

A Review of the Requirement for Employers'  
Liability Compulsory Insurance for Limited  
Companies that Employ only their Owner



## Title of proposal

1. Review of requirement for Employers' Liability Compulsory Insurance (ELCI) for limited companies that employ only their owner (incorporated owners/sole employees).

## Purpose, objective and effect of measure

### **Purpose**

2. To remove the requirement for ELCI from incorporated owners/sole employees.

### **Objective**

3. The objectives of the proposal are to remove an unnecessary and disproportionate requirement and reduce the cost burden on incorporated owners/sole employees by bringing their treatment in line with similar unincorporated businesses.

### **Effect of measure**

4. It is estimated that the measure will affect 300,000 incorporated owners/sole employees.

## **Background**

### **Legislation**

5. With some exceptions, for example government departments and agencies and local authorities, the Employers' Liability (Compulsory Insurance) Act 1969 (c. 57) requires employers carrying on business in the United Kingdom to insure their liability to their employees for bodily injury or disease sustained in the course of their employment in Great Britain. There is currently a penalty of up to £2,500 for failure to insure on any day.
6. A requirement has generally existed since 1 January 1973 to display copies of certificates of employers' liability compulsory insurance whilst the underlying policy is in force. There is currently a penalty of up to £1,000 for failure to display a certificate.
7. The Employers' Liability (Compulsory Insurance) Regulations 1998 (SI 1998 No 2573) consolidated with amendments the Employers' Liability (Compulsory Insurance) General Regulations 1971 and subsequent amending regulations made under the Employers' Liability (Compulsory Insurance) Act 1969.
8. ELCI premium income exceeds £1 billion.
9. An owner/sole employee is not required to purchase ELCI if the business remains unincorporated. However the incorporation of a business creates a separate employer and a requirement for that employer to purchase ELCI.

# Review of Employers' Liability Compulsory Insurance

## Partial Regulatory Impact Assessment

### Rationale

10. ELCI insures employers for the costs of compensation for those employees who are injured or made ill at work through the fault of their employer.
11. It provides greater security: to firms against costs which could otherwise result in financial difficulty; and to employees that resources will be available for compensation even where firms have become insolvent.
12. It supports the right of employees injured through their employer's negligence to be fairly compensated - 'access to justice'; and the responsibility of employers to fund the costs of their negligence - 'polluter pays'.

### Recent problems with ELCI

13. Insurers held premiums at a low level for several years. During this period EL claims significantly exceeded premium income.
14. Insurers started to change their pricing policies around 2000. In 2002, there was a step-change in the scale of these premium increases and premiums for insurance rose substantially for many businesses. This was activated by a number of factors. These are outlined in the First and Second Stage Reports on the Review of ELCI, see paragraphs 20 and 21.
15. These premium increases have had a range of adverse impacts on business. Such increases flow through directly into costs, which many businesses have difficulty passing on to customers; hence they have impacted on firms' profitability.
16. Those sectors experiencing the most acute increases have had further problems. These have included the discontinuance of some areas of activity deemed by their insurers to be too high risk, and cutbacks in the number of staff. Sharply higher premiums arriving with little notice may have contributed to some companies ceasing to trade altogether.
17. Businesses were caught off-guard by the speed and extent of the 2002 premium increases. Communication to business from insurers and sometimes brokers was poor, resulting in little warning for employers of the premium increases to come. Variable service standards within the insurance industry meant that renewal notices frequently arrived close to renewal date, leaving many businesses with little time to negotiate premiums, respond to the new price levels or to seek other sources of EL insurance.
18. Although there have been problems with obtaining EL insurance because of the short notice of renewals, availability of EL does not otherwise appear to have been the major problem.

### **Department for Work and Pensions Action on ELCI**

19. The Department for Work and Pensions (DWP) working with other Government Departments and with the help of key stakeholders (e.g. the Association of British Insurers (ABI) and employers' representatives) undertook a review of the operation of ELCI.
20. DWP published a first stage report of the review on 3 June (Review of Employers' Liability Compulsory Insurance First Stage Report web site address [http://www.dwp.gov.uk/publications/dwp/2003/elci/dw2583\\_employers\\_review.pdf](http://www.dwp.gov.uk/publications/dwp/2003/elci/dw2583_employers_review.pdf)). The first stage report sets out the key findings of the review on the case for the reform of the EL system and it identifies a number of areas for further actions aimed at improving the operation of the market and outcomes of the system.
21. DWP published the second stage and final report on 4 December (Review of Employers' Liability Compulsory Insurance Second Stage Report web site address [http://www.dwp.gov.uk/publications/dwp/2003/elci/dwp\\_employers\\_review04-12-2003.pdf](http://www.dwp.gov.uk/publications/dwp/2003/elci/dwp_employers_review04-12-2003.pdf))  
  
The second stage report sets out the work that government has been taking forward with stakeholders since the publication of the first stage report and current and future work in each of the areas for further action.
22. A number of initiatives have been put in place to improve the functioning of the EL market. These are outlined in the second stage report. They include:
  - action on longer renewal periods by insurers and brokers and a scheme called 'Making the Market Work' to help trade associations and others to access the insurance market more easily
  - postponing the introduction of the recovery of National Health Service (NHS) charges for EL claims to November 2004
  - providing improved guidance and information on the new Small Business Service (SBS) website, currently being developed
  - working with insurers, business and the Health and Safety Executive (HSE) to develop an approach to underwriting which better reflects the health and safety performance of individual firms.

### **Options**

23. The issue to be addressed is the requirement for an incorporated owner/sole employee to purchase ELCI.
  1. ***Remove the requirement for ELCI for incorporated owner/sole employees***  
  
Would reduce the cost burden on incorporated owners/sole employees by bringing their treatment in line with similar unincorporated businesses but risks a reduction in business to insurers.

Review of Employers' Liability  
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2. Do nothing

Incorporated owners/sole employees would continue to be required to purchase ELCI.

Option	Risks	Benefits	Equity and fairness	Competition assessment
1. Remove the requirement for ELCI from incorporated owners/sole employees	<p><u>For insurers</u> Loss of premium income – minus associated costs.</p> <p>Loss of platform for other classes of insurance.</p> <p><u>For incorporated owner/sole employees</u> Loss of contact with insurers for other classes of insurance.</p>	<p><u>For incorporated owner/sole employees</u></p> <p>Would remove the cost of purchasing ELCI.</p> <p>Nominal Benefits associated with deregulation.</p>	Whether the requirement is logical and proportionate if <u>incorporated owner/sole employees</u> are less likely to make successful claims for compensation against themselves.	Might place <u>incorporated owners/sole employees</u> at a marginal advantage over competitors who are required to purchase ELCI.
2. Do nothing	No change	Insurers continue to retain income from premiums	No disproportionate effects on key groups.	No change

**Risks to businesses insured**

24. The proposition being tested is whether it makes sense to continue to require the owner of a company who is also the sole employee of that company to insure because it is not apparent:

- a. what will be gained by him/her through pursuing a claim for compensation against his/her own company, and
- b. whether he/she would have any likelihood of success in attributing negligence to that company given that he/she is the owner and sole employee.

25. The figure of 300,000 incorporated owners/sole employees was provided from the Small Business Service (SBS). It relates to companies comprising only an employee director. It might be that there are more than or less than 300,000. For example, the number may be less if some of these organisations are not conducting any business and are dormant.

26. Option 2 will result in no change.

#### **Risks to other employees and wider compliance risks**

27. A potential concern is whether waiving the requirement to insure would result in companies not obtaining the necessary ELCI cover regarding themselves – mistakenly – as being in the same situation as incorporated owners/sole employees. For example, such a company might require cover because

- they sub-contract work to others
- take on seasonal or voluntary staff
- additional Directors or a Company Secretary are in place and they are classed as employees.

28. The degree to which this would present a significant additional risk is something we wish to explore as part of this consultation. It is already the case that companies need to exercise caution when deciding whether they are required to take out ELCI and guidance on this is available on the HSE's web site at <http://www.hse.gov.uk/pubns/hse40.pdf> and <http://www.hse.gov.uk/pubns/hse39.pdf>.

29. Option 2 will result in no change.

#### **Risks to insurers**

30. The principal risk to insurers would be the reduction in demand for EL products from this market segment. There might also be an effect on the take-up of other insurance products which are often sold as part of a package of insurance alongside compulsory EL. At risk would be premium income from the sale of these products. However, if the market is working effectively, then this income would broadly reflect the associated cost of providing the insurance service, namely the amounts paid out in claims and administration costs. Across the EL market as a whole, the trend has been one of convergence between income and costs. However, in 2002, the combined ratio (claims costs and expenses as a proportion of premiums received) was still 117%; in other words, total costs outstripped premiums. The ABI estimate that the average premium for EL cover in this market segment might amount to c£250. No disaggregation of costs and claims is currently available. Further views are therefore sought on any risks to insurers from this change in particular

31. Option 2 will result in no change.

## Benefits (to owners/sole employees and insurers)

- 32. Option 1 would result in the removal of the cost of purchasing ELCI and administrative costs. Views are sought on whether other benefits will arise.
- 33. Option 1 will give rise to the nominal benefits associated with deregulation.
- 34. Option 2 will result in insurers continuing to retain income from premiums.

## Equity and fairness (to owners/sole employees)

- 35. If it is not the practice of incorporated owner/sole employees to make claims for compensation against themselves option 1 raises the issue of equity.
- 36. Option 2 will not have any disproportionate effects on key groups.

### **Business sectors affected**

- 37. The principal effects would be on those insured and the insurers. Paragraphs 24 to 36 above refer.

### **Costs**

#### *Total costs*

- 38. Removal of the requirement for EL insurance would result in a reduction of costs and a reduction in administrative action on the part of incorporated owners/sole employees. Retention of the requirement would result in them continuing to incur expenditure and carry out administrative actions relating to the purchase of the insurance
- 39. In principle there may be additional costs accruing to the public purse if currently there are levels of compensation paid out under these policies. The Compensation Recovery Unit (CRU) has not disaggregated costs. In practice whether there would be any costs depends on the validity of the arguments about logicity and proportionality. A similar consideration with regard to the possibility of additional costs accruing to the public purse applies to the proposal of the Department of Health (DH) to introduce in November 2004 a provision to recover the National Health Service's (NHS's) costs for providing an ambulance service and hospital treatment from the compensator where an award of compensation has been made in respect of a claim for personal injury.

## Small Firms' Impact Test

40. DWP will work with the Small Business Service (SBS) to set up focus groups to consider further the impact of this proposal on small firms and longer term to monitor the implications of any actions taken (e.g. the effects that the change might have on other classes of insurance that companies purchase).

## Competition assessment

41. In principle there might be competition implications for both insurers and those insured though this is arguable. Whilst the proposals will reduce the number of products sold, albeit slightly, we do not believe that such a reduction would have implications for competition in the supply of these products. At this stage, it is not expected that the loss of some customers for ELCI will have implications for competition for the sale of any other insurance products and the premiums for these or for competition between customers which are in receipt of ELCI or other insurance products. However, we would welcome comments from stakeholders on this issue.
42. The proposals under Option 1 might place unincorporated owners/sole employees at a marginal competitive advantage over other employers who were required to purchase ELCI. These concerns, relating to differential affects, concern issues of competitiveness (the ability of firms to compete relative to each other) rather than the degree of competition in the market as a whole. However, in any case, any slight advantages arising from the proposal are not regarded as likely to be of a sufficient scale to have implications for competition. Similarly, whilst recognising that the sectors upon which the proposals impact will be characterised by varying premiums according to the level of risk inherent in the market concerned, we do not believe that competition in any market regardless of the risks or competition between related markets will be significantly affected as a result of the proposals. As such, it is not anticipated that the proposals will result in any or a significant number of firms exiting the market or that these would affect market structure or create barriers to entry.
43. Option 2 would result in no change.
44. We would welcome comments from stakeholders on these initial conclusions.

## Enforcement and sanctions

45. We will announce the outcome of this consultation. If it is decided to remove the requirement for ELCI from incorporated owners/sole employees this will be effected through amendment of the legislation (Negative Resolution procedure). HSE will continue to be the enforcing authority for ELCI.
46. The consultation is being conducted in line with the Code of Practice on Consultation. The Criteria are listed below. The full version can be accessed at <http://www.cabinet-office.gov.uk/regulation/Consultation/Code.htm>

## The Six Consultation Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about who may be affected, what questions are being asked, and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment (RIA) if appropriate.

DWP values feedback on how well it consults. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact the DWP Consultation Co-ordinator. In particular, please tell us if you feel that the consultation does not satisfy these criteria. Please contact

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## List of those consulted

### Consultation

#### Within government

Department of Enterprise Trade and Investment Northern Ireland  
Department for Constitutional Affairs  
Department of Health  
Department of Trade and Industry  
Health and Safety Executive  
HM Treasury  
Home Office  
National Assembly for Wales  
Office of Fair Trading  
Scotland Office

#### Public consultation

Aon  
Association of British Insurers (ABI)  
Association of Personal Injury Lawyers (APIL)  
British Aggregates Association (BAA)  
British Chambers of Commerce (BCC)  
British Insurance Brokers' Association (BIBA)  
Civil Justice Council  
Confederation of British Industry (CBI)  
Construction Employers' Federation Northern Ireland (CEFNI)  
Electrical Contractors' Association (ECA)  
Engineering Construction Industry Association (ECIA)  
Engineering Employers' Federation (EEF)  
Federation of Master Builders (FMB)  
Federation of Small Businesses (FSB)  
Forum of Insurance Lawyers (FOIL)  
LACORS (Local Authorities Coordinators of Regulatory Services)  
Norwich Union  
Thompsons Solicitors  
Trades Union Congress (TUC)  
UCATT  
UNISON

## Summary and recommendation

47. There might be a case for not considering the requirement for incorporated owners/sole employees to purchase ELCI to be necessary and proportionate. The case hinges on whether incorporated owners/sole employees ever make claims for compensation against themselves.
48. The option (1) to remove the requirement for incorporated owners/sole employees to purchase ELCI is recommended.

## Contact point

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