Financial Services Sector Report

Q3 2021

MMAN ADVOCATES

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BANKING

In this quarter, we showcase two judicial decisions that had an impact on the banking sub-sector.

I. Judicial Decisions

Surya Holdings Limited & 2 Others V CFC Stanbic Bank Limited & 2 Others [2021] EKLR (*Find link Here*)

Brief Facts

The 1st and 2nd appellants were guarantors to a facility agreement between the 3rd appellant and the 1st respondent. The 3rd appellant defaulted in its repayment obligations to the 1st respondent. That led to the appointment of receivers on February 10, 2014, in accordance with the power annexed to the debenture, as issued by the 3rd appellant. That appointment was challenged by the appellants at the High Court. By a Ruling dated June 11, 2014, the High Court confirmed the appointment of the receivers, but restrained them from selling the charged properties, and ordered the 3rd appellant to continue operating as a going concern in the interest of all the parties. Later, on March 30, 2016, the High Court in Winding up Cause 12/2013 issued Winding up Orders against the 3rd appellant.

By a ruling dated October 13, 2016, the Court found that the appellants had made an admission that the 3rd appellant owed the 1st respondent a pre-receivership sum of US$ 4,028,194.30 and Kshs. 2,706,966.13 together with interest thereon. The court further directed the parties to agree on a forensic audit. The parties agreed on the auditor, Deloitte Consulting Group. The audit report was duly filed in court, and the parties addressed the court extensively on it. The High Court found that the 3rd appellant owed the 1st respondent a sum of USD 4,028,194.30 and Kshs. 2,706,994.13, together with contractual interest as contained in the facility agreement executed between the 3rd appellant and the 1st respondent, being the pre-receivership debt. Aggrieved the appellants filed an appeal before the Court of Appeal. The court of appeal found that the orders granted by the High Court did not constitute a wrong exercise of judicial discretion. As such, the Court of Appeal did not interfere with the orders made by the High Court and dismissed the appeal with costs to the respondents. Aggrieved, the appellants filed the instant appeal.

Issues:

i. Under what circumstances would the Supreme Court have the jurisdiction to determine an appeal from the Court of Appeal as of right in cases involving the interpretation and application of the Constitution (under article163(4)(a) of the Constitution).

Held:

i. Under article 163(4)(a) of the Constitution of Kenya, 2010, the Supreme Court had jurisdiction to entertain appeals from the Court of Appeal as of right in any case involving the interpretation or application of the Constitution. An appeal had to originate from a Court of Appeal case where issues of contestation revolved around the interpretation or application of the Constitution. An appellant must be challenging the interpretation or application of the Constitution which the Court of Appeal used to dispose of the matter in that forum. Such a party had to be faulting the Court of Appeal on the basis of such interpretation. Where the case to be appealed from had nothing or little to do with the interpretation or application of the Constitution, it could not support a further appeal to the Supreme Court under the provisions of article 163(4)(a).

ii. The pleadings before the High Court confirmed that the constitutional issues raised before the Supreme Court were never pleaded and also that the trial court did not interpret or apply the same. The Court of Appeal, just like the High Court did not interrogate or apply any of the articles of the Constitution alleged to have been violated, that was, articles 25 and 50 of the Constitution.

iii. Several issues were pending determination before the trial court. There was no substantive determination by the superior courts below of a Constitutional nature, to warrant the Supreme Court to exercise its jurisdiction under article 163(4)(a) of the Constitution. Non-determination of the constitutional issues raised before the Court of Appeal, that was, violation of their right to be heard pursuant to articles 25 and 50 of the Constitution, did not form a basis for the instant court to entertain the instant appeal under article 163(4)(a) of the Constitution. It would have been pre-mature for the Court of Appeal to make a finding on the constitutional issue raised since the trial court had not fully determined the rights of the parties before it. The Supreme Court lacked the jurisdiction to entertain the instant appeal.

Implication:

Access to the Supreme Court in matters touching on enforcement by financial institutions of security instruments or challenge thereof by borrowers is strictly constrained and would largely be determined by the issues framed for determination at the trial court. New issues cannot be framed at the appeal issues just to bring a matter within the jurisdictional purview of the Supreme Court. This should be welcome as it somewhat ensures that disputes of a commercial nature in the banking industry are determined quickly without allowing a party a direct avenue of appeal to the Supreme Court.

Nairobi Civil Appeal 33 of 2017: East African Development Bank Limited vs- Mujtaba Jaffer & 2 Others (*Find Link Here*)

Facts

The suit arises from the Ruling of the High Court at Mombasa that struck out the Appellant's suit against the Respondents for recovery of US$ 9,961,114.91 and interest on grounds that a Guarantee Agreement executed by the Respondents on which the suit was founded was void for all purposes having been prepared by an "unqualified person" within the meaning of Section 34 of the Advocates Act. It was the Appellant's argument that the Guarantee in issue is a contract and does not fall under Section 34 of the Advocates Act because it is not a document relating to conveyance of property, formation of a company, formation or dissolution of partnership, grant of probate or legal proceedings. It was also submitted that the guarantee as well as the other security documents were in fact prepared by the firm of Anjarwalla and Abdulhussein & Company Advocates but under the supervision of Appellant's in-house counsel who was an advocate of the High Court of Tanzania.

Issue for determination:

Whether security documents were prepared by a qualified person within the meaning of Section 34 of the Advocates Act.

Held:

The Court was of the view that the documents raised questions whether the statement on the face of the security documents that they were drawn by the secretariat should have been taken at face value. The Court took into consideration the correspondence between the firm of Anjarwalla and Abdulhussein & Company Advocates and in-house Counsel, which was clearly indicative that the firm had prepared the documents for the Appellant's approval. It was held that the learned Judge in the High Court did not consider all the facts placed before him. The Appeal was upheld and the decision of the High Court was set aside.

Implication:

- Notably the Appellate decision was focused on who prepared the security documents and there was no specific finding as to whether or not a Guarantee falls under Section 34 of the Advocates Act
- Further, this Appeal alludes that caution has to be taken by financial institutions more particularly in respect to the qualification of the persons (within the meaning of Section 34 of the Advocates Act) who are preparing security documents and conveyance documents since there is potential of the same being invalidated if prepared by an unqualified person.

FINTECH

The departmental committee on finance and national planning tabled its report on the Central Bank of Kenya (Amendment) Bill, 2021 before the National Assembly for debate in an attempt to regulate digital credit service providers.

I. Guidelines, Notices & Circulars

Tabling of the report on regulation of licensing of digital lending service provider terms

The departmental committee on finance and national planning tabled its report on the Central Bank of Kenya (Amendment) Bill, 2021 before the National Assembly for debate on 5th August 2021. The bill is parliament's latest attempt to regulate digital credit service providers. The committee observed that there is a need for Central Bank of Kenya to be granted powers to regulate terms of licensing of digital lending service providers and recommended that parliament passes the bill with the proposed amendments within the report.

INSURANCE

The Insurance Regulations were this quarter amended in several areas. A public notice was also issued by IRA to compel all motorcycles and three wheeled vehicles used to transport fare-paying passengers will require third-party insurance.

I. Subsidiary Legislation

The Amendment of Insurance Regulations

The Insurance (Amendment) Regulations Legal Notice 167 of 2021 (Find Link Here)

The Regulations were published to amend the Insurance Regulations ,1986 as follows:

(a) by deleting Regulation 6 which provided for registration fees of an insurer and reinsurer registered under Section 30 of the Insurance Act, Cap 487 (the "Act"), and substituting it with the registration fees for insurers and reinsurers registered under Section 31 of the Act. The annual fees payable by insurers and reinsurers shall be Kenya Shillings One Hundred and Fifty Thousand (Kshs 150,000.00) and Kenya Shillings Two Hundred and Fifty Thousand (Kshs 250,000.00) respectively. In addition, the Regulations also introduce a deadline of 30th September for this annual payment and impose a penalty that the Insurance Regulatory Authority may impose on insurers for failure to pay these annual fees as follows:

i. a fine of Kenya Shillings Twenty Thousand (Kshs 20,000.00) for each day the annual fee remains unpaid; and
ii. cancellation of the insurer's licence.

by amending Part A of the Third Schedule to create specific sub-classes of liability insurance including product liability, professional indemnity, latent defects liability, structural defects liability and public liability. Previously the only sub-class was products liability.

(b) by deleting the current Form Ins 70-1 and replacing it with a new form. This form is submitted by every insurer to the

Commissioner of Insurance by virtue of Regulation 21 of the Regulations and provides the maximum permitted expenditure in long -term insurance. Section 70 (1) of the Act provides a limitation on the expenses of management as utilised by the insurers. Insurers are prohibited from spending excess of the prescribed limits and the insurers are required to submit this form to the Commissioner of Insurance as part of the prescribed reporting requirements. The information to be disclosed includes details in relation to annuities, group life, group credit and pensions, life assurance and investment policies.

II. Guidelines, Notices & Circulars

Proposals to Recommend Changes to The Insurance Act and Regulation

The Insurance Regulatory Authority issued a public notice inviting proposals for recommended changes to the Insurance Act and its regulations. The Authority noted that key areas of focus in considering proposed amendments as improving access to insurance through use of technology and enhancing mechanisms for protection of insurance consumers. Submission of proposals closed on 10th August 2021.

Members of the public were notified of the Insurance Regulatory Authority's intention to amend the Insurance (Motor Vehicle Third Party Risks) (Certificates of Insurance) Rules, 1999 with a view that all motor cycles and three wheeled vehicles used to transport fare-paying passengers will require third-party insurance. Submission of representations on the proposed amendment will close on 10th December 2021.

III. Parliamentary Bills

The Proceeds of Crime and Anti-money Laundering (Amendment) Bill, 2021 published on 30 August 2021 (Find Link Here)

The Proceeds of Crime and Anti-Money Laundering (Amendment) Bill, 2021 (**the Bill**) has widened the scope of the definition of a financial institution by including insurance undertakings and insurance intermediaries (including agents and brokers).

This express addition effectively means that persons involved in providing insurance services including agents and brokers will be categorised as reporting institutions.

If the Bill is passed into law, these businesses will have a monitoring and reporting obligation and should accordingly acquaint themselves with the anti-money laundering obligations of reporting institutions.

IV. Judicial Decisions

Association of Insurance Brokers of Kenya v Cabinet Secretary for National Treasury & Planning & 4 others [2021] eKLR (Find Link Here)

Issues for Determination:

(a) Whether section 156 of the Insurance Act as amended by the Insurance (Amendment) Act, 2019, on protection of the insurer from assuming risks of insured persons was constitutional?
(b) What was the effect of section 156 (as amended) on insurance stakeholders?
(c) Whether section 156 of the Insurance Act (as amended) had the effect of depriving the Petitioner of their property?
(d) Whether constitutional standards of public participation were met in

amending section 156 of the Insurance Act through the Insurance (Amendment) Act, 2019?

Held:

(a) In determining whether a statute was constitutional or not, the court had to determine the object and purpose of the impugned statute for it was important to discern the intention expressed in the Act itself. The constitution had to be given a purposive, liberal interpretation and that the provisions of the constitution had to be read as an integrated, whole, without any one particular provision destroying the other but each sustaining the other.

(b) An examination of section 156 of the Insurance (Amendment) Act brought to the fore three effects to the insurance industry, namely:
   (i) absolving the insurer from liability on risk claims that arose from premiums not directly received by them from the insured.
   (ii) removing intermediaries' powers to collect premiums on behalf of the insured; and
   (iii) introducing criminal sanctions to any directors or officers of intermediaries who contravene the section.

(c) The main intention of the amended section was to protect the insurer from assuming risks of insured persons by rogue intermediaries who failed to remit premiums and could therefore cause the possibility of bankruptcy and loss of business to the insurer. The court, however, had to consider whether that was reasonable and sufficient to justify the amendment and its effect.

(d) Before the impugned amendment, the Petitioner had the right to collect premiums on behalf of insurers and would proceed to pay themselves commissions and were allowed to keep the interest on the premiums collected as seen in section 156(3), (9) and (10) of the Insurance Act.

(e) The amendment would have the effect of discouraging insurance penetration since the intermediaries would be cut out from collecting premiums directly from insureds. Further, criminalization of handling of premiums by insurance brokers would lead to massive closures of insurance brokerage firms thereby jeopardizing the rights of the Petitioner's members.

(f) The impugned amendment was discriminatory to the extent that it did not permit an intermediary to handle any premiums on behalf of the insured while it permitted the insurance companies to hold on to commissions payable to intermediaries for a period of 30 days, thereby creating a possibility of insurance companies unnecessarily withholding payment of commissions.

(g) The impugned amendment was further discriminatory for criminally sanctioning officers or directors of an intermediary who received premiums on behalf of an insurer, while placing no such sanctions on officers or directors of an insurer who failed to pay an intermediary insurance commission within 30 days upon receipt of the premium.

(h) The impugned amendment was not preceded by meaningful public participation. Crucially, the views of several insurance stakeholders were not considered in passing the impugned amendments.

(i) The impugned amendment infringed on the Petitioner's right to property.

Specifically, it had the effect of depriving the Petitioner of their property since the insured public would no longer see the need for insurance brokers if premiums were paid directly to the insurers.

(j) The impugned amendment contravened article 10 of the Constitution on national values and principles of governance with regards to public participation.

(k) Section 156 of the Insurance Act as amended by the Insurance (Amendment) Act, 2019 is unconstitutional and therefore null and void.

Implication:

The declaration of unconstitutionality means that the legislative amendments introduced by Insurance (Amendment) Act, 2019 are void. Accordingly, insurance brokers retain the right to collect premiums on behalf of insurers, pay themselves commissions and keep the interest on the premiums collected as provided under sections 156 (3), (9) and (10) of the Insurance Act.

INVESTMENTS

A memorandum of understanding was signed between CMA and KEPSA to seek avenues for private and public sector finance and investment necessary to support Kenya's economic growth and complement development funding gaps.

I. Guidelines, Notices & Circulars

Memorandum of Understanding between Capital Markets Authority and Kenya Private Sector Alliance

The Capital Markets Authority issued a press release on 2nd July 2021 advising it has signed a memorandum of understanding with the Kenya Private Sector Alliance (KEPSA) with a view to support market deepening and leveraging capital market products to enhance growth in line with the Big 4 Agenda and Sustainable Development Goals. The CMA chief executive noted that the partnership is expected to promote SMEs utilization of capital markets to raise long term capital. The Authority and KEPSA intend to develop a joint workplan to support the partnership's activities.

Through a public notice of 24th August 2021, the Capital Markets Authority invited stakeholders and general public comments on the proposed Capital Markets (Collective Investment Schemes) Regulations, 2021 and the Capital Markets (Collective Investment Schemes) (Alternative Investment Funds) Regulations, 2021. The draft regulations are as a result of the Authority's review of the current Capital Markets (Collective Investment Schemes- CIS) Regulations, 2001 and the need to address emerging issues and needs of investors in the capital markets industry. Submission of comments closed on 24th September 2021.

RETIREMENT BENEFITS

RBA issued a notice advising schemes to submit their audited financial statements as well as pay requisite levy to the authorities.

I. Guidelines, Notices & Circulars

Submission of Audited Financial Statements and payment of due levies

On 21st September 2021, the Retirement Benefits Authority issued a notice advising retirement benefit schemes whose financial year ended on 30th June 2021 to submit their audited financial statements by 30th September 2021 and pay the requisite retirement benefits levy by 31st October 2021

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ADVOCATES

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