

保險業監理處

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To: Chief Executive of authorized insurers carrying on
Employees' Compensation Insurance Business

Dear Sirs,

**Adequate Reinsurance Arrangements for
Employees' Compensation (EC) Insurance Business**

As a prudent insurer, you are no doubt aware of the risk and vulnerability posed to an insurer that has not taken measure to protect itself against undue accumulation of claims arising from emerging risks such as infectious diseases or undue exposure to larger claims arising from a higher excess level (or retention) in its reinsurance arrangements. Proper measure to reduce such risks is particularly essential for maintaining the insurer's resilience to an unexpected influx of claims in the light of any hitherto unknown risks or the cumulative effect of a large number of claims. All insurers are obliged to make adequate reinsurance arrangements to deal with such risks, as required under section 8(3)(c) of the Insurance Companies Ordinance.

We understand that many insurers have purchased for the current year "catastrophe" cover (or "buy-back") to provide specific reinsurance cover against accumulation of EC claims arising from outbreak of infectious disease (e.g. SARS), where such cover has been restricted in respect of infectious disease claims by the operation of the "one person one event" recovery clause in the underlying excess of loss treaty. In view of the continued threat of new

infectious diseases and other potential new risks, we expect these insurers to keep the good and prudent practice of having such “buy-back” arrangement in place. Insurers are required to provide sound justification if they choose to discontinue such cover for the coming year. In addition, these insurers should carry out a critical assessment of the risks they have assumed and consider whether additional reinsurance protection should be obtained to safeguard their solvency from being imperiled by an upsurge of claims in the event of an outbreak of infectious diseases.

For those insurers which have not purchased the relevant reinsurance cover for the current year because of their relatively low level of exposure to claims arising from infectious diseases (e.g. SARS), their risk profile could have changed with greater susceptibility to those claims caused by such factors as a change in transmission pattern and morbidity of the infectious diseases. We expect those insurers to undertake a thorough and critical review of their reinsurance needs, and take up such reinsurance cover as is found necessary or appropriate to protect their EC business portfolio with due regard to the volatility of their risk exposures. It would give us cause for concern if the relevant reinsurance cover, i.e. the “buy-back”, is not purchased without reasonable cause.

We are also concerned to note that there is a trend for insurers to raise their excess level for reasons such as retaining more business or reducing reinsurance premiums. We wish to remind insurers that undue exposure to larger claims arising from a higher excess level could also impair their solvency condition. Insurers are advised to set their excess at a level commensurate with their net assets. We would have supervisory concern if this is not followed by the insurers.

In this regard, to enable us to carry out an early review of the adequacy of your reinsurance arrangements, you are hereby requested to send us copies of cover notes for your 2006 reinsurance program as soon as they have been finalized. If you have any enquiries regarding the above, please contact the case officers that you have been dealing with.

Yours faithfully,

(Richard Yuen)
Commissioner of Insurance
(Insurance Authority)

c.c. Chairman, The Hong Kong Federation of Insurers