

THE ROLE OF THE REGULATORY AUTHORITY IN LIFE INSURANCE AND PENSION BUSINESS

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This paper shall focus on the role of the regulator in the development of the life and pensions business. I intend to firstly address the need for regulation, look at some of the tools that regulators may use, discuss our experience in Kenya, highlight the main challenges facing regulators and lastly address what I would consider as some winning strategies for the future.

I wish to note from the outset that in Kenya different regulatory bodies regulate life insurance and pensions business. I will therefore emphasize more on life business and later give an overview of pensions regulation. However the two businesses exhibit similar characteristics.

Why State regulation

Mr. Chairman, it is important at the outset to ask ourselves this pertinent question – why state regulation? It has been said that the main justification for state regulation should be to protect the public, but this aim must also be accompanied by socially desirable strategy.

During his address to the 15th African Insurance Organization conference held in Harare in 1988, the then Nigerian Insurance Commissioner Mr. Eugene Okwor observed that:

“--- it is not enough for governments to concern themselves mainly with ensuring the safeguard and protection

of policyholder’s interests, but also to create the atmosphere for the growth of the industry and encourage it to respond to the prevailing needs of the society in general. These can be achieved by creating suitable investment opportunities and taking monetary and fiscal measures.”

Indeed, governments have a duty to impose on insurance enterprises regulations that go beyond the normal provisions of company law. A few examples of government intervention in the conduct of insurance business can be traced back several centuries. However, it was during the 19th century that the mushrooming of new insurance companies in the United States and Europe, often followed by their equally rapid failure due to increasing competition for business, management incompetence and sometimes fraud, led to public demands for official supervision of the formation, organization and financial well-being of insurance companies and certain aspects of behaviour.

Before examining the various elements of insurance supervision, it may be worthwhile to list first those characteristics of insurance business which single it out from other industries for special treatment.

- Insurance contracts are promissory in nature in 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 future event.

- The value of the insurance contract to the insured is entirely dependent upon the ability and willingness of the insurer to honour its undertaking, which in some cases may fall due many years after the commencement of the contract.
- The amount to pay and when to pay may not be known in advance and will depend upon chance as protection is normally provided upon against uncertain future events. Major costs relating to these obligations are not known at inception of a contract when the premiums are normally fixed. Eventually the claims costs may substantially deviate from the contract expectations.
- For insurers to be able to meet their obligations, they must:
 - (i) hold sufficient funds to cover run-off risks and
 - (ii) manage, adequately their continuing underwriting risks
 - (iii) invest prudently, premiums collected to generate adequate returns to cater for extra risks.
- The value of assets, premiums and investment returns do fluctuate substantially from time to time.
- The insurance industry plays a vital role in the economic and social development. Insurance is a mechanism for transferring risk from those exposed to uncertain loss producing events to insurers.

Insurance companies in a bid to manage such risks do resort to creating large pools of similar and homogenous risks in addition to seeking further protection by way of reinsurance.

Let me now briefly identify the broad areas, which comprise the main regulatory tools. These are: -

- Entry restrictions through licensing
- Disclosure of information
- Conduct of business
- Product development
- Governance and fiduciary responsibilities
- Solvency and capital requirements
- Liquidity requirements
- Accountability requirements

Historically, supervisory examinations focused primarily on compliance; that is, on finding contraventions of the rules and regulations regardless of their materiality. This view is gradually changing to a more proactive risk-based approach, which emphasizes on development of policies geared to ensuring capital adequacy and good corporate governance.

Kenyan experience

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 United Kingdom and India. 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.

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 UNCTAD.

In 1986 the Insurance Act was enacted with an enforcement date of 1st January 1987.

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.

Kenya is one of the largest insurance markets in Africa. At the end of 2004, there were 40 insurance companies, 4 reinsurance companies (including Zep Re and Africa Re which are regional bodies), 200 insurance brokers, 250 service providers and about 4000 insurance agents. Five insurers transact life insurance business only while twenty-one others transact both life and general business.

The Insurance Act of Kenya is very comprehensive and generally provides for the following:

- 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 Kenya citizens while
- brokers must be owned 60% by locals.
 - Local incorporation. Branch operations or subsidiaries of foreign companies are outlawed.
 - Reinsurance arrangements must be approved by the Commissioner.
 - Margins of solvency are prescribed and the requirement of admissibility of assets is quite conservative.
 - 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 1st 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, CEOs and Managers of Insurance companies.
 - The Act provides for the intervention in the management and eventual winding up of insurance companies.

- The Act also regulates 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.

Regulation of Pension Business

In Kenya, the pensions or retirement benefit schemes are regulated separately from life assurance.

The Retirement Benefits Authority (RBA) regulates, supervises and promotes retirement benefits schemes, development of the retirement benefits sector and other connected establishments. This regulatory authority is established under the retirement benefits Act of 1997.

The Retirement Benefits Act defines Retirement benefit schemes as “any schemes or arrangements (other than a contract for life assurance) whether established by a written law for the time being in force or by any other instrument, under which persons are entitled to benefits in the form of payments, determined by age, length of service, amount of earnings or otherwise and payable upon retirement, or upon death, termination of service, or upon the occurrence of such other event as may be specified in such written law or other instrument.”

Thus pension schemes can be seen as facilitators of deferred wages, with unique features such as monetary payment of specified amounts in advance for specified/unspecified period of payment.

The need for pensions arrangements is mainly driven by the lack of:

- capacity to earn in old age.
- Financial support since no savings were made during the active earning life.
- Financial support from family members.
- Financial support from other sources such as employer and social security benefits from government and society and the need to have financial freedom.

Pension schemes, such as those relating to civil service may be financed directly from the exchequer but the bulk of occupational pension schemes are based on the pooling of regular payments by both employees and employers into a trust fund, out of which pensions will be paid. These payments may fall due many years after the commencement of the contract. The value of assets, contributions and investment returns do fluctuate substantially from time to time. These investments should match the pension fund long-term obligations.

In Kenya as elsewhere there are two types of pension arrangements, the defined benefits and defined contributions type of schemes.

The RBA protects interests of members and sponsors of retirement benefit schemes, promotes development of retirement benefits industry, advises the minister of finance on the national policy to be followed with regard to retirement benefits policies and implements all government policies related to retirement policies.

The RBA social agenda aims at reducing old age poverty, educating

citizens on the importance of saving during working life and safeguard retirement savings of the citizens through prudential management of those savings.

RBA's economic agenda aims at encouraging savings for retirement, increasing the country's domestic savings as well as the asset base of the retirement benefits industry through encouraging adoption of prudential management principles.

Regrettably, in Kenya the life and pension market is still very underdeveloped. Statistics for example show that currently there are 1352 registered schemes with a total asset value of Kshs.135 billion. On the other hand, as at the end of year 2004, gross written premiums for life assurance amounted to Kshs.10 billion which translates to 1/3 of the total gross direct premium written in the market. In addition, the penetration rate of life assurance is below 1%. *[Kshs. 75 = 1 USD]*

However, since the introduction of the RBA Act in 1997, we have seen tremendous growth of individual as well as occupational pensions plans.

Challenges

The development of life and pensions business in developing countries poses several challenges both to the regulators and the providers. These include the following:

- Most of the available products are traditional and do not address the modern needs of the public.
- Due to the collapse of insurance companies and insolvencies of Retirement schemes, the public has lost trust and confidence in the

institutions that offer insurance and pensions arrangements.

- Low public awareness regarding life insurance and pensions.
- Poor and imprudential management of funds by insurers and trustees.
- In economies with uncontrolled rates of inflation, the life and pensions sector suffers as the savings are eaten away. Traditional life insurance products find it difficult to appeal in those situations.
- In addition, where the contract guarantees a fixed rate of return, any major change in the interest rates in the economy can seriously affect life and pension business.
- Skills on life assurance and pension business particularly on actuarial science are lacking within our markets. This hinders the development of these classes of business.
- HIV and AIDS pose a serious challenge to life and pension business in Africa. Insurers have reacted in diverse ways in the face of this challenge. This is certainly one problem that shall continue to haunt the industry into the future.
- Globalization which has led to liberalization and opening up of our markets.

Winning strategies

The strategies outlined below apply to both life and pension arrangements.

- Packaging and repackaging of products
- Availability of customized and flexible products

- Innovation and development of need driven products e.g. HIV/AIDS and dread diseases insurances
- Adopting and encouraging professionalism in the industry
- Introduction of good governance and transparency in the insurance companies and pension schemes
- Increasing the public confidence regarding the credibility of insurance and pensions providers.
- Increasing the public confidence regarding the credibility and ability of regulators
- Increasing the public awareness in relation savings, available investment channels and the advantages of savings.
- Encouraging the development of professional skills.
- Correcting the negative perception by upholding high degree of discipline in the conduct of business amongst insurance practitioners.
- Improved channels of distribution.
- To protect 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.
- To promote an even, fair playing ground by ensuring members of the industry operate within acceptable principles, practices and standards.
- To foster 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.
- To play 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.

Conclusion

In conclusion therefore, the role of the regulator can be summarized as follows:

However, to achieve these objectives, there must be close cooperation and partnership between the regulator and the market players. ■