

THE LEGAL IMPACT OF PRIVATIZATION OF THE INSURANCE AND RE-
INSURANCE INDUSTRY IN KENYA IN LIGHT OF LIBERALIZATION OF THE
ECONOMY.

A dissertation submitted in partial fulfillment of the
requirements for the LLB Degree, University of Nairobi.

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DEDICATION:

This dissertation is dedicated to my parents for their love and support.

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INTRODUCTION

State control of various sectors of the economy has been a common phenomenon since independence. Insurance and Re-insurance industry has not been left out.

Unlike countries like Tanzania which went for full nationalization of the insurance industry, Kenya opted for partial nationalization whereby the government's Kenya National Assurance Company operated in competition with other private insurance companies. These insurance companies used to mainly re-insurance with their parent companies abroad until the enactment of State Re-insurance Corporation Act 1970, which created state Re-insurance Corporation now Kenya Re. The Act requires all insurance companies to give twenty five percent (25%) mandatory re-insurance cessions.

The Kenya government was also party to an agreement forming Africa Re which started operations in Kenya in 1978. All insurance companies were (still are) required to give Africa-Re legal cessions amounting to five percent (5%).

The most recent and interesting development was the creation of Zep-Re and the Kenya government being a member of PTA was party to its creation. By PTA Reinsurance company (Mandatory Re-Insurance Cessions) Act 1993 insurance companies were (still are)

required to give mandatory re-insurance cessions amounting to ten percent (10%). This aroused protests from insurance industry especially for coming at a time when the trend is towards liberalisation of the economy.

In this thesis we will assess the legal impact of privatization on insurance and re-insurance industry in light of liberalisation, as proposed in the Insurance Amendment Bill 1994 and further assess whether complete privatization and phasing out of legal cessions is in the best interest of the national economy and Kenyan people at large. We will also look into the position of mandatory re-insurance cessions to regional re-insurance corporations at this time of liberalisation of the economy.

We will begin in our first chapter by briefly defining insurance and re-insurance. We will then proceed to look at the historical development in Kenya of insurance and re-insurance industry with specific reference to state control. We will see the various forms of and circumstances surrounding state intervention.

Our second chapter forms the gist of our thesis. We will be looking at the legal impact of privatization and liberalisation of insurance and re-insurance industry in regard to the uncertainty surrounding the process. We will be assessing the legal issues surrounding the privatization and the liberalisation and particularly look into the question of mandatory re-insurance

to both state and regional corporations. Another area of our interest will be the Preferential Trade Area Re-insurance Company (Mandatory Re-insurance Cessions) Act in light of liberalisation of the economy and see whether Zep-Re creation contradicts the spirit of liberalisation as it was accused of upon its formation.

In our third and final chapter we will review the legal issues raised and make recommendations especially on whether there should be complete privatization and the phasing out of legal cessions and also whether mandatory re-insurance to regional corporations are in line with the spirit of liberalization of the economy.

We will then make our conclusion based on our findings.

CHAPTER I

"HISTORICAL DEVELOPMENT IN KENYA OF INSURANCE AND REINSURANCE INDUSTRY WITH SPECIFIC DEFERENCE TO STATE CONTROL"

1.0 Insurance and Reinsurance: Definitions

To start off we will begin by defining the concepts of Insurance and Reinsurance.

Insurance has been defined as:

"A social devise whereby a large group of individuals through a system of equitable contributions may reduce or eliminate certain measurable risks of economic costs resulting from the accidental occurrences of the disastrous events. Its effect is to spread to costs which normally would fall on a single individual in an equitable manner on members of large groups exposed to the same hazard."¹

The above shall operate as our working defination we however must bear in mind Harts words that "definitions are of doubtful utility in law". Our working defination may be inadequate or lacking in some aspects. The economics of insurance is of paramount consideration. As Shivji pointed out. "However, few

1. *Encyclopedia Britannica Vol. 12 P.354*

(definitions).... go deep enough to reveal the economic substratum that makes insurance and insurance companies tick".²

Reinsurance on the other hand may be defined as:

"a system whereby the insurers who deal with the insuring Public (and who are known as direct insurers) cede all (or part) of an insurance to other insurers known as reinsurers".³

In other words, the ceding company pays to the reinsurers the whole (or part) of the premium it has received, and reinsurers there upon agree to reimburse to the ceding company the claims (or an agreed proportion of them) which the ceding company may find itself liable to pay under the original insurance. The contractual rights at the original insurers are unaffected by the reinsurance transaction of which indeed the original insured will almost certainly remain unaware.

Reinsurance arises from the need of the original insurer to spread the risks he has assumed.

2. Shivji I.G. "Insurance and Development" E.A. L.R. (1970) Vol. 3

3. Cockrell 'Insurance' Chapter XVI English Univ. Press 1970

1.1 Insurance and Reinsurance During Pre-colonial and Colonial Period

In the traditional setting, there was what we may roughly refer to as insurance and further reinsurance. Though not much like the adopted English type, there was a way of showing risks. One man's loss was the loss of the entire clan or the community at large as a form of reinsuring the clan. There was a form of pooling together by the whole community to insure against the risk. The extended family system was a form of social insurance.

Songuemas Observes:

".... grouping for mutual aid and public assistance are also characteristic of indigenous African institutions. They are organised in the tribal, clan village or family basis. Those institutions cover all the risks and members of community on the sole condition that they belong to one of the above groups."⁴

The establishment of colonial government and the consequent influx of settlers led to mushrooming of western type of insurance industry. Statutes which were operating in England were 'translated' and introduced to Kenya through the reception clause.

4. Songuemas N. 'Social Security Among Traditional Societies' E.A. Journal (1968) Vol. 2 p.108

The Kenyan Insurance law like other laws at the time was based on the English statutes of several application, the common law and doctrines of Equity in force in England on 12th August 1897.

Very little consideration if any on the local circumstances was taken into account. East Africa's was soon as extension of the metropole, therefore insurance was soon only as a kind of investment. It should be noted that laws that were adopted were drawn from an advanced commercial practice so that they were meant to apply like in metropole. Songuema in noting the impact this had on the local situation observed:

".... the new transformed institutional although arising from progress are difficult for African societies to understand because of the move or sudden upset which the cause to existing social order. As long as African societies preserve their forms, those continual changes which seen to them more in-comprehensive in spite of this they fortunately not deprived of all social security."⁶

The insurance industry remained the domain of settlers largely due to its nature. In addition, there was a deliberate intention to exclude the African through discriminatory laws. This fit the industry under the control of foreigners serving the interests of their parent companies in Europe.

5. *Supra* (2) P.148

6. Songuema N. 'Precursor of the Beveridge plan security among Traditional societies in Africa' *E.A. Journal* 1969 p.109

In 1903 the Credit Trade with Native ordinance was enacted. It excluded the African participation in business including insurance business. This ordinance was repealed by even a more detailed and restriction ordinance of 1948.⁸

The control of Business of life Assurance with African Ordinance of 1945 had an elaborate provision which effectively excluded the African from security offered by life Assurance. This was repealed by the 1948 African Life Insurance (control) ordinance. This had the effect of discouraging underwriters from dealing with Africans.

The foregoing show that before independence the insurance industry was not only in hands of foreigners but that the interests of the local people were completely disregarded by the law. Another characteristic of the insurance industry then was that there was little or no control of their operations.

Although the 1946 African Life Insurance Control ordinance had an element of control in certain aspects of the industry, the first statute to address itself to the issue of regulation was enacted in 1961. This was The Insurance Companies Act. It is in 1946 Act that we first notice state intervention but we should be

7. Act No. 5 1903
8. Act No. 6 1948
9. Act. No. 5 1946

quick to note that it was restricted to transactions with Africans.

Forster Sutton, the mover of the motion on the debate on the bill state that its objective was to:

"Make provision that will ensure that any company desiring to carry on life assurance business with natives is a company which is likely to be in a position to meet its obligations."¹⁰

In the same year 1946, The Motor Vehicle (3rd Party Risks) ordinance was enacted. On independence this statute continued to be in force and unlike the African (Life Assurance Control) Ordinance, it still applies. Its overriding objective was to make insurance of motor vehicles against Third Party risks compulsory.

Various arguments in support of the bill advanced by members of the legislative council.

IJ Couldrey in his contribution said it all:

"...it is pretty obvious that insurance companies are not insuring for the benefit of insuring altogether. They are naturally making money out of it and it is

10. *F. Sutton was the Attorney General in 1946*
11. *Cap 405 Laws of Kenya 1946*

obvious they are going to have tremendous increase in turnover."¹²

The 1961 Insurance^{'13} companies ordinance which later became The Insurance Companies Act specifically addressed itself to the issue of regulation of the operations of insurance companies. It was based almost exclusively on the Insurance Companies Act 1958 of the UK and the Insurance Act 1956 of the Federation of Rhodesia and Nyasa Land (Now Zimbabwe and Malawi respectively^{'14}) Before its enactment insurance companies were operating in a largely unregulated business environment. On independence this statute continued to be in force as part of the law of Kenya until it was repealed by the 1984 Insurance Act.

The Insurance Companies Act provided that no^{'15} person shall be allowed to carry on insurance business in Kenya except a company incorporated. The Act also introduces the idea of registration and licensing of insurance companies. D.W. Convoy in his^{'16} memorandum of the objects of the statute stated that the overriding aim was to ensure stricter control and supervision of Insurance Companies in an effort to maintain financial stability in those companies and as a result protect the insuring policy.

12. *Legislative Council official Reports op. cit. p.457*

13. *Act No. 46 of 1960*

14. *Ougo J.A. "A critical appraisal of the objectives of Insurance Act". 1985 LL.B Dissertation p.32*

15. *Section 4 Insurance Companies Act 1961*

The argument is that financially weak companies are unreliable in that they may be unable to honour claims. K.W.S Mackenzie the then Kenyan Minister of Finance and Development when moving the bill had this to say:

"It was felt the legislation should be introduced to protect Insuring Public."¹⁷

It has been the interest of the government and insurance companies achieve the important role of capital accumulation. This probably explains the reason why the government has been particularly interested in the continuance of public confidence in the industry. Thomm Izentes when commenting on the intervention of state on the economy says:

"....state intervention takes place mostly in the interest and protection of the whole capitalists system of the economy in order to curb spontaneous tendencies effect."¹⁸

1.2 Insurance and Reinsurance During Post Independence Period

The Insurance Companies Act (1961) continued being in operation for a long time after independence until it was repealed by the Insurance Act¹⁹ 1984. The need for such new legislation was imperative as according to the then commissioner of insurance Mr. Marcellin Muriithi put it:

"The replacement of the insurance companies Act of 1960 with the new Act was necessary to remove. The numerous defects

17. *Legislative Council Official Reports* vol. 86 Column 458

18. Thomas Szentos 'Status quo and socialism' *Unv. of Dar-esalaam (mimeo)* p.18

19. Cap 487 laws of Kenya

and loopholes which existed in the insurance environment. Apart from seeking to protect the interest of the insurer as well as developing a strong healthy and solvent infrastructure of insurance operations... the overhaul of legislation governing the insurance industry."²⁰

The then minister of finance Prof. Saitoti in his introducing speech said:

"The Insurance industry can no longer be left to operate on its own. Kenya can no longer operate in the precepts of Insurance Act of 1960. At that time Kenyans were barely in the industry but today Kenyans are well into the industry and would like to control it."²¹

A study of the AG's memorandum of objects and reasons and²² the legislative debates on the insurance Bill reveals that the Act has four principle objectives namely:

- Kenyanization of insurance industry
- Maintenance of financial stability in the insurance firms
- Consolidation and amendment of the law relating to insurance
- Strict government control at the industry.

20. Daily Nation Nov. 23rd 1984

21. Ibid

22. Insurance Amendment Bill 1984

Working into the issue of government control of the insurance industry as one of the objectives of the insurance we find that the preamble of the insurance Act states the desire to enhance the government to exercise strict control over the operations of insurance companies as an important objective of the Act.

The Act contains numerous provisions concerning the control of operations of the insurance companies. The principal organ through which the government seeks to exercise control is the office of the commissioner of insurance. These are the provisions that give the commissioner of insurance power over applications for registrations, premium rates, appointments of principle officers of insurance companies, statement of accounts, management expenses among others.

The insurance industry has since independence been dominated by private insurance companies. The state owned Kenya National Assurance has existed in competition with these private companies. It has however enjoyed a protected sphere of operation in handling the insurances of state or semi-state enterprises.

Reinsurance is another area that has been characterized by state control, since the government penetrated this market in 1970. Prior to this reinsurance remained the domain of parent companies abroad of the insurance companies operating locally. State

control on reinsurance business was minimal, restricted to provisions of the 1961 insurance companies Act.

In 1970 the²³ state Reinsurance Corporation was set up by the State Reinsurance Corporation of Kenya Act.

In its preamble the Act describes itself as:

'An Act of Parliament to establish a State Reinsurance Corporation; to provide for compulsory²⁴ reinsurance with the corporation by insurer's, and for matter incidental thereto and connected there with.

It would probably help to understand how state reinsurance came up and the objectives for which it was established.

In developed countries with few exceptions, reinsurance companies are formed mainly for a profit motive. In developing countries on the other hand, due to relatively low cover of economic development and consequently very limited indigenous capital and relevant expertise, the governments in the immediate post Independence period were forced to take part in commercial industries and other economic ventures. This intervention gave rise to a number of parastatals of which national reinsurance corporations are but one category of such institutions.

23. Cap 485 Laws of Kenya
24. Ibid - Preamble

Other than for reasons outlined above, in some developing countries, governments with socialistic inclinations such as Tanzania nationalised most of their major industries, insurance included.

Professor Thomas Odhiambo argues that irrespective²⁵ of dominant force, government interventions made a lot of sense and some of the reasons are highlighted as follows:

- Intervention gave the new governments some measure of control of economic activities because at the time of independence, the private sector was in some countries still largely foreign owned.
- African leaders and other in world countries that parastatals would be useful agents for economic development.
- The profits that were expected from the operations of some parastatals were to contribute to national capital formation for investment in various areas.
- Public enterprises were in view of the governments, to take the role played by entrepreneurs in developed countries and would consequently help harness, mobilise and exploit resources which would otherwise be idle or be developed only by foreigners.

25. *'Hope Born Out of Despair - Managing The African crisis', ed. Odhiambo et.al Nairobi Heinmann 1988 p.50*

Parliament in enacting the state reinsurance corporation Act which created the state reinsurance corporation now Kenya Re had similar objectives as the foregoing.

Part II of²⁶ The Act deal with establishment and functions of the corporation S4 states.

The functions of the corporation shall be to undertake, carry on and transact in any manner whatsoever whether in Kenya or elsewhere, the business of insurance and reinsurance of all kinds, classes, nature and descriptions whatever

Part V.²⁷ deals with compulsory reinsurance S18(1)states.

Every insurer shall reinsure with the corporation such proportion as the minister may by notice in the Gazette prescribe of each policy of reinsurance issued or removed in Kenya by insurer.

S18(2) goes further to describe how this will be effected.

It states: 'The minister may, by a notice under subsection (1) of this section or by a separate notice in the Gazette prescribe the manner in which and the times at which reinsurance shall be

26. Cap 485 Part II laws of Kenya

27. Ibid Part V s.18

effected under this section and may also so prescribe the terms and conditions on which such insurance shall be so effected.'

S18(3) declares that this will apply to all insurers. It states:

'A notice under this section may apply to all classes of insurance business as may be specified therein and may make different provisions for different classes of insurance business.'

The original act has since been repealed and the corporations now established under'²⁸ Part XIII of insurance Act of 1984. Section 129. The functions of the corporation are to be found under section 132, which provides as follows:

'The function of the corporation shall be to undertake, carry on and transact in any manner whatsoever, whether in Kenya or elsewhere, reinsurance business of all kinds, classes, nature and description whatsoever and such direct business as may be prescribed.'

The functions of the corporation are however, only a means of achieving the objective for which the organisation was established. According to the relevant bill, the objective was to reduce to the minimum possible, the outflow of funds from Kenya under the heading of reinsurance. Apart from the saving of foreign exchange, it was also the governments intention to raise

funds by its participation in the business of reinsurance and to see that such funds were utilised to help finance development programmes.

The state reinsurance corporation (Kenya Re) also play other roles. They are:

- The provision of technical expertise to the ceding companies
- Collection of market statistics and other information for the use of ceding companies
- General supervision of the insurance industry where controller offices have not been established or where some of such functions are delegated to the organisations.
- vehicles through which international reinsurance business can be written reciprocally and otherwise.

Another way that the state has intervened in the insurance industry is by enabling regional and sub-regional corporations to get compulsory legal cessions.

Africa Re is a regional reinsurance corporation established in 1976²⁹. Kenya was a signatory to the agreement establishing it and consequently bound by its charter. It came into operation on 1st January 1978. The objective or the purpose for which the

29. *Africa Re Charter 1976*

institution was established is to be found in Article 3 of the Africa Re Charter. It states:

"The purpose of the corporation shall be forster the development of the insurance and reinsurance industry in Africa, to promote growth of the nation regional and sub-regional underwriting and retention capacities to support African economic developments."

Article 4 provides³⁰ for how the above is to be achieved and states as follows:

'To implement its purpose it shall have the following functions:

- (a) To transact reinsurance business through treaty and facilitate cessions in respect of all or some classes of insurances inside as well as outside Africa.
- (b) To create and administer pools for the various risks for the account and to the interest of African insurance and reinsurance markets.
- (c) To assist in the establishment and operation of national, regional and sub-regional insurance and reinsurance

30. *Ibid* Article 4

institutions and to provide technical assistance to African insurance and reinsurance markets.

- (d) To invest funds in African countries in a manner that promises African economic development. It may however invest abroad on short term basis to meet its operational and/or technical requirements.
- (e) To provide wherever possible technical assistance to African countries in the field of insurance and reinsurance.
- (f) To undertake such other activities excluding the writing of direct insurance and provide such other services as may advance its purpose.

All the signatories Kenya included committed themselves to ensure that all insurance companies operating within their borders will give Africa Re legal cessions of all reinsurance business amounting to five percent (5%). Kenya government has successfully intervened to ensure that this five percent compulsory cession is given to Africa Re.

The most recent intervention by the state in reinsurance industry is by enabling the newly created Zep Re the PTA Reinsurance Corporation to compulsory legal cessions from the insurance industry amounting to ten percent (10%) Kenya being a PTA member country and a signatory of the agreement leading to creation of Zep Re undertook to fulfil the obligations of the Zep Re Charter,³¹ Article 20(1) of the Charter states:

'Each member state shall allow the company to carry out its functions in its territory in accordance with the provisions of this agreements.'

Parliament Pursuant to the obligations under the Zep Re Charter enacted the preferential Trade Area Reinsurance Company (mandatory Reinsurance cessions) Act 1993.

In its preamble the Act'³² introduces itself as:

'An Act of parliament to provide for mandatory re-insurance cessions to the Preferential Trade Area Re-Insurance company and for connected purposes'

³³S3(1) of the Act states that:

Any Insurance or re-Insurance Institution shall on or after the commencement of this Act, offer to place with the company a minimum of ten percent (10%) of each of reinsurance cessions both present and future'.

31. *Zep-Re Charter Article 20(1)*

32. *Kenya Gazette Supplement No. 51 (Act No. 3) 1993*

33. *Ibid. S.3(1)*

³⁴S3(2) further demonstrates the free hand that Zepre is accorded. It states
*Subsection (1) shall not restrict the height of the company to accept re-insurance cessions in
lie or any other type of insurance business.'*

Article 4 gives the objectives of the company. They are:

- (a) *To foster the development of the insurance and reinsurance industry in the PTA sub-region.*
- (b) *To promote the growth of national, sub-regional and regional underwriting and retention capacity; and*
- (c) *to support sub-regional economic development.*

The creation of Zep Re as we will be in the next Chapter raised concern in the insurance industry for coming at a time when the trend is towards the liberalisation of the economy. Many insurance companies felt that giving compulsory cessions to Zep Re was not in line with the spirit of privatisation of the industry and the liberalisation of the economy at large.

There is a proposed insurance Amendment Bill 1994 which seeks among other things the privatisation of Kenya

Re and the insurance industry at large. This bill shall form the gist of our discussion in Chapter

II.

34. *Ibid* S. 3(2)

In this Chapter we have looked at the history and circumstances surrounding state control of the insurance and reinsurance industry. We have seen the various ways that state intervention has taken place.

We are now ready to look at the validity of state control and assess it in light of the proposed privatisation of insurance and reinsurance industry and the ongoing liberalisation of the economy.

CHAPTER II

"LEGAL IMPACT OF PRIVATISATION AND LIBERALISATION OF INSURANCE AND RE-INSURANCE INDUSTRY - A CASE OF UNCERTAINTY"

1.0 Earlier Justification For Insurance Legislation Provision on State Control

In our first chapter we saw the historical background of state control of insurance and re-insurance industry. We have also established that being a newly de jure independent state there was need to establish defacto independence economically. It has been argued that "without a minimum of political, economic or military defacto independence, de jure independence is meaningless."¹

At the time at putting in place insurance legislation and ensuing close supervision there was a general agreement that supervision was a fundamental requirement for sound development of insurance activities and that insurance activities properly supervised would play an outstanding role in the process of economic growth of this country. The insurance legislation was meant to provide a basis for a continuous supervision over insurance concerns so as to ensure that the legislation was observed in all respects.

1. *'The Principal of International Economic Law' 117 Recueu decours (1966) 1,31*

2. *Preamble cap 487 Laws of Kenya*

In a newly independent country greater supervision³ shouldn't only play a traditional role protecting policy-holders, beneficiaries and third parties, but should also take constantly into account the general economic, social and other national interests. It was stressed that the role of insurance supervision in coordinating the investment activities of insurance concerns with the general economic policies of the government and guiding them accordingly.

The prevention of an outflow of foreign exchange which could result from excessive resource to foreign insurance and re-insurance facilities was also a good reason for intervention.

UNCTAD in a session in 1965 was of the view that an additional, specific and very important task⁴ of insurance supervision in the developing countries was in the opinion of experts, to provide for measures to establish and strengthen national insurance and reinsurance market being an essential characteristic of economic growth. Legislative and other measures could be adopted to achieve this objective most of which offered a certain degree of protection to domestic insurance institutions, so that they could grow and take over an important part of the business of the national market.

3. *Insurance Legislation and Supervision in Developing Countries* UNCTAD Corricendum TD/B/393

4. *Ibid*

During the 1965 UNCTAD session it was said that as to the method of state supervision which the insurance legislation should provide for, the participants were unanimous that a purely formal supervision was not only inadequate but also could be harmful to the different interests involved as the extent⁵ of supervision. On the other hand supervision only with respect to the financial position of the insurance concerns would not be sufficient either since other subjects, like tariffs and a fair treatment of policy-holder in the formulation and the general condition of the insurance policies were also considered as an essential element in the protection of the public. The need to extend supervision, to the whole range of activities of insurance concerns, particularly in fields where excessive profits, malpractices or harm to the insured might occur. Effective and continuous supervision of the insurance enterprises' activities was strongly advocated.

Some participants were of the opinion that such an effective control should not interfere with day-to-day activities of insurance companies, as it might paralyse the managerial and commercial initiatives of other concerns. Another aspect which was emphasised was that sufficient discretionary powers for intervention should be given to supervisory authorities, to enable them to exercise their sound judgement and prompt and effective measures of the situation of a particular concern-

5. *Ibid*

should in its opinion warrant any kind of immediate attention.

The foregoing explains the reasoning behind state control and intervention of the insurance industry. The need for such control was real as Prof. Mungungi describes social economic and legal structures situation at the time of independence. He states that the African governments inherited 'highly explosive social, economic and legal structures which the colonising states had developed and practiced for decades in the interests of their home governments and peoples'⁶

It is therefore not a wonder as the AG explained in his memorandum of the Insurance Bill⁷ 1984 that the four principal objectives of the Bill was to seek:

- Kenyanization of the insurance industry
- Strict government control of the industry
- Maintenance of finances stability in insurance firms
- Consolidation and amendment of the law relating to insurance.

S.22 of the⁸ 1984 Insurance Act requires that atleast one third of the controlling interests in insurance companies should be

6. Prof. Mungungi, *'Business organisation and the Africanisation of commerce and Industry in Kenya'* J.S.D. Thesis Yale Law School p.1
7. *Insurance (Amendment) Bill 1984*
8. *Cap 487 Laws of Kenya*

held by citizens of Kenya. Commenting on this during the parliamentary debate on the bill, the then Assistant Minister for Environment and Natural Resources Mr. Martin Shikuku had this to say:

"It is a height time Kenyans became bold enough to say that shares should be at least 50 percent Kenyan. One third is just not enough."⁹

Comments such as the foregoing indicates the feelings of economic insecurity that were shared by African leaders, culminating to too much of state control of the economy. State control has thrived since independence until the events of late 1980's which have suddenly threatened its survival.

In the late 1980's and early 1990's the Eastern block which perfected state control collapsed. This resulted into a world wide trend to economic liberalisation. Kenya has not been spared from these forces of liberalisation. There is a lot of pressure to move towards market economies and away from government involvement in commercial and other economic activities, as it is generally being accepted that the governments would only provide enabling environment. Developing countries such as Kenya for economic reasons are being forced by the IMF and World Bank to accept certain conditions to qualify for loan assistance. The

9. *Daily Nation* Nov. 1984 p.8

conditions are normally in package under the heading 'balance of payments' 'stabilization' and 'structural adjustment' programmes. Some of the standard conditions demanded by programmes include trade liberalisation, privatisation of public enterprises and open door policy to foreign investment and drastic budget cuts.

In this chapter we will concern ourselves with the legal impact of privatisation and liberalisation of insurance and Reinsurance industry and whether by so privatising or liberalising the industry we will be sacrificing, national, sub-regional or regional interests.

In discussing the 'future of national sub-regional and regional insurance and reinsurance organisations',¹⁰ William Olotch the then General Manager, Kenya Re was of the view that our economy is certainly not healthy and that is the reason why our country is undergoing structural adjustment programmes. He argued that there is more indigenous participants in the economic activities in Kenya than at the time of independence. Due to legislative action taken as we have seen, insurance companies are required to have to stated minimum local shareholding. Mr. Olotch observed that the retention of local companies have also been growing and

10. William Olotch *'The Role of National Sub-regional, and Regional Reinsurance Organisations.'* Paper presented in the 19th African Insurance Conference. Held in K.I.C.C. Nairobi 1992 pg. 14

there is certainly more qualified manpower than in the earlier years of independence. These developments require that state insurance and Reinsurance companies adjust their operations to contribute more to the economy.

1.1 Accommodating Liberalisation and Privatisation of Insurance

Industry - A Case for Amendment of Current Insurance Law.

Whereas there is nothing¹¹ inherently wrong with state control, there is no doubt that government intervention in the management of insurance aspects. Taking the case of state reinsurance company it is managed by a board whose members are political appointees and this is certainly one of the problems with the management of parastatals where undue influence is placed on this criteria. There is also a feeling of insecurity as far as political appointments are concerned. On the part of appointees, in that changes in the political scene, invariably have an effect on the management of parastatals. An example is when new appointments are made with this feeling of insecurity, parastatal managers need a lot of time and energy securing their survival to the detriment of their institutions.

11. *Ibid* Pg. 17

On the question whether legal cessions are compatible with private enterprise, Mr. Olotch was of the view¹² that for state

reinsurance corporation to be privatised they would have to stop relying on legal cessions because some of the business written could have been retained by the ceding companies. He urged that taking such business from one group of private investors and pass it on to another would certainly be unfair, neither does a country benefit from such a transaction because of national level, it does not matter whether the profits made from the business accrue to the producing company or national reinsurer.

The need to review the insurance Act 1984 to make it in line with contemporary insurance and reinsurance demands has been overwhelming.

The first major attempt for such review came in 1990 with the publication of the insurance¹³ (Amendment) Bill 1990 which unfortunately had to be withdrawn for failing to meet the expectations and wishes of the main players in the industry and other bodies mainly through lack of adequate consultation during its preparation.

The insurance (Amendment) Bill¹⁴, 1994 was a second attempt to

12. *Ibid* pg. 18

13. *Insurance (Amendment) Bill 1990*

14. *Kenya Gazette Supplement No. 37 (Bills No. 6) 1994 pg. 735*

substantially amend the insurance Act. In his memorandum of the objects and reasons of the bill, the Attorney General begins by stating¹⁵ that the bill seeks to ensure stricter supervision of the insurance industry. He states that to ensure continuous and effective supervision of the operation of insurers, the bill empowers the commissioner to conduct routine inspections of insurers. It also enables the commissioner to appoint managers to intervene in the management of insolvent insurers.

The bill also seeks to strengthen the financial base of insurers by proposing to raise the minimum paid up capital to fifty million Kenya Shillings (KSh. 50 million) and five hundred million Kenya Shillings (KSh. 500 million) for insurers and reinsurers respectively. A transitional period of twenty four months, in the case of insurers and thirty six months in the case of reinsurers is provided to give insurers sufficient time to adjust to the new paid up capital requirements.

The gist of the Bill is the intention to introduce measures geared towards liberalisation of insurance industry. It for instance introduces measures to liberalise the investment of the assets of insurers taking into account considerations of security, yield and diversifications. If enacted the bill will enable insurers to invest in private companies, commercial paper, promissory notes and Bills of exchange. The investment of

15. *Ibid*

assets of insurers in government securities which at twenty five percent (25%) and twenty percent (20%) for long term and general insurance respectively is reduced to ten percent (10%) to give insurers more freedom to invest in securities of the choice.

Further in order to facilitate international trade, the Bill relaxes restriction on insurance policies in foreign currency. To promote liberalisation and deregulation of the industry, the Bill proposes to phase out the mandatory cession on direct insurance payable to Kenya Reinsurance Corporation under section 145(1) of the Act over four year period.

The insurance (Amendment) Bill, 1994 as a second attempt to substantially amend the insurance Act was welcomed and received with great expectations by the insurance industry as a whole and the Associations of Kenya insurers (AKI) and insurance Brokers of Kenya (ABK) in particular, who saw it as one of the initiatives of the Government towards creation of a more favourable environment for the investment and development for Kenya.

With this in mind, the industry carefully studied the Bill¹⁶ section by section to see whether the provisions therein were not only fair, but also practicable, and singled out some areas in the proposals which needed to be amended further. AKI forwarded

16. *Association of Kenyan Insurance (AKI) proposals on the Insurance (Amendment) Bill, 1994 to be re-submitted to the Advisory Board for consideration and Re-submission the Government.*

these proposals to the insurance Advisory Board, the commissioner of insurance and the minister for consideration and action. Unfortunately, and in spite of the Insurance Advisory Board having made its recommendations to the authorities, no significant changes were made to the original proposals in the Bill.

Among the key issues in the comments and proposals made on the insurance (Amendment) Bill 1994 and the Finance Bill 1994 are the issues of powers of the commissioner of insurance.¹⁷

AKI's view was that increasing the power of the commissioner raises the spectre of the position holder interfering in the management of insurance business. Indeed, it raises the question as to whether his role is supervisory, regulatory or controlling and managing insurance companies.

The Bill according to AKI dilutes the influence and impact of Advisory Board since the commissioner can do anything he wants without any consultation or knowledge of Board. It is dangerous to concentrate too much power on an individual such as the commissioner to become, as it were lord and master of all, rather than bound by law.

The other issue is the quest of Advisory Board. Aki expressed concern about the increase of¹⁸ the number of persons appointed

17. *Ibid*

18. *Ibid*

by the minister or commissioner from four to five. Also regretted was that all nominees of the Aki were appointed to the Board inspite of having raised the issue previously. More balanced representation in the Board and more active role by the Board would be beneficial. Aki therefore recommended that the appointees by Government to the Board should not exceed fifty percent (50%) of membership of the board.

On the question of phasing out of cessions to Kenya Reinsurance Corporation and other compulsory reinsurance, Aki comments that the industry would like to know the timetable for the phasing out of cessions to enable insurers to re-align their reinsurance treaty arrangements¹⁹.

By the time of writing this thesis the Insurance Amendment Bill 1994 is still awaiting presidential Assent. It will be interesting to observe whether the bill will go through regardless of the objections by Aki.

It is however interesting to note that the Insurance Bill seems to give with one hand and take with the other, while as we have seen in the Attorney²⁰ General's memorandum that the bill was intended to introduce measures geared towards liberalisation of the insurance industry. It is a contradiction in itself for the same bill to talk of stiffening the supervisory powers of the

19. *Ibid*

20. *Supra (14)*

Commissioner of insurance. As Aki comments such strict supervision is not in like with the spirit of liberalisation the same bill seeks to perpetuate.

Mr. Olotch Managing Director²¹ Pan African Insurance urges that the current insurance law and even the proposals in the insurance (Amendment) bill 1994 is much behind time. A serious review of the laws regulating the insurance industry he says should invite the views of the industry and give a candid emphasis on the liberalisation of the economy. He further argues that time is ripe for complete privatisation of the insurance industry.

It is therefore clear that Privatisation with the current insurance law would only lead to further confusion.

1.2 Liberalisation and Legal Cessions to Regional Reinsurance Organizations - Case Study, Zep-Re

As we saw in the first chapter the creation of Zep-Re and subsequent enactment of the Preferential²² Trade Area Re-insurance Company (mandatory Re-insurance cessions) AG raised alot of concern in the insurance industry, more so for coming at

21. *An Interview conducted by the writer of this thesis on June 16th 1995 with Mr. William Olotch Managing Director Pan African Insurance, see Questionnaire annexed Appendixes 1*

22. *Kenya Gazette Supplement No. 51(Acts No. 3)*

a time when the trend is towards economic liberalisation. The insurance industry was already giving legal cessions to another regional insurance corporation Africa Re. In his own admission during an interview with the Financial Standard six months after its inauguration, the Zep-Re Managing Director Mr. Shadrack Lubasi said that his organisation only came in to supplement Africa Re. He said that Africa insurance organisation's objectives include the promotion and the development of insurance and reinsurance in Africa. Africa-Re, he added, is a member, and so is Zep-Re. Zep-Re does reinsurance business just like Africa-Re. By and large Mr. Lubasi said Zep-Re and Africa-Re have the same customers just like banks may have same customers.

The PTA Reinsurance²² (Mandatory Cessions) bill which formally legalised the giving of 10% legal cessions to Zep-Re faced a lot of opposition. Commenting on the bill, the Public Relations Officer, Association of Kenya Insurers (Aki) was quoted as saying that such provisions as contained in the bill would make the local insurance business unattractive and could force the industry to depend on second- tier re-insurers in the world market for their reinsurance support. He said:²³

"The bill presently before Parliament is an effort by the Ministry of Finance to retroactively legalise a directive issued by the commissioner of insurance last October that

23. *Daily Nation*, Friday April 6 1993

required insurers to place 10% share of their premiums with Zep-Re an action for which the association sued the commissioner in the courts and is presently awaiting a hearing".

He went on to state:²⁴

"The effect of the legislation is to give the commissioner of insurance exceedingly broad powers to bring charges against principal officers of insurance companies including those who might have offended him in the past or offend him in the future."

The foregoing shows the feeling of blackmail that gripped the insurance industry with the enacting of PTA reinsurance Act which provided for stiff penalties for any failure to observe the requirement of legal cessions. The industry felt that the coming of the legislation was ill times as Aki observed.

"The new bill is against the spirit of economic liberalisation and will force Kenyan insurance firms to subsidise a regional corporation body."

Aki was of the view that insurance firms should be allowed to cede to Zep-Re freely.

24. *Ibid*

The coming of Zep-Re at a time when the trend is towards economic liberalisation was a mere coincidence.²⁵ The idea of Zep-Re was conceived long before the concept of liberalization of economies was adopted in most African countries. This is as early as late 1970's and early 1980's. Though the objectives of the organisation have good intentions, they have never-less been overtaken by events.

The question whether legal cessations to local insurance firms being pretty bothersome and whether this form of protection is any longer rational has of late been raised in many forums.

We submit that one has to have a historical perspective to this issue of mandatory cessations. The government instituted them to develop a local re-insurance capacity and hence the setting up of Kenya Re-insurance Corporation. That was certainly a positive move because of the infancy stage, you need to have a facilitator firms. There after we had legal cessations to Africa-Re and now there is the new legislation aiming to give Zep-Re Legal cessations. All these cessations that have been put in place is with the over all objective of the policy makers to nurture capacity for re-insurance and to that extent they are good. We cannot however continue with legal cessations for too long because we will be acting against the spirit of liberalisation and the need for competition environment, where the reinsurance

25. *Supra* 21

firms go to the market and convince the local insurance companies to give them business.

Mrs. Kariuki the Company Secretary Zep-Re argues that creation of Zep-Re and consequent demand for²⁶ reinsurance cessions is beyond debate with the local insurance industry and that it is any a matter which can only be discussed on an international plane. She argues that Zep-Re was created pursuant to paragraph(e) of Article 28 of the Treaty for the establishment of Preferential Trade Area for Eastern and Souther African states which makes provision for the taking in common of such steps as are calculated to further the aims of Preferential Trade Area.

Mrs. Kariuki explanation perhaps reveals the complex nature of the issue of compulsory regal cessions to regional bodies, six months after inauguration of Zep-Re, Mr. Shadrack Lubasi the Managing Director Zep-Re was asked in an interview with finance Standard why Kenya Government was urging forced cessation of premiums to Zep-Re just when most African countries are liberalising their economies and whether Zep-Re did not believe in the spirit of free market and he had this to say:

"Article 20 of the PTA heads of state Agreement establishing Zep-Re in Swaziland in November 1990 states that 'each

26. *An interview conducted by the writer of this thesis on May 22nd 1995 with Mrs. Kariuki Company Secretary Zep-Re see Questionnaire annexed Appendixes 2.*

member, country which is signatory to this agreement undertakes to guarantee upon entry into force of this agreement that all insurance and reinsurance institutions operating in its territory shall offer to place with the company a minimum of 10% of their reinsurance cessations both present and future'. So when the Kenyan Government gazettes this requirement it will be in the spirit of fulfilling the aims of Zep-Re establishment agreement verified by all Heads of state of PTA. We are employed to do this business whether or not there is liberalisation or freemarket in a particular member state. We want to work hand in hand with other companies to develop our business in the region."

Mr. Olotch in an interview acknowledged the complex situation²⁷ privatisation of the regional bodies would pose. He was however quick to add that eventual privatisation and complete phasing out of legal cessations as inevitable. He saw those coming soon after the state Reinsurance Corporation (Kenya Re) is itself privatised.

We submit that privatisation of the regional reinsurance corporations is imminent bearing in mind that the pressure to liberalise is sweeping through out Africa.

27. *Supra* 21

The Government appears to have appreciated the need for and importance of liberalisation. The Minister of Finance Mr. Musalia Mudavadi was quoted as saying that²⁸ liberalisation of the insurance industry would have the region's insurers stronger. He went on to say that competition sweeping through economies of the region would see the exit of weaker insurance companies from the market.

He advised insurance companies in his own words:

".....pay greater attention to development of technical expertise and professional management if the insurance industry is to survive in an increasingly competitive environment."

The Managing Director Kenya Re Mr. William Mbote while welcoming the changes in the parastatal was quoted as saying that the changes were not meant to destroy the company. He said that government's aim was to create an atmosphere where all would perform their business on equal basis. He said:²⁹

"We are talking of a situation where Kenya-Re and other reinsurance companies will be able to perform their business on a level playing ground."

28. *Daily Nation* Friday July 19th 1994

29. *Daily Nation* 30th Nov. 1994

In this thesis we started by assessing the justification of law relating to state control of insurance industry. We saw that insurance legislation in developing countries had the blessing of United Nations Conference on Trade and Development (UNCTAD) in light of the circumstances prevailing in such developing countries essentially soon after independence.

We went further and saw that circumstances have since changed and the tide now is towards privatisation of state controlled organisations and liberalisation of the insurance industry at large. We saw how attempts to change the law to facilitate such liberalisation have been failing.

We then looked into the controversial issue of setting up of Zep-Re and having to give it mandatory legal cessations at a time when the trend is towards liberalising the economy. We saw how delicate the controversy is bearing in mind that the corporation was set up by an international agreement making it subject of international law.

From the news and interviews with leading personalities in the insurance industry we gather that complete privatisation is just a matter of time.

We are now ready to make a few recommendations and conclusion based on our findings in our research.

CHAPTER III

'RECOMENDATIONS AND CONCLUSION'

1.0 RECOMMENDATION

History has proved that private enterprise is a more effective tool for economic development particularly with the collapse of Socialism. While this might be the case, wholesale privatisation might not be in the interest of the countries which have established national reinsurance corporations. What seems to have happened over the years is that not much emphasis has been placed in making the organisations more relevant to their economies, partly because the management of the institutions did not have to look beyond legal cessions, with the pressures brought about by the need for economic liberalisation, the pressure is building up. Each country, however, should be allowed to choose how best to cope with the demands.

In giving our recommendations we will assess methods followed by various countries so far as they were explained by Mr. Olotch¹ when he was the General Manager Kenya Re. They are as follows:

1. Olotch William *'The Role of National sub-Regional and Regional Reinsurance Organisations.'* 19th African Insurance Conference held in K.I.C.C. Nairobi 1992. p.19

- Complete Privatization
- Phasing out of legal cessions
- Commercialisation

Complete Privatization and Phasing out of legal cessions

In Africa, it appears that there has been no example where a national reinsurer has been sold to private interest following the world wide trend, towards economic liberalisation. The only case so fare relates to a direct writing company SONAGAR in Gabon, which was sold 8 years ago. There are indications also that SGR Morocco might be sold to private interests and from discussions with some of their senior officials shares will be sold mainly to local insurance companies but foreign participation might be possible.

There are already on the other hand, national reinsurance corporations which have a substantial private shareholding, such as Tunis Re where the government has only 10% direct participation with the balance held by the local insurance companies and banks. The company does not receive legal cessions as already observed but writes a substantial amount of premium by African Standards (above US\$ 20 million) local business forms 40% of the company's annual premiums income and the balance is obtained from external sources. Another national reinsurer with private participation is SEN Re at Senegal and the private shareholders are the local insurance companies.

Mr. Olotch further observed that cases² of privatization of former national reinsurance companies are to be found in South Korea and Chile among other developing countries. In the case of South Korea, Mr. Olotch explained that The Korean Reinsurance company was formed by the Government in April 1963, as the Korea Non-life Reinsurance Corporation. It added life reinsurance in 1968. The company was reorganised as a private owned company from March 1978, with the local non-life insurance companies owing a substantial share in the new company. As reported in the company's Annual Report (1990) The company has been notably successful since its re-organisation and has played a pivotal role in supporting domestic companies. Its reinsurance activities are worldwide in scope, operating through its head office and overseas network.

In the case of Chile Mr. Olotch³ further observes that the National Reinsurer, Caja de Reaseguradora de Chile was formed in 1927 and for 52 years had the monopoly on all Chilean reinsurance business. In 1980, Caja was transformed into a joint stock company and its reinsurance monopoly was removed. Since then, there has been complete freedom for approved reinsurers and brokers. Apart from some companies with foreign origins, all local companies have some dealing with the Caja and they do not appear to have greatly suffered from the changes in 1980. The amount of premium ceded abroad according to authoritative source,

2. *Ibid p.20*

3. *Ibid p.21*

increased from 37% in 1980 to 42% in 1983. Caja fortunately, was able to retain 50% of the local reinsurance business and it was helped in attaining this achievement partly due to expertise the company has built over the years.

Ultimately, even those reinsurers and others which have made progress in making regal cessions more relevant to their industries should aim at operating on voluntary cessions like other professional reinsurers. For developing countries however, the only problem in allowing domestic insurance companies reinsure freely with external reinsurers, would be the availability of foreign exchange and so long as the shortage persists, restrictions on placement will be necessary.

Commercialisation

Mr. Olotch explained in his paper that⁴ this is a scheme which has been implemented in Nigeria under the Privatization and Commercialisation Decree No. 25 1988. The decree only affects those public enterprises that are not privatized and where the Government is to remain a shareholder. The objective of the scheme, is to make the organisations concerned, more efficient and as much as possible operate on profit maximization basis. The enterprises are divided into two groups, those that are to be particularly commercialised and those that have to be fully

4. *Ibid* p.22

commercialised, with the following definitions given for the two categories:

Full Commercialisation

Means that enterprises so designated will be expected to operate profitably on commercial basis and be able to raise funds from the capital market without government guarantee. Such enterprises are expected to use private sector procedures in the running of their business.

Partial Commercialisation

Means that such enterprise so designated will be expected to generate enough revenue to cater for their operating expenditures. The Government may consider them for capital grants to finance intensive projects.

For our discussions, what appears to be of great interest in the Nigerian example, is the attempt at making the enterprises in question operate in an atmosphere where an organisation's maximum potential can be achieved as an alternative to privatization. In this connection, Nigeria Re and the National Insurance Corporation of Nigeria are to be fully commercialised. Among the areas the scheme has addressed itself and which will have a great impact in the performance of the organisations are:

- Redefining the role of the Board of Directors to avoid interference with operational decisions

- Defining the role of the Board of Directors so as to distinguish the expected contribution from that of management

- The expansion of the role of management to enable them operate with the units of their business charters and the capacity of the balance sheets. In addition, the Board can delegate specific duties to management. A performance contract setting out specific operation targets will be signed between the supervisory ministry and the Board on enterprise.

In addition to the above, the scheme provides procedures for the appointment and removal of Boards of Directors, Chief Executives and Management staff. The appointment of Directors both executive and non-executive, the scheme requires that only persons who can contribute meaningfully to the growth and development of an enterprise by virtue of their training and experience be considered. Appointments viewed as patronage to be discouraged and merit emphasised on all cases.

Other provisions are also made to ensure that the enterprises would be managed effectively, with the necessary checks and balances. As far as restructuring and the administration of such institutions are concerned, the framework provided is very comprehensive but the role which the national reinsurer should play in keeping with economic liberalisation trends and the changes in the industry, following increased retention and the like should so be reviewed along the suggestions already made.

As we have established in this thesis privatization and liberalisation of the insurance industry is surrounded with a lot of uncertainty due to conflicting interests. It is therefore in the best interest of nation that the foregoing possible alternatives be considered. The Government on its part should be open and genuine in inviting opinion from experts in the private sector of *insurance industry and involve them in preparing various proposals aimed at privatization or liberalisation of the insurance and reinsurance industry in Kenya.*

1.1 CONCLUSION

In this thesis we have established that taking into account the economic environment existing at the time of independence for most African countries, there is no doubt that state control of insurance and reinsurance industry was justified and the question now remains whether time is ripe for complete privatization and liberalisation of the insurance industry.

We submit that the ultimate aim should be privatization and removal of legal cessions but bearing in mind our country's peculiar circumstances, preference, level of economic development and other factors privatization should be handled with a lot of care.

There is pressure to liberalise but while these pressures are welcome in as far as they are bound to promote efficiency in the management of national sub-regional and regional insurance and reinsurance corporations. It would be unfortunate to sell them to foreign interest as has in fact happened in some African countries. The Chairman of the Board of Directors and the General Assembly of Africa Re Mr. Eugene Okwor cautioned that⁵ liberalisation of the African economies should be prioritised to ensure that national interests are preserved. He said liberalisation must take into account specific economic circumstances in different African countries. He added that some African countries had opened up their economies in such a way that foreign companies found it easier to establish themselves than those run by their own nations. In his opinion this was retrogression and amounted to indirect "re-colonisation of Africa."

‘Any country liberalising its economy must take into account what is vital for its national interests.’ He said.

Mr. Okwor singles out the insurance sector which he said was critical to economic development, urging that the sole of key companies in the sector would not be in the interest of countries concerned.

"Insurance is a key sector in any society, particularly in Africa because it is a mobiliser of developing funds right down to the grassroot". He added.⁶

He further noted that many Governments relied on the insurance sector for funds.

While Mr. Okwor sentiments seem to down play the importance of privatization and liberalisation of the insurance industry they are nevertheless persuading.

The whole question of privatization and liberalisation of insurance industry as we have established in this thesis is one

5. Daily Nation. Business week 5th July 1992.

APPENDIXES.

Appendixes 1.

QUESTIONNAIRE DIRECTED TO MR. OLOTCH MANAGING DIRECTOR PAN AFRICAN INSURANCE COMPANY LIMITED.

1. What is your view of Privatisation of insurance and Reinsurance industry, in Kenya in view of the liberalisation of the economy?
2. What is your reaction to the creation of Zep Re and consequent requirement of insurance companies to give it compulsory legal cession?

APPENDIXES 2.

QUESTIONNAIRE DIRECTED TO MRS. KARIUKI COMPANY SECRETARY ZEP. RE.

1. What is your response to the criticism levelled against the creation of the Zep Re and the subsequent requirement to give it compulsory legal cessions.