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**PHCF**

# POLICYHOLDERS' COMPENSATION FUND

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**ANNUAL REPORT & ACCOUNTS**  
**For 18 Months Ended 30th June 2006**

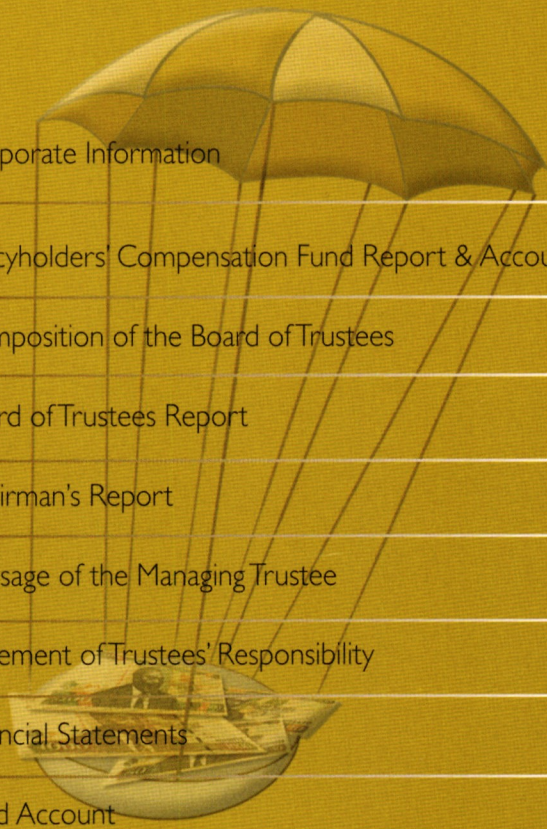
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**POLICYHOLDERS' COMPENSATION FUND**

FOR 18 MONTHS ENDED 30TH JUNE 2006

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## Board of Trustees

1. Prof. Chege Waruingi - Chairman
2. Prof. Joseph Kimura - resigned 11 April 2005
3. Bill Inamdar
4. Charles Mwaure
5. Andrew Greenwood
6. Ann Rama
7. Geoffrey Njenga
8. Commissioner of Insurance

## Managing Trustee and Board Secretary

Retirement Benefits Authority  
Rahimtulla Tower, 13th Floor, Upper Hill Road  
P.O.Box 57733-00200  
Nairobi

## Registered Office

Bima House, 11th Floor  
Harambee Avenue  
P.O.Box 43505-00100  
Nairobi

## Bankers

Kenya Commercial Bank Ltd  
University Way Branch  
P.O. Box 7206-00300  
Nairobi

Date 21st May 2007

The Honourable  
Minister for Finance

Dear Sir,

I am pleased to submit this report which covers the first 18 months of the Policyholders' Compensation Fund operations, from 1st January 2005 to 30th June 2006.

Yours faithfully,



**Prof. Chege Waruingi**

**Chairman, Board of Trustees  
Policyholders Compensation Fund**



**Prof. Chege Waruingi** (*Chairman*)

A management consultant by profession holds a doctoral degree in Business Administration (Marketing) from Indiana University, USA. Has over 30 years of University level teaching consulting experience in the USA and Kenya. He is currently the Vice Chancellor of Gretsia University, Thika, a director of Magadi Soda Company and Chairman of the Capital Markets Authority.



**David B Nyakundi** (*Representative of Managing Trustee*)

An advocate of the High Court of Kenya and a masters degree in Law finalist from the University of Nairobi. He is currently the Head of Compliance, Retirement Benefits Authority. He has considerable knowledge in the law relating to pensions and old age income security. He represents the Retirement Benefits Authority which is the Managing Trustee of the Fund.



**Sammy Makove** (*Commissioner of Insurance*)

Holds a BCom degree in Insurance from the University of Nairobi and an ACII. Has worked in the Insurance Department since 1987 having previously worked at Phoenix East Africa Insurance Company.



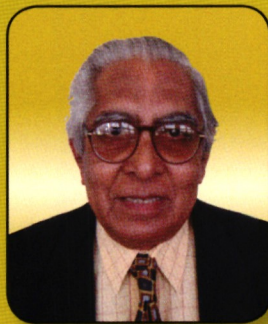
**Andrew Greenwood** (*Trustee*)

Chief Executive, Pan Africa Insurance Group and is a Chartered Accountant (SA) and (Aus). He is the Chairman of AKI life Insurance Council, Deputy Chairman AKI Board.



**Geoffrey Njenga** (Trustee)

The Chief Executive/Principal Officer of Intra Africa Assurance Company with vast experience in the Insurance Industry spanning over 21 years. He is the Vice Chairman of the Association of Kenya Insurers and Chairman of the General insurance Council (AKI) and the Convener of the Ethics and Self Regulation Committee of Association of Kenya Insurers.



**I.T. Inamdar** (Trustee)

An advocate of the High Court of Kenya and the Senior Partner in the firm of Inamdar & Inamdar Advocates of Nairobi and Mombasa. He is one of the leading Commercial Litigation lawyers in this country and has considerable specialist knowledge in the field of Insurance Law and Practice.



**Charles Njonjo Mwaura** (Trustee)

The Chief Executive, Range Hawk Loss Adjusters & Risk Assessors (K) Limited. A loss Adjuster and Risk Manager by profession holds a Masters degree in Business Administration (Insurance and Risk Management), FCII, AClarb, AILA, FIIC CIP. Also the Chairman, Institute of Loss Adjusters & Risk Surveyors (Kenya)



**Ann Ngiana Rama** (Trustee)

The Managing Director of Assured Insurance Brokers. A trustee of the College of Insurance and an executive Member of AIBK.

## **Establishment**

The Policyholders' Compensation Fund was established under Section 179 of the Insurance Act by the Government of Kenya on 24th September 2004, through the Legal Notice No.105. The operations of the Fund commenced on January 1, 2005 and are governed by the terms of that Legal Notice.

## **Purpose**

The purpose of the Fund is to provide compensation to policyholders in the event of an insurer becoming insolvent

## **Funding**

The policyholders, who are the beneficiaries of the Fund contribute 0.25% of the premiums payable monthly. The insurance companies also contribute 0.25% of the premiums receivable monthly, resulting in a total of 0.5% contributions from insurance companies payable by 15th day of every month. The Government has committed itself by way of financial support.

## **Management**

The Fund is run by a Board of Trustees, which is accountable to the Government through the Ministry of Finance. The trustees who held office during the period under review are shown on page 2. The Retirement Benefits Authority (RBA) are the Managing Trustee.

## **Financial Performance**

During the period under review, the Fund received contributions from insurers totaling Kshs. 190,289,144. This statutory levy is invested in short term governments securities. During the same period, investment income of Kshs. 5,358,594 was generated. Investment diversification would be considered once the Fund's Investment Policy is approved by Government. The Treasury allocated Kshs. 15,000,000 during the period under review.

## **Future Operations**

The Board has submitted to Treasury a comprehensive Budget Estimate for the financial year 2006/2007. This budget estimate provides a detailed structure that reflects the Fund's preparedness for anticipated claims.

## **Trustees' Responsibilities**

The Trustees are responsible for the preparation of the financial statements which give a true and fair view of the state of affairs of the Fund as at the end of the financial year and of its operating results for the period under review. It is also the Trustees' responsibility to maintain proper books of account and safeguard the assets of the Fund.

## **Board Initiatives**

During the period under review, the Board of Trustees undertook various initiatives including the following: -

- Development of a number of operational documents.
- Attending a course on Corporate Governance.
- Conducting a Workshop on claims procedures and settlement.

## **Taxation**

Under the Legal Notice No. 68 dated 15th June 2006, the Minister for Finance has exempted the income of the Fund from tax.



**Prof. Chege Waruingi**

**Chairman**

**Dated: 18th Sept. 2006**



**Prof. Chege Waruingi**  
*Chairman*

The Policyholders Compensation Fund (Fund) was established by the Government on 24th September, 2004 through a Legal Notice No. 105 of 2004 signed by the Minister for Finance in exercise of his powers conferred by section 179 (2) of the Insurance Act. Following the amendments to the Insurance Act through the Finance Act, 2005, the Fund became a body corporate.

## **a. Governance**

### **Organization**

The PHCF is a non-profit legal entity. As indicated above the Fund is a state corporation established under the provisions of the Insurance Act with a board of trustees who under the law have the mandate to administer it. The law requires the Commissioner of Insurance to second staff to the Fund in the meantime. However the Minister in consultation with the board of the trustees has power to appoint the Managing Trustee.

### **Co-operation with the supervisory authority**

Another important governance issue is the relationship of the Fund with the Department of Insurance. The Fund was established through the Insurance Act and hence has to work closely with the Office of the Commissioner of Insurance in order to carry out effective policyholder protection.

### **Relation with judicial insolvency procedure**

The functions of the Fund arise in the wake of insolvency of an insurance company. It is the judicial insolvency procedure that would facilitate action from the Fund. The obligations of the Fund will not be invoked until the insurer has been declared insolvent and a policyholder lodged a claim.

### **Board Composition**

The Fund is run by a Board of Trustees. The Board is accountable to the Government of Kenya through the Ministry of Finance. The Board consists of seven members. The Managing Trustee acts as the Secretary to the Board. In line with the principles of good governance, the Board represents a skills-mix appropriate to the Fund's role and functions. The current Managing Trustee is the Retirement Benefits Authority. By the end of the period under review, the Board of Trustees was composed as follows:

1. **Professor Chege Waruingi** is the Chairman appointed by the Minister for Finance
2. **Bill Inamdar** - A representative of other interests deemed appropriate and appointed by the Minister for Finance

3. **Charles Mwaura** – A representative of loss adjusters
4. **Andrew Greenwood** – A representative of long-term insurance businesses
5. **Ann Rama** – A representative of insurance brokers
6. **Geoffrey Njenga** – A representative of general insurance
7. **The Commissioner of Insurance**

Prof. Joseph Kimura was the first chairman of the Fund; however, he resigned on 11th April 2006 and was replaced by Prof. Chege Waruingi. The term of office of the Trustees except the Commissioner of insurance is three years.

### **Board Business**

The Board of Trustees of the PHCF met 15 times during the period under review excluding the Board Sub-Committee meetings. It was necessary for the Board of Trustees to meet frequently to set up the operational systems of the Fund.

### **Responsibilities of the Board**

The principal responsibility of the Board of Trustees is that of establishing the long term goals of the PHCF and ensuring that effective plans are developed and implemented. This entails:

- Establishing and reviewing the mission, vision and values and developing strategies
- Putting in place management structures (organization, systems and capacity requirements) to achieve those objectives;
- Setting targets and monitoring performance;
- Guiding the implementation of strategic decisions and actions and advising management as appropriate;
- Reviewing and adopting annual budgets for the financial performance of the Fund and monitoring the Funds performance and results;
- Overseeing the implementation of adequate control systems and relevant compliance with the law, governance, accounting and auditing standards;
- Ensuring the preparation of annual financial statements and reports, communication, and disclosure of information to stakeholders.
- Reviewing the Legal framework of the Fund

### **Board Committees**

The Board has delegated its authority to two committees which operate within defined terms of reference. During the year, the Board had two standing committees:

#### **1. The Finance and Management Committee**

This committee consists of four members. The committee is chaired by Mr. Charles Mwaura. They met sixteen times during the financial year. The Committee is mandated to broadly oversee the following:-

- All financial and management issues including preparation of annual budget estimates.
- Appointment of external accountants to help in the preparation of management accounts and the maintenance of a professional relationship with them;
- Review of the Fund's risk management and internal control procedures.

#### **2. The Legal and Education Committee**

The Committee consists of five members. The Committee is chaired by Mr. Bill Inamdar. They met eleven times during the year. The committee is mandated to oversee the following:-

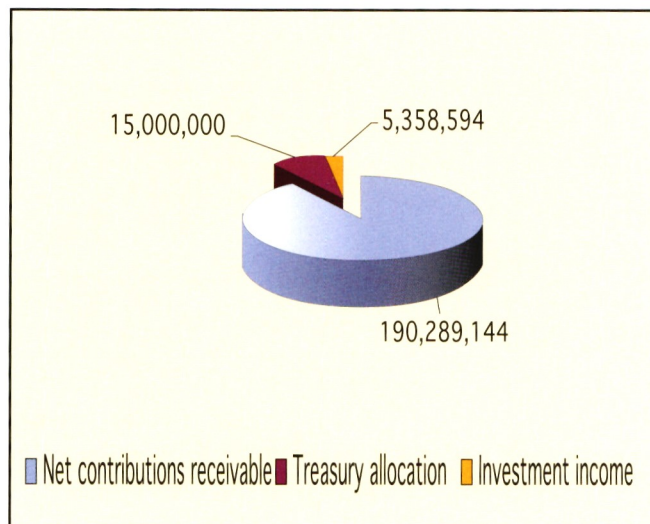
- All matters related to the legal and Institutional framework;
- Drafting and amendment of legal notices and finance bills;
- Public education and awareness;

## Activities of the Fund

The operations of the Fund were commenced on January 1, 2005 before the institutional framework was developed. Without staff of its own and relying on four seconded staff two partially seconded from the Department of Insurance and two from the Retirement Benefits Authority, the Board felt obliged to meet regularly to monitor operations and set up operational procedures for the Fund. The Board of Trustees has developed a number of operational documents some of which have been implemented and some are awaiting approval of the Ministry before implemented.

The Board also has continued to collect the statutory levy from insurers as required under the law. This money collected is invested in short term government securities.

### Contributions during the period, Investment income and Treasury allocation



## Achievements by the Board of Trustees during the year

The principal responsibility of the Board of Trustees is that of establishing long term goals of the Fund and ensuring that effective plans are developed and implemented. Achievements by the board during the year include:

- **Rules for Board Business.** The Board of the Fund has established rules governing its business which have been submitted to Treasury for comment and further guidance. The response of Treasury is being awaited.

- **The Fund's Institutional Structure and organizational chart.** This entailed putting in place management structures (organization, systems and staff capacity) to achieve the Fund's objectives.
- **The Fund's case for public education Campaign.** This was adopted but no activity was scheduled in the course of the year because there are legal issues which needed to be settled on the clear mandate of the Fund before the campaign is commenced.
- **The Fund's Financial policy.** This document was implemented immediately to facilitate smooth operations of the Fund.
- **The Fund's Budgets for 2005/2006 and 2006/2007.** The Board prepared budget estimates for the said financial years which were submitted to the Treasury on which basis Treasury allocated funds for administration activities of the Fund. During the period financial consultants were engaged to facilitate the process. The financial consultants were also mandated to:

- 1) Oversee the implementation of adequate control systems and relevant compliance with the law, governance, accounting and auditing standards of the Fund assets.
- 2) Prepare annual and quarterly financial statements and reports for the Board's use.

The engagements of the financial consultants were necessitated because the Fund did not have a staff qualified to prepare management financial statements.

- **The legal framework.** The Board has been engaged in drafting an amendment to legal notice which set it up. In addition, the Fund was able to recommend an amendment to section 179 of the Insurance Act with a view to having the Fund set up as a body corporate. This was enacted by parliament into law in the 2005/06 financial year.
- **The Fund's investment policy.** This document was intended to ensure prudent investment of the

monthly contributions submitted by the insurance companies to the Fund. The document has been submitted to Treasury for comment and further guidance. The response of Treasury is being awaited.

- **The Fund's procurement procedures.** This is a document that is currently used as a manual for the day to day procurement procedures. The document is under consideration for purposes of review in view of the recently enacted Public Procurement and Disposal Act, 2006.
- **The Fund's training policy.** This document is in place and may be implemented as soon as the legal limitations on staffing of the Fund are cleared.
- **The Fund's funding proposal.** The need for the government to inject more funds to the PHCF kitty is very crucial if the overall objective of the Fund is to be realized. This document is a justification of the need for additional funding with projections up to the year 2012. The document has been submitted to Treasury for comment and further guidance. The response of Treasury is being awaited.
- **Setting up of the Secretariat.** Based within the premises of the Department of Insurance offices, the Secretariat manages the day to day operations of the PHCF, and co-ordinates the Board of Trustees' activities. The Secretariat is manned on a full time basis by two members of staff seconded from the Commissioner of Insurance's office and the Retirement Benefits Authority (RBA), respectively. The other two officers oversee the operations of the Fund from their respective offices at RBA and Department of Insurance as they are partially seconded to the Fund.
- **Corporate governance training for Board members.** Corporate governance training for two Board members was carried out in the year. This is in keeping with the principle of improving governance of public institutions.

- **Workshop on claims management process.**

The PHCF Board of Trustees organized and participated in a workshop at the Naivasha intended to help the Board develop an operational system for the management of claims for purposes of compensation. The document on claims management is being developed to help in setting up the system of claims management.

## **b. Challenges Faced by the Fund**

### **Staff recruitment and capacity building**

The Fund does not have its own staff employed specifically to assist the Board in implementing policy and run the Fund on a day-to-day basis and develop the detailed operational procedures. In particular, the Fund needs to have its own Managing Trustee for purposes of overseeing and ensuring implementation of Fund policies and programmes.

The current Managing Trustee which is Retirement Benefits Authority has formally indicated that its mandate of regulating the pensions sector does not give it room to effectively act as Managing Trustee of the Fund. It has thus requested to be relieved of the duty of being the Managing Trustee of the Fund.

### **Location of Fund's Offices**

The office space of the Fund is a small room within the Department of Insurance. With expanding activities, the space will be insufficient in the very short-term.

### **Funding Level**

The funding level of the Fund is small compared with the impending compensation of all qualifying claims that will probably to arise out of the collapse of United Insurance Company Ltd. The Board has written to the Treasury justifying the need for further funding from government and the response is expected to provide guidance towards the implementation of the relevant policy decisions.

## **Moral hazard**

The most important argument made by some against the Fund that must be mentioned is the moral hazard problem of establishing the compensation fund. It is argued that when there is a safety net, consumers may be less inclined to assess the financial situation of the insurer that they contract with and to make a prudent selection. Even worse, they may seek the cheapest products regardless of the risk associated with the insurer; because of the belief that they will not suffer from the negative consequences of their choice in the event that the risk materializes.

This could lead to a loosening in the financial discipline of the companies and an increase in moral hazard in the industry as a whole, which may cause several insurance bankruptcies at once, resulting in de facto bankruptcy of the protection fund itself. This challenge needs to be appreciated and addressed by the newly established insurance regulatory authority.

## **Financial burden on soundly managed insurers**

The Fund is financed by contributions collected from insurers. The establishment of the Fund therefore imposes new financial burdens for insurance companies covered by the Fund. This raises the following two arguments against setting up such systems:-

The first argument focuses on the fact that the Fund intends to subsidize the mismanagement by one member company at the expense of other members that run their business in a prudent manner. Under this mechanism, prudently managed companies, which avoid effectively being in financial distress, need not only contend with reckless competitors that offer aggressive pricing to attract customers, but also compensate for the eventual failures of such competitors. This situation could seriously undermine sound and fair competition in the industry.

The second argument is the financial burden on member companies to finance the Fund. Again this challenge can be managed by the regulatory authority which is mandated to ensure prudence in insurance business.

## **c. Way Forward**

The Board of the Fund has planned for the following key deliverables:-

### **Proactive Operations**

- Develop an operations plan detailing the specific actions the Fund will take to respond to future insolvencies. The operations plan will address actions relating to the unlikely risk of failure of a major insurer, or of several insurers at the same time.
- Recruit a small, professional staff to manage the Fund with a focus on building capacity for improved operations, governance and research.
- Create a financial contingency plan for the Fund, including an examination of the adequacy of the Fund.
- Study the potential role of risk-based assessments of insurers and make recommendations for the management of risks that would affect insurers.
- Proactively work to maintain the strong positive relationship that has been established between the Fund and the major stakeholders.

### **Effective Governance**

- Deliver a comprehensive report with recommendations on effective governance, including:
  - developing a mission statement, mandate, vision and business concept.
  - examining the size and composition of the Board, and the compensation of members of the board of trustees
  - documenting the responsibilities of board members.

- Consult with member insurers, regulators and other stakeholders regarding proposed changes in corporate governance.

### **Relevant Research/Training**

- Establish a multi-year research/training program to identify possible improvements in the operations and governance of Fund based on lessons learned from the countries with similar but established compensation funds such as Canada, the United Kingdom and elsewhere.

### **The Fund's public education Campaign**

- This was adopted but no activity was scheduled in the course of the year because there are legal issues which needed to be settled on the clear mandate of the Fund before the campaign is commenced. Once the legal issues are cleared, then education campaign will be carried out to sensitize the public on the importance of the Fund and how it works.

### **d. Conclusion**

The establishment of the Fund is clearly beneficial in promoting the protection of policyholders and supplementing insur-

ance supervision in the event of insurer insolvency. However, there are also drawbacks that cannot be ignored, which perhaps explains why only a limited number of countries have introduced such funds. In recent years, however, there seems to be a trend towards creation of these funds, mostly triggered by the failure of one or more larger insurance companies. It has also probably been driven by the convergence of financial service sectors, especially that of insurance and banking. The banking sector in most jurisdiction usually has a deposit protection scheme. Given the difficulty of abolishing a safety net system and the deepening convergence of financial markets and perhaps of financial regulations, this trend is likely to continue. The Fund was established to compensate individual policyholders from the risks associated with the collapse of an insurer as a way of building confidence in insurance business. It is the first of its kind in Sub-Saharan Africa and we are determined to make it a success story and a model Fund for other countries.

Signed by,



**Chairman**



**David B Nyakundi**

*(Representative of Managing Trustee)*

## **a. Justification for a Policyholders Compensation Fund**

The protection of policyholders against insolvency of insurance companies is one of the primary objectives of insurance regulation. In order to achieve this goal, a range of regulatory and supervisory measures are normally established to ensure financial and managerial soundness of insurance companies and supervisory authorities are expected to do their best to avoid the failure of supervised companies. It is sometimes inevitable however, that in spite of all possible supervisory measures some insurance companies will encounter serious financial difficulties and fail.

In order to protect the interests of policyholders in the event of insolvency of an insurance company, certain special regulatory arrangements are normally established. These arrangements can be divided into two groups; (a) those included in the winding-up procedure and (b) those outside of it. The former type of arrangement is used in most jurisdictions, but typically varies considerably in detail across jurisdictions, largely depending on idiosyncrasies of the judicial insolvency procedures of respective jurisdictions as well as the specificity in the insurance regulatory frameworks. In addition to these measures, in many jurisdictions, policyholder's compensation funds have been established to provide protection for policyholders outside of the winding-up procedure.

When an insurance company becomes insolvent, policyholders face potential financial losses as their claims may not be fully met. In order to protect policyholders under such a situation, a fund to compensate their losses is often created. Such schemes may be designed to collect necessary contributions or levies to finance the compensation of policyholders in the event an insurance company goes bankrupt.

These funds can be classified into two types. The first type includes the funds that focus on the policyholders of one or a few branches of insurance. In the second type, the funds cover most of the insurance contracts subscribed to by the participating insurance companies. The former type is often referred to as a fund for a specific class of insurance, while the latter is a general fund.

## **b. Legal set up of the Policyholders Compensation Fund**

### **Enactment**

The Policyholders Compensation Fund (The Fund) was established by the Government on 24th September, 2004 through a Legal Notice No. 105 of 2004 signed by the Minister for Finance in exercise of his powers conferred by section 179 (2) of the Insurance Act.

## **Main objectives**

The core purpose of the Fund is to provide compensation to the policyholders of an insolvent insurer.

## **Other objectives**

### **Protection of non-professional policyholders**

The primary objective of the Fund is to protect the interest of policyholders, especially individual or non-professional policyholders in the event of bankruptcy of an insurance company. The funds are expected to serve as the final safety net for policyholders, when, in spite of all possible supervisory measures, bankruptcy occurs. The Fund may provide the final safety net for policyholders in such extraordinary cases and, thereby, supplement supervision as a means of protecting the interests of policyholders.

### **Maintenance of public confidence**

The insurance industry is built on the public's confidence in the business. The Fund can help to maintain the public's confidence in the insurance business and, thereby, help to sustain the sound development of the industry. Non-professional policyholders not only have limited ability to evaluate appropriately the financial soundness of insurance companies, but also have little incentive to do so. Without the ability to appropriately assess the risks of individual companies, the general public may lose their confidence in the soundness of other insurers. Knowing the possibility of damages in the event of a company's insolvency, the public may be discouraged from seeking insurance, which would again affect the industry as a whole and lower social welfare. The establishment by government of the Fund is therefore intended to contribute to the development of the insurance industry.

### **Development of competitive markets**

The establishment of the Fund will also contribute to the development of competitive markets. The Fund may prepare a smooth exit mechanism for incompetent insurers from the market, which supports dynamics in the marketplace. Competitive markets experience failures. The failure of an insur-

ance company affects policyholders significantly. They would suddenly face risks they thought had been transferred to a third party. The Fund can alleviate significantly the difficulties that policyholders might face in the event of the failure of an insurance company. Having the safety net, the supervisory authority may let a financially impaired insurer go bankrupt without taking extraordinary measures that often disturb the efficient functioning of the market. The Fund therefore can serve to help develop dynamic and pro-competition insurance markets.

### **A level playing field across sectors**

Last but not least, the compensation funds are an important tool for preparing a level playing field for insurance companies and banks. In recent years, the insurance and banking sectors have converged. Cross-selling is increasingly common in many countries. At the product level, banks sell financial derivatives that effectively provide guaranty against certain risks, and insurance companies, especially life insurance companies, offer products that have significant savings elements. Insurance companies and banks are competing more and more directly. In the same context, it is argued that insurance policyholders should be protected by a safety net system as bank depositors are, and that insurance companies should have a similar back-up as deposit insurance in order to compete with banks.

## **c. Implications of the Legal Notice to the Insurance Industry and other Stakeholders**

### **(i) Coverage and Payment of Claims**

#### **Insurance branches covered**

Various contracts of insurance business are normally divided into two: life insurance and non-life insurance. Given the difference in the nature of the two sectors of insurance (particularly, the former which is normally a long-term business while the latter generally short term) and also reflecting the segregation policy in most countries, compensation funds in most jurisdictions cover only one of two sectors. However, in Kenya the Fund covers eligible policyholders whether in long-term or short-term insurance.

In accordance with the objective to protect non-professional policyholders, certain insurance products that are designed particularly for corporations are often excluded from the coverage of the funds, as corporations should normally be able to get sufficient information on the products and the companies and assess appropriately the risks involved. In Kenya, the branches covered by the funds are positively listed to limit the protection to those largely targeted i.e. individual customers

### **Eligibility of claimants**

In order to limit the protection by the Fund to those who really need it, the law does not allow corporations to apply for compensation for their claims. The Fund also excludes from its protection claimants who are not natural persons.

### **Limitations on compensations**

The Fund has certain limits on the compensation it guarantees to compensate policyholders in respect of claims covered by the insurance policy they have taken in the event of the insurer's insolvency. The Fund compensation rate is shillings 100,000.00 per claim. The claim must be lodged by the policyholder and not a third party.

### **Payment of compensations**

The fundamental objective of the Fund is to compensate losses of policyholders in the event of insolvency of an insurer. A basic operation of the Fund is, therefore, to pay out compensation to eligible policyholders after an insurance company is declared insolvent. Upon payment,

the rights of the policyholder are automatically assigned to the Fund to the extent of the amounts paid.

### **(ii) Funding**

The Fund is financed by contributions collected from member companies and policyholders. The law requires that contributions by insurers be calculated at 0.25% based on monthly premiums and should be paid monthly to the Fund. The policyholders, who are the direct beneficiaries of the scheme, are also required through their insurers to pay a levy at 0.25% on premium. All registered insurance companies in Kenya are under a statutory obligation to collect monthly the levy from policyholders and make a payment of the same to the Fund by the 15th day of each calendar month.

Until disbursed to protect the interests of policyholders of an insolvent company, funds in the schemes are invested in safe and liquid assets, typically government bonds.

### **d. Conclusion**

The establishment of the Fund will certainly promote the confidence in the insurance industry by the insured and those contemplating to take insurance policies. In order to manage any unlikely risk of moral hazard, the Fund shall work closely with the regulator of the insurance industry to regularly monitor the solvency of insurance companies without assuming the role of the regulator.

Signed by



**Representative of Managing Trustee**

The Legal Notice establishing the Policyholders' Compensation Fund requires the Trustees to prepare financial statements for each financial year, which include a balance sheet showing in detail the assets and liabilities of the fund, a statement of income and expenditure, and such other statements that the Trustees may deem necessary. It also requires that the fund keeps proper books of account and other books and records in relation to the fund and to all the undertakings, funds, investments, activities and property of the Fund.

The Trustees accept responsibility for the Management Accounts, which have been prepared using appropriate accounting policies supported by prudent judgment and estimates, in conformity with generally accepted practices. The accounts were audited and the audit report for the 18th months ended 30th June 2006 from the Controller and Auditor-General is detailed herein after:

Nothing has come to the attention of the Trustees to indicate that the Fund will not remain a going concern for at least the next twelve months from the date of this statement.

Signed by,



**Chairman**



**Representative of Managing Trustee**

## **REPORT OF THE CONTROLLER AND AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE POLICY HOLDERS' COMPENSATION FUND FOR 18 MONTHS ENDED 30 JUNE 2006**

I have audited the financial statements of Policy Holders' Compensation Fund for the 18 months ended June 30, 2006 in accordance with the provisions of Section 14 of the Public Audit Act, 2003. I have obtained all the information and explanations which, to the best of my knowledge and belief were necessary for the purpose of the audit. The financial statements are in agreement with the books of account.

### ***Respective responsibilities of the Directors and the Controller and Auditor General***

The Trustees are responsible for the preparation of financial statements which give a true and fair view of the Fund's state of affairs and its operating results. My responsibility is to express an independent opinion on the financial statements based on my audit.

### **Basis of Opinion**

The audit was conducted in accordance with the International Standards on Auditing. Those standards require that the audit be planned and performed with a view to obtaining reasonable assurance that the financial statements are free from material misstatement. An audit includes an examination, on test basis, of evidence supporting the amounts and disclosures in the financial statements. It also includes an assessment of the accounting policies used and the significant estimates made by the Trustees, as well as an evaluation of the overall presentation of the financial statements. I believe the audit provides a reasonable basis for my opinion.

### **Opinion**

In my opinion, proper books of account have been kept and the financial statements give a true and fair view of the state of the financial affairs of the Fund as at June 30, 2006 and of its net increase in the Fund and cash flows for the period then ended in accordance with the International Financial Reporting Standards and comply with the Insurance Act, Cap 487 of Laws of Kenya



**P.N. Komora**

**Controller and Auditor General**

Nairobi

10 January 2007

	Notes	18 months to 30 June 2006 Kshs
<b>Contributions and Claims</b>		
Contributions receivable	2	190,289,144
Claims payable		-
<b>Net contributions receivable</b>		<b>190,289,144</b>
<b>Treasury allocation</b>	3	<b>15,000,000</b>
<b>Investment income</b>	4	<b>5,358,594</b>
<b>Administrative expenses</b>	5	<b>(10,175,848)</b>
<hr/>		
<b>Net increase in the fund during the period</b>		<b>200,471,890</b>
Fund balance brought forward		-
<hr/>		
<b>Fund balance carried forward</b>		<b>200,471,890</b>
<hr/> <hr/>		

# Net Asset Statement

FOR 18 MONTHS ENDED 30TH JUNE 2006

	Notes	30 June 2006 Kshs
<b>ASSETS</b>		
Fixed assets	6	609,432
<b>Current Assets</b>		
Contributions outstanding	7	12,713,591
Treasury bills	8	173,333,951
Savings account		13,765,382
Current account		365,089
Cash on hand		48,545
		200,226,558
<b>Less: Current Liabilities</b>		
Accounts payable	9	(364,100)
Net Current Assets		199,862,458
<b>Total Assets</b>		<b>200,471,890</b>
<b>FINANCED BY</b>		
<b>Fund Balance</b>	<b>10</b>	<b>200,471,890</b>

The accounts on pages 19 to 23 were approved by the Board of Trustees on September 2006 and signed on its behalf by:



**Prof. Chege Waruingi**  
**Chairman**



**David B. Nyakundi**  
**For: Managing Trustee**

# Cashflow Statement

FOR 18 MONTHS ENDED 30TH JUNE 2006

**18 Months  
to 30 June 2006**  
**Kshs**

## **Cashflow from operations**

Contributions received	177,575,553
Treasury allocation received	15,000,000
Expenditure paid	(9,811,748)

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## **Net cashflow from operations**

182,763,805

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## **Cashflow to investing activities**

Purchase of Treasury bills	(172,293,349)
Purchase of fixed assets	(815,760)
Investment income received	4,524,320

(168,584,789)

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## **Net increase in cash and cash equivalents**

**14,179,016**

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## **Cash and Cash equivalents at the end of the period**

Savings account	13,765,382
Current account	365,089
Cash on hand	48,545

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**14,179,016**

**1. Accounting policies****(a) Basis of preparation**

The accounts were prepared in accordance with and comply with International Financial Reporting Standards. The accounts were prepared under the historical cost convention.

**(b) Depreciation**

The fixed assets are depreciated on a straight line method. The following rates of the depreciation have been applied:

Computers	33.3%
Office furniture & equipment	12.5%

**(c) Revenue recognition**

Contribution receivable is accounted for in the period it relates to.

Interest on treasury bills is net of withholding tax. Interest on saving account is recognised when received. Treasury allocation is recognised when received.

**2 Contributions Receivable**

43 insurance companies participated in the levy contributions.

**3 Treasury Allocation**

During the period under review, treasury allocated Shs. 15 million to the fund to meet operational expenses.

**4 Investment Income**

Total interest on treasury bills	Kshs	8,226,366
Less unearned portion at 30th June 2006		(3 666 048)
Interest earned from Treasury bills		4,560,318
Interest earned from saving Account		798,276
		5,358,594

**18 months to 30 June 2006****5 Administrative expenses****Kshs**

Board expenses	5,887,275
Managing Trustee	982,896
Staff emoluments	257,145
Telephones & postage	380,956
Computer maintenance	45,163
Travelling expenses	212,000
Printing & stationery	112,015
Bank charges	10,640
General office expenses	112,607
Depreciation	206,328
Professional fees	442,200
Public education & publicity	75,098
Partitioning and repairs	257,341
Training and development	1,026,259
Parking fees	3,770
Audit fees	150,000
Library expenses	14,155

**10,175,848**

**6 Fixed Assets**

	<b>Computer furniture &amp; equipment 33.3% Kshs.</b>	<b>Office 12.5% Kshs.</b>	<b>Total Kshs.</b>
Cost			
At January 2005			
Additions	503,133	312,627	815,760
At 30 June 2006	503,133	312,627	815,760
Depreciation			
At January 2005			
Charge for the period	167,544	38,784	206,328
At 30 June 2006	167,544	38,784	206,328
Net book value			
At 30 June 2006	335,589	273,843	609,432

**7 Contributions Outstanding**

	<b>Kshs</b>
May 2006	3,330,124
June 2006	9,261,137
Treasury	122,330
	12,713,591

April 2005 contribution from United Insurance Co. Ltd had been remitted directly to Treasury.

**8 Treasury Bills**

Treasury Bills stated at cost plus accrued interest.

**Kshs**

**9 Account Payable**

Accountancy fee	92,800
Audit fees	150,000
Training & development (Lake Naivasha Si)	121,300
	364,100

**10 Fund Balance**

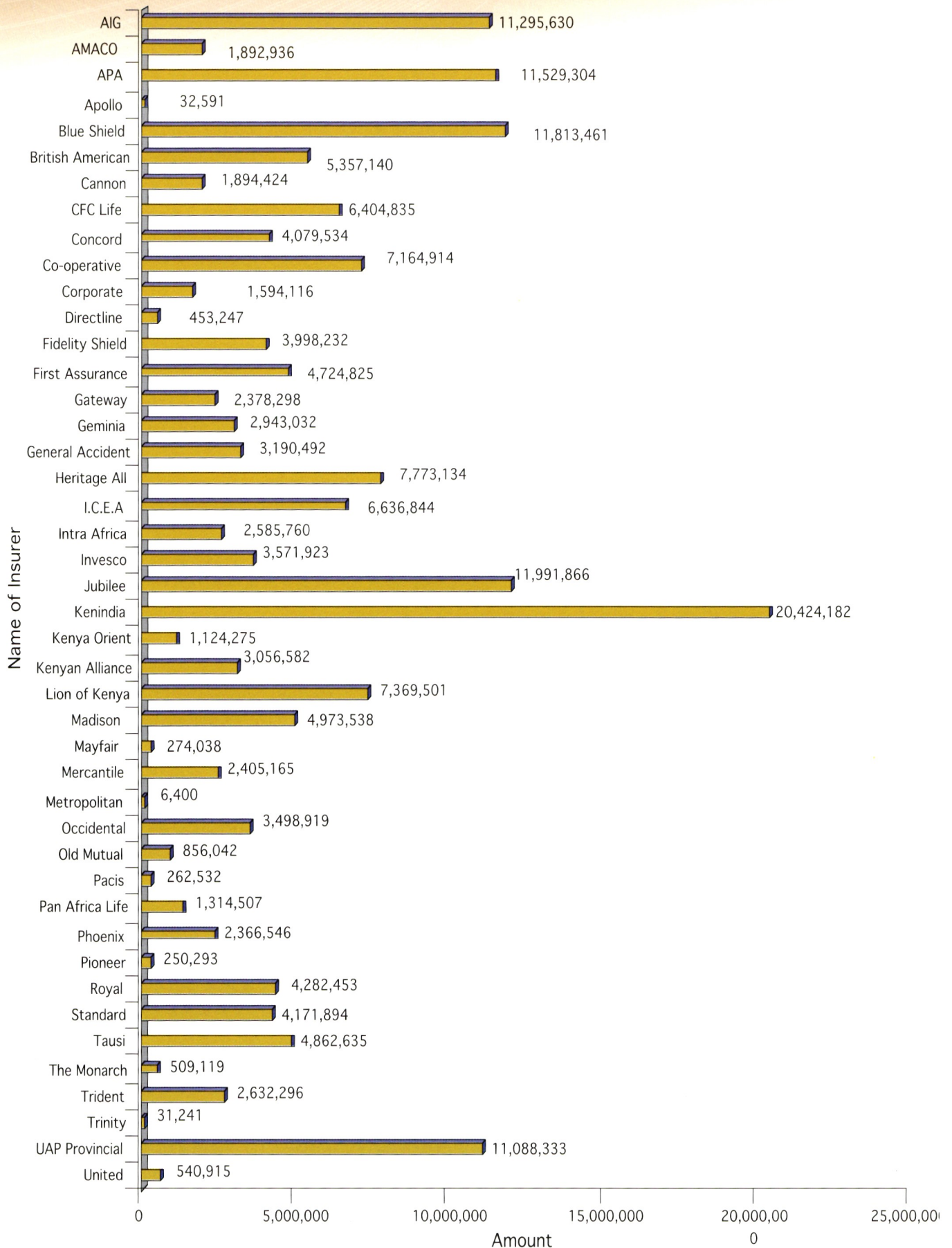
The fund balance is earmarked for the settlement of claims.

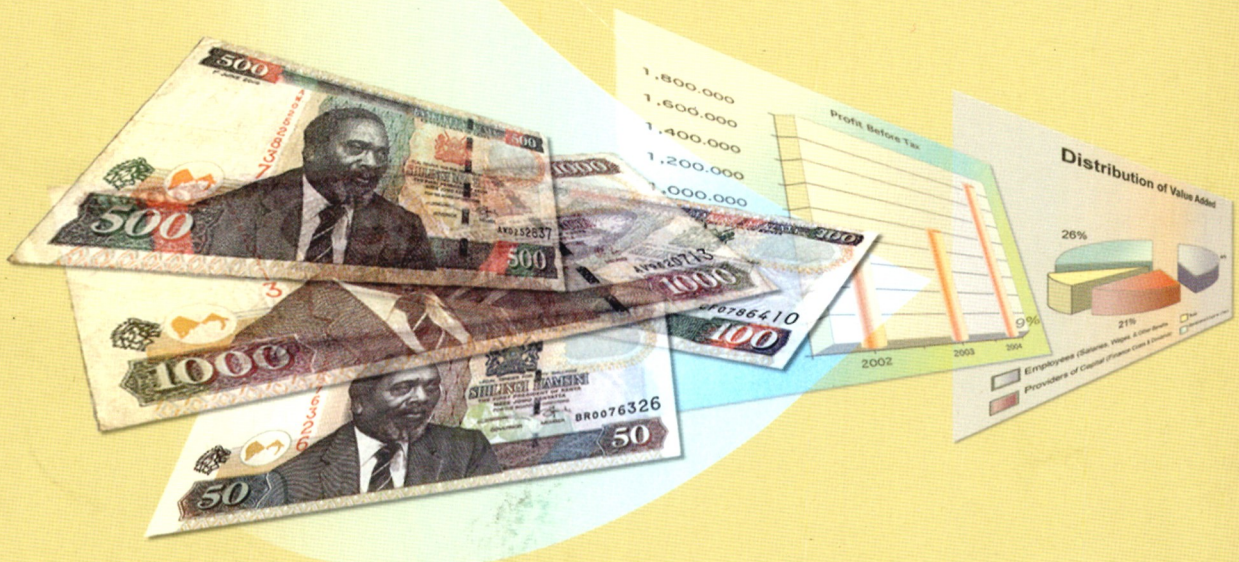
**11 Currency**

The accounts are presented in Kenya Shillings (Kshs).

# PHCF Levy Payment

FOR 18 MONTHS ENDED 30TH JUNE 2006





# PHCF

## POLICYHOLDERS' COMPENSATION FUND

### Registered Office

Bima House, 11th Floor, Harambee Avenue

P.O.Box 43505-00100

Nairobi