

# **‘A WORLD-CLASS INSURANCE INDUSTRY’-AN ACHIEVABLE DREAM IN KENYA?’**

**A DISSERTATION IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR  
THE AWARD OF THE DEGREE OF BACHELOR OF LAWS (LLB) OF THE  
UNIVERSITY OF NAIROBI.**

**BY:-**

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**MR.YASH VYAS**

\_\_\_\_\_  
**DATE**

**DEDICATION**

**To my beloved mother who would have been proud in my work, one who believed in me even in times of weakness.**

**I LOVE U MOTHER.**

**To all policy holders who have been defrauded of their investment by insurance companies that collapsed indefinitely.**

**To all organizations, institutions and persons who strive to improve the insurance industry in Kenya.**

**GOD BLESS.**

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## 1. ABSTRACT

Insurance industry management in Kenya has become a problem for years. With the collapse of many companies, most policy holders are losing confidence in insurance day by day. Kenyans have stopped considering insurance as a kind of cover. The whole idea of having insurance cover to compensate the policy holder when the risk occurs has been distrusted by many.<sup>1</sup> At the time when the policy holder is faced with the risk, insurance companies are not willing to pay as promised.

Moreover most of them have gone underground, others are doing poorly because of management problems, others delay in payments, while others in fact, are unable to pay compensations at all. This raises questions as to whether consumer protection laws in Kenya have been put in force at all.

The loss of confidence in insurance has in turn caused poor performance in the industry and has therefore negatively affected the entire economy in Kenya.

Since insurance contracts are promissory in nature that at the time of the sale the insurer undertakes to make a payment to, or on behalf of the policyholder upon the occurrence of a specified event,<sup>2</sup> it is expected of them to stay in business until that occurrence. The exit of health management organizations and the collapse of some insurance companies have therefore resulted in a negative impact on the industry as a whole as they are seen as short term organizations that do not live up to their promise. This problem is not just confined in Kenya but has spread to the rest of Africa as well; an example is Donewell Insurance, one of the leading insurance companies in Ghana, which is at the moment battling a critical financial setback which has even led to the non-payment of staff members and economic loss to policyholders.

The insurance industry is also faced with problems of fraud: exaggerated claims, fake documents, misconduct of sales agents: these are all serious issues requiring solutions.

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<sup>1</sup> Geoffrey Njenga ,*Comparative Study Of Insurance Industry Between Kenya And Singapore 1963-2003*, Institute Of Diplomacy And International Relations ,University Of Nairobi,2005

<sup>2</sup> Colinvaux law of insurance.

Insurance in Africa generally suffers serious stagnation and is in urgent need of resuscitation and deliberate care so as to contribute to economic well being of the African people.<sup>3</sup>

'Modernization of the management of African insurance' is seen as the only hope for the stagnated industry. By this, it is meant that, a whole lot of things including wholesome technical operations, development of new products ,increased company and market capacities ,sound financial and commercial management ,business recapitalization of companies and use of technological tool.<sup>4</sup>

In 1998,AKI contracted PWC(Pricewaterhousecoopers) to analyze the challenges facing the Kenyan insurance industry. The study identified a full set of problems facing the industry ranging from low penetration ratio, unprofessional behaviors, inadequate regulatory framework and low adoption of technology as a management tool as key issues.<sup>5</sup>

The government has made efforts to come up with regulatory organizations to supervise and manage insurance companies but the question is still being asked: have these regulatory organizations achieved what they were intended for?

Today people are talking about bancassurance<sup>6</sup> and micro insurance<sup>7</sup> as ways of improving the performance of this very important industry in Kenya. We are still wondering whether this will work. Bancassurance refers to the integrated business of offering core banking services and products together with insurance. Bancassurance has been embraced in countries such as France, Japan and the United Kingdom with tremendous success. The Insurance Regulatory Authority (IRA) says bancassurance is the way forward in raising insurance penetration in Kenya.<sup>8</sup> bancassurance has various benefits to the bank and also to the insurers.<sup>9</sup>

Micro insurance on the other hand targets the low income earners. It protects them against specific perils in exchange of regular premium payments proportionate to the likelihood and cost of the risk involved.<sup>10</sup>

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<sup>3</sup> Bakary Kamara 'Challenges Facing the African Insurance Industry in the Next Millenium' unpublished paper.  
<sup>4</sup> Bakary Kamara 'Challenges Facing The African Insurance Industry In The Next Millenium' unpublished paper  
<sup>5</sup> <http://www.pwc.co.ke/insurance>-accessed on 15<sup>th</sup> March 2010.  
<sup>6</sup> The Kenya insurer, no.1 vol.7, July 2009 defines 'bancassurance' as the integration of offering banking services as well as insurance services.  
<sup>7</sup> This is offering of insurance cover to the low income in the society such as 'jua kali'.  
<sup>8</sup> The Kenya insurer, No. 1 vol.7, July 2009.  
<sup>9</sup> See the Kenya insurer.no.1 vl.7 July 2009 at pg 25.  
<sup>10</sup> The Kenya insurer, no. 1vol.7 at pg 4.



Since insurance sector plays a vital role in the economic development in Kenya, there is need to address these problems at the earliest stage possible. The industry is not collecting adequate premium as expected. The number of Kenyans with insurance is dismal and the industry has barely scratched the surface in terms of potential earnings. This explains why insurance industry is not growing hence handicapping the whole economy.

Other factors related to slow growth include:

- Intense competition among insurance companies.
- Slow economic growth.
- high supply costs(insurance products have become very expensive)
- Inadequate marketing (only 3 million of Kenya's 17 million people enjoy insurance cover)
- Lack of government support.
- Poor corporate governance.

Kenya's insurance law is also to blame for the problems the insurance industry is facing. The Insurance Act imposes conditions that stifle the growth of business. For instance, the requirement that unless insurance is processed through an intermediary, it will only be sold to direct customers on a cash and carry basis. The insurance companies are not allowed to run in-house premium finance schemes by law, hence the presence of shylocks. This is not an acceptable way of growing insurance services it restrains the business and therefore stifles its growth.

This project identifies constraints in the Kenyan insurance sector and concludes that the Kenyan industry is in desperate need to learn new ways of conducting business and endeavor professionalism so as to experience growth and have a meaningful contribution to the overall economic well being of the Kenyan economy.

## 2. CHAPTER ONE: INTRODUCTION

### BACKGROUND

The concept of insurance and particularly the social insurance program dealing with socio-economic problems has been around Africa for a long time. Members of a community pooled together resources to create a "social insurance fund". The premiums ranged from material to moral support or other payments in kind. From the fund "drawings were made out "to support the few unfortunate members exposed to perils. However the history of the development of commercial insurance in Kenya is closely related to the historical emancipation of Kenya as a nation<sup>11</sup>

With the conquest of Kenya as a British colony, settlers initiated various economic activities particularly farming and extraction of agricultural products.<sup>12</sup> These substantial investments needed some form of protection against various risk exposures. British insurers saw an opportunity in this, and established agency offices to service the colony's insurance needs. Prosperity in the colony soon justified expansion of these agencies to branch networks with more autonomy, and expertise to service the growing insurance needs. By independence in 1963, most branches had been transformed to fully fledged insurance companies.<sup>13</sup>

After independence in 1963 the Government of Kenya saw the need to have some control of the insurance sector. The market was then dominated by branch offices of foreign insurance companies particularly from the Europe and India<sup>14</sup>. The Insurance Companies Act of 1960 was based on the UK legislation. In 1978 the Minister for Finance issued an order stopping the operations of branch offices and all insurance companies had to be locally incorporated.<sup>15</sup>

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<sup>11</sup> Throup W.D, *Economics and social origins of the Mau Mau 1945-1953*, Ohio University press Columbus.OH.

<sup>12</sup> Huxley E, *Settlers of Kenya*, Greenwood Publishing Group Oxford. 1990

<sup>13</sup> Maxon R.M, *Struggle for Kenya. The loss and reassertion of imperial initiative 1912-1923*.Fairleigh Dickson,1993

<sup>14</sup> <http://www.ira.go.ke/about.html>

<sup>15</sup> Commissioner of insurance 'The Role Of The Regulatory Authority In Life Insurance And Pension Business'

The Insurance Act <sup>16</sup> commenced on 1<sup>st</sup> January 1987 and it replaced the Insurance Companies Act of 1960 which was repealed as it was deemed to be totally inappropriate to cope with the modern day insurance industry.

Thereafter in the early 1980's the process of drafting a law to regulate the insurance sector was started by the government with the support of United Nations Conference for Trade and Development (hereafter referred to as UNCTAD).<sup>17</sup>

In 1986, the Insurance Act CAP 487 was enacted with the commencement date being 1st January, 1987. The insurance act of 1987 has been governing insurance operations since then. The Act established the Office of the Commissioner of Insurance as the regulator of the insurance industry and stipulated the mandate and functions of the office. This office was created as a Department in the Ministry of Finance and was mandated to supervise the insurance industry.<sup>18</sup>

In order to enhance the supervisory capacity of the regulator, the government delinked the Department from the Ministry to give it some autonomy. The Insurance (Amendment) Act 2006 enacted on 30th December, 2006 established the Insurance Regulatory Authority (hereafter referred to as IRA) to take up the role of regulating, supervising and developing the insurance industry. The Act became effective on 1st May 2007.<sup>19</sup>

The Insurance Act (Cap 487) introduced the Office of the insurance regulator and stipulated the various requirements for registration of Insurance companies, reinsurance companies, Insurance brokers, Insurance agents, Loss Adjusters, Assessors, Insurance Surveyors and other service providers.

The insurance industry in Kenya, as at December 2009<sup>20</sup>, according to Association of Kenya Insurers (AKI), 2009 Annual Report, had 42 licensed insurance companies in operation. Twenty (20) of these exclusively write general insurance business, seven(7) write long term insurance

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<sup>16</sup> CAP 487

<sup>17</sup> Commissioner of insurance *'The Role Of The Regulatory Authority In Life Insurance And Pension Business'*

<sup>18</sup> <http://www.ira.go.ke/about.html>

<sup>19</sup> Kenya Gazette, legal notice 427 of 2007.

<sup>20</sup> Association of Kenya Insurers(AKI), 2009 Annual Report, AKI Website accessed on 20<sup>th</sup> February 2010

business only, while fifteen(15) write composite insurance business<sup>21</sup>. 4 reinsurance companies (including Zep Re and Africa Re which are regional bodies), 200 insurance brokers, 250 service providers and about 4000 insurance agents.

The insurance industry in Kenya is faced with one of the most challenging periods in history since the enactment of Kenya's insurance law in 1987 and one could probably predict with a measure of certainty that barring urgent and decisive intervention by the government and concerted remedial action by all the players, the industry is staring disaster in the eye with real possibility of failure at least for some of the companies.<sup>22</sup> Failure in the industry will have painful consequences for the insuring public.

Some of the most affected people by collapse of insurance companies include shareholders, directors, employees, the government, creditors, debtors, policy holders etc.<sup>23</sup>

The major reasons for failures have been put forward these include: the regulatory body failing to perform its work, the inefficiency of the laws governing the insurance industry and also the general practices in the insurance business.<sup>24</sup>

Insurance business has great impacts on the economy of a country, that is why it is of much concern when the industry's profits are reported to be negative (-81.46 after taxation).<sup>25</sup> A review of international cross-country data over the last 40 years reveals that insurance consumption is not only strongly correlated with economic output; its growth actually outpaces that of the economy.<sup>26</sup> The data also shows us that the growth of insurance consumption (measured as insurance penetration or total premiums as a percentage of GDP) generally follows what is referred to as an "S-Curve": it is slower at lower levels of development, accelerates as the insurance market and the

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<sup>21</sup> (AKI) statistics, 2009 Annual Report, AKI Website

<sup>22</sup> The Daily Nation, Business News, 28<sup>th</sup> November 2009

<sup>23</sup> Henry Lugulu 'The Winding Up Of Insurance Companies: Are Interested Parties Adequately Protected?' Moi University Law Journal No.2, 2007 Pg132.

<sup>24</sup> David Ngugi 'A survey of factors contributing to the slow growth of premium in the insurance industry'

<sup>25</sup> AKI report 2008.

<sup>26</sup> <http://www.iifdc.org/pubs/Insurance%20Assessment%20Report.pdf>

economy expand, and then slows down again as the market matures. A similar pattern is seen with the growth of life insurance consumption worldwide.<sup>27</sup>

When the industry is making profits then the economy of that particular country will also do well for example Singapore.<sup>28</sup> However the Kenyan insurance industry has had little impact in the overall economic well being of the Kenyan economy. Its contribution to the economy is insignificant.<sup>29</sup>

Kenya is predominantly an agricultural economy with over 70%of the adult population in small scale agriculture, while agri-business produces up to one third of measured national output. The agricultural sector has contributed 23.4%of the GDP (GROSS DOMESTIC PRODUCTS) in 2000.insurance which falls in the broader service sector contributed about 0.3%of GDP in the same period.<sup>30</sup>

Comparing Kenya with other economies, the insurance sector should fetch more premium than it is doing currently. For example, Singapore which achieved independence about the same time as Kenya, and also experienced the same GDP growth rate as Kenya in 1970's is doing quite well in the insurance sector.<sup>31</sup>

The Singaporean insurance industry has evolved into a premier insurance center in Asia. The vibrant and growing insurance industry has made a significant contribution in the overall economic growth in Singapore. Insurance industry in Singapore has 134 insurance companies, 29 reinsurance companies and 150 licensed brokers. The industry is grouped in broader financial sector together with banking and non-banking institutions under the monetary authority of Singapore. In 2003, the insurance sector contributed 7.9% of GDP which unfavorably with Kenya's 0.3%for the same period.<sup>32</sup>

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27 Financial sector blanket purchase agreement. '*Assessment on how strengthening the insurance industry in developing countries contribute to economic growth*' Task order no.1

28 Standards forum, Financial standards report 2005, Singapore

29 Economic survey 2004, government of Kenya 2004.pg 21

30 Economic survey 2004, government of Kenya 2004.pg 21.

31 Standards forum, Financial standards report 2005, Singapore

32 Geoffrey Njenga ,*Comparative Study Of Insurance Industry Between Kenya And Singapore 1963-2003*, Institute Of Diplomacy And International Relations ,University Of Nairobi,2005

While the vital indications for Singapore point to a vibrant and a growing economy, Kenya has regressed further into poverty. The pattern of growth of the insurance sub sector in Kenya has followed the features of the wide economic performance. In his annual report for 2002 the Kenya commissioner of insurance stated that the insurance industry was growing at a decreasing rate. In other words, the insurance industry was experiencing a declining pattern over time and the sectoral share shrinking progressively in the GDP. Overcapacity was singled out as the real reason for the decline in growth. The commissioner suggested mergers and acquisition as the formula to restore the industry back to the rails of prosperity.<sup>33</sup>

Although overcapacity is a problem in the insurance industry, it is only one of the many serious ailments afflicting the insurance industry in Kenya. The causes of business failure in the insurance industry as documented include: low pricing of the products to avert competition, poor financial management, poor corporate governance, imprudent investments decisions and poor underwriting. The commissioner also noted that the number and size of insurance companies in operation has a bearing on business failure rate in the industry.<sup>34</sup>

Singapore on the other hand has managed to attract sufficient business turnover not just to remain in business but to also make profits for the shareholders in very competitive business environment.

Singapore's general insurance industry saw good growth with a steady increase in both gross premiums and underwriting profits during the first nine months of the year 2005. Figures released by the General Insurance Association showed a 10 percent jump in underwriting profits for local general insurers to S\$166 million during that period. Total gross premiums climbed by 2.2 percent to S\$1.71 billion. The association of insurers reported that all major classes of business performed very well. Motor insurance continued to be the largest class of business underwritten by local general insurers, taking up a 31 percent share of the market. Underwriting profits for motor insurance jumped nearly four-fold to S\$36 million during the first nine months of the year.<sup>35</sup>

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<sup>33</sup> Department Of Insurance, Ministry Of Finance, Report Of Commissioner Of Insurance 2002, Government Of Kenya 2003, Pg4.

<sup>34</sup> Commissioner Of Insurance Report 2002

<sup>35</sup> Geoffrey Njenga ,*Comparative Study Of Insurance Industry Between Kenya And Singapore 1963-2003*. ,Institute Of Diplomacy And International Relations ,University Of Nairobi,2005

The fire and personal accident insurance also registered good growth during that period. Premiums for personal accident showed the highest jump that is 13 percent as more Singaporeans bought travel insurance cover.<sup>36</sup>

In addition Singapore has a code of insurance practice; LIA Code of Life Insurance Practice aims to give one a guide to the practices used by the life insurance industry in Singapore. Life insurers, their representatives and representatives of financial advisers are operating within the guidelines provided in the document to make sure that the standard of practice within the industry is maintained for everyone concerned.<sup>37</sup> The consumers are therefore adequately protected.

The contrast between Kenya and Singapore is profound not just in the sectoral experience but also in the overall economic growth. One industry is robust and experiencing growth while the other is regressing and making insignificant contribution in the overall economic well being of the country.

Germany is the 4th largest market in the world after United States of America, Japan, Great Britain, this paper is going to show how the German market is operated and then borrow some of their practices into the Kenyan market. In Germany, insurance isn't just a good thing to have. It is mandatory. There are more than 430 insurance companies registered in the Federal Republic of Germany, employing around 245,000 employees. Of this 40 are subsidiaries of foreign companies. Some well-known names are Allianz, Aachener und Münchener Lebensversicherung, etc. German Allianz is one of the world's biggest insurer. Allianz, like most big multinational companies, has been built up by a series of mergers and acquisitions. It was founded in Berlin in 1890, and set up its first international branch office (in London) in 1893.<sup>38</sup>

The economic, legal and regulatory framework of Germany is the reason for Germany's success in insurance. It is also the reason why insurance plays a major role in the economy of Germany. This will then show the reader areas in which the Kenyan insurance industry goes wrong.

Kenyan insurance companies are now introducing micro-insurance which seeks to promote access of insurance by the low income population. Micro-insurance is defined by the International Association Insurance Supervisors as "*insurance that is accessed by the low income population.*

<sup>36</sup> Standards forum, Financial standards report 2005, Singapore.

<sup>37</sup> [http://www.lia.org.sg/files/document\\_holder/Consumer\\_Guides/COLIP3rdEdition%28updated%29.pdf](http://www.lia.org.sg/files/document_holder/Consumer_Guides/COLIP3rdEdition%28updated%29.pdf)

<sup>38</sup> <http://www.economywatch.com/insurance/germany.html>

provided by a variety of different entities, but run in accordance with generally accepted principles.<sup>39</sup> Companies like UAP, CIC and Old Mutual have already introduced micro insurance products in the market.

IRA has initiated studies to find out if micro-insurance will achieve full penetration, the results of the study would also help insurance stakeholders to decide whether to adopt the Indian-like model where a separate regulation was put in place to cover micro insurance or to pursue further amendments to the Insurance Act.<sup>40</sup> Micro insurance has worked in other developing countries and Kenya is the second after South Africa.<sup>41</sup>

Public awareness programmes are being intensified in the country in efforts to improve the industry's performance. These programs are aimed at reaching the low income population in the country who mainly live in the rural areas of Kenya.

IRA is also in a view of improving the insurance sector, is undertaking a survey on the extent of poor public perception of insurance and the effects of it in the entire country.<sup>42</sup>

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*The Kenya insurer*, volume 7, number 1 July 2009.

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<http://www.coastweek.com/3312-19.htm>

41

<http://www.kbc.co.ke/story.asp?ID=62765>

42

Interview with IRA's Surveillance Assistant Manager, MR.OSERO on 15<sup>th</sup> April 2010.



### 3. STATEMENT OF THE PROBLEM

The insurance industry faces various challenges in its quest for growth yet it plays a vital role in economic development of Kenya. Some of the insurance companies have been wound up for example United Insurance Company,<sup>41</sup> Standard Assurance, United Insurance Company, Stallion, Lakestar and Liberty, their foray into public service vehicle (PSV) insurance proved far too costly with the firms collapsing in the face of heavy debt.<sup>44</sup>

Insurance business in Kenya has experienced unfavorable growth pattern over the years and that the industry is faced with severe challenges which requires urgent attention.<sup>45</sup>

When an insurance company is wound up or collapsed the most affected group are the policy creditors. This therefore means that the claims are not settled as per the policies that is, timely.<sup>46</sup>

Standard Assurance Kenya Limited is one of the companies that went on its knees. The heavily indebted insurance firm was placed under statutory management over its inability to settle some Sh100 million in outstanding claims owed to policyholders and creditors. The closure of Standard Assurance followed closely on a similar incident involving another motor underwriter, Invesco Insurance, which closed its doors two years ago and is still under statutory management<sup>47</sup>. Recently the company was given a license to continue with business and questions are still being raised as to what process was used to allow Invesco back into the market after it had failed.

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<sup>41</sup> <http://www.nation.co.ke/business/news/-/1006/663816/-/ifvbsvz/-/index.html>

<sup>44</sup> <http://www.businessdailyafrica.com/Company%20Industry/-/539550/669932/-/view/printVersion/-/httvp/-/index.html>

<sup>45</sup> William Ototch 'the future of insurance industry in kenya'2000-unpublished paper.

<sup>46</sup> Henry Lugulu '*The Winding Up Of Insurance Companies: Are Interested Parties Adequately Protected?*' Moi University Law Journal No.2, 2007 Pg132.

<sup>47</sup> Collapse of Standard Assurance sparks fresh market jitters 'the standard' on line edition. Published on 17/03/2009

Others are Access Insurance, Stallion, Lakestar Insurance and United Insurance who collapsed in similar circumstances.

In total, three insurance companies are now under statutory management, with two of them facing liquidation, as efforts to revive them remain doubtful.

While managers of United Insurance have already made proposals to the effect that the company should be wound up, the Insurance Regulatory Authority (IRA) recently rushed to court to protect the assets of Invesco and policyholders of the company. As matters stand, the fate of United now lies with a decision made by the High Court, which granted an extension to the term of statutory managers at Invesco.

The contribution of the insurance industry in the GDP per capita is very minimal.<sup>48</sup> In Kenya compared to other countries. Swiss Re sigma Report of 2007 indicates that the contribution of insurance to GDP is very low in Kenya even though the penetration is at 2.47 percent.<sup>49</sup> In the 2007 report by association of Kenya insurers, it is clear that the insurance industry is working at a loss.<sup>50</sup>

In underwriting, overall technical results for the industry registered an underwriting profit of Kshs.236 million in 2007 compared to the previous year's underwriting profit of Kshs.715.86 million. This shows a decrease in underwriting results of 67% from the previous year.<sup>51</sup>

In 2007, net earned premium increased by 11.6%. This is lower than the growth of 15.9% witnessed between 2005 and 2006.<sup>52</sup> This therefore shows that between 2006 and 2007 the insurance industry was working at losses.

Insurance Regulatory Authority (IRA) confirmed that clients' complaints over delayed payment had shot up sharply in the last six months<sup>53</sup> this clearly shows that insurance companies are not paying claims in time.

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<sup>48</sup> Geoffrey Njenga, *Comparative Study Of Insurance Industry Between Kenya And Singapore 1963-2003*, Institute Of Diplomacy And International Relations, University Of Nairobi, 2005

<sup>49</sup> Swiss Re sigma Report of 2007.

<sup>50</sup> Association Of Kenya Insurers Report 2007

<sup>51</sup> Insurance Regulatory Authority Report for 2007pg 26.

<sup>52</sup> Insurance Regulatory Authority Report For 2007pg 17

<sup>53</sup> Business Daily 'Complaints Rise Over Insurance Payment Delays' 5<sup>th</sup> October 2009pg 19.

Various factors have contributed to the collapse and slow growth of premiums: these include, overcapacity, slow economic growth, low penetration,<sup>54</sup> high supplier costs, inadequate marketing practices, poor industry image, lack of government support, inefficient legislation, and poor corporate governance.<sup>55</sup>

Interestingly, despite apparent difficulties and problems in the motor underwriting business, the industry watchdog — IRA — remains aloof and a reluctant observer as one motor insurance firm after another falls by the wayside<sup>56</sup>.

The history of insurance regulation has indeed been ad hoc response to successive insurance failures<sup>57</sup>

On the spot at IRA is Commissioner of Insurance, Sammy Mutua Makove, under whose watch six insurance firms dealing in motor underwriting have shut their doors and who promise to be vigilant and strict on compliance of the provisions of the Insurance Act.<sup>58</sup>

The establishment of a dynamic insurance industry is part of the responsibility of the legislators and supervisors. It is then their role to set the enabling environment for the healthy development of the insurance industry and to deal with the possible incidence of market failures and imperfections. It is incumbent upon regulators to ensure that a suitable environment is created so that the industry would develop towards optimal effectiveness and efficiency for maximum productivity.<sup>59</sup>

IRA has not achieved full regulation of insurance companies, although promising to deal with fraudulent insurance companies they end up standing a loof and are very lenient in imposing

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<sup>54</sup> Association of Kenya Insurers Report 2007.

<sup>55</sup> David M Ngugi, *A Survey of the Factors Contributing to Slow Growth of Premium in the Insurance Industry*, - .School Of Business and Economics 2007.

<sup>56</sup> <http://www.nation.co.ke/business/news/>

<sup>57</sup> Colinvaux's law of insurance ,at pg 264.

<sup>58</sup> Rodney Nyandika, *Why insurance industry in Kenya needs a makeup* –.,standard online publications.

<sup>59</sup> Fields,GS and OS Mitchell. 'Reforming Social Security and Social Safety Net programs in Developing Countries'Joint ministerial committee of the Boards of Governors of the World Bank and the international Monetary Fund,Annual Report of the Joint Ministerial Committee(1993)pgs 56-73.

their penalties; an example is Invesco Insurance Company.<sup>60</sup> Invesco has been under statutory management and they have now been given a license to go into insurance business which had failed previously. The circumstances under which the license was given are very unclear.

Nothing signifies the slumber in the insurance industry like the failure of the insurance regulator to publish an annual report that can help Kenyans understand how it is performing. An assessment report of the industry for 2009 has not been released to date. Yet the data makes it easier for individuals and corporate bodies to navigate through the path of seeking insurance and assurance against a plethora of risks. Most Kenyans' understanding of insurance does not go beyond cars and matatus, which, by law, are required to be insured. Otherwise, most Kenyan businesses or premises are not insured<sup>61</sup>.

The IRA has an obligation to perform the following:

1. Ensure and maintain market confidence in the financial system.
2. Public awareness: promoting public understanding of the financial system
3. There is need for consumer protection: securing the appropriate degree of protection for consumers
4. Reduction of financial crime: reducing the extent to which it is possible for a business carried on by a regulated person to be used for a purpose connected with financial crime.

IRA has not achieved much and that is why we still have penetration of 2.47%<sup>62</sup> today and public perception of insurance is still poor. From what Kenyan insurance is experiencing we can conclude that IRA has not achieved proper regulation and the insurance industry in Kenya still needs regulation, the objectives included in the IRA corporate plan should not be the 2010/2011 plan<sup>63</sup> they should be talking of ways to improve the regulatory mechanisms such that the insurance sector will by then be a step further.

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<sup>60</sup> <http://www.nation.co.ke/business/news>

<sup>61</sup> Why Insurance Industry in Kenya Needs a Makeup, nation media article accessed on November 25<sup>th</sup> 2009.

<sup>62</sup> Association Of Kenya Insurers Report 2007

<sup>63</sup> Insurance regulatory authority, corporate plan 2008/2009-2010/2011

There are fundamental problems in the industry owing to the outdated Insurance Act<sup>64</sup> whose review is long overdue. The statute deals more with procedure than substance. It does not elaborate on the major principles of insurance law.<sup>65</sup> Other Acts affecting insurance industry also need to be repealed or amended. These inadequacies in the law are gross and that is why fast solutions have to be found to solve insurance problems in Kenya.

#### **4. JUSTIFICATION OF THE STUDY**

Very little has been done to inquire why insurance companies collapse in Kenya and the reasons for collapse, yet insurance plays a major role in the economy of a country. Most writers have avoided this issue and therefore this leaves the problem growing and worsening the entire economy in Kenya.

This paper will set out why Kenya as a country has failed to achieve the best from the industry. This research project investigates the causes of collapse on the basis of legal and regulatory framework, the insurance practices and public perception.

It also puts in the open what effects the collapsed insurance companies have on the entire society and to the public image of insurance business. This will therefore enable insurers know where they go wrong and what causes this.

The insuring public will also benefit from this study. Because the study indicates signs of collapse of insurance companies the public will better understand why insurance companies fail and can avoid getting into any contracts with collapsing insurance companies.

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<sup>64</sup> Insurance regulatory authority, corporate plan 2008/2009-2010/2011 at Pg12  
<sup>65</sup> Tim Mweseli- Introduction To Commercial Law, Paralegal Handbook 10, Claripress Limited, Nairobi, 1997.

The regulatory authorities will find recommendations in this paper on how to improve the regulatory framework. The comparison between Kenya and other foreign economies that have made it in the insurance industry for example Germany, United Kingdom and Singapore will enable the players in the insurance market see that Kenya can also do it, and therefore come up with policies that will improve service quality and the performance of insurance in the economy of Kenya.

The research project will carry out questionnaires from the public and participants in the insurance market. This will put across the perception of those groups towards insurance; it will therefore explain why Kenyans do not believe in having insurance cover.

Insurance companies will benefit from this project in that they will collect data from the German model and better their market practices. This will have a great impact on the insurance industry as a whole.

The proposals put across will help the country have a better insurance system and therefore boost the economy of the country.

## **5. HYPOTHESES**

This research paper holds the assumption that:-

1. Insurance business in Kenya is not performing well in the economy of this country and yet insurance plays a major role in promoting the economy of a country. For example Germany where insurance is the main player in that economy.
2. The insurance industry is faced with hurdles that are making it difficult for the industry to make any significant contribution to the economy of Kenya. The insurance industry is faced with both external and internal hurdles.

- Internal factors include poor corporate governance, management weaknesses, malpractices, fraud and weak statutory management.
  - The external factors include chaotic operation in the sector, weak enforcement of rules, a weak and corrupt judiciary, fraud and loopholes in the Civil Procedure Act, Cap 21.
- (i). The first problem the industry faces are the practices by insurance companies in selling their products. They employ unqualified people to market and sell insurance covers which contributes significantly in creating poor public perception of the industry and therefore discourages people from taking insurance cover.
- (ii). Insufficient reserves, rapid growth, fraud, overstated assets, catastrophe losses, significant change in business, impaired affiliate, re-insurance failure, poor corporate governance, poor image and many others, the list is endless. All these barriers have great negative impacts on the insurance industry and in turn to the economy of Kenya as a whole.
3. The insurance regulatory body in Kenya has also failed to regulate and supervise over insurance companies. The Insurance Act<sup>66</sup> clearly states that the commissioner of insurance may examine reinsurance treaties and direct certain actions to be executed by insurers and may also carry out investigations under section (9) if he believes an offence is about to be committed or an insurer is carrying out its affairs in a manner detrimental to policy holders. This power has not been exercised fully.
  4. The Insurance Act<sup>67</sup> is also to blame for the failures and this can be solved by amending the insurance laws. The research holds that the laws governing insurance transactions need serious amendments before insurance in Kenya becomes competitive with other world markets. The old fashioned provisions need to be amended to keep up with the current insurance practices.
  5. However the problems facing the insurance industry can be solved, and that if the whole system is changed insurance business will make a lot of difference in the economy today. Comparing Kenyan insurance industry with other world economies, the Kenyan industry only needs amendments in the legal and regulatory framework to achieve a better insurance system.

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<sup>66</sup> CAP 487  
<sup>67</sup> CAP 487.

## **6. OBJECTIVES OF THE STUDY**

The objectives of this study include:-

### **GENERAL OBJECTIVES**

1. To improve the insurance industry by addressing the problems faced by insurance players.
2. To propose reforms that will improve the performance of insurance in the overall GDP of the country.

### **SPECIFIC OBJECTIVES**

1. To offer comprehensive analysis of the insurance industry in Kenya the main factors which have the greatest impact (both negative and positive) on the insurance industry in Kenya
2. To illustrate how the negative factors have contributed to Kenya's poor economy and how they have affected the society as well.
3. To find out if those causes can be mitigated upon by adopting policies that prevent collapse of insurance companies and also to attempt to find the inadequacies in the law and in the regulatory body, and propose amendments in the law that would improve the industry's performance.



## 7. THEORETICAL FRAMEWORK

### 7.1 PUBLIC INTEREST THEORY AND ECONOMIC ARGUMENTS

These theories hold the assertions that the insurance industry holds a very crucial position in any modern economy; therefore insurers ought to be more closely scrutinized on their financial situation than any other financial institutions in the interest of the public. Consequently, because of the importance of insurance, the risks involved and the need to ensure that the insured persons do not suffer the risks involved at the hands of reckless or fraudulent insurers, the government, in the interest of the entire public, should ensure that proper regulatory framework or mechanism is in place.. The extent to which governmental regulatory role on the private businesses should go has remained controversial to date.

In a free market economy businesses and consumers are free to engage their resources in any desired production, consumption or exchange without government restriction, regulation or control. The position relies extensively within unregulated markets<sup>68</sup>. The principles of a free enterprise system support the idea that businesses should be owned and controlled by private persons and not by the government. It is further argued that when the government interferes actively in economic life, there are too many opportunities for corrupt alliances between state officials and the market players to fleece the public. Milton Friedman<sup>69</sup> observes: *'A liberal is fundamentally fearful of concentration of power. His objective is to preserve the maximum degree of freedom for each individual separately that is compatible with one's freedom not interfering with another man's freedom. He believes that this objective requires the power to be disposed. He is suspicious of assigning to the government any functions that can be performed through the market both because it substitutes coercion for voluntary co-operation in the area in question, because by giving government an increased role, it threatens freedom in other areas'*

From the above assertion, the question of the role of government in economic sector becomes inevitable. Most people do not want the government to interfere with their private businesses in the name of regulation. On the one hand is the argument that there should be no governmental interference with the natural operation of a free market system as the

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<sup>68</sup> Fraser institute 2004, Economic Freedom of the World: Annual Report B.C  
<sup>69</sup> Milton Friedman, Capitalism and Freedom p.39

government is viewed as a primary threat to efficient allocation of resources. The efficiency disrupting government interventions include taxes and regulation<sup>70</sup>. The government for example through the IRA regulates insurance companies. On the other hand it is argued that only through government's vigilant oversight can there be a constructive benefit marginally made to outweigh their inherent destructive tendencies<sup>71</sup>. Undoubtedly, the actual equilibrium point lies somewhere along this continuum. However, the debate as to what the best balance between governmental regulation and economic freedom is one that continues unabated and unresolved in political as well as economic circles.

Underlying this research work is the Public Interest Theory; *it* states that to correct market failures, monopolies, externalities and imperfect information that lead to inefficient outcomes, the strategic private businesses ought to be regulated by the state in the public interest<sup>72</sup>. In essence, regulation is designed for the protection and benefit of the public at large. This theory stresses what the purpose of regulation should be but does not explain the reason why the regulation produces policies that it does.

It is contended that industry domination by regulatory process is not perfect because small firms have disproportionate influence on the industry action<sup>73</sup>. This is seen where regulation generates procedural safeguards that impose costs and therefore, only the economically powerful and the strongly established private firms have an upper hand on matters regarding the running of the industry. Again, this must be understood against the background that regulation cannot be a simple supply and demand relationship between the regulated industry and the government if the position of other interests must be considered.

The proponents of the free enterprise economy advocate for a very limited role of government to primarily fulfilling three functions<sup>74</sup>. First, the government should be restricted to the protection of property and property rights. Secondly, it should concern itself to codification and enforcement of rules of free and fair competition acting as 'an umpire.' Therefore, the government should facilitate proper operation of court systems and the

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<sup>70</sup> Djankov, Simeon and Andrei (2001)- 'Regulation of Entry' Harvard Institute for Economic Research Working Paper NO 1904

<sup>71</sup> Brittan, Samuel (1983)- the Role and Limits of Government, Essays in Political and Economic Minneapolis

<sup>72</sup> The Political Economy of Regulation: The Case of Insurance- the US Perspective, Kenneth J. Meir

<sup>73</sup> The Case Against Public Interest Theory, Stigler, 1971

<sup>74</sup> John Kilcollen-The Philosophy of Free Enterprise, Macquires University, 2006

regulatory bodies in ways that improve the working of the markets. Thirdly, should engage in minimizing the cost of market failures which are manifest of external effect through regulation of privately owned firms<sup>75</sup>.

A regulated industry does not always dominate the regulatory process and at times have to accept regulation that it would have preferred to avoid<sup>76</sup>. Richard Posner<sup>77</sup> identifies the limits of economic public interest theory. According to him what economist term inefficiencies are often policy outputs demanded by interest groups rather than blame for mismanagement by regulatory bodies who are asked to do the impossible yet they are not able to do so. It is also contended that in equilibrium-based regulation, much of the regulation is the product of coalitions between the regulation theories. Posner notes:

*'The economy theory is so spongy that virtually any observations can be reconciled with... At best it is a list of criteria relevant to predicting whether an industry will obtain favourable legislation. It is not a coherent theory yielding unambiguous and therefore testable hypotheses'*

The public interest theory of regulation holds the assumption that economic markets are extremely fragile and apt to operate inefficiently (or inequitably) if left alone. The other problem is that government regulation is virtually costless. With these assumptions it was very easy to argue that the principal government interventions in the economy were simply responses of government to public demands for the rectification of palpable and remediable inefficiencies and inequities in the operation of free market. The research paper totally agrees with these assumptions: a case in point is the establishment of the IRA .After there was a lot of complaints about the commissioner sleeping on his job, the government considered establishing an authority that would deal with insurance regulation.

Behind each scheme of regulation could be discerned a market imperfection the existence of which supplied a complete justification for some regulation assumed to operate efficiently without cost.

The conception of government as a costless and dependably effective instrument for altering market behavior has also gone by the boards. Theoretical revision has both stimulated and been

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<sup>75</sup> Friedman, Capitalization and Freedom, 1998

<sup>76</sup> Clarkson and Moris on regulation of private firm by the state. 1981

<sup>77</sup> Theories of Economic Regulation, Richard Posner, 1974 pg. 337

reinforced by a growing body of case studies demonstrating that particular schemes of government regulation -whether of taxicabs, or producers of natural gas, or truckers, or airlines, or stockbrokers, or new drugs, or electricity rates, or broadcasting-cannot be explained on the ground that they increase the wealth or, by any widely accepted standard of equity or fairness, the justice of the society.

This theory makes a significant contribution especially to the aspect of regulation in the insurance industry and also the economic perspectives of regulation. There may be merits and limitations of the systems pursued but ultimately, a balance between governmental regulation and self-regulation of the insurance business has to be obtained in order to come up with a system that can serve the interest of all the players in the industry including the insuring public<sup>78</sup>.

## **7.2 UTILITARIANISM**

Utilitarianism arguments are among those considered in assessing whether or not there is a moral duty to obey the law and whether the conventional morality of a community should be legally enforced. In the context of legal reasoning, one of the criteria suggested for determining what rules judges' should lay down is utility. "The greatest happiness of the greatest number" is the maxim adopted by Bentham to popularize his philosophy. A measure may be justified by utility which increases the happiness of a society.

The happiness of the community will be increased if the total of all the pleasures of all its members is augmented to a greater extent than their pains. Therefore a law enacted by the legislators should cause more happiness than pain to the society. Similarly, a law that protects the insured should be encouraged than that which causes pain to them. Laws that do not regulate insurers and as a result bring pain to the insured should be repealed.

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<sup>78</sup> Paul Franks and Neil Brown- Responding to Regulatory challenge: A Strategic Approach in Insurance, Australia, 2006

Bentham advances the principle of utility as the sole proper basis for morality and legislation. Both the rightness of every act we do in private life and the rightness of public measures of all kinds should be tested by his 'felicific calculus'.

Utilitarianism reflects on the spirit of Bentham's advocacy of the principle. Why should we accept that actions are morally required unless their consequences are good for people-meet their demonstrable needs and desires, or cater for their satisfactions?

Austin accepted the principle of utility but believed it should be applied to rules. "Our rules would be fashioned on utility: our conduct, on our rules" he regarded "the laws of God "as the test of what positive laws ought to be.

In the context of legal philosophy, the version of utilitarianism most often appealed to is 'ideal rule-utilitarianism'. This stipulates that an action is right if required or permitted by a rule, where that rule, if obeyed by all to whom it applies, would have better consequences compared with any other rule governing the same act<sup>79</sup>.

Where a rule governing insurance is enacted, the rule should bring better consequences on all players rather than a few of them (insurers).

The rules should ensure better practices that ensure insurance companies are managed in a better way to keep their promise and prevent them from collapsing.

The theory therefore is a basis for the contention in the research project that if the insurance act is not regulating the insurance industry in the way it should and therefore improve the industry's performance it is causing "pain" to the economy and should therefore be amended.

### **7.3 UTILITY CONCEPT APPLIED TO INSURANCE.**

It has been shown that if a company follows well defined objectives in its re-insurance policy, these objectives can be represented by a utility function which the company seeks to maximize. This formulation of the problem will in general make it possible to determine a unique

reinsurance arrangement which is optimal when the company's objectives and external situation are given.<sup>80</sup>

Guldberg<sup>81</sup> wrote about probability of ruin. This is the traditional approach to reinsurance problems. It does obviously not lead to a determinate solution. Most authors taking this approach conclude their studies by giving a mathematical relation between some measure of stability such as the probability of ruin and some parameter, for instance maximum retention to which the company can give any value within a certain range. Such studies do usually not state which particular value the company should select for this parameter, that is, what degree of stability it should settle for. This question is apparently considered as being outside the field of actuarial mathematics. The traditional approach implies that the actuary should play a rather modest part in the management of his company. He should provide facts and figures for use of his superiors who would make the final decision on behalf of the company. How these decisions were reached should in principle be no concern of the actuary. However, today there has been developments of mathematical theories for decision making under uncertainty and in light of these theories it appears that the actuary should take a broader view of his duties. These mathematical theories can obviously not eliminate the subjective element referred to by Guldberg. However, if one assumes that there is, or at least that there should be some consistency in the various subjective judgments made by an insurance company, fairly extensive mathematical treatment becomes possible. To introduce a utility function which the company seeks to maximize means only that such consistency requirements are put into mathematical form.

#### **7.4 AGENCY THEORY**

**Agency theory** refers to a set of propositions in governing a modern corporation which is typically characterized by large number of shareholders or owners who allow separate individuals to control and direct the use of their collective capital for future gains. These individuals, typically, may not always own shares but may possess relevant professional skills in managing the corporation. The theory offers many useful ways to examine the relationship

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<sup>80</sup> Karl Borch, the utility concept applied to the theory of insurance. at pg245 paragraph 1.1

<sup>81</sup> Guldberg, Alf, reports of the sixth international congress of actuaries, vol 1 pp753-764.

between owners and managers and verify how the final objective of maximizing the returns to the owners is achieved, particularly when the managers do not own the corporation's resources. Following Adam Smith (1776)<sup>82</sup>, Berle and Means (1932) initiate the discussion relating to the concerns of separation of ownership and control in a large corporation. However, the concerns are aggregated by Jensen and Meckling (1976)<sup>83</sup> into the 'agency problem' in governing the corporation. Jensen and Meckling identify managers as the agents who are employed to work for maximizing the returns to the shareholders, who are the principals. Jensen and Meckling assume that as agents do not own the corporation's resources, they may commit 'moral hazards' (such as shirking duties to enjoy leisure and hiding inefficiency to avoid loss of rewards) merely to enhance their own personal wealth at the cost of their principals. To minimize the potential for such agency problems, Jensen (1983)<sup>84</sup> recognizes two important steps: first, the principal-agent risk-bearing mechanism must be designed efficiently and second, the design must be monitored through the nexus of organizations and contracts. The first step, considered as the formal agency literature, examines how much of risks should each party assume in return for their respective gains. The principal must transfer some rights to the agent who, in turn, must accept to carry out the duties enshrined in the rights.

The second step, which Jensen (1983)<sup>85</sup> identifies as the 'positive agency theory', clarifies how firms use contractual monitoring and bonding to bear upon the structure designed in the first step and derive potential solutions to the agency problems. The inevitable loss of firm value that arises with the agency problems along with the costs of contractual monitoring and bonding are defined as agency costs (Jensen and Meckling, 1976).

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<sup>82</sup> Smith, A., (1776) *The Wealth of Nations*. Edited by Edwin Cannan, 1904. Reprint edition, 1937. New York, Modern Library.

<sup>83</sup> Jensen, M.C., and W.H. Meckling (1976) "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" *Journal of Financial Economics*, October, V.3, 4, pp. 305-360.

<sup>84</sup> Jensen, M.C., (1983) "Organization Theory and Methodology" *The Accounting Review*, V.LVIII, 2, pp. 319-339.

<sup>85</sup> Jensen, M.C., (1983) "Organization Theory and Methodology" *The Accounting Review*, V.LVIII, 2, pp.

Several empirical studies have since adopted agency theory to identify solutions to specific contexts such as diversification strategies within firms (e.g., Kehoe, 1996<sup>86</sup>; and Denis, Denis and Sarin, 1999)<sup>87</sup>. We relate the theory in a more generic sense of corporate governance. Keasey and Wright (1993)<sup>88</sup> define corporate governance in terms of “structures, process, cultures and systems that engender the successful operation of organizations”.

This research project totally agrees with the agency theory and in chapter 2 there will be a discussion about how agency has brought problems in the insurance industry. most of them sell the insurance products in order to reach the targets set by the insurance company not caring whether the client has understood the benefits and implications of the policy.

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<sup>86</sup> Kehoe, M.R., (1996) “Franchising, Agency Problems, and the Cost of Capital” *Applied Economics*, 28, pp. 1485-1493.

<sup>87</sup> Denis, D.J., D.K. Denis and A. Sarin (1999) “Agency Theory and the Influence of Equity Ownership Structure on Corporate Diversification Strategies” *Strategic Management Journal*, V.20, 11, pp. 1071-1076.

<sup>88</sup> Keasey, K. and M. Wright (1993). “Issues in corporate accountability and governance: An editorial” *Accounting and Business Research*, 23(91A): 291–303.



## 8. LITERATURE REVIEW

### 8.1 BOOKS:

#### 8.1.1 COLINVAUX'S LAW OF INSURANCE-ROBERT MERKIN

The author discusses the general principles of insurance and insurance law in the United Kingdom and England. The principles are the same as the Kenyan except for a few. The chapter that draws my attention is part II of the book .this discusses regulation of insurers. He states that the UK's regulatory structure is concerned almost exclusively with the solvency of insurers<sup>89</sup>, there being no history in this jurisdiction of regulation of the terms of insurance contracts or levels of premiums charged by insurers. Such control as there is over the terms of insurance policies and the ability of insurers to rely upon defenses consists of self regulation under the statements of insurance practice 1986, as administered by the Insurance Ombudsman Bureau and The Personal Investment Authority Ombudsman and The Unfair Terms in Consumer Contracts Regulations 1995.

The author states that the reason for regulation is that although the general principle of the common law is that anyone with contractual capacity may enter into contract ,parliament has by a succession of enactments culminating in the insurance companies act 1982(UK)restricted the classes of persons who may engage in insurance business and has regulated insurance business generally .the justification for such regulation may be summed up by the words of Maugham J in Re North and South Insurance (1993)47 LI.L.R.356,358.

*"An insurance company differs in its nature from almost every other trading concern. It starts in the first instance without liabilities. it obtains premiums sometimes to very large amounts ....in as much as the claim comes in in every case after the premiums have been secured, there is always a risk that an insurance company may by offering what looks like very advantageous terms to the public, obtain a very large premium income which as the result of the practical working of the company, proves to be an insufficient income for the purpose of meeting claims"*

The author states that Part II of the Insurance Companies' Act 1982, sets out a series of controls on the operation of insurance business applicable under section 15 to all insurance companies which carry on insurance business in the UK other than friend societies, trade

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<sup>89</sup> Colinvaux's law of insurance at pg 259

unions, employees associations and insurers providing exempt benefits in kind. Lloyd's underwriters receive partial exemption.

The author sets out some of the regulation mechanisms that are used in regulation of insurance companies in the UK:

1. Restriction of business.
2. Accounts and statements.
3. Separation of assets.
4. Solvency margins.
5. Liabilities and unlimited amount.
6. Powers of intervention by secretary of state in protecting policy holders.
7. Transfer of insurance business.
8. Winding up powers by secretary of state.
9. Changes of director, controller or manager.

He also discusses the conduct of insurance business in the UK. For instance in advertisement and disclosure by intermediaries.

This book will be an asset in the research paper in that the regulatory mechanisms may be adopted in improving the Kenyan industry. Proposals may be made in the insurance act of Kenya and also for the insurance regulatory authority giving them enough power to regulate insurance companies.

### **8.1.2 THE MODERN LAW OF INSURANCE, ANDREW MC GEE**

The author discussed the elements of insurance contract widely and the players of insurance business. Chapter 2 of this book discusses regulation of insurance. The author states that there are various reasons why the conduct of insurance business needs to be regulated more strictly than many forms of business. Policyholders have to be able to rely on the competence and probity of those providing insurance so that the insurer will be able to meet claims which may arise. The importance on insurance in modern life he says can scarcely be overstated, since it is used for financial planning (including pensions) as well as for the more traditional role of protecting against loss.

He states that the regulatory structure may be divided into 4:

- Initial authorization

- Capital requirements
- Fit and proper person requirements
- On-going monitoring.

He states that the rules are clearly intended to address one part of the information deficit problems, namely the need for the purchaser to pay for the product in advance and then to trust that the insurer will still be available and solvent if a claim arises.

He states that the UK market has self regulatory organizations that intend to ensure that businesses show proper regard to the needs of the clients and that their financial aspects of the business were appropriately conducted. Thus in particular they imposed strict rules on the process of dealing with and accounting for client money.

He further expounds on regulation of insurance brokers and also regulation of marketing and selling of investment policies.

He discusses the complaints handling schemes as organizations that ensured that clients complaints against insurance companies were addressed. They offered policy holders a service free to them and funded by the industry, in which they could seek relatively quick and informal considerations of their complaints against their insurance companies.

### **8.1.3 AN INTRODUCTION TO INSURANCE LAW ‘Policies and Perceptions of Insurance’-MALCOLM CLARKE.**

In this book Clarke discusses the general principles of an insurance contract and of insurance business in general. The chapter that draws my attention is “**taking the drama out of the crisis**” –law and market practice where he particularly states that ‘when adjudicating complaints, the insurance ombudsman must have regard not only to the contract and to the law but also to the codes of insurance practice and to the general principles of good insurance, investment or marketing practice’ if they are favorable to the insured, these principles are to prevail. In the book Clarke suggests that the public interest is a priority in the insurance contract and no matter what the contract states the insurance practice will prevail.

He states that in the earlier days of the insurance ombudsman bureau good market practice was equated with actual practice.

He also discusses compensation for late payment as a desirable practice, damages for distress, insolvency watch, watchdogs( E.g. IRA in Kenya's scenario) and the policy holders protection act(1975)all these which are applicable in this discussion and relevant contribution to the makeup of Kenya's insurance industry. I agree with Clarke that these are desirable practices that any insurance system needs to adopt. My research project therefore will recommend compensation for late payment and insolvency watch to be adopted by Kenyan insurance companies in order to improve the industry. For instance our insurance companies have 90 days to pay for claims, this period is even delayed by some .therefore in my recommendations I will propose Clarke model for the Kenyan industry.

#### **8.1.4 INTRODUCTION TO COMMERCIAL LAW –By Tim Mweseli**

The writer similarly talks about the general principles of insurance law. He acknowledges that insurance is a contract of utmost good faith and therefore full disclosure is required from both parties. The insurer must not mislead the proposer so as to make him take a less favorable concept. He has discussed remedies for breach in line with our Insurance Act and Contracts Act. These include: avoidance of contract by either parties repudiating the contract ab initio or from the very beginning or avoiding liability for claims if fault is on the insured.

He acknowledges that life insurance business is of immense value to insurers. This is because the insurance companies are assured of steady flow of income for quite a while until the policy matures upon death of the insured. The money is to be invested in long term projects that will generate good income for the companies and which will help them strengthen their capital base and assist in making good payments for losses and other liabilities. Here the managers must make a prudent decision on the kind of investment; otherwise the companies will run losses and be closed down eventually. The writer discusses re-insurance, pointing out that Kenya has only one recognized re-insurance company(they are two currently).These are supposed to help insurance companies when they go down but if the re-insurance companies are too few to handle the many insurance companies ,many will collapse because of insufficient funds.

The book further agrees that the Insurance Act is far from thorough. It only caters for certain insurance terms and classes of insurance, insurers and their intermediaries while leaving out information for the insured public who may wish to have some guidance in the substantive matters of insurance.

It further states that legislation as will have been evident is essential in regulating any industry, more so an industry like insurance which is fraught with accusations of fraud, dishonesty and failure to honor obligations, it is only the law which can save the day. However, this law has to be foolproof and regularly updated to keep up with demands of the industry .The Insurance Act in particular is very essential as it is the government's tool of supervision .As under it, the commissioner of insurance can oversee activities in the industry and protect the public in the process.

My research project totally agrees with Mweseli's contentions regarding Kenya's insurance system .he states that the industry has problems in the whole system from practices to regulatory and legal frameworks. These are the same issues that the research paper attempts to address and like Mweseli states that the act in particular is very essential as the governments' tool of supervision, the research paper proposes amendments to the Insurance Act.

#### **8.1.5 JOHN BIRDS ON INSURANCE LAW**

Professor John Birds an authoritative author on English insurance law<sup>90</sup>, analyses consumer insurance law particularly the UK law. The author expounds the approach of self-regulation by the insurers themselves that is employed in the UK. He argues that the general freedom of insurers from state control has led to benefits for consumers in terms of both cover provided and its costs<sup>91</sup>.

Self-regulation and complaints mechanisms for consumers is briefly described and how the system operates where the insurers observe certain insurance practices<sup>92</sup> though they are not legally binding. However, the aspect of self-regulation<sup>93</sup> by the insurers is concerned with the complaints mechanism through which the insured can lodge their complaints as against the insurers. In essence, the established Complaints Committee oversees the observance of self-regulatory and statutory devices though he points out that there is need for necessary reforms.

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<sup>90</sup> John Birds on Insurance Law

<sup>91</sup> The Institute for Fiscal Studies. Insurance: *competition or regulation* Report series No 19 (1995) comparing the British system with the much more regulatory German system

<sup>92</sup> Birds, 'Self Regulation and insurance contracts', New Foundations For Insurance Law. gives a detailed account of self-regulation

<sup>93</sup> The Rules require insurers to have and operate appropriate and effective internal complaint handling procedures, and that they co-operate with the complaints committee.

From this review, it is obvious that Birds sets out to explain self-regulation of consumer insurance law which is just but a small aspect of the entire insurance business. However, it will be of great importance especially in bringing out the regulatory systems that are in place in other jurisdictions for comparative purposes. The proposed research paper will be generally concerned with the Kenyan jurisdiction an aspect that has not been covered in the forgoing review.

## **8.2 WORKING PAPERS:**

### **8.2.1 INSURANCE COMPANIES' FAILURES: WHY DO THEY COST SO MUCH? BY MARTIN GRACE, ROBERT .W.KLEIN, RICHARD .D. PHILIPS**

The objective of this working paper was to demonstrate to what extend failures of insurance companies cause loss. It states that while insurer insolvencies dropped sharply in mid 1990's experience indicates the potential vulnerability of the industry to economic shocks and changes on market conditions. Most recently, the number and projected cost of property liability insurer's insolvencies have again begun to rise rapidly .the recent failures of several large insurers and the financial troubles besetting several other will likely result in insolvency costs that will eclipse all previous records.

Prior research suggests resolving the new round insolvencies will be especially expensive .historically, resolution costs incurred for property liability insurance company insolvencies have been significantly larger than the costs incurred for other failed financial institutions of comparable size.

Their analysis based on a larger sample of insurers and over a longer time period 1986-1999, puts the average cost of insolvencies accessing the guaranty funds at \$1.10 per \$1 of pre insolvencies assets .these costs are orders of magnitude larger than losses realized in the typical bank failure, which during the late 1980's averaged around \$0.20 for banks that failed from 1995-2001.

Their interest was to determine the extent to which these costs are driven by incentives on insurance company managers prior to being insolvent verses the incentives regulators have to

minimize costs by closing down troubled insurers and efficiently managing the liquidation of a failed insurer.

The goal was to re-examine the determinants of loss due to insurance companies' insolvencies. They state that the regulatory framework is essential in the insurance industry. They state however that tighter solvency standards will tend to reduce the supply of insurance and increase its price. Hence in theory, regulators should seek to enforce an optimal balance between insolvency costs and regulatory costs. The paper examines the cost of insurance solvency resolution. They find three main determinants of those resolution costs.

- Pre-insolvency condition of the firm.
- Degree of regulatory forbearance
- The transparency of the post solvency administration.

These factors are present in the Kenyan scenario as well and therefore the research project discusses the same in the Kenyan context and tries to analyze how these factors have affected Kenya as a developing country today.

The research paper will also analyze Kenya's regulatory body and see if they make a balance between insolvency costs and regulatory costs .recommendations will then be proposed in the concluding chapter on what Kenya needs to do to strike a balance.

## **8.2.2 DIAGNOSIS AND IMPROVEMENT OF THE SERVICE QUALITY IN THE INSURANCE INDUSTRIES OF GREECE AND KENYA –BY RAND, GRAHAM K**

Here the working paper intended to find out the problems encountered by the players in the insurance sector. They state that there is widespread customer dissatisfaction in the insurance industry, stemming from insurers failure to satisfy customers needs. Therefore, further research to improve the industry's understanding of the service quality is required .quality improvement strategies are recommended in both Greece and Kenya. In this paper an investigation into the service quality of the two countries is done by collecting data from various insurance companies .the data collected included

- tangibles(physical facilities ,equipments, personnel and communications materials)
- reliability(the ability to perform the promised service dependably and accurately)
- assurance(the knowledge ,competence and courtesy of service employees and their ability to convey trust and confidence )
- Empathy (the caring individualized attention provided to customers).

Kenya's data analysis showed a gap between their expectations of the insured and the perceptions. The research project is therefore looking at how service quality has affected insurance industry in Kenya and the necessary improvements that companies need to make to make the service quality up to standards.

The research paper had talked about insurance practice as a whole and how it has greatly affected its performance .the research project will not go into details as this working paper, it will only show how good services in terms of offices equipment can substantially improve a company's performance and also how Kenyan companies need to improve their selling practices to remain competitive in the market.

### **8.2.3 MANUAL PRODUCED BY THE EDUCATION COMMITTEE OF THE INTERNATIONAL ASSOCIATION OF INSURERS SUPERVISORS (IAIS) IN COLLABORATION WITH UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD)-2002**

In the *Training Manual on Supervision of Insurance Operation*<sup>94</sup> which reflects the international attempt to incorporate insurance and insurance regulation in international instrument through United Nation Conference on Trade and Development (UNCTAD) mandate. The objective of UNCTAD Insurance Programme is to assist in the establishment of competitive and regulated insurance markets in developing countries and countries with economies in transition<sup>95</sup>. Since insurance provides a critical layer of protection, it is argued that the industry must be supervised in order to try and guarantee the availability of the necessary fund when they are needed for payment of claims. The manual describes many areas

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<sup>94</sup> Manual produced by the Education Committee of the International Association of Insurers Supervisors(IAIS) in collaboration with United Nations Conference on Trade and Development(UNCTAD)-2002

<sup>95</sup> UNCTAD website accessed on 15<sup>th</sup> January 2010



where insurance should be regulated and in varying ways in which the same should be undertaken.

When introducing reforms to an established insurance market based on market economy principles, effective regulatory and supervisory system focusing on consumer protection should be put in place<sup>96</sup>. Upon introduction of market economy principles and liberalization the nature of state involvement in monitoring changes. The role of the state leans towards establishing market conduct rules and towards implementing prudential regulation focusing, in particular, on solvency and consumer protection measures, facilitating the development of a robust insurance industry and enforcing the rules and regulations accompanied by effective and efficient supervision.

It is further argued that introduction of market economies and liberalization promote entrepreneurial freedom, responsibility, accountability, optimized allocation of resources, increased productivity and efficiency which will in turn bring a better match between demand and supply<sup>97</sup>. This encourages entry of new participants thus leading into mutualisation and risk spreading process which constitute the basis for insurance and increased capacities to underwrite local risks. However in a liberalized environment, competitive pressure may induce some insurers to turn to unsound practices such as uneconomic pricing and cash flow underwriting in order to retain market share. Under such conditions, insolvencies are more likely and therefore greater consideration may have to be given to insurance consumer protection measures.

The foregoing literature bring to fore the insurance principles as viewed from the international perspective and the general international framework. The regulatory elements required for promoting sound insurance markets are discussed which include the strengths and weaknesses of regulatory measures taken during the financial crisis as well as measures that should be taken over the longer run to promote sound insurance markets<sup>98</sup>. Key elements for sound insurance markets include an appropriate legal system, protection against fraud, adequate accounting standards and a strong supervisory infrastructure. However, it only

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<sup>96</sup> Education Committee of the International Association of Insurers Supervisors (IAIS) 2003

<sup>97</sup> The Geneva Papers, 2005, 30 (29-33), The International Association For the Study of Insurance Economics, source [www.Palgrave-Journals.com](http://www.Palgrave-Journals.com)

<sup>98</sup> Rio de Janeiro Brazil and Basel, Switzerland – October 26, 2009 – The International Association of Insurance Supervisors (IAIS) concluded its Annual Conference and General Meeting in Rio de Janeiro, Brazil on Saturday 24 October 2009

discusses the general overview of international framework which then has to be put in context of every local jurisdiction. The proposed study will look into the applicability of the core principles and guidelines as enunciated in the international insurance legal framework and the extent to which the same has been followed.

### **8.3 ARTICLES :**

The articles are some of the reports that have been published on this topic and which make a major contribution in showing that Kenya's insurance industry is facing challenges. They include on line publications and those in the newspapers .These are a great source of material since the local dailies report on issues that are taking place in the country.

#### **WHY INSURANCE INDUSTRY IN KENYA NEEDS A MAKEUP**

By Rodney Nyandika

Mismanagement, resulting from poor corporate governance, is partly blamed for the collapse of several insurance companies in Kenya, which has led to low public perception of the industry. This has prevented some Kenyans from taking up insurance products, despite their potential to act as savings net and provide assurance for consumers against unforeseen future risks. Perception of insurance industry in bad light is a major issue in Kenya. Lots of consumers are complaining that they do not get quality services from the insurance companies. This negative perception is exemplified by the reality of the low life insurance penetration in the country.

Insurers must meet the capital adequacy levels and solvency requirements. Failure by insurance companies to compensate for post election violence has further dented the image of the industry, with the public seeing it as selfish.

Mismanagement and bad decisions have resulted in collapsing of some insurance companies like Kenya National Assurance, United Insurance Company and Lakestar Insurance Company. The insurance industry in the country has lagged behind other financial sector players, contributing only 2.5 per cent of the GDP against a 7.5 per cent world average. This article will

be an importance information source to illustrate how the Kenyan insurance system is deteriorating in its performance.

## COMPLAINTS RISE OVER INSURANCE PAYMENT DELAYS

Steve Mbogo-business daily

The Insurance Act requires that all approved insurance claims be paid within three months, failure to which the IRA will levy a penalty of five per cent on the outstanding amounts. Inability to pay claims plus interest will result in winding up of the company. It is however evident that some insurance companies however are now taking more than six months to settle claims.

This article is evidence that some insurance companies delay in payment of claims, therefore fuelling concerns that the investment income losses they suffered when share prices fell ballooned into a cash crunch.

The article states that Insurance Regulatory Authority (IRA) also confirmed that clients' complaints over delayed payment had shot up sharply in the last few years.

Insurance companies were some of the major casualties when stock prices crashed at the Nairobi Stock Exchange (NSE) in late 2007. Estimates were that the industry had put up to Sh30 billion, equivalent to 20 per cent of their total assets as at end of 2008 in equities.

Insurance agents, who form the first line of contact between underwriters and clients, say the situation is becoming worse. In at least two insurance companies, delay is happening even after the matter has been taken to court and determined, indicating a case of genuine cash crunch.

Association of Kenya Independent Insurance Agents stated the problem now runs across almost all insurance companies. *"The situation is bad for some companies, which are sending agents to scout for premiums at matatu termini to raise money to settle some of the claims."*<sup>99</sup>

However IRA said rising increased awareness by consumers of the role of IRA through its consumer education activities was the reason for rising complaints. IRA also did not give details of complaints against specific companies "because complaints against any insurance company are confidential to the complainant and the company."

Although the insurance industry experienced a premium income growth in 2008, most of the companies recorded a significant drop in their cash flow when shares prices fell dramatically. The market has not picked yet. Although the general economic downturn has slowed insurance

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<sup>99</sup> Mr. Kennedy Gichimu, who heads the Association of Kenya Independent Insurance Agents.

business, the cash and carry model where premiums are paid upfront should have helped insurance companies improve their liquidity.<sup>100</sup>

"The most important for insurance industry is to improve governance. A good number of companies are controlled by owners and this can affect how they are managed," said Mr. Ng'aru. The Association of Kenya Insurers (AKI) industry report for 2008 shows that gross written premium by the industry was Sh55.19 billion compared to Sh48.09 billion in 2007, representing a growth of 14.8 per cent.

During the year, 21 out of 42 insurance companies made underwriting profits. The overall underwriting profit posted under general insurance was Sh0.8 billion while life insurance recorded an underwriting deficit of Sh1.2 billion.

Earnings from investment and other income reduced from Sh12.1 billion in 2007 to Sh11.7 billion in 2008. The combined industry profit before taxation increased by 25.9 per cent to Sh5 billion compared to Sh4 billion in 2007. Cases of delay in claims payment were first highlighted this year when Ukwalu Supermarket came out publicly when an insurance company delayed settling its post-election claims for over a year.

Evidence abounds of individuals who have been following insurers to settle their claims for more than six months now. Local insurance companies are blamed for taking too much risk without the corresponding capability to pay for claims because of a small market that has too many companies, which use the destructive price undercutting methods to get clients.

By December, 2008, total insurance penetration was 2.6 per cent of the gross domestic product compared to 2.4 per cent in 2003. To end this exposure, some industry players have suggested consolidation to strengthen the new companies financially to be able to undertake more risks and have the capacity to pay claims.

### **Price undercutting**

Mr. James Wambugu, the managing director of UAP Insurance, said earlier that although consolidation within the industry is not popular because of cultural issues, the dynamics of the economy, competition and regulation, the industry will not have a choice. "Competition among the many insurers is causing price undercutting that is detrimental to the whole industry and regulation for higher capital base and ownership structures means the law is moving towards encouraging consolidation."

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<sup>100</sup> Insurance consultant, Mr. Isaac Ng'aru

Mr. Moses Banda, the CEO of Microensure, new entrants in the field of micro insurance, said local insurers have been slow in diversifying their products, showing to remain with the conventional products, whose market is shrinking all over the world. "There is a market that needs to be served here. It will help to increase penetration and premiums so that the industry does not experience cash crunch" he said.

## **KENYA'S INSURANCE INDUSTRY STILL FACES HURDLES**

Posted Monday, August 31 2009 at 13:15

**By Smartbiz Correspondent**

In order to address the problem of imprudent investments by some pension schemes in total disregard of the Retirement Benefits Authority (RBA) rules and regulations, the Kenyan government in the 2009/10 Budget moved to ensure that members' contributions are safe and prudently invested. This was through amending the Retirement Benefits Act to require new investments by pension schemes that receive statutory contributions.

The amendments of the Banking Act is set to allow banks to offer insurance products and other financial products without seeking additional licenses, and will assist in the penetration of insurance services in the country. However it has been argued in some circles that for Kenyans to benefit from bancassurance, financial regulation should clearly be more integrated and flexible. This requires financial sector activities to fall under fewer regulators to avoid the overlaps currently in place, and have some flexibility to respond to innovations which may result in new products that were not envisaged at the time of establishment of the regulatory structure.

However there are challenges; and some of them include undercutting of premium by new entrants in search of big volumes of business. Brokers switching from one underwriter to another due to the tendering process every year make it difficult to project premium growth; same as arm twisting (by brokers) as they seek reduced premiums and enhanced product features.

HIV and AIDS have presented a major challenge in the ordinary life business. The enactment of the HIV/AIDS Act will greatly impact on the insurance sector. The insurance industry as a whole does not have a good image; and the exit of health management organisations and collapse of some insurance companies has resulted in a negative impact on the industry as a whole. Issues to do with fraud are quite common, exaggerated claims, fake documentation,

delays in claims settlement, misconduct of sales agents are all serious issues that require to be tackled.

The enactment of the Insurance Act has presented its pros and cons. One of the major cons is that general insurance agents are now allowed to represent more than one company. This may lead to a similar situation of price undercutting and unfair competition currently being experienced with brokers in general insurance.

In addition, there are very many taxes applied to the industry including premium tax, compensation levy, stamp duty, reinsurance tax, and stamp duty on mortgages. All these greatly impact on the company's financial bottom line as they are expenses.

Corruption is also a serious problem in Kenya today. It manifests itself in various aspects e.g. fraudulent claims and high court awards coupled with price undercutting and other unethical practices to procure business. Brokers continue to dominate group life and general insurance business and a long term strategy to bypass their stranglehold is essential. The penetration of life insurance business in this country is very low when compared to the leading markets in Africa. There is need therefore, for players in this sector to come up with life products that are more attractive and affordable by the people.

## **8.4 DISSERTATIONS:**

### **8.4.1 A SURVEY OF THE FACTORS CONTRIBUTING TO THE SLOW GROWTH OF PREMIUM IN THE INSURANCE INDUSTRY: DAVID M NGUGI, SCHOOL OF BUSINESS AND ECONOMICS.RESEARCH AND PUBLICATIONS**

The writer did a survey of the factors that cause the slow growth of premiums. he acknowledges the fact that insurance sector plays a vital role in the economic development of a country and that a vibrant insurance sector is of paramount importance to all stake holders .he states that the insurance industry in Kenya could grow much bigger compared to its current size, however the industry faces various challenges in its quest for growth like most other financial sectors in the Kenyan economy.

He studies the factors contributing to the slow growth of premium after carrying out a survey he identifies factors such as intense competition, slow growth, inadequate marketing practices etc. From his research it is clear that these factors play a major role in the slow growth of the insurance industry in Kenya. The writer proposes recommendations which would see the insurance system in Kenya change in the positive end.

### **8.4.2 FAILURE PREDICTION OF INSURANCE COMPANIES IN KENYA,ISAAC KIBANDI 2006 -Masters In Business Administration ,School Of Business ,University Of Nairobi**

The writer acknowledges the fact that the regulatory bodies in Kenya have proved to be inefficient .He discusses the rate of failure of insurance companies and also the structural, organizational and economical framework that would lead to a failure. He states that it's worth noting that these businesses failures have arisen despite the presence of stringent regulation .regulations have come up with revisions to the existing regulations but this has not deterred business failure. The Insurance Act has had various revisions affecting solvency margins, capitalization levels and even underwriting guidelines .however this did not prevent failure of united insurance company limited and standard assurance company limited.

Isaac has discussed failure predictions of insurance companies. This will be a good resource material in this project since it is these failure signs that lead to collapse and final winding up

of companies. We need the failure predictions to know if an insurance company is soon collapsing. The research project however goes beyond failure prediction and discusses the failures, effects and also ways to prevent these failures. Isaacs work will contribute in detecting structural, organizational and economical framework that would lead to a failure

#### **8.4.3 A SURVEY OF KEY SUCCESS FACTORS FOR FIRMS IN THE INSURANCE INDUSTRY IN KENYA-KARIUKI GN Masters in Business Administration, School Of Business, University Of Nairobi**

THE writer acknowledges that insurance industry like any other financial industry faces challenges. He states that despite the importance of insurance many people have continued to live without insurance cover. Globalization and liberalization have opened up the economy to fierce competition .rapid population growth; low economic growth and high level of unemployment have resulted in increased poverty, crime and reduced purchasing power of the population.

Information technology process and communication has improved over the years, leading to a better and changing business processes. The society has also brought other challenges higher educational standards have resulted in more sophisticated consumers with different needs .HIV and AIDS have emerged as a major public health issue. New laws and regulations have been promulgated and existing ones amended. The introduction of legislation prohibiting discrimination against persons suffering from HIV and AIDS is still a significant threat to the industry.

In order to survive firms have to put in place strategies that would give their competitive advantage over the others. Insurance companies have to find the best ways to use their capabilities and resources to develop organizational competitive advantage on the basis of capabilities demands that firms focus their efforts on building business processes. Firms can do this by transforming their critical business process into strategies and capabilities that are not easy to be replicated by rivals. The writer looks at packaging of the insurances products as a way of increasing premiums e.g. putting an additional rider that goes with a particular product.

The research project is different from this dissertation, in that it discusses the factors that lead to collapse of insurance companies. This dissertation will be of great contribution in



analyzing the success factors that have worked and in proposing the success factors for the Kenyan industry.

## 9. SCOPE AND LIMITATIONS

The project is going to investigate mainly on the problems that face the insurance industry in Kenya and reasons why the industry is faced with such problems. The factors contributing to the collapse of insurance companies and why the Kenyan insurance industry has very low contribution to the economy.

The research is also going to investigate the extent of loss that these factors cause and which ones cause great loss. The factors contributing to collapse of insurance companies are endless but the research project will only look at the ones that have significant effects in the collapse of insurance industry and are experienced by all insurers in Kenya. This will mainly be discussed against the financial statements submitted at IRA and also data collected by the researcher.

The research project will also collect data from the insurance players and this will mainly cover insurance practices: public perception, personnel employed, payment of commissions among others.

The research will also cover diagnosis of the problems and recommend amendments in the law and practice of insurance business in Kenya. The solutions will be those that Kenya can manage e.g. countrywide public rallies to create awareness, amendments in the law, more governing power to IRA etc.

The research project will make a comparison between Kenya and other foreign economies in the performance of insurance. This will mainly be based on the policies adopted by those foreign countries and the market practice of insurance. The comparison with the foreign industries is mainly intended to see how other countries have managed to perform so well in insurance and adopt some of their practices and their system of regulation. A short discussion will cover micro insurance and how it has been achieved in South Africa and if micro – insurance is going to positively improve the performance of insurance industry in Kenya.

However this project will not compare Kenya with other economies which may or may not add value to the research work. It will not also have a comparison with east African countries

since most of them perform either poorly or on average compared to Kenya. The research project will confine itself to insurance industry only and not other economic players like banks and cooperative societies which are in the financial sector just like insurance business.

The research project when comparing Kenya to foreign industries will restrict itself to the factors that Kenya as a developing country can keep up with. It does not intend to have an insurance industry like Germany's but only to improve the Kenyan industry by adopting some of the practices in foreign insurance industries.

The research project will only use the materials that could be accessed and are latest from the records: the records that were collected last as at the time of the project.

Data collected by questionnaire will only be in Kenya because of the technical difficulties of getting them from other countries.

## **10. RESEARCH METHODOLOGY**

This research project is going to employ both primary and secondary research methods.

Firstly most of the research materials will be:

- Books; both published and unpublished
- Articles on insurance both published and unpublished.
- Network places on the internet
- Questionnaires and interviews: I will carry out a random questionnaire and also interviews with the Commissioner of Insurance and the players in insurance companies.

## **11. CHAPTER TWO:**

### **EFFECTS OF FAILURE AND INTERNAL AND EXTERNAL FACTORS OF FAILURE.**

#### **Summary**

Chapter two of this project will examine the main problems the research paper will look into. It will mainly discuss the signs, reasons and effect of failure of insurance companies. The effect those failures have on the society as a whole which includes the government, policy holders, employees of insurance companies, beneficiaries of insurance policies etc.

An in-depth discussion of the reasons for failure is also included and the major factors are discussed widely. This discussion will be collaborated by statistics which will show how the issues have become problems and to what extent they have affected the industry as a whole. The focus of this paper is insurance company failure and ways to improve service quality and performance of the industry. This definition covers insurance and re-insurance, property and casualty companies. The paper tends to focus on the Kenyan industry. The main reasons for this are because this market has the potential but the players in the market are not employing the right mechanisms to run it. Kenya has also experienced recorded failures in the past and which have had great impacts on the economy of Kenya and generally the public attitude towards the insurance industry.

Chapter two will discuss the reasons and effects of failure of insurance companies will also be discussed in this chapter. The effect those failures have on the society as a whole: the government, policy holders, employees of insurance companies, beneficiaries of insurance policies etc.

This chapter will also discuss the causes of insurance companies' failure: both internal and external. Internal, meaning factors within the running and management of the company, external being other factors not caused by the company itself. An in-depth discussion of the reasons for failure is also included and the major factors are discussed widely.

Germany's insurance system will be discussed in depth since it is the world's third best insurance system and the factors that have led to the success of its insurance system.

## INTRODUCTION

Failure of insurance companies is basically insolvency and when an insurance company is insolvent when it's unable to pay its claims. In simple terms a company has failed when its capital has been eroded to the point where it is unlikely that it will be unable to meet its insurance liabilities<sup>101</sup> or its liabilities exceed its assets it becomes a failed insurance company. When a company is insolvent it is wound up or liquidated. Winding up of a company is a legal process that leads to the company being dissolved and its property administered for the benefit of its members and creditors.<sup>102</sup> The issue that this paper attempts to address is whether the interested parties are protected when these insurance companies are dissolved.

Reasons for failure arise out of the internal operations and the external environment in which insurance companies compete.

As with all good pieces of actuarial work, having looked backwards at the historical reasons for failure ,this research project explores and predicts the future.

There are many reasons why the insurance industry and those associated with it should be concerned with the failure of insurance companies.<sup>103</sup>

The insurance industry in Kenya faces a number of challenges, among them;

- Overcapacity and price wars.
- Poor corporate governance
- Inadequate legislative and regulatory framework
- Financially weak insurance organizations
- Negative public perception and awareness of insurance.
- High cost of insurance.
- Corruption and fraud among the stakeholders.
- Overdependence on traditional products and distribution channels

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<sup>101</sup> Insurance company failure,Roger Massey

<sup>102</sup> Moi University law journal-number 2-2007,the winding up or liquidation of insurance companies :Are interested parties adequately protected?Henry JA Lugulu and George O Ochich.pg109

<sup>103</sup> Moi University law journal-number 2-2007,the winding up or liquidation of insurance companies :Are interested parties adequately protected?Henry JA Lugulu and George O Ochich

## **11.1 EFFECTS OF FAILURE ON THE SOCIETY AS AWHOLE**

The failure of an insurance company has an impact on:

### **(1) The policyholders at the time of failure.**

The business of insurance is to sell policies. These may relate to the long term insurance business<sup>104</sup> including ordinary life insurance, industrial life assurance, bond investment business or business incidental to all these.

The policyholders suffer economic loss if they have an outstanding claim that may not be paid or\ paid in full. Even if there is a market scheme to pay claims in such a situation, it may not pay the full value of the claim. In addition the policyholder may not get all the unexpired premium back, and even if they do, they will probably have to take out new policies before they get the money.<sup>105</sup>

Other third party interests may arise in compulsory insurance schemes for example motor vehicle insurance. Here, the victims of the tortfeasors who hold these third party policies may be entitled to claim under the policies as if they are privy to them.

The interest of policyholders would be that when the risk insured against attaches, the insurance company would pay. This interest exists whether the policy holders suffer the loss themselves or create the loss to third parties. The settlement of third party claims on behalf of the policyholder absolves the policyholder from liability and protects his property from claims of such third parties. Any failure by the insurer to settle such claims of third parties disrupts the policyholder's operations.

Policy holders of life insurance are at a more vulnerable position. The reason people buy life policies is because they want to hedge against the risk of either dying early and thereby leaving their dependants unprovided for, or else being disabled from earning a living thereby being rendered destitute. The same situation applies to those with pension/retirement policies.

The policyholders interest is that when the time or event envisaged reaches, the insurance company will be solvent and able to pay under the policy or scheme.

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<sup>104</sup> See section 21 of the Insurance Act.

<sup>105</sup> Insurance company failure, Roger Massey

## **(2) Other insurers**

Insurance companies are re-insured by other companies against insolvency and other risks. If the reinsuring company fails and is liquidated then the reinsured companies will suffer. The reinsured companies are basically like policyholders.

Other insurance companies also suffer in the market because of poor public perception and lack of trust in insurance. This will lead to fewer sales of insurance products and therefore poor overall performance of the insurance sector.

When one insurance company fails more restrictions are implemented to prevent further failures. These restrictions have proved to stifle sales of insurance products and the running of insurance companies.

## **(3) Employees of the insurance company**

An insurance company employs personnel working in the company who receive a monthly salary; these would suffer economic loss if the insurance company collapses.

The companies have sales people who technically sell the insurance products to consumers and receive a percentage commission out of the premiums paid by policy holders. They receive payments only as long as the policyholders are paying premiums. In this case therefore the sales people would not receive salary if the company collapses yet they work so hard in getting the senior people working for the company will not be able to shake off the tag of the fact that they worked for a failed company. They will always be associated with the collapsed company.

## **(4) The shareholders and creditors of the company**

The essence of a limited liability company is that the liability of a shareholder in the event of the company being wound up while insolvent, will be limited to the amount, if any, unpaid on the shares they hold. If the shareholder will have paid up all his shares, then even if the assets of a company under liquidation are less than the liabilities, the shareholders will not be called upon to meet the deficit. However, if any shareholders will not have paid up all the capital on the shares subscribed for, then they will be required to pay for these shares.

They will therefore become contributors under the Companies Act, to contribute to the assets of the company in amounts equal to the unpaid value of the shares they hold. But in the event of the company being wound up while solvent, upon the settlement of all liabilities out of the assets of the company, then any residue of the assets is shared among the shareholders.

Shareholders lose out on future dividends and their capital. It is interesting to consider where this capital has gone.

Creditors may ordinarily be unsecured. Insurance brokers or agencies may also be owed money by insurance companies in the ordinary course of business. Insurance companies may also borrow money either on security or unsecured.<sup>106</sup> A secured creditor may lay claim to the assets offered as security, the unsecured creditor on the other hand has no such rights. In fact, the unsecured debts are governed by the *pari passu* rule in insolvency, which means, if there are insufficient assets to meet all the claims, the unsecured creditors' claims will abate ratably among themselves. In other words, the pool of the assets of the company will be distributed to its unsecured creditors in proportion to the size of their respective claims and each of the creditors will bear a proportionate share of the shortfalls.

These unsecured creditors therefore will not be able to recover their full money.

#### **(5) The general public and the economy.**

The general public could suffer from higher taxes used to fund increased regulation, higher taxes to pay unemployment benefits, higher premiums to pay for levies on insurers to pay the shortfall in claims and higher premiums because of the reduced competition in the market place. There can also be a general cost to the economy of the country as a whole. For example the happening in Australia, where HIH, the second largest insurer collapsed in 2001 as a result many small businesses and community organizations have been unable to get cover or have had very large premium increase. Without cover, many organizations are unable to continue operating.

In summary the failure of other companies cost money, so it should be a concern of every company both to identify potential failures and so to minimize the financial impact of such failures. Actuaries are well placed to do a lot of this work. From a public interest point of view they also might have a role to play in preventing and minimizing the cost of such failures to the public.

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<sup>106</sup> See generally Ellis Ferrain, *Company Law and Corporate Finance*, Oxford University Press, 1999, at 457-487.

## **12. GENERAL STATISTICS OF THE INSURANCE INDUSTRY.**

Kenyan insurance companies generally report high loss ratios. Between 2004 and 2007, the loss ratios for the industry as a whole ranged between 56% and 60%. Insurers have traditionally relied on investment income to act as a cushion for their underwriting results<sup>107</sup>. This loss ratios are quite huge considering that insurance sector plays a major role in the economy of a country.

In 2007, according to the PricewaterhouseCoopers website, there were 43 insurance companies and 2 domestic reinsurance companies operating in Kenya. Gross insurance premium written during the same period amounted to approximately USD 586.4 million. With regard to insurance intermediaries, the insurance industry comprised 201 insurance brokers and 2665 insurance agents in 2006.<sup>108</sup> From this one can see that the insurance sector has the potential to perform well, the number of the players is quite sufficient.

Gross written premium by the industry was Sh55.19 billion in 2008, compared to Sh48.09 billion in 2007, representing a growth of 14.8 per cent.<sup>109</sup>

During the year, 21 out of 42 insurance companies made underwriting profits. The overall underwriting profit posted under general insurance was Sh0.8 billion while life insurance recorded an underwriting deficit of Sh1.2 billion.

Earnings from investment and other income reduced from Sh12.1 billion in 2007 to Sh11.7 billion in 2008. The combined industry profit before taxation increased by 25.9 per cent to Sh5 billion compared to Sh4 billion in 2007.

### **Insurance low penetration percentage**

By December, 2008, total insurance penetration was 2.7 per cent an increase of 0.10%.<sup>110</sup> The long term insurance business accounting for 0.9% while general business accounted for 1.8%.<sup>111</sup> This shows that the industry's growth is insignificant or very minimal and the penetration rate as well needs to be improved. Penetration has been a major problem in the

<sup>107</sup> <http://www.pwc.com/ke/en/industries/insurance.jhtml>

<sup>108</sup> IRA's 2006 Annual Report

<sup>109</sup> IRA's annual reports of 2007 and 2008.

<sup>110</sup> IRA's Annual report of 2008

<sup>111</sup> The Insurance Regulatory Authority (IRA) report for 2008.



insurance industry and the records show that it has been at a constant value 2.44% in 2003, 2.54% in 2004, 2.57% in 2005, 2.54% in 2006, 2.65% in 2007 and 2.63% in 2008.<sup>112</sup>

According to the Chairman, Mr. Steve Mainda's statement the IRA's strategic plan 2009-2011 is intended to increase the penetration from the current 2.7% to 5% only time will tell if this will come to pass.

### **Illustrations of the industry's downstream growth**

There have been reports of companies collapsing and therefore failing to pay policy holders their money, this has caused negative growth in the insurance industry as a whole and this is the main concern of this research paper. An example is the Standard Assurance Company Limited. The heavily indebted insurance firm was placed under statutory management over its inability to settle some Sh100 million in outstanding claims owed to policyholders and creditors.<sup>113</sup>

The closure of Standard Assurance followed closely on a similar incident involving another motor underwriter, Invesco Insurance, which closed its doors a year before and has been under statutory management until its revival last month.

Others are Access Insurance, Stallion, Lakestar Insurance and United Insurance who collapsed in similar circumstances. In total; three insurance companies are now under statutory management, with two of them facing liquidation, as efforts to revive them remain doubtful<sup>114</sup>. Interestingly, despite apparent difficulties and problems in the motor underwriting business, the industry watchdog — IRA — remains aloof and a reluctant observer as one motor insurance firm after another falls by the wayside. This is the concern of a discussion in the subsequent chapter and will be discussed widely in that chapter.

Some insurance companies are delaying payment of claims, fuelling concerns that investment income losses they suffered when share prices fell has ballooned into a cash crunch.

Insurance Regulatory Authority (IRA) confirmed that clients' complaints over delayed payment had shot up sharply in the last six months, although it did not provide the actual numbers of complaints. The Insurance Act law requires that all approved insurance claims be paid within

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<sup>112</sup> AKI insurance annual Report for 2008 pg 10.

<sup>113</sup> 'the standard' on line edition- Published on 17/03/2009 Collapse of Standard Assurance sparks fresh market jitters

<sup>114</sup> <http://www.marsgroupkenya.org/multimedia/?StoryID=285083&p=Gem>

three months, failure to which the IRA will levy a penalty of five per cent on the outstanding amounts. Inability to pay claims plus interest will result in winding up of the company.

But some insurance companies are now taking more than six months to settle claims. Insurance companies were some of the major casualties when stock prices crashed at the Nairobi Stock Exchange (NSE) in late 2007. Estimates were that the industry had put up to Sh30 billion, equivalent to 20 per cent of their total assets as at end of 2008 in equities.

Cases of delay in claims payment were first highlighted last year when Ukwala Supermarket came out publicly when an insurance company delayed settling its post- election claims for over a year.

Evidence abounds of individuals who have been following insurers to settle their claims for more than six months now. Local insurance companies are blamed for taking too much risk without the corresponding capability to pay for claims because of a small market that has too many companies, which use the destructive price undercutting methods to get clients.<sup>115</sup>

### **13. EXTERNAL AND INTERNAL REASONS FOR FAILURE**

#### **CHALLENGES FACING THE INSURANCE INDUSTRY IN KENYA**

##### **13.1 LOW DEMAND**

Effective demand for insurance product is generally low this is attributed to the fact that Kenya has experienced low growth of GDP over the years and individual sectoral performance rests on the general economic performance.

Kenya experienced GDP growth of 5.8 in 2005, 6.4 in 2006 and 7.0 in 2007 the improvement is very minimal<sup>116</sup>

It is evident that from the available statistics the growth of industry has been on a downward trend since 1997 when the industry grew by 5% and declined to -1% in 2000. The industry experienced a significant improvement in 2002 to reach growth premium amounting to Kshs

<sup>115</sup> <http://www.marsgroupkenya.org>

<sup>116</sup> Economic survey 2008.

25.9 Billion with 7.2 billion or 28% coming from life business and the rest was earned from the general insurance business.

A declining growth rate observed in the industry is a strong indication that the industry require thorough review to identify possible bottleneck but its also an indication of the general economic performance. The wide spread poverty owing to stagnated economic growth means that the general populace has little disposable income for “luxury” such as insurance.

The low demand for insurance product can also be attributed to the low rate of penetration of the insurance and poor public perception <sup>117</sup> the public has lost trust in insurance companies after experiencing collapse of insurance companies and loss of investments.

### 13.2 PUBLIC SERVICE VEHICLES( PSV)SECTOR

The PSV subsector is a preserve of a small group of underwriters. The majority of the underwriters keep away from this sector owing to heavy personal injury claim. The subsector is characterized by wide spread indiscipline among the managers of the vehicles including excessive speed which lead horrendous road accident with heavy toll on human life injuries and material damage losses.

The problem is exacerbated by a convoluted legal process which is largely corrupt and which often hands down exaggerated and discordant judgements on personal injury. The effect has been to scare away underwriters from this potentially profitable business. Public service vehicle insurance is compulsory in Kenya and has been reported to earn the highest net premium of 8.4million in the year 2008. <sup>118</sup>

The ministry of transport introduced tough safety rules to contain this undesirably situation and the trend is beginning to show marked improvement especially with regard to the frequency and severity of road accidents <sup>119</sup>

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<sup>117</sup> Insurance regulatory authority reports of 2007 and 2008.

<sup>118</sup> IRA report for the year 2008 at page26.

<sup>119</sup> The east African ,nation media group ,November 22,2004.

### 13.3 SKEWED PORTFOLIO MIX

The industry is characterized by a skewed portfolio mix with the life business contributing about 5 billion in 2003 or about 1/3 of the general insurance business. This has been the trend over the years and it is in sharp monstrence with the developed economies like Zimbabwe and South Africa where life business lead by wide margins. Life business has been the growth sector in insurance business in the developed countries and life products are increasingly moving away from pure insurance businesss to become suitable vehicles to mobilize savings at individual and national level. In south Africa for example life business accounted for 79% of the total gross premium in 2002.this means that in addition to having generally underdeveloped insurance market ,Kenya has a huge untapped potential life business.

### 13.4 SHORT TERM BUSINESS.

Inspire of being in existence for over 40 years, the Kenyan insurance industry is yet to achieve its potential. A cursory comparison of premiums as percentage of GDP shows that the Kenyan insurance industry has a long way to go before it achieves the prominence enjoyed by the industry in more developed economies like South Africa.

The Kenyan insurance subsector continues to be dominated by short term business which contributed about 72.1% of total gross direct premium written in 2008,the other classes account for only 27.9%.<sup>120</sup>The short term insurance industry is driven by 4 main lines of business which in total make up about 70% of all premiums: motor commercial, fire and engineering, motor private and personal accidents. It's worth noting that about 40% of the industry's premium is derived from motor insurance which is statutory requirement.<sup>121</sup>

Short term business refers to annual contracts in general insurance business. The term is too short to allow for meaningful investment of premium reserves for higher returns. The heavy reliance on short term business therefore prevents insurance companies from making

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<sup>120</sup> IRA report for the year 2008 at pg 25

<sup>121</sup> See Kenya insurance survey.paradigm shift ,insurance ,institute of Kenya &KPMG ,2004(pp7-8)

any significant investment. The short term business have a shorter period and therefore have most claims.

### 13. 5 INFORMATION TECHNOLOGY.

An investigation on IT application in business management in the insurance industry in Kenya revealed that the insurance subsector has yet fully adopt the use of technology in its operations especially at the top decision making level .<sup>122</sup>

In general the Kenyan industry appears not to appreciate that the advent of internet has had profound implications in the conduct of business worldwide. The consumer has become increasingly sophisticated and is aware of the available choices at the touch of the button. The insurance industry in Kenya would need to embrace IT as a matter of extreme urgency if it hopes to make progress in providing products and the level of service demanded by the modern consumer.

### 13.6 FRAUDULENT CLAIMS.

In times of economic down turn, the insurance sector worldwide suffers high claims experience as it is seen as easy target to those trying to mitigate their misfortunes as their businesses crumble. The Kenyan economy has been on rapid decline in the last two decades and it's no wonder then that the insurance industry has been faced with increased incidences of fraud, such as motor vehicle theft and loss through incidences of fire. The insurance sector has continued to lose billions of shillings from both internal and external fraud.

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<sup>122</sup> Abwawos V.IT application in business management within Kenyan companies 2002.unpublished research paper .

### 13.7 RURAL POPULATION.

The industry has done little to reach the majority of the population living in the rural areas .consequently insurance has received the preserve of the middle and upper income population mainly in the urban centers .the elitist character of the insurance industry has effectively alienated itself from the majority of the Kenyan population thus denying itself huge premium reserves available in the rural areas.<sup>123</sup>

The industry may need to take a leaf from especially the Indian insurance industry on how to develop appropriate insurance products for the population in rural areas engaged in small-scale economic activities. Even though the rural population is relatively poorer, the sheer numbers hold real prospects for premium growth especially if the industry developed suitable and relevant products appropriately priced.

### 13.8 RESISTANCE TO CHANGE.

A sampling of insurance products in Kenya's insurance market in the course of this study revealed an industry that has experienced very slight change in keeping up with the modern financial needs. Most companies have largely continued to offer the traditional classes of insurance inherited from foreign markets at independence.<sup>124</sup>This is at variance with the consumers of insurance services especially in the developed economies who have become sophisticated and increasingly demanding. The companies writing life business in Kenya have however shown a little more creativity in product design and development than those writing non-life businesses. However the industry in general is seen to shy away from the rapid change sweeping through the insurance business worldwide were especially the life products are increasingly becoming important saving vehicles. The success of insurance industry will depend on its ability to embrace change so as to serve its customers more effectively.

The industry is just introducing micro-insurance now after it has been seen to work in other parts of the world.<sup>125</sup>This means that the introduction of micro-insurance in Kenya is long overdue.

Bancassurance is another concept that Kenya's insurers need to embrace. This basically refers to the collaboration between banks and insurers to distribute insurance products to the same

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<sup>123</sup> Insurance journal ,insurance institute of Kenya,2000,pg 10.

<sup>124</sup> Mwaura C. N General Principles of Insurance Practice, Accounted International limited 2000, pg 143.

<sup>125</sup> According to 'the insurer' volume 7july 2009.

clientele.<sup>126</sup> It is the amalgamation of assurance and banking business within a financial environment.

### 13.9 RATE UNDERCUTTING.

We found out that the industry is faced with serious problem of unethical competition amongst insurers. The industry has experienced little growth in real terms over the last two decades. This means that the underwriters are faced with ever decreasing premium revenue this has precipitated a bitter price war among underwriters. The preoccupation with survival in a shrinking market has introduced undercutting and outright corrupt deals have the primary means by many insurers of preserving their book of business and attracting new clients.

The brokers and agents have joined the bandwagon and their role has been reduced to nothing more than that of merchants selling insurance business to the highest bidder on account of price in a manner very much reminiscent of road side auctioneers in an industry where over 70% of the business is placed through intermediaries one can begin to appreciate the enormity of this problem. A good proportion of intermediaries are alias to insurance business they migrated from professions especially the banking sector during the banking crisis of the 80s these entrepreneurs exhibit little concern for the professional demand of the insurance business thus exacerbating the problem further. Of similar concern is the rampant abuse of the statutorily prescribed premiums in terms of brokers, which has continued to undermined insurance cash flow and reduce their capacity to optimize returns from invisible funds derived from operations. Decreasing premiums in real terms high loss ratio from hefty court awards and increased fraudulent claims have all conspired to drive 5 underwriters out of business and left many more dangerously dangling on the edge

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<sup>126</sup> The insurer, volume 7 july 2009pg 25.

### 13.10 INVESTMENT INCOME

Most common is real estate and government securities for example: lucrative treasury bills where the returns were high. Investment income supporting the revenue account to post positive results even when the company had registered negative underwriting results. Investment income has plummeted dramatically due to low interest rates, poor and non performing assets and decreased asset values.<sup>127</sup>

No doubt the easy option for insurance business in Kenya are rapidly being squeezed out and the investors will have to increasingly take the hard choices based on professional requirement of the trade with their sight trained on the long term .insurance business is a delicate undertaking that requires a state management process and actuarial skills.

### 13.11 LOCAL ENTREPRENEURS.

Since the pronouncement of minister of finance in his budget speech in 1978 that all insurance companies must be locally incorporated most individual entrepreneurs migrated from their professions into insurance .they had no knowledge of insurance business .the aftermath of this is all evident in the industry today as the indigenous companies have continued to struggle while some of them have already collapsed.

The effect has been to strike the public confidence of the industry whose very survival depends on trust and public confidence.

The Kenya national assurance case is somewhat difficult whose collapse is blamed on the political expediency and corruption.<sup>128</sup>

These are some of the reasons that the Kenyan industry has been at a constant or decreasing rate. A look at the operations of other countries shows that the Kenyan industry needs a make up. Looking at Germany's insurance industry, there is a lot to be done in Kenya to make it more competitive with other markets.

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<sup>127</sup> Kioma K.A A study of the challenges in the regulation of insurance industry in Kenya, unpublished research paper.

<sup>128</sup> Daily nation ,March 5,1995.KIS Paradigm shift.IIK &KPMG 2004.



## **14. GERMANY'S INSURANCE INDUSTRY**

In Germany, insurance is not just something good to have, it is a mandatory requirement. The first law governing state supervision of private insurers, subsequently the insurance supervisory law of May 1901 created a central regulatory and supervisory body. In addition the insurance contract law of May 31, 1908 regulated the legal rights and duties of parties involved in insurance contracts. Both created legislative basis for the private insurance industry and increased the influence of the state on the insurance business.

General economic growth and the rapid development of industrial manufacturing led to an increased demand for insurance coverage.

Before World War I, there were 962 life insurers 48 property and casualty, 101 fire and building insurers in Germany. After World War I the destruction of German industry and confiscation of assets owned by German insurers in coalition countries combined with high inflation dealt severe blow to the insurance industry.

The currency inflation in 1924 left many companies on the brink of bankruptcy and therefore the number of life insurance companies reduced to 691. This intensified calls for state regulation. This was done by insurance company act in 1931.

Economic community in 1957 facilitated the establishment of strong and reliable structures in the German private insurance market.

### **14.1 GERMANY'S LEGAL STRUCTURE**

German insurers are organized as stock corporations, mutual insurance associations or insurance companies under public law. They are organized in section 7 and capital requirement section 22 which explains partly why stock corporations are the dominating legal structure in the private insurance sector market.<sup>129</sup>

German insurance regulation also forbids conducting life and health insurance business and property and casualty business under the roof of one legal entity. This aimed to prevent unmanageable cross subsidies between insurance lines within one insurance company or

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<sup>129</sup> [http://www.google.com/Germanys insurance industry](http://www.google.com/Germanys%20insurance%20industry).

compensatory pricing that could endanger the financial stability of the company. To offer insurance coverage in different lines, holding companies listed on the stock exchange were created whereby the separate legal entities are fully owned by the head of the group.

Germany also has the requirement that to combine the advantage of a mutual insurance association with those of a stock company and to avoid the legally and economically difficult process of outright demutualization a holding company in the form of a mutual insurance association is often created with wholly owned subsidiaries as stock corporations.

Foreign insurers are allowed to conduct business in Germany provided that their relevant subsidiaries are incorporated in Germany and are under the supervision of the federal financial supervisory authority.

The German market is dominated by insurance companies domiciled in Germany with share of foreign companies under federal supervision by premiums written comprising less than 25 of the market. These are supervised by German authorities and are thus statistically treated as German companies.

There are no general restrictions on foreign investors but special requirements are set up for owners of significant insurance stakes that is more than 10% of equity capital. Those are codified in the Insurance Supervision Act. If an investor intends to acquire a significant participation of an insurer, the supervisory body must be informed. Under certain quite restrictive circumstances the supervisory body can delay or forbid the transaction.

#### 14.2 GERMANY'S ECONOMIC STRUCTURE.

Germany mainly provides property, casualty and private health insurance.

Life insurance has the largest number of companies. They are 324 in number.

- Property and casualty 251
- Private health insurance 55
- Reinsurance 49
- Motor vehicle writes the most number of contracts 98 million in 2002
- Life 91 million,
- Property 67.

Life premiums constitute 46% of the total premium volume. German insurance is the 4<sup>th</sup> largest market in the world after United States, Japan and Great Britain.

With more than 800 billion Euros worth of assets under management in 2003, insurance companies are among the most important institutional investors in the country. The market standard for the majority of German insurers is the multichannel approach such as agents, brokers, banks, direct insurance, internet and other niche distribution channels.

Kenya on the other hand has not only distribution problems but also penetration and lack of awareness. Customers' perceptions (of insurance service) are short of their expectations, suggesting that quality gaps existed amongst the companies.<sup>130</sup>

#### 14.3 REGULATION OF THE GERMAN MARKET

The insurance industry has always been highly regulated due to the longevity of most insurance contracts and their possibly significant impact on the economic situation of the insured and the position of the insured as a conditional creditor to the insurance company in case the insured event occurs.

The main goal of state regulation for the German insurers is to protect the insured by providing high credibility that the insurance company is able to meet its contingent obligations against the insured persons and policy holders. It controls financial stability of the company by restricting its solvency and risks to a low level. A company must get official authorization before they offer insurance products in the German market.

In Germany, the market is much less diverse.

Understated assets has been a general feature of German accounting. This was changed after companies were required to disclose the market values of assets. For German insurers this made a huge difference to their declared solvency ratios. The estimate of the change to the average solvency ratio for German insurers was an increase from 75% to 160% for the year 1998. This was well above UK's solvency ratio of 116%.<sup>131</sup>

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<sup>130</sup> Diagnosis and Improvement of Service Quality in the Insurance Industries of Greece and Kenya- Lancaster University Management School, Working Paper 2004/046- Rand, Graham K at pg 17

<sup>131</sup> SIGMA no.1/2000.

Players in the German market have various cross holdings and operate under informed competition. This means that they operate under a system which can set rates to their preferred level.

The tax regime in Germany is also favourable to insurers in that it does not penalize those who wish to over reserve. Reserves are built up out of pre-tax earnings.

In summary, there are many features of the German market that may be associated with low levels of insolvencies. Namely:-

- Understated assets.
- Little competition.
- Tax regime that encourages prudent reserving.
- Products that have exposure limits.

From the study of the Germanys industry compared to Kenya certain factors are important in any insurance industry. These indicators determine whether the industry will flourish or not.

Ensuring proper enforcement of these indicators will greatly improve the industry's performance. These may be summarized as follows:-

**Important Indicators in Insurance Industry.**

- Regulatory framework
- Code of practice
- Technological advancement
- Corporate governance.
- Weak macro –economic environment
- Professionalism
- Research and development
- Judicial system
- Public awareness.

**Good or bad enforcement of these indicators determine the performance of the insurance industry.**

## **CHAPTER THREE:**

### **15. KENYAS REGULATORY FRAMEWORK AND THE NEED FOR CONSUMER PROTECTION**

This chapter will analyze the regulatory framework that we have in Kenya including the specific laws that govern insurance, the IRA and other regulatory bodies. The chapter will then set out the principles in regulation and also how far the industry has ensured regulation. It will look at the need to make amendments in our current system to ensure that the trust by consumers that existed years ago is won back. The regulatory environment should not be that one of 'zero failure' but that which reduces the impact of failure.

Consumer protection will be covered in this chapter. There is a need to protect consumers in Kenya especially with the occurrences of insurance company failures and the advent of fraudulent pyramid schemes which have caused a negative perception in any investment scheme.

Insurance companies have therefore suffered in trying to make the public have trust in them. More consumer protection laws need to be legislated upon, to protect consumers against economic loss.

Consumers also need to have sufficient knowledge on laws and also rights so that they can seek remedies in case of grievances they may have.

#### **15.1 THE ROLE OF REGULATION**

Regulation is the key to defining the level of competition in the market. It may restrict who is able to provide cover through requiring evidence of suitability ('fit and proper'), licensing and capital requirements. It may also restrict how companies compete through minimum policy requirements, restrictions on pricing and how products are sold.<sup>132</sup>

This therefore means that those who determine the regulatory environment have the power to determine the fortunes of the market and the companies within it. Less regulation leads to greater competition, with more companies entering into the sector and therefore as a result, a consequence of a larger number of failures. Those setting regulation need to balance the need

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<sup>132</sup> Insurance company failure. working paper-Roger Massey

for competition in improving the efficiency of the market with the cost of companies failing as a result of competition.<sup>133</sup>

In the UK market the four main objectives of regulation include:-

- **Market confidence:** maintaining confidence in the financial system.
- **Public awareness:** promoting public understanding of the financial system.
- **Consumer protection :**securing the appropriate degree of protection for consumers and
- **Reduction of financial crime:** reducing the extent to which its possible for a business carried on by a regulated person to be used for a purpose connected with financial crime

New entrants seek regulatory environments that offer least resistance in terms of the requirements of entry in to the market. The lower resistance may be in the form of easier and quicker authorization, lower regulatory costs, lower capital requirements and less onerous on-going requirements to meet approval. With such less resistance, insurance companies are likely to fail.

The regulatory environment can have a significant impact on insurance company failure rates, and changes in that environment can also result in exceptional changes in the level of insolvencies

In Kenya, the main regulatory tools include:-

- **Entry restrictions through licensing.**
- **Disclosure of information**
- **Product development**
- **Governance and fiduciary responsibilities**
- **Solvency and capital requirements**
- **Liquidity requirements**
- **Accountability requirements.**<sup>134</sup>

The regulatory authority mainly plays the following roles<sup>135</sup>:-

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<sup>133</sup> Kenya Financial Consumer Protection Diagnostic.FSD Kenya report,Nairobi 18 March 2010

<sup>134</sup> The role of the regulatory authority in life insurance and pension business-sammy makove

<sup>135</sup> The role of the regulatory authority in life insurance and pension business-sammy makove

- Protects the public interest by ensuring that the insurers and schemes are financially solvent and that policyholders are not exposed to loss by underwriters being not able to meet their obligations.
- Promotes an even ,fair playing ground by ensuring that members of the industry operate within acceptable principles, practices and standards.
- Fosters competence by requiring a high level of professional competence and conduct. Insurers must uphold professional ethics and encourage professionalism among their technical and field staff.
- Plays a developmental role by encouraging the industry to take an active part in the economic development of the country. Indeed regulators must participate actively in the education of and creation of awareness to the members of the public on the benefits of life assurance and pension arrangements.

## PURPOSE OF REGULATION

Governments primarily regulate the insurance with a view to protecting consumers. Insurance, which is part of the financial sector, would need more rigorous regulation than any other sector in order to maintain financial stability. Regulation of the insurance should therefore achieve the following key principles<sup>136</sup>:-

### 15.2 KEY PRINCIPLES OF REGULATION

1 .CLEAR OBJECTIVES:-The regulator should have a clear mandate set out in its enabling legislation. Regulation should ideally be only limited to correction of market failures and should not be a burden to the regulated institutions. Any developmental objectives requiring for example, research and public education, should be clearly provided in the statutes.

2. INDEPENDENCE AND ACCOUNTABILITY:-Decisions by the regulator within its subsector should not be subject to undue influence from the Minister or any other parties. The principal officer and top management should have an element of security of tenure or at least

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<sup>136</sup> Abrams Richard and Taylor Michael(2000). Issues in the unification of financial sector supervision ,IMF Working paper.

clear rules governing their removal. Similarly, their recruitment should be done transparently and competitively and their remuneration should not be significantly discordant with that of senior officials in the regulated entities.

The regulator must also be accountable and must report to the legislature through periodic reports including audited financial statements. In addition there must be a mechanism for the regulator to be held accountable by the regulated industry while avoiding regulatory capture by the industry.

**3. ADEQUATE RESOURCES:-**The regulator must have adequate funding, preferably through industry levy so as to enable the industry have a role in checking the regulators spending. Adequate resources are a prerequisite to enable the regulator recruit, train and retain cadre of experienced professional staff. In addition, the regulator requires resources for timely and effective data collection and processing.

**4. EFFECTIVE ENFORCEMENT POWERS:-**the regulator must be able to take enforcement measures against all the players that it is required to regulate. These powers should include ,inter alia,powers to:-

- Require information to be provided.
- Assess probity of owners and managers of regulated entities.
- Intervene in operations of regulated entities including removal of managers.
- Revoke licenses or registration.
- Sanction entities or individuals.

Enforcement powers are best only set out broadly in legislation with regulations having powers to issue guidelines and directives. This allows flexibility and reduces the need for frequent cumbersome and time consuming legislative amendments. Staff of regulators should also be protected from legal actions arising from their enforcement actions.

**5. COMPREHENSIVENESS OF REGULATION:** - Regulation should be clearly comprehensive and not leave any unregulated areas, so called regulatory gaps. Activities should not be left unregulated due to lack of clarity as to which regulator is responsible. Also



this requires regulators to have some flexibility to respond to innovations which may result in new products which were not envisaged at the time of establishment of the regulatory structure.

**6. COST EFFICIENT REGULATION:-** The direct cost of regulation in terms of levies and fees should clearly be reasonable and not an undue burden on the regulated institutions . This is clearly more important where, as is usually the case, these costs are untimely passed on to the consumers. It is important for the amounts raised and how they are utilized to be transparently disclosed and accounted for to the industry and the legislature.

In addition, there are indirect costs of compliance which must also be controlled to avoid undue burden on the industry. Indirect costs include costs of appointing service providers and experts, costs of having “compliance officers” within the organizations as well as costs of installing systems to provide required reports and data to the regulator.

**7. MARKET DEVELOPMENT AND INDUSTRY STRUCTURE:-**Regulatory structure should mirror the sectors being regulated. Different countries have different industry structures and each country should seek to have a regulatory structure tailored to this other than attempting a one- size-fits-all structure or borrowing those in other countries. Presence of financial conglomerates, universal banking, bancassurance and other unified products leads the industry to a more unified regulatory framework than in the case of disaggregated sectors. When one financial institution is in several sectors facing different risks, there is a need for some mechanism to assess the overall risk facing the institution.

### **15.3 REGULATION BY THE INSURANCE ACT**

The insurance act of Kenya provides for regulation provisions. These include:-

- Authorization of all persons transacting insurance business in Kenya.
- Minimum capital requirements for insurance companies and brokers as well as local participation. Insurance companies must be owned 1/3 by Kenyan citizens while brokers must be owned by 60% by locals.
- Local incorporation: branch operations or subsidiaries of foreign companies are outlawed.
- Re-insurance arrangements must be approved by the commissioner.
- Margins of solvency are prescribed and the requirements of admissibility of assets.

- Investments of assets by insurers are controlled under the Act.
- Separation of assets attributable to life business from those of general business.
- Balance sheets and other financial statements are in a prescribed format.
- Audited accounts must be submitted by 1<sup>st</sup> April of the following year and there are strict penalties for delays or for falsifying statements.
- On site inspections of all members of the insurance industry.
- Management expenses including acquisition costs are monitored and the law provides maximum ceilings.
- Rates, policy terms and conditions of insurance contracts are approved by the commissioner.
- Approval of boards of directors, CEO's and managers of insurance companies.
- The Act provides for the intervention in the management and eventual winding up of insurance companies.
- The Act makes provision for the process of transfers, amalgamations and mergers of insurance companies.
- The Act stipulates minimum basis for actuarial valuations of all statutory funds and schemes, which must be conducted annually.

#### **15.4 IMPROVING INSURANCE REGULATION AND SUPERVISION**

The primary foundation of an insurance market is an adequate insurance law. The law must provide a specific definition of insurance and set forth the fundamental insurance market parameters, such as a supervisory authority, licensing criteria, and prohibited practices.<sup>137</sup>

Following the development of an appropriate legal framework, an insurance market requires a sound regulatory framework, including efficient and effective supervision. Lacking these preconditions, an insurance industry can be curtailed by arbitrary, opaque, ineffective, and unnecessarily costly regulatory interventions, which can diminish consumer confidence and dissuade potential consumers from buying insurance. In addition, lack of effective supervision

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<sup>137</sup> USAID Report ,Assessment On How Strengthening The Insurance Industry In Developing Countries Contributes To Economic Growth,February 15 2006

can discourage foreign and domestic investors from supplying capital, retard insurance market efficiency, and dampen industry development.

Essential aspects of supervision are protecting policyholders from the possible insolvency of their insurers and ensuring that insurers treat policyholders fairly. Moreover, because of the potential for money laundering, effective supervision is also a concern to the integrity of the global financial system.

To meet the above demands, a supervisory agency requires adequate resources, training, guidance and co-operation and partnership from market players.<sup>138</sup>

The emergence of micro-insurance, the regulatory environment needs to be amended to be able to regulate the business.<sup>139</sup>

The traditional insurance industry in Kenya has regulatory laws, rules and regulations designed to ensure the stability of the insurance system and to protect the interests of policyholders.

However, these laws have been developed over time with traditional insurance in mind.<sup>140</sup> There is therefore a need to revise the regulatory laws to accommodate the upcoming products.

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<sup>138</sup> The role of the regulatory authority in life insurance and pension business-sammy makove

<sup>139</sup> The Kenya insurer, vol 7, july 2009

<sup>140</sup> The Kenya insurer, vol 7, july 2009 at pg5

## **16. CONSUMER PROTECTION**

Since insurance depends on consumer confidence, enlightened insurers safeguard their reputation. They police the marketplace through self-regulatory organizations. Through policy statements and codes, they shape the expectations of consumers regarding the benefits of insurance, responsible sales practices, the products offered, fair treatment in claims, ways to control losses, and other aspects of insurance transactions. In some markets, insurers also offer a grievance procedure to resolve consumer complaints. Creating a positive image can enhance consumer confidence and expand the market.<sup>141</sup>

Following the failure of an insurance company, both market confidence falls and consumers suffer.<sup>142</sup> There is therefore a need to protect consumers and to keep market confidence alive.

Consumer protection ensures that Consumers receive quality services that are characterized by transparency, fair treatment and effective recourse mechanism.

The three Pillars of consumer protection include:-

1. Regulation and supervision
2. Industry standards and codes of conduct
3. Consumer awareness<sup>143</sup>

### **16.1 MEASURES TO PROTECT POLICY HOLDERS' INTERESTS**

#### **Open competition**

A large number of international insurers from different countries should be introduced to compete with each other to offer a large variety of Products. Policy holders can compare and choose the most suitable product for themselves.

#### **Qualification of agents**

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<sup>141</sup> USAID Report .Assessment On How Strengthening The Insurance Industry In Developing Countries Contributes To Economic Growth,February 15 2006pg22

<sup>142</sup> Insurance company failure, working paper-Roger Massey

<sup>143</sup> Kenya Financial Consumer Protection Diagnostic,FSD Kenya report,Nairobi 18 March 2010

IRA should establish the Insurance Agents Registration Board as a central body to handle the registration of agents to ensure that they comply with certain minimum requirements such as fitness and properness. IARB is also responsible to handle complaints about agents' malpractice pursuant to the Code of Practice for the Administration of Insurance Agents.

A quality assurance scheme consisting of a qualifying examination and a continuing professional development programme should be introduced to establish a common professional standard for all insurance agents.

#### Procedure to guard against mis-selling by agents

According to the IRA reports, most complaints emanate from workers whose complaints relate to unauthorized deductions by their employers, which are remitted to insurers for policies they have not signed for. This comes up as a result of mis-selling by insurance agents.<sup>144</sup> Agents selling insurance should explain to every prospective policy holder the likely policy benefits receivable from a policy in accordance with an illustration standard issued by the IRA. Where replacement of policy is involved, the agent should explain to the policy holder any potential disadvantage of replacement and must obtain his signed acknowledgement. After signing up for purchase, policy holders have a right to cancel the policy and obtain a full refund of premium if they change their mind within a cooling-off period of 21 days. The crucial building block for a robust insurance market is a reliable cadre of insurance professionals, including actuaries, underwriters, agents, claims personnel, policy administration and customer service personnel, managers, and supervisors. Formal training programs are by far the most efficient means to develop knowledge and skills in staff. However, since relatively few countries have formal professional training programs, on-the-job training dominates. Not only is on-the-job training generally deficient in ensuring accuracy, thoroughness, currency of practice, and uniformity of subject matter; in a new company, there may be no one qualified to provide it. Centralized institutes located in the capital city or at a university often reach only a limited number of employees and suffer from lack of curriculum materials in the local language and suited to the local market.<sup>145</sup>

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<sup>144</sup> IRA Report 2008 at pg 17.

<sup>145</sup> USAID Report ,Assessment On How Strengthening The Insurance Industry In Developing Countries Contributes To Economic Growth,February 15 2006

### Claims complaints Board

IRA should establish an Insurance Claims Complaints Board which will be an independent body to provide a speedy and inexpensive avenue for resolving claims. The decision of the Board would be binding on insurers but not policy holders. This will ensure that policyholders' interests are protected more.

### Code of Conduct for Insurer

A Code of Conduct for Insurers which requires its member insurers to establish and follow good practice in relation to different aspects of their operations should be put in place. This will mark a milestone development in the self-regulatory system. The Kenyan code of conduct was recently put in place and its suggested that it is working since some disciplinary cases have been dealt with.<sup>146</sup>

## **16.2 CONSUMER PROTECTION COVERED BY THE INSURANCE ACT**

- Regulation: Insurance Act offers extensive Consumer Protection provisions; the Commissioner has wide powers to enforce Consumer Protection and decide on small cases of consumer complaints. In the year 2007 and 2008 approximately 80% of complaints were addressed by the IRA<sup>147</sup> approximately 2500 complaints were received in the year 2008 according to the IRA report. However more effective enforcement is needed.
  - (a) Intermediaries need regulations, minimum standards.
  - (b) Consumers have poor image of industry based on slow claims processing, agents malpractices, insurer insolvencies. This therefore hinders penetration.
  - (c) Transparency: contracts, term and pricing are unclear (Small Print) .this has been the major complaint of most policyholders<sup>148</sup>

Recourse: consumers can complain to IRA.

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<sup>146</sup> According to a questionnaires filled regarding the insurance code of conduct in Kenya.

<sup>147</sup> IRA reports of 2007(pg 5) and 2008(pg17)

<sup>148</sup> According the interviews conducted between January 2010-May 2010 at Nairobi.

Section 179 of the Insurance Act was amended in 2008 to protect policyholders by providing compensation for the policyholders of any insurer wound up where the court is satisfied that they have sufficient grounds to justify the winding up petition.

Section 203 of the insurance Act requires insurance companies to settle claims within 90 days after liability has been determined by court, failure to which the IRA will levy a penalty of 5% on the outstanding amounts. Inability to pay claims plus interest will result in winding up of the company. This section however raises questions, in the contract, it is clearly agreed that the insurer will pay the insured when the risk attaches then why is it that the insured has to claim in the first place? And why do these cases go to the extent of liability being determined in court?

Section 204 of the insurance Act gives the Attorney General powers to appoint public prosecutors to handle any matter of a criminal nature arising under the act.

### **16.3 SHORTCOMINGS OF KENYAS INSURANCE INDUSTRY.**

#### **THE INSURANCE ACT.**

According to the New Partnership for Africa's Development (NEPAD) 2006 report, which mentions the results of a joint International Monetary Fund/World Bank 2003 Financial Sector Assessment Program (FSAP) for Kenya, the Insurance Act had serious shortcomings and needed to be revised in line with the Insurance Core Principles promulgated by the International Association of Insurance Supervisors. It was further recommended that Kenya enhance the operational independence of the Office of the Commissioner of Insurance by separating it from the Ministry of Finance.<sup>149</sup> The NEPAD report indicated that the Kenyan authorities were in the process of implementing most of the FSAP recommendations, but with some delays. The Insurance Act was amended in November 2006 to establish the Insurance Regulatory Authority (IRA) as the new supervisor and regulator for the insurance sector. The Insurance (Amendment) Act entered into force on May 1, 2007. However, a number of challenges remain in the Kenyan insurance industry, points out the IRA's Corporate Plan for the period 2008 to 2011, including poor corporate governance, outdated provisions of the

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<sup>149</sup> New Partnership for Africa's Development (NEPAD) 2006 report

Insurance Act, lack of well-documented operational manuals, and inadequate resources of the regulator

## **17. IN SURANCE CORE PRINCIPLES**

### **1 Conditions for effective insurance supervision**

There is insufficient publicly available information as to Kenya's compliance with this principle. The only regulatory body is the IRA. Whether the conditions for supervision are conducive or not is equivocal. We have however had suggestions that IRA should be independent of government interference for it to work effectively.

### **2 Supervisory objectives**

As reported in the IRA's 2008-2011 Corporate Plan, the Insurance (Amendment) Act, which entered into force in 2007, stipulates the objectives and functions of the IRA. These supervisory objectives include supervising and regulating the (re)insurance business, as well as formulating and enforcing standards for the conduct of (re)insurance activities; licensing all persons involved in or connected with insurance business; protecting the interests of policyholders and insurance beneficiaries; and promoting the development of the insurance sector.<sup>150</sup> However, the report does not directly address Kenya's compliance with this principle.

### **3 Supervisory authority**

Until 2006, the Office of the Commissioner of Insurance, a department in the MoF, was the competent authority for regulating and developing the insurance industry. It was responsible for administering the Insurance Act of 1986, advising the government on policy matters regarding insurance, and protecting the interests of policyholders. The World Bank's 2004 Project Appraisal Document reported that the Office of the Commissioner of Insurance was not operationally independent, and did not have adequate resources to carry out effective insurance supervision. In order to enhance the supervisory capacity of the insurance regulator and give it more autonomy, the government of Kenya separated the Office of the Commissioner of Insurance from the MoF. The Insurance Act was amended in November 2006 to establish the

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<sup>150</sup> IRA's 2008-2011 Corporate Plan.



Insurance IRA as the new supervisor and regulator for the insurance sector. The Insurance (Amendment) Act entered into force on May 1, 2007. As part of its strategy to strengthen the regulatory authority, the IRA plans to develop its human resource capacity, as reported in the IRA's 2008-2011 Corporate Plan. Despite the information provided above, the available assessments do not directly address Kenya's compliance with this principle.

#### 4 Supervisory process

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### 5 Supervisory cooperation and information sharing

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### 6 Licensing

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### 7 Suitability of persons

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### 8 Changes in control and portfolio transfers

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### 9 Corporate governance

In light of poor corporate governance in the insurance industry, the IRA, as reported in its 2008-2011 Corporate Plan, is "determined to put in place and maintain good corporate governance standards at all levels of its operations" (p. 14). However, the report does not directly address Kenya's compliance with this principle.

#### 10 Internal controls

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### 11 Market analysis

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### **12 Reporting to supervisors and off-site monitoring**

An assessment of the accounting and auditing environment in Kenya was conducted by the World Bank in 2001. The World Bank noted that Kenya had adopted International Accounting Standards, later renamed International Financial Reporting Standards (IFRSs) and International Standards on Auditing in 1998, thereby "closing the gap" between national and international standards. In 2006, the UNCTAD issued a report, which stresses that insurance companies prepare accounts in accordance with IFRSs. In practice, however, the level of non-compliance is quite high. Nevertheless, the available assessments do not directly address Kenya's compliance with this principle.

#### **13 On-site inspection**

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### **14 Preventive and corrective measures**

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### **15 Enforcement or sanctions**

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### **16 Winding-up & exit from the market**

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### **17 Group-wide supervision**

There is insufficient publicly available information as to Kenya's compliance with this principle.

#### **18 Risk assessment and management**

As part of its strategy to enhance the regulatory and supervisory framework, the IRA plans to adopt risk-based supervision and establish prudential guidelines, as reported in the IRA's 2008-2011 Corporate Plan. However, the report does not directly address Kenya's compliance with this principle.

### 19 Insurance activity

According to the IRA's 2006 Annual Report, there are two domestic reinsurance companies operating in Kenya. Furthermore, international reinsurance companies are present in the Kenyan market through reinsurance brokers or liaison offices. The Annual Report points out that reinsurance companies are generally treated as insurance companies under the Insurance Act. However, the report does not directly address Kenya's compliance with this principle.

### 20 Liabilities

As part of its strategy to enhance the regulatory and supervisory framework, the IRA plans to establish prudential guidelines, as reported in the IRA's 2008-2011 Corporate Plan. However, the report does not directly address Kenya's compliance with this principle.

### 21 Investments

As part of its strategy to enhance the regulatory and supervisory framework, the IRA plans to establish prudential guidelines, as reported in the IRA's 2008-2011 Corporate Plan. However, the report does not directly address Kenya's compliance with this principle

### 22 Derivatives and similar commitments

As part of its strategy to enhance the regulatory and supervisory framework, the IRA plans to establish prudential guidelines, as reported in the IRA's 2008-2011 Corporate Plan. However, the report does not directly address Kenya's compliance with this principle.

### 23 Capital adequacy and solvency

As at end of December 2006, according to the IRA's 2006 Annual Report, insurance companies in Kenya were required to maintain a solvency margin of about USD 12,476, or 5 percent of assets in excess of liabilities. As a measure of the solvency margin ratio, per the same report, the industry was generally solvent. However, the report does not directly address Kenya's compliance with this principle.

### 24 Intermediaries

There is insufficient publicly available information as to Kenya's compliance with this principle.

### 25 Consumer protection

There is insufficient publicly available information as to Kenya's compliance with this principle.

### 26 Information, disclosure & transparency towards the market

There is insufficient publicly available information as to Kenya's compliance with this principle.

### 27 Fraud

There is insufficient publicly available information as to Kenya's compliance with this principle.

### 28 Anti-money laundering/ Combating the Financing of Terrorism

According to the U.S. Department of State's 2009 International Narcotics Control Strategy Report, Kenya does not have an effective anti-money laundering regime and has not yet criminalized terrorist financing. The 2007 World Bank Country Assistance Strategy report on Kenya notes that the country has taken steps towards implementing legislation to combat money laundering and financing of terrorism.. The Financial Action Task Force (FATF), in its 2007-2008 Annual Report, names Kenya as one of the jurisdictions that have undertaken to implement the FATF's 40+9 recommendations. Nevertheless, the available reports do not directly address Kenya's compliance with this principle.

## **18. CHAPTER FOUR:**

### **CONCLUSIONS AND RECCOMENDATIONS.**

This is the final chapter that will propose recommendations for the Kenyan insurance system and will also be the conclusion to the discussion. It will set out areas that need more research and also the areas that raised difficulty to research on.

The annexure will contain questionnaires used during the research project.

### **18.1 PROPOSALS FOR REFORM**

#### **THE POLICYHOLDERS COMPENSATION FUND.**

The amendment of section 179 of the Insurance Act by the Finance Act of 2005 appropriately provided for the establishment of the policy-holders compensation fund in the Act itself and not in the subsidiary legislation. The creation of the board of trustees to manage and administer the fund is also a step in the right direction. The role of the IRA in the board of the fund should however be appropriately circumscribed. The fund should consist of monies paid into the fund from insurers' contributions. The requirement of contribution from policyholders is unfair as it presupposes that policyholders are responsible for the risk their premiums are exposed to by unsound insurers. The contribution from insurers should instead be pegged to the risk the insurers pose to the fund. Other sources of the money to be paid into the fund include any interest and profits from the fund investments: money borrowed by the fund, money received as grants or donations and any proceeds from the sale of property of insolvent insurers whose policy holders will have been compensated by the fund. The manner of managing the fund and of calculating the protected premiums could then be left to the regulations. Once properly established, the fund should then be given the power to subrogate to the rights of the policyholders it compensates, in the insurance company's property. The Insurance Act could also be amended by adding a provision which would give the policyholders compensation Fund board the right to rank in priority over unsecured creditors.

### THIRD PARTY VICTIMS OF POLICY HOLDERS

Third party insurance schemes are compulsory in nature. This is in recognition of the risk certain persons are perceived to pose to the public. It therefore removes the discretion of whether to take out the policy or not from the potentially risky persons and makes it compulsory. In doing so, the law may be intending to ensure that victims of such third party committed against them. The danger to be avoided is then presumed to be that when the risk compensation claims, the victims will be paid by the insurer, as if he were privy to the contract, but on proof that the insured person caused injury. The insolvency of the insurer adds another risk to the victims. The policy holder's compensation fund ought to provide for the payment of such victims. The current situation is very prejudicial to policyholders and to their victims because where the insurer becomes insolvent, the victims have to pursue the policyholders who may themselves be insolvent.

Although the Insurance Act requires preparation and audit of accounts, it does not specify the basis of preparing these accounts.<sup>151</sup>

### 19. RECOMMENDATIONS

The following are a summary of the suggested recommendations for the Kenyan industry:-

- The economy –government adopt policies
- Overhauling insurance act
- Code of practice for self regulation.-when adjudicating claims the IRA should have regard to the codes of insurance practice and to general principles of good insurance, investment or market practice. If they are inconsistent with rules of law and are more favourable to the insured these principles are to prevail.
- Dispute resolution mechanism
- Public education
- Research and development.
- Information technology.

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<sup>151</sup> UNCTAD, Review of practical implementation issues of international financial reporting standards. case study in Kenya, Geneva, 2006

## IMPROVING INSURANCE REGULATION AND SUPERVISION

an adequate insurance law will ensure proper regulation. The law must provide a specific definition of insurance and set forth the fundamental insurance market parameter as stated above, such as a supervisory authority, licensing criteria, and prohibited practices. Following the development of an appropriate legal framework, an insurance market requires a sound regulatory framework, including efficient and effective supervision. Lacking these preconditions, an insurance industry can be curtailed by arbitrary, opaque, ineffective, and unnecessarily costly regulatory interventions, which can diminish consumer confidence and dissuade potential consumers from buying insurance. In addition, lack of effective supervision can discourage foreign and domestic investors from supplying capital, retard insurance market efficiency, and dampen industry development.

Essential aspects of supervision are protecting policyholders from the possible insolvency of their insurers and ensuring that insurers treat policyholders fairly. Moreover, because of the potential for money laundering, effective supervision is also a concern to the integrity of the global financial system.

To meet the above demands, a supervisory agency requires adequate resources, training, and guidance. The primary source for training and guidance is the International Association of Insurance Supervisors (IAIS). Since 1994, IAIS has worked to establish sound insurance markets and contribute to financial stability around the world. With insurance supervisor members from 118 countries, the IAIS issues global insurance **principles, standards, and guidance papers**; provides training and support on issues related to insurance supervision; and organizes meetings and seminars for its members. The Financial Stability Forum has recognized the IAIS as the relevant standard-setting body for insurance supervision and included the IAIS' core principles of insurance supervision among the 12 key standards for financial stability. These core principles serve as the benchmark for the evaluation of insurance supervision in the IMF/World Bank's Financial Sector Assessment Program (FSAP).

Compliance with the IAIS core principles speeds developing countries' integration into the global economy. Establishing an effective supervisory body also drastically reduces the potential for fraud and financial crimes and signals foreign investors that the country intends to

meet its responsibilities in the global financial system. To benefit fully, however, countries need various types of help in understanding and implementing the core principles. Countries at earlier stages of development tend to require more assistance with fundamental reserving and financial analysis practices, while those at later stages may need help with risk-based capital and asset-liability risk modeling. At all levels, however, the principles relating to supervisory independence, corporate governance, internal controls, and investment regulation present the greatest challenges. Technical assistance that transfers the expertise and lessons learnt from more mature to emerging insurance markets has been an essential component of insurance market interventions for decades.

Since the mid-1990s, the IAIS, the International Insurance Foundation, the OECD, the Financial Stability Institute, and other organizations have organized regional seminars for insurance supervisors. These seminars are an elementary step towards training and guidance. The IAIS core curriculum modules being developed with substantial assistance from the World Bank will be another good source of training materials, once they are finished and taken up by trainers. These participatory modules can serve as the foundation for other insurance seminars, in house training, or in distance learning.

An unmet and pressing need for many developing countries is technical assistance to complete the IAIS self-assessment and prepare for the IMF/World Bank Financial Sector Assessment Program (FSAP). Not only is the process new and unfamiliar, the terminology can also be confusing in different contexts. International experts with a wider perspective can facilitate a country's preparation for the FSAP. Following the FSAP, these same emerging markets require technical assistance in the interpretation of the results and implementation of the recommendations.

#### COLLECTING AND SHARING INSURANCE DATA

The insurance industry relies on information to function. While much of an insurer's added value comes from its superior ability to analyze and price risk, that ability requires having sufficient data to calculate losses and expenses per unit of exposure.<sup>152</sup> Lacking adequate data,

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<sup>152</sup> 21 Up-to-date information about people and properties insured is critical to the insurance business, not only to ensure its efficiency and cost effectiveness but also to help encourage better risk identification and loss mitigation. Useful information includes risk profiles of individuals; risk/hazard profiles of properties, machinery, operations



insurance companies tend to manage their balance sheets (amounts of reserves and investment selection) inefficiently, causing inefficiency in the use of capital and raising the cost of insurance.<sup>153</sup> Without sufficient data to estimate losses more precisely, insurers either set prices too low and eventually become insolvent or set prices too high and attract few customers. Neither scenario is good for market development. A robust market needs a sound system to collect, organize, and make available detailed data on losses and exposures. The more comprehensive, the better, as an industry-wide system of data collection can help to mitigate fraud, reducing the cost of insurance for all.

Creating a data-sharing mechanism that protects confidentiality and preserves market neutrality is a complex challenge. Large insurers may perceive a competitive advantage from their larger database and may therefore resist pooling loss statistics on an industry-wide basis. Smaller insurers may balk at sharing costs. Consumers may fear anti-competitive motives in concerted industry action. And the possibilities for improved risk classification systems and better understanding of the causes of loss often go unrecognized.

There are, however, turnkey solutions to these problems. The U.S. insurance market relies heavily on services of statistical organizations, the largest of which is the Insurance Services Office (ISO). ISO has experience in advising emerging markets on procedures for data sharing. ISO also has a successful three-way partnership with government and insurers for the collection, aggregation, and analysis of data for risk assessment. The major obstacle to apply this model in developing countries is cost. If a donor provided initial support, however, an industry-wide data collection agency eventually could become self-supporting as the insurance market grows. Another organization that could potentially provide beneficial workshops on how to approach and enhance data collection is the Insurance Data Management Association.

### **BUILDING ACTUARIAL RESOURCES**

Actuaries — specialized statisticians who compute insurance risks, premiums, reserves, and capital requirements — are as important to insurance markets as doctors are to medicine. Many

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and locations; demographic trends; economic and financial trends; geophysical trends; and documentation of the details regarding losses.

<sup>153</sup> Gathering and managing detailed statistical data differs from recording and compiling the aggregate data needed for financial reporting. Although both are essential to sound insurance markets, statistical reporting and financial reporting are different functions requiring different tools. In emerging markets, they are often confused

emerging insurance markets have minimal input from actuaries, and they have reduced efficiency, effectiveness and product flexibility to show for it. Often they make do with occasional visits by foreign actuaries or take suggestions from reinsurance company actuaries. Without the technical skill to evaluate risks and adapt products to local conditions, markets cannot innovate. Many emerging insurance markets, moreover, do not have actuaries within the supervisory agency, which weakens the supervisor's ability to monitor reserves, pricing adequacy, and solvency. Some emerging markets have no actuaries at all, which causes inappropriate reserving and non-enforced solvency requirements, further reducing market efficiency.

The actuarial society of Kenya (TASK) brings together qualified and trainee actuaries in professional, educational and research organizations with an aim of promoting the actuarial profession in Kenya.<sup>154</sup> They are concerned with improving actuarial work in computing insurance risks, premiums, reserves, and capital requirements. This therefore has an impact of improving the entire industry.

Today actuaries are involved in a whole range of activities including pricing product development, reserving, capital modeling and strategy.

Actuaries hold senior management positions and overall, they play an important part in how the industry operates.<sup>155</sup>

Training actuaries involves formal education in statistics, finance, economics, and insurance company operations, followed by an apprenticeship that introduces the realities of a particular marketplace (including regulations, product characteristics, data quality, and environmental risks), and then, by training in statistical software and how to apply to insurance company operations.<sup>156</sup>

The most cost-effective approach to improving the actuarial capacity combines local university resources with foreign or local-trained actuaries and involves tailoring one of the many existing actuarial training curricula to a local market, to establish a local training curriculum and, theoretical subjects of actuarial education. Local universities can teach the introductory

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<sup>154</sup> TASK-The Actuarial Profession in Kenya-Sundeep K.Raichura,June 2007.pg1.

<sup>155</sup> The Insurer,volume 7No.1 july 2009.pg20.

<sup>156</sup> As much of what actuaries calculate is carried out with software programs, familiarity with the variety and application of such software is also important to the actuarial education

actuarial courses in statistics, finance, and economics. In addition, some emerging markets have a few practicing resident actuaries and large international insurers with substantial actuarial resources. The International Actuarial Association has already established a model actuarial training curriculum for emerging markets, and other actuarial associations have also made efforts to provide model curricula. Some professional associations utilize online training programs, which can help trainers ensure quality standards, while allowing materials to be adapted to the local environment.

The standards and procedures by which professionals earn actuarial designations and the standards and guidelines actuaries are expected to follow are crucial. National actuarial associations can help establish and promulgate such standards. The International Actuarial Association and its leading member organizations are good sources for such actuarial standards of professional practice. In Kenya we have The Actuarial Society of Kenya (TASK).

#### SUPPORTING PROFESSIONAL INSURANCE EDUCATION

The crucial building block for a robust insurance market is a reliable cadre of insurance professionals, including actuaries, underwriters, agents, claims personnel, policy administration and customer service personnel, managers, and supervisors. Formal training programs are by far the most efficient means to develop knowledge and skills in staff. However, since relatively few countries have formal professional training programs, on-the-job training dominates. Not only is on-the-job training generally deficient in ensuring accuracy, thoroughness, currency of practice, and uniformity of subject matter; in a new company, there may be no one qualified to provide it. The selling agents therefore sell a product that they do not understand. Centralized institutes located in the capital city or at a university often reach only a limited number of employees and suffer from lack of curriculum materials. Employees in rural Kenya can therefore barely sell insurance products.

Technical assistance can help establish insurance educational bodies in countries where they do not exist and strengthen them where they do. Appropriate technical assistance includes both consultations regarding administrative issues and educational needs analysis for the specific insurance market, as well as consultation on the applicability of substantial educational materials developed for other mature markets.

Lack of professional education has led insurance companies to employ persons who are not competent to sell insurance products and this has led to misadvising of consumers and giving wrong information on product offers.<sup>157</sup>

#### EDUCATING MARKETS AND CONSUMERS ON STANDARDS

Since insurance depends on consumer confidence, enlightened insurers safeguard their reputation. Insurers need to ensure that their consumers are well educated about the standards and their compliance to the standards. This will boost market confidence and increase penetration. Insurers police the marketplace through self-regulatory organizations. Through policy statements and codes, they shape the expectations of consumers regarding the benefits of insurance, responsible sales practices, the products offered, fair treatment in claims, ways to control losses, and other aspects of insurance transactions. In some markets, insurers also offer a grievance procedure to resolve consumer complaints.<sup>158</sup> Creating a positive image can enhance consumer confidence and expand the market.

Technical assistance can help build consumer confidence by creating mechanisms that encourage transparency and enable the industry to devise marketplace standards on consumer education. Appropriate technical assistance includes facilitating exchanges of information on marketplace standards and codes, establishing a self-regulatory industry organization, supporting peer exchanges with self-regulatory agencies or best practices organizations in the U.S. or other developed markets, and providing models of consumer education web sites. To increase consumer awareness of how insurance works and can benefit them, consumer education campaigns should be undertaken. IRA is set to undertake awareness and educational program to increase awareness in Kenya.<sup>159</sup>

#### ENCOURAGING ETHICAL MARKET DISCIPLINE

The market can play a crucial role in disciplining bad performers, but only if there is adequate information and proper incentives. Countries without developed capital markets and insurance company rating agencies exhibit less market discipline, particularly if most insurers are closely held. Rating agencies enhance transparency and strengthen market discipline. Potential investors, as well as agents and brokers of insurance products, use ratings of insurance

<sup>157</sup> Questionnaires collected during the research clearly established this.

<sup>158</sup> IRA reports of 2007 and 2008, shows they resolve 80% of complaints by consumers.

<sup>159</sup> IRA Reports of 2007 and 2008.

companies. These ratings can influence the amount of business placed with an insurer and the amount of capital an insurer can raise. Technical assistance that supports and promotes the development and use of insurance company ratings will strengthen insurance markets.

**PROMOTING INSTITUTIONAL DEVELOPMENT AND MARKETING**

Like other financial institutions, insurance companies can use a variety of technical assistance and training to strengthen their management and governance, from the development of actuarial databases and information management systems to new product development.

Because insurance, in many cases, will not be bought unless substantial efforts are made to educate consumers about its benefits, it is a product whose success depends entirely on how well it is advertised and marketed. Marketing technical assistance can help firms to serve new markets, but should be provided to the industry in general to avoid giving an unfair advantage to just one firm.

### CONNECTING REGULATORS WITH THE PRIVATE SECTOR

An effective insurance supervisor can transfer a substantial part of the monitoring responsibility to the private sector through codes of corporate governance, standards for actuarial and accounting professions, and the expectations of investors, reinsurers and consumers. To achieve this, the supervisor needs to foster an environment in which all parties play an active role in improving the efficiency of the market. In developing countries, it is common for insurers to perceive supervision as an unwelcome burden, and the supervisor as an opaque entity, creating an adversarial relationship between the private and public sectors that can diminish supervisory effectiveness.

A modest, but effective technical assistance intervention in such an environment could orchestrate peer-to-peer exchanges, exposing regulators and industry leaders to environments where a healthy interaction exists between supervisor and industry.

### FACILITATING NEW INSURANCE MARKETS

Private markets can be expected to respond to any demand for insurance that is economically feasible. There are situations, however, in which mutually advantageous risk transfers do not occur in the absence of relevant information and expertise. In these situations, technical assistance can foster new markets by gathering the information and demonstrating its application.

One example is the market for agricultural insurance. Substantial obstacles facing insurers in the form of increased moral hazard,<sup>160</sup> inadequate loss data, and monitoring complexities, have made most types of agricultural insurance unsustainable without external subsidization. Nevertheless, some forms of innovative loss coverage, such as coverage based upon weather derivatives or crop yield indices, can be introduced through technical assistance.

Another form of technical assistance for new market development involves insurance products for lower income and rural populations (micro-insurance). There are many examples in the history of developed markets of how to market to these populations, but these lessons may have not yet reached these markets. Nontraditional insurance distribution agents are an

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<sup>160</sup> Moral hazard is "the tendency whereby people expend less effort protecting those goods which are insured against theft or damage." Frank (1991, p.193).

important method to make such insurance cost effective (such as through bank branches {bancassurance} or cooperatives).

Annuities provide another example. Annuity markets cannot thrive without an adequate regulatory structure to define the solvency requirements for companies selling these products, the marketing practices, and the guarantees provided to policyholders. Many economies have privatized their pensions systems over the last few decades, causing the level of accumulated pension funds to increase dramatically. This increase is creating a parallel increase in demand for annuities. Other socio-demographic changes interrelated with cultural changes can also increase the demand for retirement products. Unfortunately, annuities are not often understood by regulatory staff, which can hinder market development. Technical assistance directed toward explaining the risks and characteristics of these products to regulatory staff and assistance in establishing appropriate regulations and supervisory monitoring would be a good starting point for markets where annuities have not been successfully launched.

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**Insurance (Motor Vehicle Third Party Risks) Act.**

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**ANNEXURE:**

**(1) LETTER OF INTRODUCTION.**

**WINNIE.S.EGUCHI  
UNIVERSITY OF NAIROBI,  
FACULTY OF LAW,  
P.O.BOX 30197,  
NAIROBI.**

**THE PRINCIPAL OFFICER/GENERAL MANAGER/UNDERWRITING  
MANAGER/CLAIMS MANAGER.**

**.....INSURANCE COMPANY.**

**P.O.BOX .....,  
NAIROBI, KENYA.**

**DEAR SIR/MADAM,**

**REF: QUESTIONAIRE FOR RESEARCH PROJECT**

**I am an undergraduate final year student at the University of Nairobi undertaking a research project as part of the requirements of a degree in Law. The topic of my research is ‘A WORLD CLASS INSURANCE INDUSTRY-AN ACHIEVABLE DREAM IN KENYA?’**

**Your firm has been selected to form part of the study, I kindly request you to fill the attached questionnaire to help me carry out the research project and present a detailed dissertation. Any information provided shall be treated in strict confidence and used solely for academic purposes. Neither your name nor that of your firm shall be mentioned in the final report.**

**A copy of the research project will be availed to you upon request .Your cooperation will be greatly appreciated.**

**Thank you in advance.**

**Sincerely**

**W.S.E**

**WINNIE .S.EGUCHI**

**(STUDENT)**

**Y.V.**

**MR.YASH VYAS**

**(SUPERVISOR)**

**LIST OF INSURANCE COMPANIES IN KENYA.**

British American Insurance Co (K) Ltd  
U A P Provincial Insurance Co Ltd  
Pioneer Assurance Co Ltd  
Insurance Brokers Companies  
Co-Operative Insurance Co of Kenya Ltd,  
Panafrica-life insurance company.  
Mayfair Insurance Co Ltd  
CFC Life Assurance Ltd  
Heritage All Insurance Co Ltd, The  
Cannon Assurance (Kenya) Ltd  
AIG Kenya Insurance Co Ltd  
Pacis Insurance Company Ltd  
CFC Life Assurance Ltd  
Heritage All Insurance Co Ltd, The  
U A P Provincial Insurance Co Ltd  
Mercantile Insurance Co Ltd  
Pioneer Assurance Co Ltd  
A P A Insurance Ltd  
Africa Merchant Assurance Co Ltd  
Aon Minet Insurance Brokers Ltd  
Apollo Insurance Co Ltd  
Blue Shield Insurance Co Ltd  
British American Insurance Co (K) Ltd  
Co-Operative Insurance Co of Kenya Ltd,  
The Concord Insurance Co Ltd  
Corporate Insurance Co Ltd  
Direct line Assurance Co Ltd  
Fidelity Shield Insurance Co Ltd  
First Assurance Co Ltd  
Gateway Insurance Co Ltd  
Geminia Insurance Co Ltd  
Insurance Co of East Africa Ltd  
Invesco Assurance Co Ltd  
Jubilee Insurance Co Ltd  
Kenindia Assurance Co Ltd  
Kensure Insurance Brokers Ltd  
Kenya Commercial Insurance Corporation Ltd  
Kenya National Assurance Co Ltd  
Kenya Orient Insurance Co Ltd  
Kenyan Alliance Insurance Co Ltd  
Liberty Assurance Co Ltd  
Lion of Kenya Insurance Co Ltd  
Madison Insurance Co Kenya Ltd  
Madison Insurance Co Kenya Ltd  
Mercantile Life & General Assurance Co Ltd  
Mercy Insurance Services Ltd.

**(2) QUESTIONNAIRE**

**TO BE COMPLETED BY CHIEF EXECUTIVE OFFICER, MANAGING DIRECTOR, GENERAL MANAGER, PRINCIPAL OFFICER OR HEAD OF THE COMPANY.**

The questionnaire seeks to collect information on the factors that may have contributed to the slow growth of insurance industry in Kenya. The objective of the study is to provide status analysis of the insurance industry in Kenya and the insurance industry of other foreign countries, to find out which problems face the Kenyan industry that other countries have overcome and how we can improve our current insurance system. Any information given shall be treated confidentially and will be used purely for academic purposes. The identity of the respondent shall be held in confidence.

PLEASE ANSWER ALL QUESTIONS.

**SECTION A:**

NAME.....

DESIGNATION.....

NAME OF COMPANY.....

COMPANY INCORPORATED IN YEAR.....

THE COMPANY UNDERWRITES THE FOLLOWING:-

.....  
.....  
.....  
.....

**SECTION B:**

1. Do you think that the general performance of the economy has a direct bearing on the performance of insurance business?.....  
.....
2. In your view do you think the insurance industry in Kenya is making a significant contribution to the country's economy?.....
3. Do you think the insurance regulatory authority is doing its job well?  
Why?.....  
.....  
.....
4. In your view is the Insurance Act CAP (487) effective in regulating and guiding the insurance industry in Kenya?.....  
.....  
.....
5. In your opinion, what is the attitude of the general public to the insurance business in Kenya?
  - Hostile
  - Good
  - Very good

- Excellent.

6. Do you think the public needs more awareness on the importance of insurance cover?.....
7. Has the self regulation code of practice proposed by Association of Kenya Insurance (AKI) been effective?  
.....
8. What in your view what factors negatively affects the insurance industry growth in Kenya?.....
9. Do you think that Kenya's insurance companies have poor claims settlement and history?.....
10. Is the insuring public also to blame for the poor settlement of claims for e.g. in false and inflated claims?.....
11. What do you propose should be done to improve the industry's performance in future?.....
12. Do you think that intermediaries have undue influence on the insurance practice?.....
13. What is your view on the delay by brokers to remit premiums on time and therefore creating a threat to the insurance industry?.....
14. Do you think that the government should step in an initiate ways of improving the insurance performance in Kenya?.....  
(a)In what ways?  
.....
15. Do you think that a company needs to come up with new products in order to cater for developing needs? E.g. a product to cover political unrest in the country?  
.....
16. Which new product has your company come up with in the last 2 years and what does it cover?  
.....
17. Do you think that the solvency of an insurance company is very important being a company that covers risks?.....

18. Do you think that the insurance industry in Kenya can learn important lessons from other foreign countries? Which one(s)?.....

19. What have they employed that the Kenyan system has not?

.....  
.....  
.....  
.....

20. Any other comments on the insurance industry in Kenya.....

.....  
.....  
.....

THANK YOU VERY MUCH FOR YOUR CO-OPERATION, ASSISTANCE AND MOST IMPORTANTLY, TIME.

WINNIE.S.EGUCHI.  
STUDENT  
UNIVERSITY OF NAIROBI,  
FACULTY OF LAW.