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Legislative Council Panel on Financial Affairs

Employees Compensation Insurers Insolvency Scheme

Introduction

This paper briefs Members on the proposed establishment of the Employees Compensation Insurers Insolvency Scheme (ECIIS), which will take over from the existing Employees Compensation Assistance Scheme (ECAS) the responsibility of meeting the liabilities arising from employees compensation (EC) insurance policies in the event of the insolvency of the relevant insurers.

Background

2. At present, ECAS provides payment to injured employees who are unable to receive EC because the relevant employer is untraceable or uninsured. The Scheme also provides protection for policyholders (employers) in case their EC insurer becoming insolvent. This principle of rendering protection to policyholders of compulsory EC insurance was established in 1991 upon the enactment of the Employees Compensation Assistance Ordinance (Cap. 365).

3. In recent years, ECAS has run into financial difficulties. To restore the long-term viability of ECAS, the Employees Compensation Assistance (Amendment) Ordinance 2002 (the Amendment Ordinance) was enacted on 28 June 2002. Experience has shown that the cash flow needs arising from general EC claims and those arising from EC insurer insolvency are different. The latter tends to create a sudden strain on the cash flow of the ECAS Fund, further exacerbating the Fund’s cash flow problems. The Amendment

Ordinance has therefore contained provisions which seek to excise claims arising from EC insurer insolvency from the scope of ECAS. In enacting the Amendment Ordinance, the Legislative Council was informed that the intention was for the insurance industry to establish a separate scheme (i.e. the ECIIS) to cater for claims arising from insurer insolvency. The legislative provisions in relation to the excision of claims arising from insurer insolvency would be brought into force when that separate scheme is in place.

The Proposed ECIIS

4. The Office of the Commissioner of Insurance (OCI) and the Hong Kong Federation of Insurers have now worked out the structure and mode of operation of the ECIIS. The purpose of the ECIIS is to replace the ECAS in meeting the liabilities of EC insurers in the event of insolvency of such insurers. Its scope of coverage as well as all EC claims, subrogation and settlement procedures will be largely the same as those of the existing ECAS in relation to the protection of policyholders (i.e. employers) in the event of insurer insolvency. The main features of the ECIIS are as follows -

(a) ***Constitution*** – The ECIIS will be administered by the Employees Compensation Insurer Insolvency Bureau (ECIIB), which will be established as a non-profit making company limited by guarantee. The aims and objectives of ECIIB will be set out in the company's memorandum of association. OCI (the Insurance Authority) will restrict insurers who have not joined ECIIB as members and made themselves subject to the memorandum and articles of association of ECIIB from effecting new EC contracts. The operation of

ECIIB, including the processing of claims, will be undertaken by a secretariat[1] and overseen by a Council to be elected by ECIIB members.

(b) ***Scope of Coverage and Processing of Claims*** – Under the ECIIS, an Insolvency Fund will be set up to meet EC insurance claims and related expenses in the event of insurer insolvency. The relevant procedures, for example, how to determine whether an insurer has become insolvent and the day of becoming insolvent, will be the same as those under the present ECAS. ECIIB will take an active role in this regard, and would defend the claims or negotiate for settlement where appropriate.

After the setting up of ECIIS, the determination of the amount of compensation or common law damages will still rest with the Labour Department or the Court, as the case may be. The ECIIB will determine applications from employers for payment under the ECIIS.

(c) ***Funding*** – The ECIIS will be financed by a contribution from EC insurers. It is intended that the level of the contribution would be determined by ECIIB taking into account actuarial advice.

(d) ***Checks and balances*** – ECIIB will act as a trustee of the Insolvency Fund and the usage of the Fund would be confined to the scope set

[1] To minimize administrative expenses, the insurance industry is exploring the possibility of relying on the existing secretariat of the Motor Insurers' Bureau to act as the secretariat of ECIIB.

out in (b) above. The financial position of ECIIB will be subject to independent audits. The annual accounts and the auditor's report will be scrutinized by OCI and available for public inspection.

The duties of the ECIIB will be set out in ECIIB's articles of association and an agreement to be signed between the ECIIB and OCI. Any claimant who is dissatisfied with the handling of his claim by ECIIB may lodge complaint with OCI.

(e) ***Commencement*** – It is intended that insurers would start contributing to the Insolvency Fund in early 2003. The Fund will be given a year to accumulate funds before it formally take over the liabilities of EC insurers arising out of their insolvency.

The above features mirror the arrangements under the existing Motor Insurers' Bureau (MIB), which provides payment in situations where the concerned motor insurer is insolvent. The MIB arrangements have been in place since 1985 and have been working smoothly since then.

5. Insurance policyholders protection schemes are also available in other economies, for example, the United Kingdom, Canada and Singapore. The scope of such schemes varies. Australia is also exploring the feasibility of establishing one after the HIH incident. All these schemes are funded by the market. Details of such schemes are set out at **Annex.**

6. The rights of EC claimants (i.e., employees or their representatives) will not be affected by this new arrangement. The Hong Kong Federation of

Insurers is content with the proposed framework and mode of operation in respect of ECIIS. The OCI would finalize the agreement with a view signing it with the ECIIB in January 2003.

7. Members are requested to note the contents of this paper for information.

Financial Services and the Treasury Bureau (Financial Services Branch)
Office of the Commissioner of Insurance
Labour Department

26 November 2002

Annex

Policyholders Protection Schemes in Overseas

The United Kingdom

Before December 2001, the Policyholders' Protection Scheme (PPS) in the UK was the industry scheme providing cover to the UK policyholders in the event of an insurance company becoming insolvent. The scheme covered all classes of life and non-life business and was financed by a levy on insurers.

2. On 1 December 2001, the Financial Services Compensation Scheme (FSCS) was established under the Financial Services and Markets Act 2000 to replace the various compensation schemes in the financial services sector including PPS. The FSCS meets the claims against insolvencies of financial services institutions including insurance companies, banks and investment houses. It is funded by levies on the market, i.e. the relevant insurance companies, banks and investment houses.

3. Policyholders are protected if they are insured by authorized insurance companies under contracts of insurance issued in the UK. The maximum level of compensation depends on the type of insurance policy. For compulsory insurances, the compensation is up to 100% of the claim. For other classes of insurances, the compensation is up to 90% of the claim.

Canada

4. In Canada, the Property and Casualty Insurance Compensation Corporation (PCICC), an industry funded, non-profit organization, responds to claims of policyholders in the event of the insolvency of a property and casualty (i.e. non-life) insurance company. The maximum protection offered to a policyholder is 250,000 Canadian dollars with respect to all unpaid claims for losses arising from a single occurrence. Policy deductibles are applied to the total amount of insured loss. Property and casualty insurance companies are required to contribute to the PCICC.

Singapore

5. The Monetary Authority of Singapore (MAS) establishes and maintains a Policy Owners' Protection Fund for the purposes of protecting insurance policyholders (both life and non-life but restricted to compulsory classes) against the insolvency of registered insurance companies. A life insurance policy is compensated up to 90% of the amount of the liability. A non-life insurance policy is compensated to the full amount of the entitlement under the terms of the policy. The Fund is funded by a levy made on registered insurance companies.