

**REGULATORY CHALLENGES OF BANCASSURANCE: A COMPARATIVE
ANALYSIS BETWEEN KENYA, INDIA AND SOUTH AFRICA**

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By

KIGUTA IVY NUNGARI

083707

Prepared under the supervision of


DR. JOY MALALA- SCHOLZ

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Declaration

I, IVY NUNGARI KIGUTA, do hereby declare that this research is my original work and that to the best of my knowledge and belief, it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

Signed: 

Date: 29/05/2018

This dissertation has been submitted for examination with my approval as University Supervisor.

Signed: 

DR. JOY MALALA- SCHOLZ

28/05/18

ABSTRACT

The provision of insurance and banking products and services through a common distribution channel or to a common client base is referred to as bancassurance. Today the situation has totally changed wherein each and every individual in relatively every edge of our country has access to insurance products because of the role played by banks in the distribution. The part that banks play as intermediaries in the distribution of these products to consumers through their tremendous networks produces enormous business incomes all around. In Kenya, banks and insurance agencies have collaborated to offer insurance products to customers regardless of want of regulations governing these partnerships. This issue is aggravated by the way that these partnerships between banks and insurance agencies have for a long time been prohibited by express provisions of law. Here lies the issue that this paper tries to investigate and resolve. The paper recommends direction of bancassurance and proposes a system, which such control should take. The main strategy adopted in this paper is the risk based research approach.

DEDICATION

This paper is dedicated to my family in particular my little niece and goddaughter Natalia.

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2. Central Bank of Kenya Act 1996
3. Insurance Act of Kenya 2012
4. Competition Act 2010
5. Consumer Protection Act Kenya 2012
6. Reserve Bank of India Act 1934
7. Insurance Act of India 1938
8. Banking Regulations Act of India 1949
9. Insurance Regulatory and Development Authority Act, 1999
10. Banks Act (South Africa) 1990
11. Short Term Insurance Act 1998
12. Long-term Insurance Act 1998
13. Financial Advisory and Intermediary Services Act 2002

LIST OF ABBREVIATIONS

CBK- Central Bank of Kenya

IRA- Insurance Regulatory Authority

SLA- Service Level Agreement

ALICO- American Life Insurance Company

RBI- Reserve Bank of India

IRDA- Insurance Regulatory and Development Authority (of India)

SARB- South African Reserve Bank

FSB- Financial Services Board

STIA- Short Term Insurance Act

LTIA- Long Term Insurance Act

FSP- Financial Service Provider

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Chapter 1: INTRODUCTION

1.1 Background

In its Policy Research Paper on bancassurance The World Bank defines bancassurance as the process of using a bank's branches, sales network, and customer relationships to develop sales of insurance products¹ The concept of bancassurance can also be defined as the collaboration between banks and insurance companies whereby banks may manufacture, distribute or market insurance products offered by partner insurance companies in one form of construct or other, which ranges in complexity on a continuum depending on the degree of collaboration between the bank and its partner insurance provider²

Bancassurance is a fairly new concept in Kenya. It dates back to the year 2009. During this time banks were trying to diversify their channels of income and to secure their profits and customers, which were under threat and dilution caused by increasing alternatives to their financial services such as the use of Mpesa and Airtel money. Banks therefore developed the concept of bancassurance also known as the Banking Insurance Model (BIM). This move has brought about numerous benefits to the players in both the banking and insurance industries, which include increased profits. Consumers too are reaping benefits from the concept of bancassurance since they can now get numerous financial services all under one roof which is very convenient.

In Kenya there are a number of banks carrying out bancassurance some of which include:

1. First Insurance Agency license issued to CBA Bank under CBA Insurance Agency
2. Equity Bank under Equity Insurance Agency
3. KCB under KCB Insurance Agency
4. National Bank under National Bank Insurance Agency

¹Gonulal S, Goulder N and Lester R, "Bancassurance A Valuable Tool for Developing Insurance in Emerging Markets." The World Bank, Financial and Private Sector Development, Non-Bank Financial Institutions; Policy Research Working Paper 6196 September 2012

²Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

Despite the evident advantages of bancassurance in Kenya, it is important to analyse the legality of these practices in Kenya in light of the Banking Act, which provides for the functions of banks. A bank is a company, which carries on, or proposes to carry on, banking business in Kenya but does not include the Central Bank³.

1.2 Statement of the problem

This paper posits two principal issues. Firstly, whether bancassurance arrangements generally fall outside of the current relevant legislative framework in Kenya and if so what framework has been put in place to regulate these arrangements? Secondly, as result of lack of legislation whether there are any legal set backs of bancassurance.

1.3 Justification of the study

This study is justified on the basis that although most banks if not all in Kenya carry out bancassurance, there is no legislative framework regulating it. Therefore this paper seeks to address the legal basis of bancassurance in Kenya and the legal challenges that have risen in bancassurance. The problem the study seeks to resolve has arisen because the law has not moved at the same pace with innovations in e-commerce and therefore the void must be filled and the regulatory challenges must be addressed. The reality on the ground is far removed from the law and this study seeks to bridge the two.⁴

1.4 Statement of Objective

The following are the objectives of this research paper:

1. To determine the regulatory framework of bancassurance in Kenya.
2. To determine the regulatory challenges bancassurance brings to Kenya.
3. To determine what an appropriate regulatory framework should look like through a comparative analysis.

1.5 Research Questions

The following are the research questions this paper hopes to answer:

³ Section 2(1), *Banking Act*, (Act No.25 of 2015)

⁴Hamwela A, '*A model framework for Bancassurance regulation in Zambia*' Unpublished LLM Thesis, The University of Zambia, November 2013

1. Is there a regulatory framework for Bancassurance in Kenya?
2. What are the regulatory challenges that Bancassurance brings to Kenya?
3. What should an appropriate regulatory framework look like?

1.6 Hypothesis

This paper shall precede on the basis of the hypothesis that bancassurance although essential for the promotion of insurance has a number of regulatory setbacks mainly because it is not covered by specific legislation in Kenya. In addition because it is also a fairly new concept in India bancassurance in India also faces some of the same challenges faced here in Kenya and therefore it would provide a lens through which these challenges can be dealt with in Kenya. Similarly, the South African regulation of financial services is at a forefront in the continent and therefore many lessons can be learnt by Kenya with regards to bancassurance.

1.7 Literature Review

There exists a wealth of literature concerning the legal framework of bancassurance in other jurisdictions such as France that has practiced bancassurance since the 1980s. However, in Kenya since the concept is fairly new, there is an apparent scarcity regarding the treatment of the issue this paper seeks to address. Despite this, some important aspects of this paper relating to the legal framework of bancassurance both in Kenya and India have been crafted with heavy reliance being placed on the existing literature.

In his thesis Dr Erastus Muriuki states that, the greatest challenge facing bancassurance in Kenya lies within the Banking and Insurance Acts.⁵ He goes on to explain that under the Insurance Act, only registered brokers, agents, risk managers, loss adjusters, motor assessors, insurance investigators, surveyors and claims settling agents to carry on insurance business.⁶ In addition, he states that the Banking Act defines banking business very restrictively.⁷ Muriuki's paper does not exhaustively assess and analyse the regulatory framework that has come about from the guidelines set by the Central Bank of Kenya (CBK)

⁵Muriuki E, 'The application of the bancassurance distribution model for increasing insurance penetration in Kenya' Unpublished PHD Entrepreneurship Thesis, Jomo Kenyatta University of Agriculture and Technology.

⁶ Section 150, *Insurance Act* (Act No. 487 of 2015)

⁷Muriuki E, 'The application of the bancassurance distribution model for increasing insurance penetration in Kenya' Unpublished PHD Entrepreneurship Thesis, Jomo Kenyatta University of Agriculture and Technology

and the Insurance Regulatory Authority (IRA), therefore the question of the legal challenges of bancassurance has not been addressed in his paper.

In his paper Hamwela, posits that one of the major issues regulation should address is a bancassurance distribution model that is permissible.⁸ This is on the basis that many European countries such as France and Germany whose regulatory framework on bancassurance have adopted one or another bancassurance distribution model. There are three main distribution models; simple commercial distribution agreements on an exclusivity basis, joint ventures coupled with exclusive distribution agreements and the fully integrated model where a bank wholly owns an insurance company that acts as its bancassurance partner.⁹ Although his paper is on the legal framework in Zambia, Hamwela brings up legal challenges that are also evident in Kenya for example the use of different distribution models in different Kenyan banks. His paper acts as guide that facilitates this paper in an in depth analysis of the legal challenges of bancassurance.

In its report on bancassurance, the Committee on Bancassurance constituted by the Insurance Regulatory and Development Authority (IRDA) of India, many challenges facing bancassurance are highlighted. In addition, the committee sets forth a number of recommendations. One of the legal challenges highlighted in this report, is the restriction of the number of agreements that a bank can have with insurers. The law restricts one bank to one insurer making it difficult for the bank to diversify the insurance products it distributes to its consumers. As a way to combat this challenge the committee recommends that, banks should be allowed to have tie-up with any two sets of insurers.¹⁰ For example two life insurers sectors or two no life insurance sectors excluding health.¹¹ This report informs this paper on the legal challenges facing bancassurance in India. However, since the report was written more than five years ago, this paper will assess whether these challenges were

⁸Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

⁹Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

¹⁰ Insurance Regulatory and Development Authority, ' *Report of the Committee on Bancassurance*' India, 7 June 2015

¹¹ Insurance Regulatory and Development Authority, ' *Report of the Committee on Bancassurance*' India, 7 June 2015

combated in Indian legislation on the basis of the recommendations highlighted by the committee.

1.8 Limitations

This paper limits its research to the regulation of bancassurance in Kenya and the regulatory challenges that have come about since its development .The study will also be limited to a comparative case study of the legal frameworks of bancassurance in India and South Africa.

1.9 Chapter summary

Chapter 1: Introduction

This chapter introduces the paper by giving the background of the topic, reasons for the research and will give the purpose for the study. It will explain the research problem and also the importance of studying this topic. It will include the following subsections:

Chapter 2: Conceptual/Theoretical Framework.

This chapter deals with the risk based regulatory theory to provide a lens through which the above topic will be analysed.

Chapter 3: Study/analysis of the research questions

This chapter will contain an examination of the research questions by discussing case studies from other jurisdictions that have had similar questions to answer. It will put into perspective the regulatory challenges in Kenya.

Chapter 4: Comparative analysis

This chapter will focus on comparing the regulatory frameworks of India and South Africa with that of Kenya so as to determine what an appropriate framework for Kenya looks like.

Chapter 5: Recommendations and conclusion

This chapter will contain recommendations and will give an opinion on what the best model is for regulating bancassurance in Kenya.

CHAPTER 2: CONCEPTUAL FRAMEWORK - RISK-BASED REGULATION OF BANCASSURANCE

2.1 Introduction

In his June 2015 budget speech, National Treasury Secretary Henry Rotich highlighted some of the key changes to the financial sector among them the adoption by regulators the risk-based supervision model in line with international best practices.¹²

Risk has become a new focal point through which the world is viewed. This is because according to Julia Black, the role of 'risk' is to guide decision-making by leading governments and regulators in attempts to find stability through the rationalization processes and procedures, attempts, which are often unsuccessful due to the inherent nature of risk itself. Risk is a focal point in terms of business, academic studies, government and more so in regulation. Risk based regulation involves a 'top down' point of view where solutions to problems are explored, as opposed to the traditional approach which, takes a 'bottom up' approach in where the possibilities are bound by what is provided for under the law.

The risk- based approach has been described as a regulatory approach that focuses on the delivery of outcomes and public value, in which the regulator seeks to partner with the regulated in the proactive prevention of harms.¹³ This therefore means a risk-based approach to regulation will focus on harm or risks that prevent the distribution of common good rather than expending resources on ascertaining compliance to laws where no authentic harm is being done.

The traditional/ neoclassical notion of regulation is the exercising of public authority through a system of rules and laws in which the regulator ensures technical compliance by the regulated and if there is no compliance the regulated is faced with high penalties. Such approaches are seen as reactive and focused on enforcement, and may miss critical emerging

¹² <<https://oxfordbusinessgroup.com/analysis/shifting-gears-new-regulatory-framework-bringing-sector-further-line-international-best-practices>> on 20 January 2018.

¹³ Nicholls A, 'The Challenges and Benefits of Risk-Based Regulation in Achieving Scheme Outcomes' Injury Schemes Seminar, Adelaide Australia, 8th-10th November 2015, <https://www.actuaries.asn.au/Library/Events/ACS/2015/NichollsRegulation.pdf>, as accessed on 9th October 2017

risks because they are seen as being outside of jurisdiction, with regulators often being slow in their response.¹⁴

Risk-based approaches to regulation have gained traction among governments around the world, as they attempt to deal with their accountability for public outcomes that are being delivered by the private or not-for-profit sectors within their jurisdictions.¹⁵ Risk-based regulation emerged between the 1980s and 1990s in Britain when a number of industries faced a ‘regulatory crisis’ caused by over-regulation, absence of adequate attention being given to the cost regulation which were mostly viewed as high and inflexibility of laws at that time. As a result of this ‘regulatory crises’ Britain faced a deregulatory initiatives that would enhance efficiency and effectiveness of the operations in industries therefore increasing public value as put by Mark Moore. Such a climate, of deregulation rhetoric, created an environment that favored the adoption of approaches that incorporated costs benefit analysis, were objective and transparent, characteristics of the risk-based approach of regulation.¹⁶ Nicholls states that,

“In a risk-based regulatory framework, there is greater transparency about the objectives to be achieved, and greater accountability placed on both the regulator and the regulated to work proactively to ensure delivery of the outcome.”¹⁷

¹⁴ Nicholls A, ‘The Challenges and Benefits of Risk-Based Regulation in Achieving Scheme Outcomes’ Injury Schemes Seminar, Adelaide Australia, 8th-10th November 2015, <https://www.actuaries.asn.au/Library/Events/ACS/2015/NichollsRegulation.pdf>, as accessed on 9th October 2017

¹⁵ Nicholls A, ‘The Challenges and Benefits of Risk-Based Regulation in Achieving Scheme Outcomes’ Injury Schemes Seminar, Adelaide Australia, 8th-10th November 2015, <https://www.actuaries.asn.au/Library/Events/ACS/2015/NichollsRegulation.pdf>, as accessed on 9th October 2017

¹⁶ Hutter B, ‘The Attractions of Risk-Based Regulations: Accounting for the Emergence of Risk- Based Ideas in Regulation’, ESRC Centre for Analysis of Risk and Regulation, March 2005, <https://www.lse.ac.uk/accounting/CARR/pdf/DPs/Disspaper33.pdf>, on 9th October 2017

¹⁷ Nicholls A, ‘The Challenges and Benefits of Risk-Based Regulation in Achieving Scheme Outcomes’ Injury Schemes Seminar, Adelaide Australia, 8th-10th November 2015, <https://www.actuaries.asn.au/Library/Events/ACS/2015/NichollsRegulation.pdf>, as accessed on 9th October 2017

The main aim for regulators when implementing the risk-based approach is to prevent harm and foreseeable financial risks and crises such as the global recession of 2008. The risk-based approach calls for a regulator that is not solely focused on technical compliance and enforcement, but rather a more purpose-driven and agile approach in which the regulator exercises choices about the issues to focus on and employs a range of instruments to address harms that impede the achievement of outcomes, and thus influence or ensure the delivery of common good.¹⁸

2.2 Risk- Based Regulation and Bancassurance

Cooperation between financial market entities, in particular between banks and insurers, is the field of rapid development and constant innovation. Both the high growth rate and the intensity of changes leave open the area of bancassurance to creation, exposure and implementation of risks associated with the nature of financial market and operational risks arising from the involvement of several entities in the business undertaking.¹⁹ As Vincent Vandendael, chief commercial officer, Lloyd's of London posits,

“With too many players operating in a low growth environment, the insurance industry faces the risk of a race to the bottom on rates, a risk that is accelerated by changing distribution models and new technology.²⁰ But where there is risk, there is opportunity. Innovative insurance solutions like cyber, intellectual property rights or reputation, to name a few. We are addressing needs of our customers, attracting new talent to our industry and helping accelerate growth.”²¹

The focus on risk seems to derive from regulatory concern about potential failures that might result from bancassurance mergers and the possibility of the transmission of that risk to the

¹⁸ Nicholls A, 'The Challenges and Benefits of Risk-Based Regulation in Achieving Scheme Outcomes' Injury Schemes Seminar, Adelaide Australia, 8th-10th November 2015, <https://www.actuaries.asn.au/Library/Events/ACS/2015/NichollsRegulation.pdf>, as accessed on 9th October 2017

¹⁹ http://cejsh.icm.edu.pl/cejsh/element/bwmeta1.element.desklight-c2214452-e4c5-4c9e-84aa-2d69295092fb/c/9_D.Szewieczek_The_Risk_of_Cooperation....pdf on 19 January 2018

²⁰ http://cejsh.icm.edu.pl/cejsh/element/bwmeta1.element.desklight-c2214452-e4c5-4c9e-84aa-2d69295092fb/c/9_D.Szewieczek_The_Risk_of_Cooperation....pdf on 19 January 2018

²¹ <https://www.strategic-risk-europe.com/the-biggest-challenges-facing-the-insurance-industry/1421855.article> on 19 January 2018

entire financial system.²² There are many risks inherent in the bancassurance sector that may affect all the stakeholders including consumers and stockholders in both the banking and insurance industries. It is therefore important for regulators to use these risks as guiding factors when drafting laws with regard to bancassurance.

2.2.1 Risk facing banks

From a banking perspective, bancassurance offers a great opportunity to improve their profitability by enhancing fee-based income because this income is purely risk free for the bank since the bank plays the role of an intermediary for sourcing business to the insurance company as an agent or broker does.²³ Agency and brokerage is mainly a commission and/or fee-oriented business, therefore it is not a capital-intensive activity and since the bank is merely acting as a distribution channel there are little safety and soundness concerns.²⁴ However, it can be assumed that corporations, which provide brokerage functions, have taken into account elements of operational risk in their overall capital requirements.²⁵ Therefore, bancassurance risk would refer to chances of bank making financial loss because of engaging in insurance alongside banking activities. Risks faced by banks with regard to bancassurance include incurring loss, resistance from customers, operational inefficiency and deviation from core business goals. These risks are however not provided for under any

²² Mwangi J, 'An Assessment Of The Determinants Of Growth Of Bancassurance In Kenya,' Unpublished MBA Thesis, University of Nairobi, October 2010, <http://erepository.uonbi.ac.ke/bitstream/handle/11295/5760/Fulltext?sequence=1> as accessed on 19 January 2018

²³ Mwangi J, 'An Assessment Of The Determinants Of Growth Of Bancassurance In Kenya,' Unpublished MBA Thesis, University of Nairobi, October 2010, <http://erepository.uonbi.ac.ke/bitstream/handle/11295/5760/Fulltext?sequence=1> as accessed on 19 January 2018

²⁴ Mwangi J, 'An Assessment Of The Determinants Of Growth Of Bancassurance In Kenya,' Unpublished MBA Thesis, University of Nairobi, October 2010, <http://erepository.uonbi.ac.ke/bitstream/handle/11295/5760/Fulltext?sequence=1> as accessed on 19 January 2018

²⁵ Mwangi J, 'An Assessment Of The Determinants Of Growth Of Bancassurance In Kenya,' Unpublished MBA Thesis, University of Nairobi, October 2010, <http://erepository.uonbi.ac.ke/bitstream/handle/11295/5760/Fulltext?sequence=1> as accessed on 19 January 2018

legislation or regulations by the Insurance Regulatory Authority, but can be mitigated and provided for in a binding Service Level Agreement (SLA), a contract between the bank and insurance firm, which must be submitted to IRA before the business commences. Therefore in the case, the contract would provide the legal framework that would govern what happens in the case the risks occur.

In addition, with regards to the joint venture model (of bancassurance), where a bank partners with an insurance firm to form a new insurance firm, and the fully integrated model (of bancassurance), where all financial services were produced (underwritten) within and distributed by a single corporation and all activities supported by a single capital base,²⁶ there is high risk of a bank being susceptible to collapse which would put depositors' funds at risk and would subsequently cause systemic risk in the financial system. Therefore, in order to ensure that the banks liquidity ratios remain healthy and to avoid these risks Reserve Bank of India has provided in its guidelines that these forms of bancassurance shall be sufficiently covered under the Insurance Act agency provisions.²⁷ Furthermore RBI provides that any form of equity based bancassurance model must be made subject to Central Bank prior approval.²⁸

2.2.2 Risk facing insurance firms

Historically, there has been a fear that allowing banks and insurance companies to mix ownership could lead to financial instability. For example, a bank in financial trouble could cause the collapse of an affiliated insurance company²⁹ As a result of this risk, the Reserve Bank of India (RBI) set guidelines in the year 2000, that a commercial bank is permitted to undertake insurance business as an agent of an insurance company, or through equity

²⁶http://shodhganga.inflibnet.ac.in/bitstream/10603/132483/11/11_chapter%204.pdf on 19 January 2018

²⁷ Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

²⁸ Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

²⁹Muruiki E, 'The Application Of The Bancassurance Distribution Model For Increasing Insurance Penetration In Kenya' Unpublished PHD Entrepreneurship Thesis, Jomo Kenyatta University Of Agriculture And Technology.

²⁹ Section 150, *Insurance Act* (Act No. 487 of 2015)

participation in a joint venture with an insurer, provided that a bank could not hold more than 50% equity in the joint venture without RBI prior approval.³⁰ Therefore it would almost be impossible for a bank under receivership to collapse its affiliate insurance company.

2.2.3 Risk facing consumers

In recent times, as result of individuals defaulting on their loans for one reason or another, it has become common practice for banks to require a loanee to take an insurance cover on the loan to act as security in case of default of payment. There a bank may exploit and induce the loanee to take an insurance cover (which may not be favourable to the loanee) from an insurance firm that bank is in agreement with and under the banks brokerage firm so as to get a commission from the insurance firm. To prevent this exploitative risk that consumers may face, Section 71 of the Insurance Act provides that a bank shall not prescribe or assign an insurance company or broker to a loanee unless the loanee forfeits in writing he right to select an underwriter or broker. The bank should inform a loanee that they have a right to select an insurer or broker from all those licensed by Insurance Regulatory Authority (IRA).³¹ Contravention of the above provision would lead to a fine not exceeding 5 million Kenyan Shillings.³² The above shows an example of a risk based regulation that seeks to prevent consumers from being exploited.

2.3 Conclusion

Although bancassurance has numerous advantages, such as increasing insurance penetration to new markets through banks huge clientele and providing an efficient mode of insurance distribution, it can be noted that there are many risks that come with bancassurance that could gravely affect the financial system. Therefore, a risk- based approach of regulation can impede these risks and ensure an efficient bancassurance system.

³⁰ Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

³¹ Section 71A (1), Insurance Act (Act No. 487 of 1987)

³² Section 71A (2), Insurance Act (Act No.487 of 1987)

CHAPTER 3: REGULATION OF BANCASSURANCE IN KENYA

3.1 Introduction

A supportive regulatory framework is important for the success of bancassurance. Price Waterhouse Coopers (PWC) explained that regulation affects the pricing and delivery of insurance products. The study done by Teunissen in 2008 showed that the development of bancassurance products in countries such as France, Italy and Spain was favored in part by a high degree of regulatory freedom.³³

There exist both legal and institutional frameworks that govern Bancassurance in Kenya.

3.2 Legal framework

The legal framework of bancassurance in Kenya has been formulated to address; concerns of consumer protection, the insurance products that may be distributed through bancassurance, the relationship between institutions (banks and insurance companies) and the licenses and approval requirements (for example a bank seeking to engage in permitted incidental business shall seek the prior approval of the Central Bank before engaging in such business activity),³⁴ among other matters. Therefore, Kenya has a rich legal framework contained in various pieces of Acts of parliament and other subsidiary legislation passed in parliament.

3.2.1 The Constitution

With regards to consumer rights, the Constitution of Kenya is the ultimate guardian of consumer rights.³⁵ Protection of consumer rights is a constitutional entitlement in Kenya. Generally, consumer means any entity or person who uses, has used, or is or may be contemplating using, directly or indirectly, any of the products or services provided by an

³³Ng'etich S, 'Growing Role of Bancassurance in the Banking Sector: A Case of Kenya Tier 1 Local Banks' Unpublished Bachelor of Actuarial Science Thesis, Strathmore University, November 2016

³⁴ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

³⁵ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

institution; the term consumer may be used interchangeably with customer.³⁶ The Constitution provides that consumers have the right:³⁷

- To goods and services of reasonable quality
- To the information necessary for them to gain full benefit from goods and services;
- To the protection of their economic interests;
- To compensation for loss or injury arising from defects in goods or services.

The above provision applies to both public entities and private persons that offer services and goods. A consumer in bancassurance is a natural or juristic person who requires insurance services through a bank that provides a distribution channel.³⁸

Further, the Constitution empowers parliament in Article 95, to enact legislation that would provide regulation for different sector of the economy.³⁹ As a result parliament has enacted various laws that would provide a framework for bancassurance in Kenya.

3.2.2 Banking Act

The Act defines a bank as a company that carries on, or proposes to carry on, banking business in Kenya but does not include the Central Bank⁴⁰. Banking business means any activity carried out by a bank for purposes of:⁴¹

- a) Accepting money on deposit repayable on demand or at the expiry of a fixed period or after notice from members of the public;
- b) Accepting from members of the public, money on current account and payment on and acceptance of cheques

³⁶ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

³⁷ Article 46, Constitution of Kenya (2010)

³⁸ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

³⁹ Article 95(3), Constitution of Kenya (2010)

⁴⁰ Section 2, *Banking Act* (Act No 9 of 1989)

⁴¹ Section 2, *Banking Act* (Act No 9 of 1989)

- c) Employing of money held on deposit or any part of the money, by lending, investment or in any other manner for the account and at the risk of the person so employing the money⁴²

The Banking Act defines banking business very restrictively and does not include the distribution of insurance products (bancassurance) in its definition thus causing a great impediment to bancassurance. This barrier to entrance was seen a few years ago when a deal between American Life Insurance Company Kenya (ALICO) and Barclays Bank of Kenya to sell life cover through the bank was rejected by the Commissioner of Insurance due to the strength of the Banking Act, which excludes bancassurance as a banking business.⁴³ In addition to this the Central Bank of Kenya had for many years excluded the sale of insurance products based on the definition of banking business. However, the Central Bank, through the powers given to it in the Central Bank of Kenya Act, may prescribe regulations on any other incidental business carried out by banks and not provided for under the Act.

3.2.3 Central Bank of Kenya Act

Section 3 of the Act establishes the Central Bank as a body corporate with perpetual succession and a common seal which shall exercise any type of central banking function as provided for under this Act and shall not be subject to the Companies Act or the Banking Act.⁴⁴ The Central Bank of Kenya is the overall regulator of the country's financial system.⁴⁵ In addition to this, it may make its own rules and regulations as well as guidelines that aide in the regulation of banks.⁴⁶ Section 57 of the Act provides that the Bank may make regulations for the purpose of giving effect to the provisions of the Act and generally for the better carrying out of the objects of the Bank.⁴⁷ It may alsoin regulations, prescribe penalties to be

⁴² Section 2, *Banking Act* (Act No 9 of 1989)

⁴³Muruiki E, 'The Application Of The Bancassurance Distribution Model For Increasing Insurance Penetration In Kenya' Unpublished PHD Entrepreneurship Thesis, Jomo Kenyatta University Of Agriculture And Technology.

⁴⁴Section 3, *Central Bank of Kenya Act* (Act No. 15 of 1996)

⁴⁵Section 4, *Central Bank of Kenya Act* (Act No. 15 of 1996)

⁴⁶Section 4, *Central Bank of Kenya Act* (Act No. 15 of 1996)

⁴⁷Section 57(1), *Central Bank of Kenya Act* (Act No. 15 of 1996)

paid by authorized dealers and natural persons, who fail to refuse to comply with any guidelines or directions of the Central Bank under this Act.⁴⁸

3.2.4 Insurance Act

The Insurance Act was amended in 2012 to consolidate the laws relating to insurance while regulating the business of insurance.⁴⁹ To begin with, the Act establishes the Insurance Regulatory Authority and outlines the objects and functions of the authority.⁵⁰ It also establishes the position of Commissioner for Insurance.⁵¹

Firstly, Section 2 of the Insurance Act restricts a non-insurer, for example banks, from underwriting and performing other activities carried out by insurers.⁵² This provision doesn't hinder bancassurance because banks are only allowed to carry out distributive functions, which does not include underwriting.

Section 71A (1) provides that a bank shall not prescribe or assign an insurance company or broker to a loanee unless the loanee forfeits in writing the right to select an underwriter or broker.⁵³ The bank should inform a loanee that they have a right to select an insurer or broker from all those licensed by IRA⁵⁴. Section 71A (2) goes on to provide that any bank that contravenes the provisions of subsection (1) commits an offence and shall upon conviction be liable to a fine not exceeding five million shillings.⁵⁵ The above provisions are in the spirit of consumer protection from their exploitation by banks.

⁴⁸Section 57 (2), *Central Bank of Kenya Act* (Act No. 15 of 1996)

⁴⁹ Preamble, *Insurance Act* (Act No. 4 of 2012)

⁵⁰ Section 3, *Insurance Act* (Act No. 4 of 2012)

⁵¹ Section 3A, *Insurance Act* (Act No. 4 of 2012)

⁵²Section 2, *Insurance Act* (Act No. 4 of 2012)

⁵³Section 71A (1), *Insurance Act* (Act No. 4 of 2012)

⁵⁴Section 71A (1), *Insurance Act* (Act No. 4 of 2012)

⁵⁵Section 71A (2), *Insurance Act* (Act No. 4 of 2012)

3.2.5 Competition Act

The legislation protects the interests of the consumer by regulating the conduct of proprietors in the market. This is done through regulations that prevent agreements made by undertakings, which seek to prevent, distort or lessen competition in trade of any goods or services.⁵⁶ Therefore, bancassurance agreement that prevents competition, for instance one that provides for exclusivity for a bank (when advancing loans) to only distribute insurance services of a specific insurance firm would be illegal.

3.2.6 Consumer protection Act

A lender who offers to provide or to arrange insurance required under a credit agreement shall at the same time disclose to the borrower in writing that the borrower may purchase the insurance through an agent or an insurer of the borrower's choice.⁵⁷ A bank that provides a distribution channel is required not to engage in unfair, deceptive, oppressive or aggressive practices such as threatening, intimidating, being violent towards, abusing, being non-responsive or humiliating a consumer, or offering, accepting or asking for bribes or other 'gifts' as an inducement to serve a consumer; or discriminate a consumer in any way.⁵⁸

3.3 Regulations and Guidelines

There are two main types of regulations that are recognized: Government or government-led and self-regulation. Self-regulation is a regulatory regime under which an organization or industry sector establishes its own rules and regulates itself accordingly. Most of the regulations and guidelines concerning bancassurance are government led regulations. However, organizations undertaking in bancassurance may have self-regulatory regime as agreed upon by the bank and insurance agency in their Service Level Agreements (SLAs).

3.3.1 CBK guidelines on incidental business activities

⁵⁶Section 21(1), Competition Act (Act No 12 of 2010)

⁵⁷Section 58(2), *Consumer Protection Act* (Act No 46 of 2012)

⁵⁸ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

Firstly, the purpose of these guidelines is to prescribe the business activities a bank may undertake in addition to its core banking and financial business.⁵⁹ These guidelines apply to all banks that intend to provide a distribution channel through their branch network and other banking channels for the provision of incidental financial services or products. The provisions of these guidelines also apply to where the bank seeks to provide a distribution channel for financial services or products offered by its subsidiaries⁶⁰ (which means that commercial banks, which have subsidiaries, registered for other business must clearly specify that the seller is not the bank itself but another legal entity). Bancassurance is one of the incidental businesses permitted under this guideline. The guidelines permit banks to form and enter into partnerships for the purposes of cross selling authorized financial services and products through their branch network, and marketing authorized financial services and products. Banks are expected to differentiate own products and the incidental business so that customers do not get the wrong impression about proprietorship.

The guideline provides for the Board of Directors of each bank to be responsible for formulating policies, procedures and guidelines, which ensure that:

- The bank carries out only lawful incidental business activities.
- Risks associated with incidental business activities are properly identified, documented and mitigated.⁶¹
- The carrying out of incidental business activities does not compromise or impair the core business of the bank.⁶²

This guideline further, provides for restricted activities, which the bank should not take part in the bancassurance arrangement. The bank in this partnership shall not undertake or engage in the actual business of insurance underwriting and securities brokerage or any other financial business, which it is not, authorized to undertake by the Central Bank. *“An institution acting as a distribution channel shall not undertake or engage in the actual business of insurance, underwriting, securities and investments services. The involvement of*

⁵⁹Section 2.1, Guideline On Incidental Business Activities CBK/PG/23

⁶⁰ Section 2.2, Guideline On Incidental Business Activities CBK/PG/23

⁶¹Section 2.3, Guideline On Incidental Business Activities CBK/PG/23

⁶²Section 2.3, Guideline On Incidental Business Activities CBK/PG/23

institutions will be limited to acting as a distribution channel in the provision of these financial services,⁶³

The guidelines provide that where a bank wants to engage in permitted incidental business it should make an application accompanied by all contracts between the institutions and other service providers, the necessary board approvals to introduce the authorized business activities and approval from the Central Bank and any other financial sector regulator such as the Insurance Regulatory Authority.⁶⁴

A bank must have “well-defined risk management policies on both financial and non-financial exposures and risk concentrations, and staff with the expertise to manage the businesses as per section 4.1.1 of the guidelines.

Section 4.3 deals with the relationship between service providers and states that, a bank shall be required to ensure that; products and services on offer are adequately regulated where regulation is required and the service providers have the relevant licenses or permits to undertake such businesses⁶⁵ (this means that a bank cannot continue to distribute products of an institution whose license has been revoked), that any risks contained in the incidental business are not transferred to the banking business and that they enter into a written formal agreement with the service provider.

A bank engaged in bancassurance is required to report on a quarterly basis to the Central Bank on the performance of incidental business activities. In addition notwithstanding the periodic reporting requirements, the bank shall inform the Central Bank promptly of pertinent issues and concerns encountered in businesses carried on under this Guideline that have a material impact on the bank as and when they occur.⁶⁶

These guidelines provide for cooperation between the Central bank and other financial regulators through the signing of multilateral and bilateral agreements geared to ensure safe and efficient distribution of services and products by banks on behalf of service providers within the confines permitted under the law.⁶⁷ The cooperation will be done through coordinated supervision and information sharing between the regulators.

⁶³Section 3.2, Guideline On Incidental Business Activities CBK/PG/23

⁶⁴ Section 3.3, Guideline On Incidental Business Activities CBK/PG/23

⁶⁵Section 4.3.1 (III), Guideline On Incidental Business Activities CBK/PG/23

⁶⁶Section 5.1.2, *Guideline On Incidental Business Activities* CBK/PG/23

⁶⁷ Section 6.1, *Guideline On Incidental Business Activities* CBK/PG/23

Lastly, it may not provide the financial services or products in a manner that contravenes any law that applies to or affects those services or products: the reason for this prohibition is that, engagement in any of the above would contravene the cardinal objective of banks which is to carry out banking business.⁶⁸

3.3.2 CBK Risk Management Guidelines, 2013

According to the Basel Core Principles for Effective Banking Supervision banks and banking groups must have comprehensive risk management processes (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile and these processes should be commensurate with the size and complexity of the institution.⁶⁹

The guidelines give different categories of risks. These risks include; strategic risks, operational risks, credit risks, liquidity risks, market risks, compliance risks, Information and Communication Technology Risk and reputational risks.

Bancassurance mainly poses operational and credit risks and as a result, the guidelines provide that an institution shall also be expected to conduct regular stress tests on the incidental businesses. The institution should identify potential stress scenarios or events that could adversely impact the bank arising from these new businesses and therefore is expected to put in place mitigating techniques and contingency plans against material risks identified from these stress tests.⁷⁰ The institution should not only consider financial risk to measures like asset value, exposure and revenue but also nonfinancial risk such as operational and reputational.

⁶⁸ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁶⁹ <https://www.centralbank.go.ke/wp-content/uploads/2016/08/risk-management-guidelines-january-20131.pdf> on 20 January 2018

⁷⁰Section 1.2.3 (c), *CBK Risk Management Guidelines*, 2013

3.3.3 CBK Guideline on consumer protection

The CBK guideline on incidental business in Section 4.2 provides that a bank acting as a distribution channel in the provision of approved financial services or products shall have regard to the CBK Guideline on Consumer Protection.⁷¹

The purpose of this guideline is to promote fair and equitable financial services practices by setting minimum standards for institutions in dealing with consumers; increase transparency in order to inform and empower consumers of financial products and services; foster confidence in the banking sector; and provide efficient, effective mechanisms for handling consumer complaints relating to the provision of financial products and services.⁷²

In this regard, the scope of this guideline is to provide a specific framework for protecting customers against risks of fraud, loss of privacy, unfair practices and lack of full disclosure.⁷³

This is evidenced by the fact that service providers often prefer deceitful tactics in order to sell their products and as a result, engagement in unfair practices leads to unfair and unjust enrichment to the bank while the customer writhes.⁷⁴

An objective analysis of this purpose demonstrates that protection of consumer interests leads to a better and reputable banking sector hence success in the financial sector.⁷⁵ This guideline further provides for key principles that should guide banks in dealing with customers—fairness, reliability, transparency, equity and responsiveness.⁷⁶

⁷¹Section 4.2, Guideline On Incidental Business Activities CBK/PG/23

⁷²Section 2.1, Guideline on Consumer Protection, 2013

⁷³Section 2.2, Guideline on Consumer Protection, 2013

⁷⁴ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁷⁵ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁷⁶ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

3.3.4 IRA Guideline to Insurers on Bancassurance

In January 2015 the Insurance Regulatory Authority forwarded draft guidelines for bancassurance to the Central Bank of Kenya, after insurance agents complained that banks were breaching rules on choice.⁷⁷ The proposed guidelines, which were later passed state, “the bancassurance agent shall not induce or compel a prospect to buy an insurance product of its principal. All prospects shall be allowed to decide out of their own volition, which insurance product they wish to buy and from which insurer.”⁷⁸

This guideline aims to increase insurance penetration by allowing financial institutions to distribute and cross-sell insurance products using their wide network and customer base, provide one stop shop for integrated financial services and enhance financial inclusion.⁷⁹ Notably, it provides for approval and licensing requirement for a bancassurance arrangement. In addition, bancassurance agents are required to make reports to the Authority on a quarterly basis on the performance of the Bancassurance business activities in the prescribed format. Further, it provides for bancassurance products.

It recognizes only two bancassurance models namely; specialist and integrated bancassurance models. Specialist model refers to a model that product experts, who are generally employees or representatives of the insurance company itself, distribute the products.⁸⁰ The bankers utilize their database to identify prospective customers who are then contacted by the insurance professional and this may require less training but higher compensation to support the referral process.⁸¹

Both models can be used in conducting bancassurance business by establishing a bancassurance agency, which shall be a subsidiary wholly owned by the financial institution.⁸² The insurance agency shall be a corporate entity and shall represent insurance companies licensed under the Insurance Act. The insurance agency shall apply for a license

⁷⁷ <https://oxfordbusinessgroup.com/analysis/shifting-gears-new-regulatory-framework-bringing-sector-further-line-international-best-practices> on 20 January 2018

⁷⁸ <https://oxfordbusinessgroup.com/analysis/shifting-gears-new-regulatory-framework-bringing-sector-further-line-international-best-practices> on 20 January 2018

⁷⁹ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁸⁰ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁸¹ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁸² <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

in accordance with provisions of the Insurance Act, or directly applying as an entity to be an insurance agency to sell insurance products to its customers through its staff.

An example of specialist or referral arrangement in Kenya is the recent partnership between Diamond Trust Bank and Jubilee Insurance to sell life insurance products. On the other hand, an example of an integrated model is when Stanbic Life Assurance Company Limited became part of the Stanbic Holdings Group, and the I&M Insurance Agency that is a wholly owned subsidiary of I&M Bank.⁸³

This guideline commendably provides for enforcement mechanisms; remedial measures and administrative sanctions. This is immensely estimable because a law that does not have an enforcement mechanism is not an effective law.⁸⁴

3.4 Institutional Framework

Kenya has a fragmented institutional regime charged with the mandate of regulating financial services. Therefore as a result, there are two institutions that regulate bancassurance namely the CBK and the IRA.

3.4.1 Central Bank of Kenya (CBK)

The Central Bank of Kenya (CBK) is established under the Central Bank of Kenya Act, pursuant to Article 231 of the Constitution of Kenya (2010). Under the objects of the bank, it is included the role of formulating and implementing foreign exchange policies, the licensing and supervising of authorized dealers, formulating and implementing policies that best “promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems”.⁸⁵ The CBK closely works with the Ministry of Finance in the formulation of financial policy. The Central Bank regulates the activities of banks and sets guidelines that influence the businesses that may be carried out by banks and these include bancassurance regulations.

⁸³ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁸⁴ <http://nairobiawmonthly.com/index.php/2017/12/08/legal-framework-of-bancassurance/> on 20 January 2018

⁸⁵ Section 4A, *Central Bank of Kenya Act*(Act No. 15 of 1996)

3.4.2 Insurance Regulatory Authority (IRA)

This statutory body is established under the Insurance Act and among its core functions is includes the effective administration, supervision, regulation and control as well as formulation and enforcement of standards of conduct in the insurance and reinsurance business in Kenya. The current supervisory framework of the IRA is Compliance Based Supervision (CBS), which means that IRA provides a set of rules that insurance players are expected to fully comply with, these rules are based on past experience and therefore not as forward looking as other risk based approaches and finally the rules apply to all companies regardless of the difference in size, risk profile or net income. However, IRA is adopting the Risk Based Supervision (RBS) framework, which is forward looking and incorporates possible future events when setting rules.

The Insurance Regulatory Authority (2014) reviewed the guidelines on bancassurance in order to facilitate financial institutions to distribute and sell insurance to their customers as they have a wide customer base. It recognized the need for increase in insurance penetration in the country by using alternative methods of distributing insurance products such as financial institutions licensed by the Central Bank of Kenya, (CBK). The improved regulations have enabled most banks to venture into bancassurance.

3.5 Conclusion

The emergence and spread of bancassurance over the last 10 years has been one of the most significant developments in the retail financial services sector in Kenya.⁸⁶ Though grappling with regulatory constraints, many banking institutions and insurance companies have found bancassurance to be an attractive and often profitable complement to their core businesses.⁸⁷ While premiums generated through this channel are still low, there are expectations that bancassurance will grow to register a dominant share in the widening insurance market in coming years. Products sold through this channel range from basic credit insurance, home insurance, and mortgage protection to long- term savings, life and income protection products.⁸⁸

⁸⁶<http://www.akinsure.com/images/publications/AKIINSURERDec2012.pdf> on 27 January 2018

⁸⁷<http://www.akinsure.com/images/publications/AKIINSURERDec2012.pdf> on 27 January 2018

⁸⁸<http://www.akinsure.com/images/publications/AKIINSURERDec2012.pdf> on 27 January 2018

CHAPTER 4: A COMPARATIVE STUDY OF BANCASSURANCE REGULATION

4.1 Introduction

Bancassurance has, since the 1970's, developed as one of the major means of insurance distribution through out the world. However, its penetration differs in various parts the world. Europe, and specifically Spain, France and Italy are at the forefront as far as bancassurance penetration is concerned. Asia, Africa and the America's have fallen behind due, in substantial part, to regulatory confinements there. Nonetheless, countries such as India and China in Asia, have, as of late developed as hotspots for bancassurance inferable from lightening of regulations in that area.

This chapter investigates the regulatory patterns from different jurisdictions in the world. Its definitive goal is to gather from the worldwide experience, regulatory best practice that can be reproduced in Kenya in the advancement of bancassurance regulations. Therefore the approach taken is a straightforward one, as different administrative issues relating to bancassurance are discussed thus, from a viewpoint of the Indian and South African jurisdictions.

4.2 Regulation of Bancassurance in India

4.2.1 Introduction

The recent experience in India where a specialist committee mandated by the IRDA investigated and made recommendations on how best to regulate bancassurance in India makes India an ideal source of inspiration for this chapter.⁸⁹ The similarity between the Indian and Kenyan legal regime arising from both having common law roots and similar jurisprudence justifies its use in the comparative study as well as the heavy reliance on the

⁸⁹Hamwela A, '*A model framework for Bancassurance regulation in Zambia*' Unpublished LLM Thesis, The University of Zambia, November 2013

Report of the Committee on Bancassurance Regulation. Notably, the Indian Report presents a global comparative study of bancassurance regulation and its conclusions are representative of global trends⁹⁰

4.2.2 Legal Framework

The following Acts of the Indian Parliament provides for a regime, which gives bancassurance legality.

4.2.2.1 *Reserve Bank of India Act 1934*

Section 45JA of the Act gives the Reserve Bank of India power to determine policy and issue directions in order to regulate the financial system of the country to its advantage or to prevent the affairs of any non-banking financial company being conducted in a manner detrimental to the interest of the depositors or in a manner prejudicial to the interest of the non-banking financial company.⁹¹ This gives the bank the power to give guidelines to insurance firms and banks on bancassurance in order to uphold public policy and ensure a stable financial system.

4.2.2.2 *Insurance Act 1938*

The Act provides in Section 114A(2) and read with Sections 14 and 26 of the Insurance Regulatory and Development Authority that the IRDA can make regulations it deems appropriate in the regulation of insurance and as a result of this many guidelines and norms have been passed by the IRDA.⁹² In addition the act provides for the maximum commission payable to a bancassurance agent will be limited to 85% of the limits specified under section 40A.⁹³

4.2.2.3 *Banking Regulations Act 1949*

The Act in Section 6 prescribes the form of different businesses a bank may engage in and among them is any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a

⁹⁰Hamwela A, 'A model framework for Bancassurance regulation in Zambia' Unpublished LLM Thesis, The University of Zambia, November 2013

⁹¹Section 45JA, *Reserve Bank of India Act* (Act No 2 of 1934)

⁹²Section 114A, *Insurance Act* (Act No 4 of 1938)

⁹³ Section 40A, *Insurance Act* (Act No 4 of 1938)

banking company to engage⁹⁴ Insurance is a permissible form of business that could be undertaken by banks.

4.2.2.4 Insurance Regulatory and Development Authority Act, 1999

The Act establishes the IRDA under Section 3, which provides that here shall be established, for the purposes of this Act, an Authority to be called "the Insurance Regulatory and Development Authority that shall be body corporate with perpetual succession and a common seal with power."⁹⁵ The IRDA is the overall regulator of Insurance business in India therefore it plays a role in the regulation of bancassurance.

4.2.3 Guidelines and Regulations

The Reserve Bank of India and the Insurance Development and Regulatory Authority have a set of guidelines for companies that couple to form bancassurance.⁹⁶

RBI Norms on Insurance Business for Banks

The Government of India through the RBI issued the following norms in August 2000 to regulate bancassurance.

Firstly, any scheduled commercial bank would be permitted to undertake insurance business as agent of insurance companies on fee basis, without any risk participation.⁹⁷ Similarly the subsidiaries of banks will also be allowed to undertake distribution of insurance products on agency basis.⁹⁸

Banks should satisfy the eligibility criteria as stipulated below in order to be permitted to set up a joint venture company for undertaking insurance business with risk participation, subject to safeguards.

⁹⁴Section 6(1)(o), *Banking Regulations Act of India* (Act No 10 of 1949)

⁹⁵Section 3, *Insurance Regulatory and Development Authority Act* (Act 41 of 1999)

⁹⁶<http://www.ijrms.com/olvolume2issue10/DrRHepsiba-2.pdf> on 27 January 2018

⁹⁷http://www.irdindia.in/journal_ijrdmr/pdf/vol2_iss1/3.pdf on 27 January 2018

⁹⁸http://www.irdindia.in/journal_ijrdmr/pdf/vol2_iss1/3.pdf on 27 January 2018

- i. A net worth of at least 3 Billion Indian Rupees being at least 10%, reasonable non performing assets (NPA), performance of subsidiaries (if any)⁹⁹
- ii. There should be net profit for at least 3 consecutive.

The Norms provide for Corporate Agency Regulations under which Banks can act as corporate agents for only one life and one non life insurance company for a commission, as per the current regulatory framework set up by IRDA.¹⁰⁰

To ensure consumer protection, banks are mandated under these norms to also observe code of conduct prescribed towards both customer and the principal who is the insurer.

Banks cannot become brokers, as regulations require brokers to be exclusively engaged in insurance broking and as a result, RBI does not allow banks to promote separate insurance broking outfits.¹⁰¹

Referral Arrangements are available to Banks that do not meet the above criteria and are not eligible for corporate agency license as per RBI guidelines. This is where; the banks merely part with their client database with insurers for a fee agreed upon by both parties. The referral arrangement with a bank is for access to its customer database, provision of physical infrastructure and for display of publicity material of the insurer.¹⁰² A bank could not enter into a referral agreement with more than one insurer. The bank customer's participation was purely voluntary and there was not to be any linkage between banking services to customers and use of insurance products.¹⁰³ With time, it was noted that this system became inadequate because several banks charged high fees for entering into the referral agreement, over and above the fee which was linked to sale; an unnecessary upfront fee was being collected by banks for providing infrastructure for locating insurer's staff and advertisements in bank premises and it was also observed that in a few cases, referral banks were actually soliciting the customers for sale of insurance, through untrained staff. As the regulatory framework was found to be inadequate, the referral system had degenerated into rogue agency system and was dismantled through regulations by IRDA in 2010.¹⁰⁴

⁹⁹http://www.irdindia.in/journal/ijrdmr/pdf/vol2_iss1/3.pdf on 27 January 2018

¹⁰⁰<http://www.irdindia.in/journal/ijrdmr/pdf/vol2_iss1/3.pdf> on 27 January 2018

¹⁰¹<http://www.irdindia.in/journal/ijrdmr/pdf/vol2_iss1/3.pdf> on 27 January 2018

¹⁰²<http://www.irdindia.in/journal/ijrdmr/pdf/vol2_iss1/3.pdf> on 27 January 2018

¹⁰³<http://www.irdindia.in/journal/ijrdmr/pdf/vol2_iss1/3.pdf> on 27 January 2018

¹⁰⁴<http://www.irdindia.in/journal/ijrdmr/pdf/vol2_iss1/3.pdf> on 27 January 2018

Finally, banks are not eligible for any other form of payment other than commission as prescribed under these norms.

IRDA Norms For Insurance Companies

The norms stipulate that banks should have a minimum paid up capital of 3 billion Indian Rupees in order to engage in bancassurance business. Each bank that sells insurance must have a Chief Insurance Executive to handle all the insurance matters and activities. All the people involved in selling the insurance should undergo mandatory training at an institute authorized by IRDA and should have passed the examination conducted by the authority. Commercial banks, including cooperative banks and Regional Rural Banks may become cooperate agents for one insurance company. Banks can act as a corporate agent for any one of life or non-life insurers.

IRDA Licensing of Bancassurance Agents regulations

Regulation 3 of these regulations provides that IRDA shall be the licensing authority of bancassurance in India and that the licensing fees shall be 300 Indian Rupees.

Regulation 4 provides that there shall be a ceiling in the number of tie-ups a bank may have with an insurance firm where a bank is only allowed to be in agreement with one non-life insurance firm and one life insurance firm and one standalone health insurance firm.¹⁰⁵ In addition regulation 5 provides that an insurers shall not be tied up with bancassurance firms in more than nine Indian states. Regulation 11 provides for a code of conduct for bancassurance agents. They provide that bancassurance agents shall:¹⁰⁶

- Be responsible for any acts or omission of the Chief Executive Bancassurance Agent
- Ensure that all persons including the Chief Executive Bancassurance are well trained.
- Ensure there is no misrepresentation on policy benefits and returns available under the policy
- Ensure that no prospect is forced to take insurance cover
- Give adequate presale and post sale information.

¹⁰⁵<https://www.scribd.com/document/258815353/Banc-Assurance> on 27 January 2018

¹⁰⁶<https://www.scribd.com/document/258815353/Banc-Assurance> on 27 January 2018

- Enter into an SLA with insurer in which duties of each of the parties are defined.

These regulations also provide for instances where a licence may be suspended or cancelled by the IRDA under regulation 13. Some of these instances include:¹⁰⁷

- Contravention of any of the provisions of Insurance Regulatory and Development Authority Act 1999
- Failure to comply with conditions as set out in the licence.
- Failure to furnish the Authority with information relating to its bancassurance activities

Guidelines for Banks undertaking Insurance Broking and Agency Business:

A comprehensive Board approved policy regarding undertaking insurance distribution, whether under the agency or the broking model should be formulated and services should be offered to customers in accordance with this policy.¹⁰⁸ The policy will also encompass issues of customer appropriateness and suitability as well as grievance redress. It may be noted that as IRDA Guidelines do not permit group entities to take up both corporate agency and broking in the same group.¹⁰⁹

While undertaking insurance distribution business, either under the corporate agency or broking model under the relevant IRDA Regulations, banks must keep the following in view:

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- All employees dealing with insurance agency/ broking business should possess the requisite qualification prescribed by IRDA.¹¹¹
- There should be a system of assessment of the suitability of products for customers. Pure risk term products with no investment or growth components that are simple and easy for the customers to understand will be deemed universally suitable products

¹⁰⁷<https://www.scribd.com/document/258815353/Banc-Assurance> on 27 January 2018

¹⁰⁸<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

¹⁰⁹<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

¹¹⁰<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

¹¹¹<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

while more complex products with investment components will require the bank to necessarily undertake a customer need assessment prior to sale.¹¹²

- Banks should treat their customers fairly, honestly and transparently, with regard to the insurance product sold.
- The bank should not follow any restrictive practices of forcing a customer to either opt for products of a specific insurance company or link sale of such products to any banking product. It should be prominently stated in all publicity material distributed by the bank that the purchase by a bank's customer of any insurance products is purely voluntary.¹¹³
- Further, the details of fees/brokerage received in respect of insurance agency business undertaken by them should be disclosed in the 'Notes to Accounts' to their Balance Sheet.¹¹⁴
- A robust internal grievance redress mechanism should be put in place along with a board approved customer compensation policy for resolving issues related to services offered. It must also ensure that the insurance companies whose products are being sold have robust customer grievance redress arrangements in place.¹¹⁵

Violation of the above instructions will be viewed seriously and as such deterrent penal action against the banks will be brought.

4.2.3 Institutional Framework

Like Kenya, India also has a fragmented institutional regime: as the RBI regulates the banking sector and the Insurance sector by the IRDA. Therefore both the Insurance Regulatory Authority and the Reserve Bank of India regulate bancassurance in India since they it is an integration of both sectors.

4.2.4.1 The Reserve Bank of India (RBI)

¹¹²<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

¹¹³<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

¹¹⁴<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

¹¹⁵<https://rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=9489> on 27 January 2018

The Bank is established by the Reserve Bank of India Act and its functions as provided for under the Act is to regulate the monetary and financial system in India through the setting of appropriate norms and guidelines and by providing oversight over different financial institutions. With regards to bancassurance, any bank intending to take up the business would have to take specific approval from RBI.

4.2.4.2 Insurance Regulatory and Development Authority (IRDA)

The Insurance Regulatory and Development Authority of India (IRDA) is an autonomous, statutory agency tasked with regulating and promoting the insurance and re-insurance industries in India. The Insurance Regulatory and Development Authority Act, 1999, established it. The IRDA has constituted norms that form part of the regulatory framework for bancassurance.

4.2.5 Indian Regulation vs. Kenyan Regulation

Similarities

There are many similarities between the Indian and Kenyan regulations. Firstly, two institutions i.e. the CBK and IRA in Kenya and the RBI and IRDA in India regulate bancassurance. They both do not have extensive legislative provisions on bancassurance but there is a rich source of regulation through guidelines and norms provided for by the regulatory institutions.

Both the Kenyan and Indian regulatory frameworks provide for the fully integrated models of bancassurance.

Differences

The Kenyan regulation provides for a specialised model of bancassurance, which is similar to the outfaced Referral arrangements in India due to mischief by banks that would overcharge insurance firms.

The bancassurance regulations in India provide for exclusivity of agreements whereby one bank is only allowed to be in in agreement with one life insurance firm, one non-life insurance firm and one health insurance firm whereas in Kenya on the other hand, both insurance firms and banks can be in agreement with numerous other firms in the spirit of fair competition.

Finally, unlike the Indian regulatory regime, the Kenyan bancassurance regulatory framework does not provide for minimum capital requirements for banks to engage in bancassurance and this could be injurious to the financial system if unstable banks can easily enter the bancassurance industry.

4.3 Regulation of Bancassurance in South Africa

4.3.1 Introduction

South African bancassurance market is by far the most sophisticated and mature in the region, other countries such as Côte d'Ivoire, Kenya and Mozambique are beginning to follow suit. More generally, as a highly sophisticated market with good distribution and strong governance, South Africa looks at bancassurance as any other G20 economy would: a useful but not vital tool with an only moderately attractive risk profile and high compliance costs.¹¹⁶ There are a handful of bancassurance initiatives in South Africa, including Standard Bank, Absa and First Rand. Standard Bank acquired Liberty Life in 1999, while in 2012, Absa developed an integrated portal for online finance, which includes access to both life and non-life products.¹¹⁷

4.3.2 Legal Framework

Banks Act 1990

The Banks Act provides a regulatory framework for banks and provides for the SARB as the overall supervisory body for banks. The Act provides that no bank and no associate of a bank shall, without the prior written approval of the Registrar, either jointly or individually acquire or hold shares in any registered long-term insurer of 1998) or in any short-term to the extent to which the nominal value of those shares exceeds 49 per cent of the nominal value of all the issued shares of such long-term insurer or short-term insurer, as the case may be.¹¹⁸ This provision allows banks to own shares in an insurance firm to form an integrated model of bancassurance.

¹¹⁶ <https://oxfordbusinessgroup.com/overview/opportunity-and-challenge-sector-midst-far-reaching-transformations> on 30 January 2018

¹¹⁷ <https://oxfordbusinessgroup.com/overview/opportunity-and-challenge-sector-midst-far-reaching-transformations> on 30 January 2018

¹¹⁸Section 80 (3), Banks Act (Act No 94 of 1999)

Short-term Insurance Act 1998 (STIA)

This Act regulates all non-life players in the insurance industry, which includes risk-based insurance of assets, accident and health and liability.

Long-term Insurance Act 1998 (LTIA)

The Act regulates life insurance and long-term investments in the insurance sector.

Financial Advisory and Intermediary Services Act 2002

The Purpose of the Financial Advisory and Intermediary Services Act is to protect Consumers of financial products and services; regulate the selling and advice-giving activities of FSPs; ensure that the Consumers are provided with adequate information about the financial products they use and about the people and institutions who sell these financial products.¹¹⁹ The Act does this by requiring all FSPs are registered; ensuring representatives of all authorized service providers are adequately qualified; creating a code of conduct; defining duties in terms of compliance, establishing guidelines for record maintenance and accounting and audit requirements; providing mechanisms for enforcement and complaint procedures; and the establishment of the Financial Advisory and Intermediary Services Ombudsman.¹²⁰ Section 4 of the Act sets out that a provider other than a direct marketer must at the earliest reasonable opportunity, and only where appropriate, furnish the client with full particulars of the following information about the relevant product supplier.¹²¹ In the purview of bancassurance this means that banks are required by law to disclose to their consumers the insurance firms that, they are taking a policy from and all other relevant information as pertaining to the insurance product.

The section goes on to state that a product supplier, which is an authorised financial services provider, and which has entered into an intermediary contract or similar contractual relationship with another provider for the purpose of rendering a financial service in respect

¹¹⁹ <http://www.banking.org.za/consumer-information/legislation/financial-advisory-and-intermediary-services-act> on 30 January 2018

¹²⁰ <http://www.banking.org.za/consumer-information/legislation/financial-advisory-and-intermediary-services-act> on 30 January 2018

¹²¹Section 4(1) *Financial Advisory and Intermediaries Act* (Act No 37 of 2002)

of its financial products, must within a reasonable time after being requested to do so by such other provider, provide such other provider with sufficient particulars to enable the provider to comply with the disclosure requirements of this Code relating to the furnishing of details of the product supplier and the product in question.¹²² This section provides for transparency between banks who offer bancassurance to their partners in Insurance firms so as to enable insurers to comply with any disclosure requirements as set up in this Act and by the code of conduct.

4.3.3 Guidelines and Regulations

The SARB and the FSB have not published any guidelines regarding the bancassurance however, the Banking Association has published a code of conducts that are voluntary for banks and provide for the relationship between banks and third parties. The Code of conducts provide that:

- A bank must obtain prior approval from the Registrar the SARB
- Banks must establish or acquire a subsidiary
- Invest in a joint venture
- Acquire or hold shares in a registered long-term or short-term insurer so long as the nominal value does not exceed 49%
- Create a trust outside South Africa within which the bank is a major shareholder

4.3.4 Institutional Framework

Like Kenya and India, South Africa also has a fragmented institutional regime where, different bodies regulate the different sectors of the financial system. However, the regulatory bodies will change with the passing of the Financial Services Regulation Bill and this will make the South African Reserve Bank the prudential regulator and will form a market conduct regulator from the FSB's market conduct departments.¹²³ This move to have a unitary supervisory body will therefore make the South African framework a more risk-based one.

¹²²Section 4(2) *Financial Advisory and Intermediaries Act* (Act No 37 of 2002)

¹²³ [https://uk.practicallaw.thomsonreuters.com/1-505-2026?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/1-505-2026?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1) on 31 January 2018

South African Reserve Bank (SARB)

The SARB is the central bank of South Africa, and its primary objective is the achievement and maintenance of price stability in the interest of sustainable economic growth. The South African Reserve Bank Act, 1989 (SARB Act), together with the Banks Act and the Mutual Banks Act, 1993, assigns responsibility for the registration and supervision of banks to the SARB.¹²⁴

Financial Services Board (FSB)

The FSB is an independent institution, established by the Financial Services Board Act 1990, to oversee the South African non-banking financial services industry in the public interest, and fully funded by fees and levies imposed on this industry.¹²⁵ It oversees compliance with laws regulating financial institutions and the provision of financial services; advises the Minister of Finance on matters concerning financial institutions and financial services; and promotes programmes and initiatives by financial institutions and bodies representing the financial services industry to inform and educate users and potential users of financial products and services.¹²⁶ The executive officer of the Financial Services Board (FSB) appoints the registrars of short-term and long-term insurance as established by the STIA and LTIA respectively. The registrars are mandated to regulate the insurance industry.

4.3.5 South African Regulations vs. Kenyan Regulation

Similarities

Both Kenya and South Africa have provided extensively for consumer protection through legislation where all relevant information about the bancassurance arrangements and the products provided by these arrangements.

Differences

¹²⁴ [https://uk.practicallaw.thomsonreuters.com/w-007-6934?transitionType=Default&contextData=\(sc.Default\)](https://uk.practicallaw.thomsonreuters.com/w-007-6934?transitionType=Default&contextData=(sc.Default)) on 31 January 2018

¹²⁵ <https://www.fsb.co.za/Pages/Home.aspx> on 31 January 2018

¹²⁶ <https://www.fsb.co.za/Pages/Home.aspx> on 31 January 2018

The regulatory framework of South Africa is less detailed than that of Kenya. It provides for a more self-regulatory regime for bancassurance where players of the industry provide the code of conduct as done by the Banking association with the assistance of few legislative guidelines as put forth in laws such as the Banks Act. This is possible because bancassurance arrangements are mainly contractual and thus the players can regulate one another.

4.4 Conclusion

It can be noted that there are both similarities and differences in the regulatory regimes of South Africa and India as compared to that of Kenya. Therefore Kenya can learn a thing or two from the differences and improve on the similarities in order to improve insurance penetration in the country through bancassurance as is evident in both India and South Africa.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Given the findings in Chapter three of this paper, there is a clear and present need for the development of regulation in and around the area of bancassurance in Kenya. This Chapter proposes the framework through which such regulation may take, borrowing from the case studies undertaken in Chapter four of this paper.

5.2 Findings

This study set out to explore:

- Whether there is a regulatory framework for Bancassurance in Kenya. The study found it in the affirmative that there is a regulatory framework in place governing bancassurance in Kenya. This framework is firstly and most importantly Constitutional through Article 46 which provides for consumers rights to access to information. In addition various Acts of Parliament, which include the Banking Act, Consumer Protection Act, Insurance Act and the Competition Act provide for in one way or another for the legislative framework of bancassurance. Similarly, the Central Bank of Kenya Act provides for the Central Bank that forms the institutional framework for bancassurance. The CBK together with the IRA work in cooperation to regulate bancassurance and as a result, they have both stipulated guidelines that are mandatory for bancassurance participants to follow, which also provide extensively for bancassurance regulation in Kenya.
- What the regulatory challenges that Bancassurance brings to Kenya. At its inception bancassurance brought with it numerous regulatory challenges since both the Banking and Insurance Acts did not envisage bancassurance arrangements and as a result, companies such as ALICO Kenya were disallowed from its practices in the country. The regulatory regime has now had to play catch-up to the advancements being made

in the financial sector industry and as a result, slowly but surely, amendments have been made primarily to the Insurance Act (through the Finance Act 2017) that caters for bancassurance. Moreover, bancassurance brought about the question of who (between the CBK and IRA) would regulate these arrangements. Through its Guidelines on Incidental Business, CBK stipulated that both of them would regulate bancassurance since banks would need approval from the CBK and IRA before engaging in bancassurance and the IRA who would require quarterly reports from bancassurance agents. Finally, bancassurance brought with it the risk of consumer exploitation by banks, which was not covered by any legislation. Consumer rights are vital rights protected by the Constitution, and introduction of bancassurance to the system caused a threat to these rights.

- What an appropriate regulatory framework look like. Kenya has a good regulatory framework governing bancassurance however there is more it can incorporate to it so as it can be at par with global best practices. Through the comparative study carried out in Chapter 4 of the regulatory regimes in India and South Africa, it was noted that an appropriate regulatory framework for bancassurance is one that is risk-based and provides for the minimum capital requirements as India has done for banks in order to practice bancassurance in order to prevent destabilization of the financial system by an unstable bank offering bancassurance. Furthermore, an appropriate regulatory framework is one that is self-regulated by the major player in bancassurance sector this enables the regulations to be at par with the changes or innovations that are brought about by bancassurance.

5.3 Recommendations

- i. **Implementation for minimum capital requirements for banks interested in engaging in bancassurance.** In light of Chase bank and Imperial bank being put on receivership, the regulator should put in place minimum capital requirements for banks interested in engaging in bancassurance, as is the case in India. This will prevent banks from destabilizing the insurance sector and the whole financial system due to operational and systemic risks that banks are prone to.
- ii. **To do away with the specialised model of bancassurance.** The specialised model of bancassurance is one where banks charge insurance firms to access their database of

appropriate consumers for their products. This model is similar to the Referral system that was in place in India until it was outlawed due to the mischief by banks, which would over charge insurance firms for their services and in turn this turned away insurers from bancassurance arrangements. Therefore, in the best interest of insurers in bancassurance arrangements the specialised mode should be outlawed.

- iii. **Adoption of a self-regulatory system.** A self-regulatory system is one in which the industry players come up with a set of rules that bind them with a few legislative rules that act as guidance for them. Self-regulation of bancassurance in Kenya would ensure that the regulation does not have to play catch-up to the innovations that may come across in bancassurance making the system more risk averse.

5.4 Conclusion

The study has achieved its objectives and responded to the statement of problem. The objectives were:

- To determine the regulatory framework of bancassurance in Kenya.
- To determine the regulatory challenges bancassurance brings to Kenya.
- To determine what an appropriate regulatory framework should look like through a comparative analysis.

Finally in conclusion, as seen in the paper, there are some legislative inadequacies therefore; the recommendations in this Chapter take on a special importance. It cannot be overemphasized that the consumer ends up suffering detriment when regulations are weak and as such, it would be of great significance if these recommendations were implemented.

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