is not unique. Premium for general insurance in most other advanced economies (e.g. Australia, US, UK and Singapore) has also increased substantially and the trend is likely to continue. General insurers have also adopted a more conservative approach in underwriting policies, for example, stepping up risk assessment. Details of the business environment of the Hong Kong insurance industry is set out in the Information Paper discussed at the _____ Panel meeting on 16 January 2003, copy at Attachment A.

5. In 2002¹, the Hong Kong general insurance industry recorded an underwriting profit of HK\$1,125 million, turning around losses for five consecutive years, which totaled HK\$3,487 million.

EC and Motor Insurance

6. The latest statistics on the gross premium and underwriting performance of EC and motor insurance direct business² are set out in _____ Attachment B. In 2002, EC and motor insurance recorded a 50.7% and 7.2%

¹ All figures of the premium levels and underwriting results in 2002 are provisional figures.

² This means that reinsurance inward business accepted by direct insurers and reinsurers is not included

increase in gross premium. While the increase has helped improve the underwriting performance of motor insurance direct business, which showed an underwriting profit of HK\$24.7 million for the first time since 1996 (yet an underwriting loss of HK\$79.6 million recorded for overall motor insurance), EC insurance direct business still incurred underwriting losses of HK\$323.3 million.

Difficulties in Obtaining Insurance Coverage

7. Against the background of the hardening of the general insurance market, some transport trades (e.g. public light bus and taxi) and employers of specific sectors (e.g. diving industry) have complained that they have difficulties in obtaining the required EC and/or motor insurance cover. In some cases, the complaints relate more to the level of premium, rather than a supply problem.

8. As mentioned in the paper at Attachment A, the situation of the insurance market in Hong Kong is not unique. Insurance business is a risk-assessing and pricing business. Hong Kong has an open insurance market and there is no barrier for new qualified companies to enter the market. We believe that the level of premium rates should best be left to market forces.

9. The recent increase in premium should also be read in the context of the keen competition in the market in the past few years. Between 1996 and 1999, average premium rate for EC insurance dropped by 22% (non-construction EC business) and 28% (construction EC business), despite that in the same period claims had increased significantly. As for motor insurance, information provided by several major insurers³ regarding their underwriting

³ These insurers together have around 90% share in the motor insurance market.

performance in the past three years in respect of taxi and public light bus is set out in Attachment C. It illustrates the level of losses incurred by insurers in covering these types of vehicles. According to the statistics of the Police, the accident rates in respect of taxi and public light bus for the years 2000 to 2002 are 20% and 25% respectively, which are much higher than the 2% accident rate of private cars during the same period. Obviously, the higher the risk accepted by insurers, the higher the premium policyholders would have to pay.

Actions by OCI

10. The Administration is mindful of the need to provide assistance to those who face genuine difficulties in obtaining compulsory insurance. Towards this end, the Office of the Commissioner of Insurance (OCI) has been liaising with the associations of insurance brokers (who are specialists in finding the appropriate insurance for their clients) and the Hong Kong Federation of Insurers (HKFI). In the past two years, the OCI has received a total of 24 complaints about the difficulties in obtaining insurance coverage. With the assistance of the relevant Government departments, insurers and industry bodies, all complaints had been resolved. Moreover, OCI will continue to ensure that insurers operate in a business-friendly and open environment, so that they can react to market demand more effectively and efficiently.

11. We also attach great importance to market transparency. In this regard, starting with the financial year ended 31 December 2002, OCI will publish underwriting statistics of EC insurers in respect of ten broad occupation types. This should facilitate premium setting by insurers and help policyholders to better understand the state of the industry.

12. The Administration will also continue its efforts on promoting road and occupational safety, as well as other measures, such as facilitating the early rehabilitation of injured employees, which would ultimately help to lower the premium rates for EC and motor insurance policies.

Financial Services and the Treasury Bureau/OCI

March 2003

For information
on 16 January 2003

**Legislative Council Panel on Financial Affairs
Meeting on 16 January 2003**

**Business environment of the Hong Kong
insurance industry and the difficulties encountered by
some professional and business sectors in obtaining insurance coverage**

Introduction

This paper sets out the present business environment of both the worldwide and Hong Kong general insurance markets as well as the Administration's response to the matters raised by the Honourable Bernard Chan regarding the difficulties encountered by some professional and business sectors in obtaining insurance coverage.

Business Environment

Worldwide General Insurance Market

2. In the international scene, the last two years have been very stressful for the general insurance industry, particularly the reinsurance industry. Insurance capacity has contracted due to a combination of weak investment returns, keen competition among insurers and unprecedented losses. In 2001, worldwide general capital funds in the insurance industry decreased by about US\$90 billion. The contraction for 2002 was projected to be approximately

the same amount if the current state of stock markets continues. This would mean some US\$180 billion, or 25%, decrease in global capital funds of the general insurance industry since early 2000. The about US\$30 billion new capital infused after the 911 events has not been enough to make up for the decrease. Apart from a shrinking in capital fund, the 911 events in the United States (US) in 2001 had caused an estimated US\$50 – 70 billion loss to general insurers worldwide.

3. As a result, insurers worldwide have raised their premium rates, particularly in commercial lines and reinsurance business. Moreover, they have become more conservative in underwriting risks. The hardening of the international insurance market is projected to continue in 2003, given the global shortage of quality capital for the insurance sector and increased risk exposures after the 911 events.

Hong Kong Insurance Market

4. Hong Kong has one of the most open insurance markets in the world. As at 30 November 2002, there were 197 insurers authorized to carry on insurance business in Hong Kong. Among these, 150 were authorized to carry on general insurance business. The Hong Kong general insurance industry, similar to that in many other countries, has been hit by the sluggish economy, shrinkage of investment returns and keen competition. The overall underwriting loss of general insurers amounted to HK\$1,379 million, HK\$872 million and HK\$473 million in 1999, 2000 and 2001 respectively. For the first nine months of 2002, the general insurance industry recorded an underwriting profit of HK\$604 million.

EC Insurance Business

5. As at 30 November 2002, there were 73 authorized insurers writing Employees' Compensation (EC) insurance business in Hong Kong. In the past few years, EC insurance business had experienced continuous and significant underwriting losses. The underwriting loss for this statutory line of business was HK\$1,370 million in 1999, HK\$1,091 million in 2000, HK\$1,039 million in 2001 and HK\$315 million for the first nine months in 2002. Such losses are attributable to inadequate premium rate, an intensely competitive and fragmented EC insurance market, and substantial increase in common law damages and statutory benefits.

6. In the light of the significant underwriting losses and in response to the suggestion of the industry, in December 2000 the Office of the Commissioner of Insurance (OCI) conducted an industry-wide survey to gauge the performance of EC insurance business in two areas, i.e. construction and non-construction businesses. The survey revealed that for construction EC business, the underwriting result deteriorated by 487% from a loss of HK\$98 million in 1996 to a loss of HK\$576 million in 1999. Over this 4-year period, the number of claims reported increased by 20%. The average amount paid per claim increased by 91% and the amount of the largest claim settled increased by 90% (up to HK\$14 million in 1999). On the other hand, the average premium rate dropped by 28% in the same period.

7. As for non-construction EC business, the underwriting result deteriorated by 1,673% from a loss of HK\$42 million in 1996 to a loss of HK\$740 million in 1999. Over the period, the number of claims reported increased by 37%, the average amount paid per claim increased by 19% and the amount of the largest claim settled increased by 40% (up to HK\$21 million in

1999). On the other hand, the average premium rate dropped by 22% in the same period.

8. The results of the OCI's survey show that during the relevant period while the claims had risen substantially, both in terms of number and amount, the premium rate had on the contrary dropped by 28% and 22% in respect of construction and non-construction EC business respectively. This underlines how competitive the market had been.

9. With the amount of losses and against the background of developments in the global market highlighted above, Hong Kong EC insurers raised the premium. For the first nine months of 2002, EC insurance business recorded an increase of 33% in gross premium. Moreover, many insurers had stepped up their risk management in underwriting EC insurance policies, for example, requiring the wage roll of employers to be certified and to have more regard to the safety measures at the work place in setting the premium. These measures have improved the underwriting performance of this line of business with the underwriting loss reduced from HK\$421 million for the first 9 months of 2001 to HK\$315 million for the same period in 2002.

Motor Insurance Business

10. As at 30 November 2002, there were 68 authorized insurers writing motor insurance business in Hong Kong. Motor insurers in Hong Kong had also suffered heavy underwriting losses in recent years: HK\$166 million in 1999, HK\$407 million in 2000 and HK\$108 million in 2001. The main reasons for such losses are inadequate premium rate and increase in compensation. From 1996 to 2001, the average premium per vehicle had fluctuated between \$5,067 and \$5,797. Relevant statistics are at Annex.

Market Outlook

11. Despite the losses incurred by the general insurers in the statutory lines of business, they are compensated by profits in other profitable business, and other pre-financing arrangements such as new capital injection. Moreover, the Insurance Authority imposes stringent solvency and asset requirements for general insurers. The overall insurance industry is financially sound.

Difficulties in obtaining insurance coverage

12. The Hong Kong insurance industry is not immune to problems faced by the global market, including the tight reinsurance capacity available. In addition, the increasing amount of court award for personal injury has increased the operating costs of insurers. In light of the difficult business environment, particular in the case of general insurance, insurers have increased premium rates and tightened underwriting measures.

13. The hardening of the general insurance market has drawn a number of complaints from the insuring public, mainly motorists and employers of specific sectors. For EC insurance, the complaints are mostly related to smaller companies in the construction, engineering and diving sectors. For motor insurance, they are mostly related to motor cycles, public light buses (PLB) and taxis. In the past two years, the OCI received a total of 24 such complaints. In some cases, the complainants faced genuine difficulties in obtaining insurance coverage. In other cases, the issue was related more to the level of premium rates. With the assistance of the relevant Government department and the insurers, all complaints had been resolved.

14. As mentioned in paragraphs 2 to 4 above, given the global development,

the current business environment and the losses in the past, insurance premium would remain high. This is not inconsistent with the worldwide trend. Insurance business is a risk-assessing and pricing business. Hong Kong has an open insurance market and there is no barrier for new qualified companies to enter the market. We believe that the level of premium rates should be best left to market forces. In line with the practice in other jurisdictions with a well-developed insurance market (UK, Australia and Singapore), OCI does not interfere with premium setting by insurers. OCI is debarred under section 26(3A) of the Insurance Companies Ordinance from intervening into the premium setting by insurers.

15. For persons facing genuine difficulties in obtaining insurance coverage, they may seek the assistance of brokers, who are specialists in finding the appropriate insurance for their clients. In this regard, the OCI has been in close liaison with the two broker associations and has drawn up a list of brokers for public inspection. Moreover, a list of brokers who may help employers in securing EC insurance is now available at the Labour Department. In the longer term, the Administration will explore the feasibility of encouraging employers from a specific sector to purchase EC insurance on a collective basis.

16. The Administration will continue to ensure that insurers operate in a business-friendly environment and on a level-playing field. We will also work closely with relevant stakeholders to promote road and occupational safety, which would ultimately help to lower the premium rates for motor and EC insurance policies.

Financial Services and the Treasury Bureau/OCI

January 2003

Motor Insurance Market (Direct Business)

	Total gross premium (\$ <i>billion</i>)	Underwriting performance (\$ <i>million</i>)	No. of vehicle covered	Average premium per vehicle (\$)
1996	2.69	(82.7)	496 266	5 426
1997	2.81	(346.3)	484 922	5 797
1998	2.78	(383.9)	489 393	5 674
1999	2.35	(176.3)	456 006	5 144
2000	2.47	(324.9)	448 368	5 508
2001	2.77	(121.0)	546 072	5 067
2002 (<i>Jan-Sept</i>)*	2.23	(80.4)	N/A	N/A

*: Provisional figures.

EC Insurance Direct Business Market

	Total gross premium (\$ <i>billion</i>)	Underwriting performance (\$ <i>million</i>)	No. of policies in force	Average premium per policy (\$)
1996	2.31	(130.7)	220 477	10,473
1997	2.54	(283.8)	246 977	10,276
1998	2.08	(730.2)	238 148	8,736
1999	2.13	(1,370.0)	233 947	9,102
2000	2.46	(1,091.4)	226 141	10,897
2001	2.70	(1,039.0)	225 048	12,012
2002	4.07	(323.3)	Not available	Not available

Motor Insurance Direct Business Market

	Total gross premium (\$ <i>billion</i>)	Underwriting performance (\$ <i>million</i>)	No. of vehicles covered	Average premium per vehicle (\$)
1996	2.69	(82.7)	496 266	5,426
1997	2.81	(346.3)	484 922	5,797
1998	2.78	(383.9)	489 393	5,674
1999	2.35	(176.3)	456 006	5,144
2000	2.47	(324.9)	448 368	5,508
2001	2.77	(121.0)	546 072	5,067
2002	2.97	24.7	Not available	Not available

Note: Figures in the above tables cover direct business only, i.e. reinsurance inward business accepted by direct insurers and reinsurers is not included.

Underwriting Performance of Taxi Insurance

	2000		2001		2002	
	Third Party Cover \$M	Comprehensive Cover \$M	Third Party Cover \$M	Comprehensive Cover \$M	Third Party Cover \$M	Comprehensive Cover \$M
Gross premiums	35.5	77.7	21.1	152.1	26.4	186.9
Net earned premiums ⁴ (a)	26.9	56.7	13.4	90.8	19.5	131.5
Net commissions payable (b)	4.4	9.4	3.0	21.4	4.1	25.6
Net claims incurred ⁵ (incl.IBNR)(c)	41.4	55.5	19.7	58.1	37.4	109.0
Management expenses ⁶ (d)	2.1	4.3	1.6	11.8	1.8	11.9
Underwriting Profit/(Loss) [(a) – (b) – (c) – (d)]	(21.0)	(12.6)	(11.0)	(0.5)	(23.8)	(15.0)

⁴ Means the net amount after deducting: (i) premiums for reinsurance ceded from the gross premiums; and (ii) the amount set aside by an insurer at the end of its financial year out of premiums in respect of risks to be borne by the insurer after the end of the financial year under the relevant insurance contracts.

⁵ The gross claims incurred after deduction of recoveries from reinsurers and other parties.

⁶ Expenses incurred in the administration of an insurer or its business which are not commissions payable and, in the case of general business, are not included in claims paid, claims outstanding, expenses for settling claims and expenses for settling claims outstanding.

Underwriting Performance of Public Light Bus Insurance

	2000		2001		2002	
	Third Party Cover \$M	Comprehensive Cover \$M	Third Party Cover \$M	Comprehensive Cover \$M	Third Party Cover \$M	Comprehensive Cover \$M
Gross premiums	27.1	23.4	67.5	27.3	78.0	32.3
Net earned premiums (a)	24.8	20.3	49.5	19.9	50.9	23.1
Net commissions payable (b)	6.6	5.4	16.9	6.9	9.5	4.5
Net claims incurred (incl.IBNR)(c)	28.3	51.4	29.4	50.4	53.0	53.7
Management expenses (d)	1.6	1.5	4.6	1.9	3.6	1.7
Underwriting Profit/(Loss) [(a) – (b) – (c) – (d)]	(11.7)	(38.1)	(1.4)	(39.3)	(15.1)	(36.8)