Quest Journals
Journal of Research in Humanities and Social Science
Volume 2 ~ Issue 6 (2014) pp: 34-38
ISSN(Online) : 2321-9467
www.questjournals.org

Research Paper

Reforming the Insurance Regulatory Framework in Kenya:An Analysis

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Received 16 June, 2014; Accepted 30 June, 2014 © The author(s) 2014. Published with open access atwww.questjournals.org

ABSTRACT: *-Insurance has grown to assume a prominent position in many countries across the world and Kenya is no exception. This growth has necessitated changes in the insurance regulatory framework in order to ensure that the relevant laws keep up with the emerging trends in the sector. While some of the new laws have contributed to creating new problems in the industry, majority of them have facilitated the creation of a better insurance regulatory framework. It is against this background that this paper seeks to trace the reforms to the insurance regulatory framework in Kenya.*

Keywords: -*amendments, framework, insurance, legislation, regulation.*

I. INTRODUCTION

The law is dynamic; it changes to respond to prevailing circumstances. This has been the case with the laws governing the insurance sector in Kenya. This paper traces through these historical developments. The discussion will integrate an analysis of the role of the law in addressing the challenges facing the insurance sector generally. The paper will also highlight a number of challenges that have faced the sector and subsequently triggered some of the changes in the law.

II. CHALLENGES FACING THE INSURANCE SECTOR IN KENYA

It is an uncontestable fact that the path tracing the growth of the insurance sector in Kenya is littered with numerous problems. Between 1963 and1984, there was no legislation that specifically addressed insurance in Kenya, thus leaving a gap. As a result, the insurance sector was characterized by chaos and confusion from the very onset. Providers of insurance services by and large had a freehand in most of the activities they undertook. This submission contends that it is this scenario which provided fertile breeding grounds for the problems that continue to bedevil the industry up to date. By the time legislation was enacted in 1984, the damage had already been done. The enactment of the Insurance Act in 1984 was aimed at streamlining the hitherto ungoverned sector. However, this objective was hardly realized. On the contrary, the Act contributed to an increase in the problems facing the sector. This was primarily because it was adopted from the British Insurance Laws of 1948.[1] As such, it did not fully take into account the local situation in which it was to be applied. For instance, one of the key provisions of the British Insurance laws was a mandatory third party liability system for public service vehicles.[2] Such a system opened the floodgates for fraud as various players in the industry sought to unscrupulously capitalize on the provisions to the detriment of insurance companies. The companies found themselves having to pay out huge claims which severely weakened their financial position and ultimately led to the collapse of many.[3] The Act also provided for a fault system.[4]This has worked to the disadvantage of insurance companies as they have been forced to operate in an uncertain environment

[1]Geoffrey Njenga, *Thriving on Borrowed Time* (Hope Centre International, 2011) 24.
[2] Ibid.
[3]Ibid.
[4]Ibid.

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withregard to the levels of risk they are exposed to.[5] Njenga notes that other challenges that have faced the insurance sector include: the growth of industry wide cartels, a temperamental judicial system, inadequate use of technology, insurance companies formed with a fraudulent intent, run-away road traffic accidents and poor mobilization of investment capital.[6]The ensuing section of the submission will discuss how amendments to the law have sought to address some of these challenges.

III. HISTORICAL DEVELOPMENT OF LEGISLATION ON INSURANCE1963-1984

Before independence, the insurance industry was governed by the provisions of the Companies Act.[7] This was a law governing the operations of companies and consequently, insurance companies fell under its purview. During the immediate post independence period, the government set out to establish a legislative framework to specifically regulate the insurance sector.[8] However, no legislation was enacted until 1984 when the Insurance Act was put in place.[9] The Act contained various provisions which sought to address some of the challenges that faced the sector at the time. Among other things, it provided for local incorporation, minimum capital requirements, reinsurance arrangements and intervention in the management and eventual winding up of insurance companies.[10]With regard to public service vehicles, the relevant law provided for a third party liability system.[11] Though initially aimed at ensuring compensation for accident victims, this system turned out to be the worst nightmare for insurance companies. The system contributed to the emergence of industry wide cartels whose sole aim was to defraud insurance companies, a situation further compounded by the fault system.[12] Over time, these two factors combined led to the collapse of many insurance companies.

One of the hallmarks of the 1964-1984 period were the 1978 government directives issued by the then Minister of Finance. The directives were meant to promote local ownership of insurance companies.[13]They made it mandatory for all insurance companies operating in the country to purchase part of their reinsurance locally.[14] However, as time as shown, these directives did not fully achieve the desired outcome. It is arguable that they actually contributed to worsening the already prevailing situation in the insurance industry. The collapse of many insurance companies in the country during the 1990s coupled with the numerous problems that bedeviled the sector necessitated amendments to the relevant laws governing insurance. The first set of significant amendments to the Act was made in 2003.

IV. 2003 AMENDMENTS

In an effort to address poor corporate governance practices in most of the insurance companies, section 27 of the Act was amended to provide for an expanded board of directors comprising at least five members.[15] Additionally, such persons had to have the requisite knowledge and experience in matters relating to insurance, actuarial studies, accounting, finance or banking.[16]The amendments to section 31(h) of the Act were also meant to ensure that the day to day affairs of insurance companies were run by highly skilled and competent persons.[17] All amendments were primarily aimed at addressing the mismanagement that had characterized most insurance companies leading to their collapse. The 2003 amendments also sought to promote financial transparency in insurance companies by making it mandatory for them to prepare quarterly financial reports to be submitted to

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[5]Arnold O B Mwang'ombe, 'A Feasibility Study of The Insurance (Motor Vehicles Third Party Risks) (Amendment) Bill 2010 and Its Impact on Kenya's Insurance Industry' <available at http:// ssrn.com/abstract=1857906> accessed 24 February 2014.

[6]Ibid pp 94.

[7]William Olotch, "The Kenya Insurance Market" The Africa Reinsurer (2006) Vol 20 pp 44.

[8]"An Evaluation of The Effectiveness of State Regulation of The Insurance Industry in Kenya" available at<http://business.uonbi.ac.ke/node/1955> accessed 24 February 2014.

[9]Ibid.

[10]Njenga (n1) 22.

[11] Insurance (Motor Vehicles Third Party Risks) Act no 6 of 1987.

[12]KPMG, *Evolving Insurance Regulation* (KPMG 2013) 3.

[13]Supra (n 6) 46.

[14]Supra n 8.

[15]Section 27 A (a) of the Insurance Amendment Act 2003.

[16]Section 27A (b) of the Insurance Amendment Act 2003.

[17] Section 31 (h) of the Insurance Amendment Act 2003 provided that before registering an insurance company, the Minister had to satisfy himself that the applicant is adequately staffed with competent personnel including a fit and principal officer who holds a technical or professional qualification in insurance as well as a management staff comprising of persons who hold technical or professional qualifications in insurance, accounting or banking.

the Commissioner for Insurance.[18] This amendment sought to enable the authorities keep a track of the financial health of insurance companies. In an effort to curb the provision of insurance services by unregistered persons and entities, the 2003 amendments sought to impose more strict penalties for any persons or entities found to be providing insurance services without following the provisions of the Act especially with regard to registration, renewal of registration or authorization.[19]

V. 2004: LEGAL NOTICE NO 105 OF 2004

During the 1990s when many insurance companies collapsed, policyholders were unable to recover their claims. Additionally, they were left exposed to risks they had insured themselves against. Consequently, the government, through legal notice no 105 of 2004,established the Policy Holders Compensation Fund (PHCF) to partially relieve policyholders from the suffering they undergo when insurance firms collapse and to boost consumer confidence in the insurance industry.[20] The PHCF was established under the Insurance (Policy Holders Compensation Fund) Regulations 2004. Under the scheme, when an insurance company goes into liquidation, the individual policyholders in that company will be entitled to K.shs. 100000 compensation from the PHCF. Though aimed at providing some sort of relief to policyholders in the event of liquidation of an insurance company, the K.shs. 100000 cap is arguably little. Additionally, the PHCF only compensates individual policyholders and not corporate policyholders.[21] However, establishment of the fund was a welcome development as it was in keeping with the international best practices in the field of insurance. International best practice provides for the establishment of a fund to provide some of protection to policyholders in the event that an insurance company becomes insolvent.[22]

VI. 2006 AMENDMENTS

The 2006 amendments are perhaps the most important as far as amendments to the Insurance Act are concerned. This is because they established the Insurance Regulatory Authority (IRA), which replaced the Commissioner for Insurance as the authority in charge of supervising and regulating the insurance industry.[23] The Commissioner of Insurance was under the Ministry of Finance but the new regulatory body enjoyed greater autonomy. This enhanced its effectiveness in supervising the industry. In an effort to enhance the ability of insurance companies to pay out claims, the amendments also introduced the 'cash and carry rule'.[24] Other amendments included: raising the amount of paid up capital for the various insurance businesses,[25] limiting the stake that an entity could hold in an insurance company to 25%,[26] barring persons who own more than 20% of an insurance company from holding senior management positions[27] in the company and requiring all insurance companies to employ anti-money laundering personnel.[28] Evidently, in addition to limiting fraud, these amendments were also aimed at promoting good corporate governance practices in insurance companies.

VII. 2010 AMENDMENTS

The notable amendments in 2010 included the expansion of the regulatory and supervisory power of the Insurance Regulatory Authority.[29] The amendments also enhanced the supervisory role of the authority as far as the preparation of accounts of insurance companies was concerned.[30] The amendments also sought to spell out the functions of the board of the Policy Holders Compensation Fund.[31] One of its core functions set out in the amendment is to monitor the risk profile of any insurer.[32]

[18]Section 54(1) of the Insurance Amendment Act 2003.
[19] Section 67D of the Insurance Amendment Act 2003.
[20]Njenga (n 1) 37; Olotch (n 6) 47.
[21]Supra n 6.
[22]Takahiro Yasui, Policyholder Protection Funds: Rationale and Structure (Organization for Economic Corporation and Development 2001) 2. Also available at <www.oecd.org/daf/insurance-pensions/> accessed 23 February 2014.
[23]Section 3(1) of the Insurance Act no 11 of 2006.
[24]Provided that premiums should be paid to the insurance company upfront at the time of assumption of risk.
[25]Part of the Schedule of the Insurance Act no 11 of 2006.
[26]Section 4 B (ii) of the Insurance Act no 11 of 2006.
[27]Section 4 B (i) of the Insurance Act no 11 of 2006.
[28]Njenga (n1) 38.
[29]Section 51 of the Finance Act 2010.
[30]Section 54 of the Finance Act 2010.
[31]Section 61 of the Finance Act 2010.
[32] Ibid.

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VIII. 2011 AMENDMENTS

Like the 2010, amendments, the main amendments in 2011 sought to increase the supervisory framework of the authority. The amendments made it mandatory to seek the authority's consent where an insurer sought to open more branches.[33] The amendments also granted the authority power to protect the assets of an insurer for the purpose of protecting the interests of the policy holders.[34]

IX. 2013 AMENDMENTS

The 2013 amendments emanated from budgetary proposals affecting the insurance industry made during the 2012/2013 budget. One amendment empowered the authority to assess the professional, financial and moral suitability of a "significant owner"[35] of a person licensed under the Insurance Act.[36]These amendments were aimed at weeding out and barring criminals from controlling or holding a significant interest in financial institutions that do not fall under the ambit of the Banking Act. Additionally, the amendments empowered the authority to conduct inquiries and investigations on licenses as requested by other regulatory authorities.[37]The Insurance (Amendment Schedule) Order 2012 amended the schedule to the Insurance Act to provide for new capital requirements for reinsurers. Reinsurers were required to maintain a paid up capital of at least K.shs 800 million divided into K.shs 300 million for long term business and K.shs 500 million for general business. The 2013 amendments also sought to facilitate the implementation of EAC Common Market Protocol which required member states to open up business opportunities to East Africans.[38]Additionally, the amendments provided for certainty with regard to the time of making payments to the policyholders once a claim has been lodged with the insurer.[39]The amendments also expanded the role of the PHCF to include participation in the liquidation of insurance companies.[40] They also expanded the mandate of the IRA to include the protection of the interests of policyholders and insurance beneficiaries in any contract.[41]

X. THE INSURANCE ACT 2013 (REVISED)

As had been indicated earlier in this submission, the Insurance Act was enacted in 1984 and came into operation in 1987. Over the years, there have been several piecemeal amendments to the Act. The end result was that it ended up looking like a patchwork. There was thus need to reorganize the Act so as to capture all the amendments that had been made over the years in a structured manner. This culminated in the revision of the existing Insurance Act. The end product was a more coherent and better organized revised Insurance Act of 2013. The revised Insurance Act marks the culmination of the era of amendments to the Insurance Act that was enacted in 1984. Going forward, amendments will be based on the revised Insurance Act of 2013.

XI. REJECTED AMENDMENTS

While the focus of this paper was on amendments which were effected to the principal Act, there are equally other amendments which have been rejected. As recently as 2013, the president declined to assent to the Insurance Amendment Bill 2013 due to a number of provisions it contained.[42]Some of the provisions in the Act which led to its rejection included the exemption of IRA from participating in the appointment of auditors for insurance companies.[43] The amendment was rejected as it would weaken the supervisory role of the IRA. The Bill also had provisions which sought to compel the authority to seek permission from the board and obtain information from insurers within 21 days, explaining how the data will be used, and to whom else it will be provided.[44] This proposal was rejected on the ground that it would compromise risk-based supervision that requires information to be provided on demand. Generally, the amendments contained in the Insurance

[33]Section 30A of the Finance Act 2011.

[34] Section 22 of the Finance Act 2012 which introduced section 67G into the Insurance Act.

[35] Section 2 of the Act defines a significant owner to mean a person who holds more than 10% of the controlling or beneficial interest of a person licensed under the Act.

[36]Section 68A of the amended Insurance Act.

[37]Section 3A and Section 9 of the amended Insurance Act.

[38]Section 22 and 23 as read with 153 of the amended Insurance Act 2013.

[39] Sec 203(1) of the amended Insurance Act 2013 makes it mandatory to provide compensation within 90 days of making a claim.

[40]Section 179(1) of the amended Insurance Act 2013.

[41]Section 3A of the amended Insurance Act 2013.

[42] "Uhuru rejects proposed insurance law", available at <http://mobile.nation.co.ke/lifestyle/Uhuru-rejects-proposed-insurance-law/-/1950774/2122806/-/format/xhtml/-/mq5knez/-/index.html> accessed 23 February 2014.

[43] Ibid.

[44] Ibid.

Amendment Bill 2013 were rejected because they were not in keeping with international best practices in the field of insurance especially with regard to supervision of the various players in the sector.

XII. CONCLUSION

From a point of virtually no legislation in 1963, Kenya has come full circle as far as regulating the insurance industry is concerned. The first Act enacted in 1984 had to be amended severally to keep up with emerging trends and new challenges that faced the industry. Thanks to the amendments, Kenya now arguably has an insurance regulatory framework which not only addresses peculiar Kenyan concerns, but that is also by and large in keeping with international best practices as far the insurance sector is concerned. However, more needs to be done to fully streamline the sector. The path of reforming the law must continue. After all, the law was made for man, not man for the law.

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