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Highlights

- Introduction of takaful insurance.
- Cabinet Secretary to issue regulations for licensing and supervision of takaful insurance.
- The capital adequacy measurement has been moved to risk based.
- Minimum capital of insurance businesses increased for existing insurers.
- Actuarial investigation of general insurance businesses now required.

Background

The Insurance (Amendment) Act, 2016 (**the Act**) received Presidential assent on 23rd December 2016 and came into force on 13th January 2017. Below are the key changes the Act brings:

Takaful Insurance

The Act has codified the Islamic faith-based concept of takaful insurance. Even though takaful has been conducted in one form or another in recent years, it now receives specific legislative underpinning. Takaful insurance is commonly based on group participation where members guarantee each other.

Under *takaful* insurance, risk is evenly distributed among the members of the group to reduce individual liability.

All members of the public can apply for the insurance as it is not restricted to members of the Islamic faith.

Persons undertaking *takaful* insurance business are now required to be licensed by the Insurance Regulatory Authority (**IRA**) for this line of business. However, regulations providing for the framework for supervising and licensing of this type of insurance are yet to be published. Further updates will be provided once regulations are published

Capital

The Act has introduced a new concept of capital adequacy as a way of determining the capital required by an insurer. The Act requires all insurers to maintain a minimum of a 100% capital adequacy ratio. Insurers who carry out both long term and general businesses are required to maintain separate capital adequacy ratios for both business streams. This concept replaces the previous criteria which was based on the margin of solvency of the insurer. The concept has been introduced to enable the insurance sector to fully adopt a more comprehensive risk-based capital model. However, various sections of the Insurance Act (Cap.487) still refer to admitted assets and liabilities (which were used to determine the margin solvency of an insurer) and these sections will require further amendment in order to harmonize the Insurance Act (Cap.487) with the new requirement on capital adequacy.

The Act also appears to have increased the scope of capital investment in new insurance businesses. The Insurance Act (Cap. 487) only provides for investment by ordinary shares. For 'new companies', the Act introduces investment by ordinary shares with a single face value with voting rights which would be irredeemable and non-cumulative preference shares. Whilst the Act does not define a "new company", we understand that this provision only applies to companies licensed after the commencement of the Act. For existing insurers, the Act has introduced other forms of capital investment including subordinated loans as approved by the IRA, share premiums, reserves and any other form of capital that will be determined by the IRA to be suitable. This amendment expands the scope of equity investment in existing insurers.

It should be noted that if the insurer goes into liquidation, these forms of capital would not rank in priority to the interest of policy holders.

Insurers are now required to consider: insurance risk, market risk, credit risk and operational risk. In addition they are required to apply a 'capital charge' on assets. A capital charge is defined as the proportion of capital required to take into account any deterioration in the value of the assets

Previously, insurers were permitted to have deposits and cash forming only a minimum of 10% of their capital. However, the Act now requires that such deposits and cash only form up to 10% of the minimum capital of the insurer held in any one bank or group of banks.

Actuarial Investigation

All insurance businesses are now required to have their financial condition investigated annually by way of a valuation by an actuary. The actuary's report must provide an assessment of the material risks and issues impacting on the financial condition of the insurer and it must be in the form prescribed by the IRA.

If you require any further information or clarification on the contents of this note, please contact **Mahesh Acharya** (MAcharya@kapstrat.com) or **Herbert Njoroge** (HNjoroge@kapstrat.com).



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