Financial Services Sector Report

Q4 2023

MMAN ADVOCATES

BANKING

REPORT OF REGULATOR CIRCULARS, GUIDELINES, LEGAL NOTICES, POLICIES, PRACTICE NOTES AND REQUESTS FOR STAKEHOLDER COMMENTS OR PUBLIC PARTICIPATION FROM 1ST OCTOBER 2023 TO 31ST DECEMBER 2023

The Central Bank of Kenya ('CBK') issued a circular on 11th October 2023 reminding financial institutions not to onboard customers providing money or value transfer services ('MVTS') without a license or authorization from the CBK and also send reports on such customers. The circular noted that financial institutions have a duty to establish if a customer engages in business which requires a license or authorization from a supervisory body as part of customer due diligence. CBK also reminded financial institutions that they are not permitted to open accounts for persons engaging in illegal business activity and their duty to report suspicious transactions involving proceeds of crime to the Financial Reporting Centre. Financial institutions were further directed to submit identification, physical locations and contact details of persons and entities illegally providing MVTS by 11th November 2023.

CBK posted the findings of its financial services sectoral risk assessment in a circular dated 17th October 2023. CBK found the banking sector as having the highest vulnerability to money laundering, terrorist financing and proliferation financing ('ML/TF/PF') due to its size, variety of products and services, diverse customer base, high level of materiality and importance in the Kenyan economy. The circular notes digital credit providers as posing the least ML/TF/PF risk to the financial sector. Financial institutions were advised to consider the findings of the assessment when conducting their own institutional risk assessments.

On 6th November 2023, CBK posted highlights of its analysis of the Anti-Money Laundering and Combating of Terrorism Finance Laws (Amendment) Act, 2023. Some of the points CBK brought to the attention of financial institutions include:

a) customer due diligence should involve identification and verification of beneficial owners based on the newly introduced definition set out in the CBK Act, Banking Act, Microfinance Act and National Payment Systems Act;
b) reporting institutions are required to submit suspicious transaction reports to the Financial Reporting Centre within two days of the suspicion having arisen;
c) reporting institutions are required to verify the identity of a person acting on behalf of another person and their authorisation to act in that regard;
d) the CBK and other supervisory bodies now have the power to compel reporting institutions to produce documents/ information in monitoring compliance with ML/TF/PF requirements;
e) cash transaction reporting threshold has been increased from US$ 10,000 to US$ 15,000; and
f) reporting institutions are required to maintain records of all domestic and international transactions for at least seven years.

LEGISLATIVE REVIEW – SUBSIDIARY LEGISLATION

THE CAPITAL MARKETS (CREDIT RATING AGENCIES) REGULATIONS, 2023 (LN171_2023.pdf (kenyalaw.org))

The Capital Markets (Credit Rating Agencies) Regulations, 2023 ("Regulations") were published on 27th October 2023 pursuant to section 12 (1) (h) of the Capital Markets Act ("Act"). The Act empowers the Cabinet Secretary for the National

Treasury and Economic planning to formulate rules and regulations as may be required to regulate the Credit rating agencies.

Some key take aways from the Regulations include:

i) Approval of credit rating agencies

An entity that intends to undertake business as a credit rating agency in Kenya will apply to the Authority[1] for approval by filling the application form and paying the requisite fee. The entity will be eligible for approval if that entity:

a) is a body corporate;
b) has specified in its formation documents that the rating of securities and issuers of securities is one of its main objectives;
c) has a stable financial base with a minimum paid up capital of at least twelve million shillings;
d) has adequate infrastructure to enable the entity to provide rating services as prescribed under the Act and these Regulations;
e) has professional competence, financial soundness and general reputation for fairness and integrity in business transactions to the satisfaction of the Authority;
f) is not or any of its directors is not involved in any legal proceedings connected with the securities market which may have an adverse impact on the interests of investors has not been convicted of any offence involving moral depravity or of any economic offence;
g) has in its employment, persons having adequate professional and relevant experience to the satisfaction of the Authority;
h) is a fit and proper entity as provided under section24A of the Act for the grant of an approval;
i) has a sample standard agreement between the entity and its clients; and
j) has a- (i) sample letter of request for rating; and (ii) draft of the information requirements for rating a security and an issuer.

A foreign applicant on the other hand shall be required to make an application in writing to the Authority for a certificate of recognition accompanied by the requisite fees and the following documents:

(a) authorization by the relevant regulator in the foreign applicant's jurisdiction that the foreign applicant is a credit rating agency in the form of a certified copy of a valid license or approval to carry on the business of a credit rating agency;
(b) a letter of license or approval status from the foreign applicant's primary regulator;
(c) proof that the relevant regulator is a member of the International Organization of Securities Commission for the purposes of information sharing and supervision;
(d) proof that the foreign applicant has the technical capacity and experience to carry on the business of a credit rating agency;
(e) a code of conduct where the foreign applicant has adopted and implemented in full the International Organization of Securities Commission Code on Credit Rating Agencies and, where there is a deviation from the Code, indicate the reason for the deviation;
(f) a business plan that includes resumes of the foreign applicant's top management staff and management structure;
(g) a brief on the rating methodology, rating grades and free structure;
(h) a sample of a standard agreement between the foreign applicant and its clients; and
(i) a draft- (i) sample letter of request for rating; and
(ii) of the information requirements for rating a security and an issuer.

The Authority may require an applicant to furnish further information or for the applicant's authorized representative to appear before the Authority in person in connection with the application for grant of approval. The Authority, on

[1] "Authority" means the Capital Markets Authority established by section 5 of the Capital Markets Act

being satisfied that an applicant meets all the requirements for approval or recognition, shall grant approval or a certificate of recognition to carry on business in Kenya as a credit rating agency. This approval or certificate granted shall be valid unless it is suspended or cancelled by the Authority.

In case of reasons to warrant a denial, the Authority shall grant the applicant a chance to be heard and communicate its decision to the applicant in writing within thirty days after the decision has been made stating the grounds for the refusal to grant the approval or certificate of recognition. In case the applicant is aggrieved, an appeal may be made against the decision to the Capital Markets Tribunal

ii) General obligations of credit rating agencies

a) Notification of changes

A credit rating agency shall notify the Authority in writing of any intended changes to its establishment status or constitution.

b) Conflicts of interest

An entity carrying on business as a credit rating agency shall operationally, legally and, where practicable, physically separate its credit rating business from any other business of the entity that may present a conflict of interest.

c) Agreements with clients.

A credit rating agency shall enter into a written agreement with each client and issuer whose securities it intends to rate and every such agreement shall include the following provisions-

i) the rights and liabilities of each party to the agreement in respect of the rating of the security or issuer;

ii) the fee charged by the credit rating agency;

iii) the obligation of the client to co-operate with the credit rating agency in order to enable the credit rating agency to conduct periodic reviews of the rating during the tenure of the security or issuer, as may be applicable;

iv) the obligation of the client to provide true, adequate and timely information to enable the credit rating agency to arrive at, and maintain, a true and accurate rating of the security or issuer;

v) the credit rating agency shall disclose to the client the rating assigned to the client or security issued by the client annually, whether or not the rating is accepted by the client;

vi) the client shall disclose in an offer document -
   i) The rating assigned to the issuer of security issued by the client, as the case may be, by any other credit rating agency during the preceding three years; and
   ii) Any rating given in respect of the issuer or security issued by the client, as the case may be, by any other credit rating agency that has not been accepted by the client;

vii) the client shall give explicit consent to the credit rating agency to obtain the details related to the client's existing or future borrowing of any nature, repayment and delay or default; and

viii) the client shall take reasonable steps to give each investor information needed to enable the investor to make a balanced and informed investment decision, in a comprehensible form, after receiving the credit rating.

The Regulations provide a guideline on all matters related to credit rating and also covers the credit rating process, monitoring of ratings, reviews of ratings, procedures to prevent insider trading and market employees among other aspects. These regulations can be accessed through LN171_2023.pdf (kenyalaw.org)

THE PROCEEDS OF CRIME AND ANTI-MONEY LAUNDERING (CRIMINAL ASSETS RECOVERY

FUND) REGULATIONS, 2023 (LN151_2023.pdf (kenyalaw.org))

The proceeds of Crime and Anti-Money Laundering (Criminal Assets Recovery Fund) Regulations, 2023 ("Regulations") were published on 6th October 2023 pursuant to Section 113 (1)(b) of the Proceeds of Crime and Anti-Money Laundering Act ("Act"). The Act empowers the Cabinet Secretary for National Treasury and Economic Planning to prescribe regulations in connection with the utilization of properties and monies standing to the Credit of the Criminal Assets Recovery Fund.[2]

The Regulations provide a framework for the administrative operations of the Fund and the utilization of properties and monies standing to the credit of the Fund. It covers among others,

a) Payments out of the Fund

There shall be paid out of the Fund—

i) moneys derived from concluded confiscation and forfeiture orders into the Consolidated Fund;
ii) five percent of the total proceeds recovered or realized from any property seized or forfeited to the Government, to the Agency[3];
iii) three percent of the total proceeds recovered or realized from any property seized or forfeited to the Government, to the Centre;
iv) claims by a third party in respect of a forfeiture order issued in accordance with (section 93) [4]of the Act; and
v) moneys in respect of administrative expenses incurred in pursuance of the objects and purposes for which the Fund is established.

b) Withdrawals from the Fund

Any withdrawal from the Fund shall only be for the purposes of payments envisaged under regulation 5.[5]

c) Role of the Advisory Board[6]

The Asset Recovery Advisory Board shall—

i) generally advise the Agency on the administration and management of the Fund;
ii) advise the Agency on the preparation of the estimates of revenues and expenditure of the Fund; and
iii) advise the Agency on the preparation of the annual financial and non-financial reports and statements of the Fund.

[2] "Fund" means the Criminal Assets Recovery Fund established under section 109 of the Proceeds of Crime and Anti-Money Laundering Act

[3] "Agency" means the Assets Recovery Agency established under section 53(1) of the Proceeds of Crime and Anti-Money Laundering Act

[4] A person appointed by the court under this Act as a receiver or trustee shall, on application by any person who has obtained an order under subsection (1), and where the period allowed by the rules of court with respect to the making of appeals has expired and any appeal against that order has been determined—
(a) direct that the property or Part thereof to which the interest of the applicant relates, be returned to the applicant; or
(b) direct that an amount equal to the value of the interest of the applicant, as declared in the order, be paid to the applicant.

[5] There shall be paid out of the Fund—
(a) moneys derived from concluded confiscation and forfeiture orders stipulated in Parts VII to X of the Act, into the Consolidated Fund ;
(b) five percent of the total proceeds recovered or realized from any property seized or forfeited to the Government, to the Agency;
(c) three percent of the total proceeds recovered or realized from any property seized or forfeited to the Government, to the Centre;
(d) claims by a third party in respect of a forfeiture order issued in accordance with section 93 of the Act ; and (e) moneys in respect of administrative expenses incurred in pursuance of the objects and purposes for which the Fund is established .

[6] "Advisory Board" means the Asset Recovery Advisory Board established under section 55A of the Proceeds of Crime and Anti-Money Laundering Act

d) Administration of the Fund

The Agency through the Director shall be the administrator of the Fund and his functions shall be to -

i. open and operate such bank accounts with the approval of the Board and the National Treasury;
ii. supervise and control the day-to-day administration of the Fund;
iii. in consultation with the Advisory Board, develop such policies as may be necessary for the attainment of the objects of the Fund;
iv. cause to be kept books of accounts and other books and records in relation to the Fund of all activities and undertakings financed from the Fund; and
v. prepare estimates of annual revenue and expenditure of the Fund and submit them to the Advisory Board for advice before adoption.

More information on the Regulations can be accessed through LN151_2023.pdf (kenyalaw.org)

INVESTMENTS

THE CAPITAL MARKETS (ONLINE FOREX EXCHANGE TRADING) (AMENDMENT) REGULATIONS, 2023 (LN 160 2023.pdf (kenyalaw.org))

The Capital Markets Online Forex Exchange Trading) (Amendment) Regulations, 2023 ("Regulations") were published in October subject to section 12 (1) of the Capital Market Act ("Act"). The Act allows the Cabinet Secretary for the National Treasury and Economic planning to make the regulations for the sector.

These Regulations amended The Capital Markets (Online Forex Exchange Trading) Regulations, 2017, by inserting a new regulation that states that

"An online forex broker shall pay to the Authority an annual fee based on the gross trading revenue which shall include the commissions and rebates from third-party related service providers for that year, at the rate specific in the Third Schedule 3."

At the same time, a Third Schedule was introduced that specifies an annual rate of 3% for a non-dealing broker and 3% for a dealing broker.

The Cabinet Secretary for the National Treasury and Economic Planning published a public notice in October 2023 inviting submission of memoranda and feedback on the 2023 Privatisation Programme. The Programme notes that privatisation and restructuring of government owned enterprises in Kenya ("GOEs") is aimed at spurring economic development by raising additional revenue and improving efficiency in the economy by encouraging more private sector participation. Treasury similarly published an ownership policy for GOEs that seeks to address deficiencies observed in governance of the entities. Submission of feedback closed on 11th December 2023.

On 7th November 2023, the Capital Markets Authority ("CMA") issued a public notice inviting public and stakeholder comments on the draft Capital Markets (Conduct of Business) (Market Intermediaries) Regulations 2023. Submissions of feedback closed on 8th December 2023.

RETIREMENT BENEFITS

On 17th October 2023, the Retirement Benefits Authority **('RBA')** published a public notice inviting public and stakeholder comments on the proposed policy changes to the Retirement Benefits Act and Regulations. Some of the proposed amendments include:

a) increasing the amount of retirement annuity or pension income exempt from income tax from KES 300,000 to KES 456,000 annually and allow for future adjustment due to inflation;
b) extending the 10-year cap for tax exemptions on lumpsum pension benefits to 20 years; and
c) anchoring Kenya Revenue Authority's function of collecting unremitted or outstanding

pension contributions on behalf of retirement benefit schemes.

Submission of feedback closed on 27th October 2023.

SACCOS

On 2nd November 2023, the Sacco Societies Regulatory Authority ('SASRA') gazetted legal notice no. 178 requiring any Sacco undertaking a specified non-deposit taking business to pay a levy known as the Annual Sacco Societies Levy. The levy will be based on the total non-withdrawable deposits held by a Saco society as indicated in the Sacco's audited financial statements for the immediately preceding financial year but shall not exceed KES 6,000,000.

SASRA issued a public caution on 19th December 2023 noting the continued operation of persons and entities undertaking regulated Sacco business without due licensing or authorization. SASRA advised the public to exercise caution and conduct due diligence before placing or authorizing the placement of their funds or moneys or deposits with any entity presenting itself as undertaking regulated Sacco business. SASRA also directed private and public sector companies, institutions and entities not to facilitate the operations of unauthorized entities through deductions and remittances, and/or providing electronic and digital channels to undertake such illegal Sacco business.

INSURANCE SECTOR

South Nyanza Sugar Company Limited v Sanlam Kenya Plc & 2 Others (Civil Case 87 of 2007) [2023] KEHC 24736 (KLR) (3 November 2023) (Judgment)[7]

BACKGROUND:

Sometime in July 2000, South Nyanza Sugar Company Limited ("**the Plaintiff**"), through FT Insurance Brokers Limited ("**the 2nd Defendant"**), obtained a medical insurance policy for its employees from Pan Africa Insurance Company Limited ("**Pan Africa Insurance**"), later succeeded in title by Sanlam Kenya Plc & APA Insurance Company Limited, the 1st & 3rd Defendants. The arrangement between the Plaintiff and Pan Africa Insurance was that the Plaintiff would settle medical bills submitted by eligible employees and seek reimbursement of settled claims from Pan Africa Insurance.

The Plaintiff paid the 2nd Defendant, for onward remittance to Pan Africa Insurance, Kshs.11,516,892.00 being premium payments in consideration for medical cover between 1 July 2000 and 31 January 2002. For the period in question, the Plaintiff settled medical bills submitted by eligible employees as and when they arose. The Plaintiff then lodged claims of Kshs.16,630,183.30 with Pan Africa Insurance. Out of this amount, Pan Africa Insurance only reimbursed Kshs.6,618,153.40 leaving a balance of Kshs.10,012,029.90.

PLAINTIFF'S CASE:

The Plaintiff presented documentary evidence showing that it disbursed the sum of Kshs.11,516,892.00 to the 2nd Defendant for onward remittance to Pan Africa Insurance. The Plaintiff contended that the Defendants breached the insurance contract when they accepted payment of premiums through the 2nd Defendant but failed to settle the entire claim arising from the policy.

The Plaintiff argued that the 2nd Defendant, to the extent that it received premium payments on behalf of Pan Africa Insurance, was an agent of the latter.

Thus, the Plaintiff prayed for Kshs.10,012,029.90 being the unsettled portion of the claim together with interest thereon at the rate of 24% p.a. from 10 June 2003 until payment in full.

[7] Available at http://kenyalaw.org/caselaw/cases/view/272695/ accessed on 5 February 2024.

THE DEFENDANTS' CASE:

1st Defendant:

In opposing the Plaintiff's suit, the 1st Defendant contended that:

(a) it did not contract with the Plaintiff.

(b) it did not contract the 2nd Defendant as its insurance broker. Rather the 2nd Defendant was and remained an agent of the Plaintiff.

(c) it settled all valid medical insurance claims presented to it.

(d) it was entitled to disclaim cover under the Policy because:

(i) the Plaintiff had lodged exaggerated, fictitious and fraudulent claims. To illustrate, the authenticity of the schedule of settled and unsettled claims was questionable. The same was not placed on the Plaintiff's letterhead and was neither dated nor signed. Additionally, the Plaintiff had not presented any proof that it incurred medical expenses of Kshs.10,012,029.90.

(ii) the Plaintiff had failed to settle the applicable premiums payable under the Policy. Under section 156 of the Insurance Act, the 1st Defendant was precluded from assuming risk in respect of insurance business until the premium payable was received by the insurer.

(iii) the Plaintiff had contravened the Policy by failing to obtain authority in respect of the eligible employees prior to any hospital treatment.

(iv) the Plaintiff failed to submit final claims in writing within 60 days of completion of treatment.

2nd Defendant's Case:

The 2nd Defendant did not participate in the proceedings. Interestingly, the Plaintiff never applied for interlocutory judgment or judgment in default against the 2nd Defendant.

3rd Defendant's Case:

The 3rd Defendant opposed the suit against it on grounds that:

(a) it had no relation to the 1st Defendant and that Pan Africa Insurance did not transfer any insurance business to its predecessor, Newco Limited; and

(b) it was not a party to the contract between the Plaintiff and the 1st & 2nd Defendants. As such, due to privity of contract, it could not incur any obligations arising from the agreement between the Plaintiff on the one hand and the 1st & 2nd Defendants on the other hand.

ISSUES FOR DETERMINATION:

The Honourable Court framed the following as the issues for determination:

1. Whether there was a valid (insurance) contract between the Plaintiff and Pan Africa Insurance Company Limited.
2. What was the connection between the 2nd Defendant and the other parties to the suit.
3. What were the consequences of non-payment of the applicable insurance premium.

HELD:

There existed a Valid Contract of Medical Insurance to Cover the Plaintiff's Employees

No party had disputed that:

(a) There were 2 medical insurance policies between the Plaintiff and Pan Africa Insurance which policies were not signed on the execution page.

(b) The Plaintiff paid premiums through the 2nd Defendant, FT Insurance Broker.

(c) Some of the Plaintiff's claims were settled by Pan Africa Insurance Company Limited.

Pan Africa Insurance had written demand letters to both the Plaintiff and the 2nd Defendant over unpaid premiums.

Given the foregoing, even though the insurance policies were not properly signed on the execution pages, the court found that the conduct of the parties and the correspondence on record established the existence of a valid insurance contract in respect of the Plaintiff's employees.

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The 2nd Defendant was an Agent of the Plaintiff

The court found that the Plaintiff's own documents showed that it contracted the 2nd Defendant for insurance brokerage services. The 2nd Defendant was to collect premiums from the Plaintiff and remit them to Pan Africa Insurance. The 2nd Defendant was also to receive claims from the Plaintiff and submit them with Pan Africa Insurance for reimbursement. In the circumstances, the 2nd Defendant was an agent of the Plaintiff and not the 1st Defendant or 3rd Defendant.

This was not one of the rare cases in which an insurance broker would be deemed to be an agent of the insurer as opposed to the insured.

The Plaintiff breached the Insurance Policies

Flowing from the finding that the 2nd Defendant was an agent of the Plaintiff, the court found that as the principal, the Plaintiff was bound by the 2nd Defendant's actions.

From the testimonial and documentary evidence, the 2nd Defendant failed the Plaintiff on two fronts. First, it received funds (insurance premia) from the Plaintiff but failed to remit them to Pan Africa Insurance. Second, it failed to submit claims within the 60 days period stipulated in the extant policies. Under agency law, the court held, it was the Plaintiff that failed to pay the insurance premia and lodged its claims for reimbursement outside the 60 days window.

On what the consequences of the Plaintiff's failure to settle the insurance premia would be, the court sought guidance from the decision of the Court of Appeal in **Nizar Virani t/a Kisumu Beach Resort v Phoenix of East Africa Assurance Company Limited Civil Appeal No. 88 of 2002 [2004] eKLR** where the appellate court held that under Kenyan law, failure to pay insurance premium does not automatically invalidate an insurance contract. Rather, regard would still have to be had to the parties' intentions and the general principle in contract law that parties are bound by the terms of the agreement. The court found sufficient evidence that Pan Africa Insurance and the Plaintiff intended for the policy to be valid and active only upon payment of the applicable insurance premiums. For instance, the court highlighted letters from Pan Africa Insurance in which it informed the Plaintiff and the 2nd Defendant that failure to pay the applicable premiums would lead to non-settlement of the Plaintiff's claims.

CONCLUSION & IMPLICATION:

In view of the above findings, the court dismissed, with costs, the cases against the 1st & 3rd Defendants. The court faulted the Plaintiff for failing to seek interlocutory judgement against the 2nd Defendant when the latter failed to enter appearance or file a defence.

The decision underscores the importance, for insurers, of stipulating in the insurance policy, the effect of non-payment of insurance premium or a portion thereof. An ambiguity on the consequence of non-payment of the applicable premium may invite the court to hold, following the Court of Appeal's decision in **Nizar Virani t/a Kisumu Beach Resort v Phoenix of East Africa Assurance Company Limited,** that non-payment of insurance premium does not necessarily invalidate an insurance policy.

NOTARIES PUBLIC • COMMISSIONERS FOR OATHS • PATENT AGENTS

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