"Towards a Resilient Insurance Industry"

Speech Given at the

INSURANCE BROKERS RETREAT

Great Rift Valley Lodge, Naivasha

25th August, 2017

By

Prof. Noah. O. Midamba, PhD

Vice Chancellor, CEO & Professor of Defence and Foreign Policy

Good morning everyone, thank you Robert Kuloba for a warm welcome. I would like to begin by thanking Mr. Kiptum and the Insurance Regulatory Authority for inviting me to give a talk on the "Good Governance in Insurance Brokerage Firms". I also like to commend the Regulatory Authority for the excellent work that it is doing to promote Good Corporate Governance in Kenya. Lastly, is to thank all you for being here and ready to move our country's developments to the next level. The theme of this retreat is "Towards a Resilient Insurance Industry" is fitting with what we have to say this morning. The link between corporate governance and economic development is probably not intuitively obvious so I will offer you my own perspective on how corporate governance can contribute to insurance industry resiliency and development of our country.

First, let me provide you with a brief definition of Corporate Governance as pertains to insurance industry and secondly, provide a brief overview of how this is practiced around the world.

Definition: Corporate Governance is the system of rules, practices and processes by which an insurance company governs itself. Corporate governance includes not only the obvious corporate structure (board of directors, senior management, business area functions, etc.), but also a company's organizational culture (values, ethics, etc.) and strategies and controls as well as all the governing documents that capture the spirit and the letter of a company's guiding principles and mandates.

All practiced around the World, Corporate governance defines all organizational roles, responsibilities and accountabilities at all levels. It describes and explains the management hierarchy, that is, the decision-making and accountability chain and ultimately who has the power to manage and legally represent the company in all settings. Corporate governance spells out requirements for documenting decisions and actions as well as the thinking behind them. It also provides for corrective action for non-compliance or weak oversight, controls and management.

Hence, corporate governance addresses the allocation and regulation of power and accountabilities within an insurer, and includes avoiding undue concentration of authority and power. Also, corporate governance has to be transparent and have appropriate systems, controls and limits to ensure the given authority and power is used for protecting the interests of all of the insurance company’s stakeholders.

A key driving force of sustainable development is the harnessing of positive externalities to Insurance Industry activities and the minimising of negative externalities. Positive externalities occur when social rates of return to investment exceed the purely private rates of return. Examples of positive externalities include the spillovers of benefits which occur when firms train workers, invest in research and development and adopt new technologies which generate "learning by increasing' benefits. Examples of negative externalities include pollution or collusive or abusive manipulation of markets. Given that investable resources are scarce, long term development requires that social rates of return are high. Hence rapid economic development is more likely to be realised in a society which can enable the insurance sector to generate high private rates of return to investment while at the same time yielding positive externalities so that social rates of return are even higher.

The insurers must document highly confidential information about their corporate governance framework, including the structure and policies of their boards of directors and key committees, the frequency of their meetings, and procedure for the oversight of critical risk areas and appointment practices, among other things. Insurance companies must also disclose the policies and practices used by their board of directors for directing senior management on critical areas, including a description of codes of business conduct and ethics, and processes for performance evaluation, compensation practices, corrective action, succession planning and suitability standards. This information will be utilized by insurance regulators to understand, review and assess the corporate governance practices of insurers to promote effective oversight on an ongoing basis.

The essence of corporate governance is to ensure that the actions of an insurance firms insiders – its managers and controlling shareholders – are consistent with the legitimate interests of all of its stakeholders, and do not benefit the insiders at the expense of outsiders. Corporate governance is not the only defence against abuse by insiders; there are also legal restraints, for example there are laws to prevent fraud and ensure minimum standards of health and safety in the workplace. But it is not realistic to expect the legal system alone to prevent all possible abuses by insiders; this would be very costly and cumbersome. Hence there is a need for standards of corporate governance which extend beyond the strictly legal obligations of a firm. The insurance industry presents unique challenges for corporate governance because the scope for conflicts of interest between insiders and outsiders is larger than in many other industries. The scope for conflicts of interest arises for several reasons.

The balance sheets of insurance institutions are opaque which makes it hard for outsiders such as insurers to evaluate their true financial condition. There are informational asymmetries with insiders having more accurate information than outsiders. Outsiders typically consist of atomised individuals which mean that they face “collective action” problems which impede their acting together in an optimal manner to defend their interests. As a consequence, the insiders of insurance institutions have opportunities to exploit outsiders in a manner which creates negative externalities such as insurance failures or even financial crises.

Moreover, excessively heavy handed regulation, although it might protect insurers, can also stifle innovation and risk taking in companies, which would be detrimental to economic development. In a market economy, the onus for sound management, including the proper management of risks, must lie with the insurance companies themselves. Insurance regulators cannot be a substitute for bad insurance managers. As such good corporate governance is an essential complement to good insurance regulation and supervision.

Let me conclude by giving you a summary of what we just talked about. Good corporate governance regulations for insurance industry must focus on four key themes: i) The fiduciary responsibilities of the Board of Directors; ii) The importance of independent oversight of insurance management; iii) The priority which must be attached to risk management; and iv) and lastly, the need for independent audit functions.

Thank you for listening.