

Health and Safety Commission Paper			HSC/03/24
Meeting Date:	11 February 2003	Open Gov. Status:	Fully Open (post meeting)
Type of Paper:	Above the line	Paper File Ref:	
Exemptions:	None		

## HEALTH AND SAFETY COMMISSION

### DWP review of Employers' Liability Compulsory Insurance: HSC/E's response

#### A Paper by Alan Morley, Strategic Development Unit, SASD

Advisor(s): Neal Stone,

Cleared by: Kate Timms on: 27 January 2003

#### Issue

1. DWP has announced a review of Employers' Liability Compulsory Insurance (ELCI).  
The terms of reference are in Annex B, paragraph 24  
This review provides a key opportunity to influence how insurance is used, so that it may motivate employers to improve their health and safety performance (Revitalising Health and Safety, see strategy statement point 'v').

#### Timing

2. Urgent. DWP requires written responses to their review by 17 February 2003.

#### Recommendation

3. The Chair should write to DWP indicating the Commission's view on issues concerning prevention, compensation and rehabilitation. The Commission is invited to consider its response to DWP Ministers taking account of these issues (see paragraph 12 below). A draft outline of the response is attached at Annex C.

#### Background

4. Under the Employers' Liability (Compulsory Insurance) Act 1969 employers are required to insure against any liability for negligence that will enable them to meet the cost of compensation for their employees' injuries or illnesses, whether they are caused on or off site.
5. DWP is responsible for policy on ELCI. HSE has enforcement responsibilities for two aspects of ELCI; the requirements for companies to maintain ELCI and to display a valid certificate of insurance for ELCI.

6. Revitalising Health and Safety strategy statement point 'v' says the Government sees a case for reforming the arrangements for ELCI to motivate employers to improve their health and safety performance to motivate them to rehabilitate injured workers. Action point 5 of Revitalising says HSC will consider how best to involve the insurance industry more closely in its work [cont.]. Following Greenstreet Berman's research report *Changing business behaviour – would bearing the true cost of poor health and safety performance make a difference? CRR 436/2002* (see also Annex B, paragraph 2), the Commission decided to promote discussions with stakeholders about how insurance might be used to obtain improvements in health and safety. In the light of DWP's review this work has not gone ahead.
7. Over the last year there have been many reports of companies, when renewing their ELCI cover:
  - facing significant increases in the costs of their premiums (some companies undertaking hazardous activities, eg scaffolding, say they have encountered fivefold increases over the previous year);
  - having difficulty finding insurers prepared to their risks to occupational health and safety.

#### *DWP's review of ELCI*

8. In his Pre-Budget Report in November 2002 the Chancellor noted the problems that many employers have faced this year with ELCI. Following which DWP announced terms of reference for a review of ELCI (DWP's Press Release is attached as Annex A).
9. The purpose of the review is to assess the case for reforming ELCI and if such a case is demonstrated, to identify the objectives and options for that reform.
10. DWP plans to report its findings to Ministers in early March and report to the Domestic Affairs Committee at the end of March. The following step may well be a Green Paper, setting out options for reform.

#### *Further background on ELCI*

11. See Annex B

#### **Argument**

12. To aid consideration, issues for inclusion in the Chair's letter to DWP have been grouped into three headings: prevention, compensation and rehabilitation.

#### **Prevention**

As indicated above, employers are required to insure against any liability for negligence that will enable them to meet the cost of compensation for their employees' injuries or illnesses. Using insurance as an incentive or lever that helps prevent people being injured or made ill as result of their work is a key part of the Revitalising strategy (see paragraph 6). DWP's review of ELCI provides a key opportunity to look at doing that.

Companies that properly manage health and safety are likely to make fewer claims against their ELCI insurance. HSE has already had discussions with insurers about how this can be used. We recommend supporting moves that will link the cost of ELCI to health and safety, perhaps by insurers offering reduced premiums to those who show their company manages health and safety well.

To make this practicable, insurers need a means of assessing how well an employer is managing health and safety. We believe that HSE should develop the necessary model.

We have identified some potential issues:

- i) HSE is not resourced to provide advice to insurers on how well individual companies manage their health and safety. So the model has to be simple enough for companies and their insurers to use on their own.
- ii) HSE has recently commissioned research work on the development of a health and safety management index, as part of its initiative to promote greater corporate responsibility and accountability for health and safety. If successful, the indicators may be appropriate for the purposes of ELCI.
- iii) It is important that employers clearly see that their management of health and safety is linked to the cost of their ELCI premiums.
- iv) Employers need to see benefits for their premiums come through quickly, delays are liable to act as a disincentive to spending money on health and safety.
- v) The size of any reduced premium or discount is, of course, for insurers to decide. But our view is that it needs to be of a scale that will encourage employers to participate.
- vi) This concept of producing a model sounds simple and has been considered by many people, but nothing concrete has yet been produced. Greenstreet Berman's report concluded that the design of insurance arrangements for ELCI, which date back to the 1960s, do not appear to support the achievement of latter day health and safety arrangements like improved management or rehabilitation.
- vii) We need to take into account any work that HSE has already done in this area. For example, we believe there was a pilot in the South West, which led to the local Business Link successfully negotiating insurance premium discounts for some small businesses that completed an exercise on health and safety.

HSE is also aware of discussions between insurers and some trade associations over making links to accreditation schemes or passport schemes in order to secure reduced premiums. We are concerned that health and safety should be being adequately covered, So long as it is, we would be content for insurers and employers to use whichever they prefer. We would also be content for such arrangements to be linked to an assessment of how well an employer is managing health and safety (as described above).

*Does the Commission agree that HSE should continue work on developing a model that would help insurers assess how well an employer is managing health and safety ?*

### **Compensation** **Non-compliance**

Some recent reports have suggested that an increasing number of employers have responded to the increased costs of ELCI by failing to insure. This is not just illegal,

it means a growing number of employees are not afforded the protection of ELCl. This potentially means an increased cost to the state. Workers not covered face considerable financial loss on top of any injury or ill health. It suggests the present scheme is not working.

It might be worth investigating so see if there are other ways to identify companies against which HSE needs to take ELCl enforcement action.

*Does the Commission agree to suggesting discussions with other government departments to see if an existing central database could be adapted to support ELCl? Employers might then be required to provide annual details of their ELCl insurer and policy number alongside other routine information, eg for tax or national insurance purposes. This would enable likely non-compliant companies to be identified, permitting HSE to better target ELCl enforcement activity.*

### *Occupational disease*

The cost of ELCl has in part been affected by an increasing number of claims for occupational disease. These diseases can have long incubation periods (in cases 20 years or more), it is therefore very hard for insurers to estimate future number of claims, investment rates and so on that far into the future.

We expect some stakeholders will favour occupational disease being handled as part of a state scheme separate from ELCl.

A state scheme would overcome the risk that in the future insurers will have insufficient funds to meet these claims or will simply choose not to provide that cover.

However, we can see no reason to exclude occupational disease for health and safety reasons. If it happens, especially if health and safety is used as an incentive, then occupational disease risks ceasing to be regarded by employers as part of health and safety. It seems to send employers the wrong message about who is responsible.

*Does the Commission agree to expressing its concerns at such a change?*

### *Legal costs*

It has been reported that legal costs and success fees represent 30% to 40% of the costs of providing for ELCl. This suggests that the system is very complex and burdensome and raises a question as to whether workers' compensation payments are adversely affected by high legal costs.

*Does the Commission agree that the review should address possible mechanisms for reducing this significant element of costs?*

### *No fault*

It is likely that a number of other issues will arise as part of the review. One may be the merits of having a no fault scheme and whether financial limits (capping) should be placed on compensation. We see these principally as commercial and cost issues. It would tackle the issue of legal cost. But it creates the risk of health and safety becoming marginalised and incentivisation being dropped.

*Does the Commission agree that from a health and safety perspective this is the only point it wishes to raise on a no fault scheme?*

## **Rehabilitation**

This review is an opportunity to look at how insurers can be motivated to develop policies that encourage and support the retention, in employment, of people who fall victim to work-related ill health and injury. This is not dealt with by current ELCI legislation.

It might be achieved by building on existing good practice among insurers and voluntary codes of practice to instigate the following:

- i) insurance companies offering financial incentives to employers who have 'best practice' rehabilitation policy and implement it;
- ii) courts to demonstrate, both in the size of settlement awards and in the way that they are calculated, that insurance funded rehabilitation strongly influences the final settlement (this could be both in a negative and positive way).

Experience shows early intervention (e.g. after no more than 4 to 6 weeks' absence) is key to successful outcome from rehabilitation, but the imputation of blame in relation to ELCI and the 90-day qualifying period for IIDB militate against such action. In addition the traditional approach is primarily to provide lump sum compensation.

The impact of moves toward rehabilitation should not be overestimated. The major reasons for work-related absence are MSD and mental health problems. Our understanding is that these account for only a small number of current ELCI related claims settlements.

Nevertheless, promoting rehabilitation would send out a strong message that it is an essential component of effective sickness absence management and would promote a workplace-managed process of helping ill or injured employees to stay in work.

*The Commission is recommended to support moves that look at:*

- i) supporting rehabilitation, or retraining where appropriate, rather than compensation as the first option;*
- ii) facilitating rather than hindering early intervention to help people back to work;*
- iii) ensuring that the employer is firmly locked into ensuring rehabilitation takes place; and*
- iv) supporting and integrating other programmes and initiatives to help ill, injured and disabled people remain in work.*

## **Consultation**

13. This paper has been circulated to HSE Directorates and Divisions with an interest in ELCI.

## **Presentation**

14. The Commission should be aware that its views will be made publicly available by DWP, unless otherwise requested. The Commission may wish to consider the need for a Press Release.

**Costs and Benefits**

15. Not applicable

**Financial/Resource Implications for HSE**

16. To support this review significant amounts of work will be required in various parts of HSE. Resourcing priority work is currently under review and this work will be considered as part of that process.

**Environmental Implications**

17. Not applicable

**Other Implications**

18. None

**Action**

19. The Commission agrees that the Chair should write to DWP indicating the Commission's view on issues concerning prevention, compensation and rehabilitation (see paragraph 3).

### FURTHER BACKGROUND ON ELCI

#### *Action point 5 of Revitalising*

1. To address action point 5 of the Revitalising strategy HSC/E commissioned some research from Greenstreet Berman. This was to look at possible changes to the UK's insurance and compensation arrangements that might best motivate changes in safety performance and encourage greater business focus.
2. As a result Greenstreet Berman prepared a report '*Changing business behaviour – would bearing the true cost of poor health and safety performance make a difference?*' CRR 436/2002. This recommended:
  - ELCI and rehabilitation best practices being drawn together into a best practice model and promoted as an industry standard;
  - A further study on how best to reform or replace current regulations on UK occupational injury and ill health insurance arrangements, including consultation with key stake holders
3. HSC considered the report at its Strategic Review on 30 April 2002. The Commission decided to promote discussion of the report's findings in association with the insurance industry, business, trade unions Government and other stakeholders. The central question being whether present insurance arrangements improve or impede health and safety. HSC/E's role would be to facilitate the wide-ranging debate. This was announced by Press Release on 19 June 2002.
4. Subsequently, DWP asked for these discussions to be held back, whilst it considered how to proceed in relation to ELCI. In due course this led to DWP's present review of ELCI.
5. The Greenstreet Berman research report (above) indicated that the cost of insurance needs to be high (above 1% or 2% of payroll) to motivate employers. DWP believes the current figure for employers is around 0.5% and rising – plus general taxation and contributions to state schemes.
6. The Greenstreet Berman report was widely read across government and external stakeholders and has helped inform the direction of DWP's review.

#### *What does ELCI do?*

7. Employers' Liability Compulsory Insurance is an essential safeguard for those at work. It provides a means of compensation for those who are injured or made ill at work through the fault of their employer.

#### *What does it cost?*

8. Greenstreet Berman's report indicated that ELCI costs as approximately 0.23% of the total salary bill for the UK. However this was prior to recent events (see below).
9. In money terms DWP has indicated that in 2001 the cost of ELCI was around £1.5bn, the income to insurers around £1.1bn and therefore an underwriting loss of around £0.4bn. Using similarly rounded figures, we estimate there are 19m jobs for which ELCI should be provided, giving an average cost per job to the insurance industry as a little

under £80 per year<sup>1</sup>. So far as many low to medium risk companies are concerned, at this level of cost, the size of a discount on an ELCI premium may be insufficient for them to see an incentive for making improvements to their health and safety.

#### *Provision of ELCI*

10. There is no statutory requirement on the insurance industry to provide ELCI; it depends on an active market.

#### *Enforcement*

11. Since 1975, through an agency agreement, HSE has had responsibility for enforcing the legal requirement for companies to maintain ELCI and display a valid certificate of insurance for ELCI. The law on ELCI is not a relevant statutory provision under the Health and Safety at Work etc Act 1974 (HSW Act), which is why the special agreement was necessary.
12. All operational inspectors in FOD are warranted to enforce ELCI but, as a result of concentrating our resources on the priority programmes, they do not do this routinely. If inspectors notice that there is no ELCI certificate then they may issue a statutory 'Notice to Produce'. Failure to produce a certificate, following service of such a Notice, can result in the employer being prosecuted. HSE staff also investigate complaints concerning ELCI.
13. HSE's Workplace Contact Officers and Working Time Officers (also Compliance Officers in a pilot in FOD's London Division) are warranted to request information on ELCI cover and specifically check that a certificate is displayed during their routine visits.
14. Penalties are up to £2500 for any day on which employers are without suitable insurance and £1000 for failure to display a certificate or, when requested, provide it to an HSE Inspector.
15. ELCI offences are only triable summarily, and it is not possible, in law, to prosecute failures to insure that occurred more than 6 months ago, even if they are now brought to HSE's attention.

#### *Local Authorities and ELCI*

16. As LA inspectors do not have powers under ELCI it is not possible for them to enforce it. There are very few referrals from LAs on issues of ELCI compliance. If any are received they are dealt with by FOD.
17. For LAs to have enforcement powers, ELCI would either have to become a relevant statutory provision under HSW Act, or there would have to be an agency agreement with each individual Local Authority.

#### *State benefits*

18. Industrial Injuries Disablement Benefit provides no-fault compensation to employees where negligence is not established. It often also provides payments (later recovered) to employees, whilst they pursue a case for negligence under ELCI.

---

<sup>1</sup> The jobs figure excludes the self-employed, some of whom will be covered by ELCI; this means the cost figure is likely to be overstated.

### *Recent events*

19. Over the last year HSE has heard of companies, when renewing their ELCI cover:
  - facing significant rises in the costs of their premiums (some companies undertaking hazardous activities, eg scaffolding, say they have encountered fivefold increases over the previous year)
  - having difficulty finding insurers – we have directed enquirers to DWP or the Association of British Insurers. We understand ELCI remains available, but again it may be at a significantly greater cost.
20. Insurers have said these arise from the co-incidence of several one-off or cyclical factors, including:
  - collapse of two leading insurers in this market
  - general reduction in capital in the insurance market
  - decline in stock market
  - insurers have traditionally regarded ELCI as a loss leader and written it at uncommercial rates
21. They also report some serious longer term difficulties, including:
  - difficulty underwriting 'long-tail' risks, eg occupational disease
  - frictional costs of the system – up to 40% goes on legal fees
  - claims inflation – which has seen settlements rise threefold in the last three years
  - the system does little to incentivise prevention (and so the incidence of claims) or rehabilitation)
22. Information we have to hand does not reveal Inspectors encountering a significantly higher number of employers without ELCI cover. However HSE is considering commissioning an external survey of the level of compliance with ELCI.
23. Many companies have complained that insurers do not reflect their good health and safety management; and they are lumped together with bad performers in their sector. We also understand that many underwriters simply price by sector with little differentiation for individual company performance, particularly for SMEs. They are writing for very many businesses and do not see individual claims records as necessarily an accurate future predictor of performance.

### *DWP's review*

24. The terms of reference for the review are:
  - Survey the operation of ELCI, taking into account any relevant aspects of the state benefits systems.
  - Assess the scale and nature of the current difficulties being experienced in relation to ELCI, in particular the extent to which these difficulties are likely to be short-term only, repeated in the future or permanent.
  - Make recommendations to Ministers as to the case or otherwise for reforming ELCI.
  - If a case for reform is found, make recommendations as to the objectives, principles and high-level options for such reform.
25. The Minister for Work, Nick Brown has said DWP will work closely with all stakeholders on this review and report to Ministers in Spring 2003.

26. DWP do not see the aim of the review as to provide a short-term fix.

**DRAFT LETTER FOR THE CHAIR TO SEND TO DWP**

Nick Brown  
Department of Work and Pensions  
Richmond House  
XXXXX  
XXXXX

[xx February 2003]

**Review of Employers' Liability Compulsory Insurance**

I am writing to express the Health and Safety Commission's and the Health and Safety Executive's views in response to your above review.

[Our comments are made on the presumption that ELCI will continue to regulate the arrangements for insuring and compensating employees who have been injured or made ill by work. There are, however, a number of important issues concerning prevention, compensation and rehabilitation that we wish to bring to the attention of Ministers:

- developing a model that would help insurers assess how well an employer is managing health and safety
- non-compliance
- occupational disease
- legal costs
- no fault

Both the Commission and the Executive are keen to be involved in further work on the future of ELCI and await the results of this review with great interest.

Please let me know if you need any clarification.

Yours sincerely

**Bill Callaghan**