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# **State Regulation and Supervision of Insurance Industry in Ethiopia: The Need for a Separate Regulatory and Supervisory Body**

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**State Regulation and Supervision of Insurance Industry in Ethiopia:  
The Need for a Separate Regulatory and Supervisory Body**

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**Approval Sheet by the Board of Examiners**

**State Regulation and Supervision of Insurance Industry in Ethiopia:**

**The Need for a Separate Regulatory and Supervisory Body**

**I hereby declare that this thesis is my original work and all source materials used in this work have been duly acknowledged.**

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Examiners

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## ABSTRACT

*Insurance is about more than just compensating for loss as it is a highly effective mechanism for assessing, managing and reducing risk. By helping customers face up to and manage risk effectively, insurance is an invaluable part of modern society. Regulation and supervision of the financial sectors generally and the insurance sector specifically is crucial in the economic development of developing countries like Ethiopia. The insurance industry is one of the most instrumental means to assist Ethiopia to achieve its macroeconomic stability and growth objectives. The insurance sector today is however marred by a lot of regulatory inefficiencies as well as emerging trends and this research is motivated to pay a fabulous endeavor on this part.*

*The main theme of this study is on the existing Ethiopian insurance sector regulation and supervision legal framework and problems associated with the insurance sector regulation. The study investigate the challenges and emerging trends in the sector, which have necessitated calls for reform in the regulatory and supervisory framework. Further, it examines internationally accepted models or types of financial sector regulation and compares the success achieved by separate insurance regulatory agencies in other jurisdictions.*

*Also, the research argues that there is a need for insurance companies to be regulated and supervised by separate insurance regulatory authority or commission responsible to the Ministry of Finance and Economic Cooperation.*

*Overall, this thesis asserts that in order to enhance Insurance penetration and growth of the industry, there is need for concerted effort by both the insurance regulatory and supervisory body and the individual Insurance companies in implementing strategies that will ensure that the various challenges identified as hindering the growth of the industry dealt with.*

## CHAPTER ONE

### INTRODUCTION AND OVERVIEW OF THE STUDY

#### 1.1. Research Background and Statement of the Problem

The financial services sector including the insurance sector plays an important role in a country's economy. Insurance is very important as an aid to trade and general economic stability for many reasons.<sup>1</sup> It ensures the spread of risks. The insurance premium paid is typically small compared to the magnitude of the overall probable loss. However, the little contributions of the many into the common pool ensure that the few who suffer loss could be compensated to the full extent<sup>2</sup> of the loss suffered irrespective of the quantum of the contribution. Consequently, insurance is a source of security against business failures and stimulus to business whereby entrepreneurs would rather apply for investment the resources they otherwise would have set aside to meet contingencies.

For an economy to thrive, a sound regulatory and supervisory framework is required.<sup>3</sup> Such a regulatory and supervisory framework should effectively protect consumers and adequately control market abuses. The terms regulation and supervision denote respectively the establishment of rules relating to a particular industry and the monitoring and enforcement thereof.<sup>4</sup> The important role played by the financial system dictates that financial institutions need to be regulated for three main reasons, viz.: consumer protection, stability of the financial

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<sup>1</sup>Isimoya, O.A. Fundamentals of Insurance (Lagos: Malthouse Press Limited, 1999) 15-16

<sup>2</sup> Subject to the incidents of contribution and underinsurance.

<sup>3</sup> DT Llewellyn, Institutional Structure of Financial Regulation and Supervision: The Basic Issues, in Aligning Financial Supervisory Structures with Country Needs (World Bank Institute 2004) 36-37

<sup>4</sup> Erika Botha and Daniel Makina., Financial Regulation And Supervision: Theory And Practice In South Africa; International Business & Economics Research Journal – November 2011 Volume 10, Number 11, 1

system, and maximizing efficiency.<sup>5</sup>Therefore, the necessity for regulation and supervision of insurance sector is rooted in both the legal, sociological and economic importance of insurance.

Regulation and supervision of the financial sectors generally and the insurance sector specifically is crucial in the economic development of developing countries like Ethiopia. The financial services sector in Ethiopia today adopts the integrated (unified) approach of regulation. The unified or integrated model is where the financial regulation and supervision covering insurances, banks and micro finance industries is completely integrated.<sup>6</sup> In the integrated model there is a single universal regulator that conducts both safety and soundness oversight (prudential supervision) and conduct of business regulation for all the sectors of financial services.<sup>7</sup> The National Bank of Ethiopia (NBE) is responsible for regulating and supervising the financial sectors as a whole including insurances, banks and micro finances. The unified or integrated model of regulation for the Ethiopian financial services sector has continually undergone a lot of challenges. Some of these include poor governance, insufficient regulation to adequately cater for the services offered by the sector and questions of independence of the regulatory bodies.<sup>8</sup>

Though, the insurance industry is one of the most instrumental means to assist Ethiopia to achieve its macroeconomic stability and growth objectives, the sector is marred by a lot of regulatory inefficiencies as well as emerging trends. This is evidenced by low level of penetration and the low contribution of the industry to economic growth. These challenges have resulted into appeal for reform of the regulatory framework, in order to enhance its supervision.

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<sup>5</sup>Goodhart, C., Hartmann, P., Llewellyn, D., Rojas-Suarez and Weisbrod, S., 1998. Financial Regulation: Why, how, and where now? Routledge.

<sup>6</sup> Group of Thirty, the Structure of Financial Supervision: Approaches and Challenges in a Global Market Place, Washington DC, 2008, 24

<sup>7</sup> Ibid.

<sup>8</sup> Interview with Mr. Hadush Hintsay, The Secretary General of Ethiopian insurers association, Addis Ababa, (March 15, 2020)

At the end of 2017, the Association of Ethiopian Insurers (AEI)<sup>9</sup> has asked the NBE, for permission to stop regulating and supervising the insurance industry and that a new body be formed to follow up with the insurance sector.<sup>10</sup> In addition to this, insurance experts in different stages claimed that, the sector was not being given adequate attention because the NBE, which regulates the financial industries as a whole, focuses on banks and this has affected the growth of the insurance sector, which contributes an insignificant percentage to Ethiopia's GDP.<sup>11</sup> The proposed regulatory and supervisory body by AEI and experts on the insurance sector would be a commission or other supervisory entity that can more fully understand and respond to the demand of the insurance industry.

This study focuses on the existing Ethiopian insurance sector regulation and supervision framework and the types or model adopted in financial sector regulation in Ethiopia and other countries. It will also examine the challenges and problems in regulating the insurance sector, which have necessitated calls for reform in the regulatory framework i.e., a need for insurance companies to be regulated and supervised by a separate insurance regulatory authority or commission. The paper also seeks to analyze case studies of the frameworks in the Kenya, Nigeria, and Ghana with a view to making comparisons with Ethiopia's insurance sector. The insights obtained from the analysis will then lead to the conclusion and recommendations for the most viable regulatory and supervisory framework for the insurance sector in Ethiopia.

## **1.2. Research Questions**

Should an insurance regulator separate from the NBE be established in Ethiopia?

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<sup>9</sup> The Association of Ethiopian Insurers (AEI) was established in September 1997 by private and state owned insurance companies in Ethiopia to promote their common interest. The objectives of the association, as stated in its formation document are; undertaking public awareness creation activities concerning the benefits of insurance and risk management, sponsoring and encouraging insurance research, training and education, and developing sound insurance market with responsibility to the community.

<sup>10</sup> Capital Ethiopian Newspaper, "Insurers ask for separate body to regulate sector", stated that the issue was raised during the second East Africa Financial Summit held at the Economic Commission for Africa (ECA) in December, 2017, Muluken Yewondwossen, January 01/2018.

<sup>11</sup> Ibid.

### **1.3. Objective of the Study**

The main objective of this study is to explore, investigate and assess whether the regulatory and supervisory role played by the NBE promotes good governance of insurance industry in Ethiopia, to scrutinize the problems and challenges in the regulation of the sector and to analyze and establish whether the NBE or the proposed separate regulatory body is the most appropriate regulatory and supervisory framework that would adequately govern the insurance sector in Ethiopia.

### **1.4. Significance of the Study**

The findings of this research will be beneficial to scholars and researchers as it will add to the existing body of knowledge in the issue of insurance industry regulation and supervision in Ethiopia and also act as a spring board for further research in the same area and other related areas, in the insurance sector. The NBE will borrow from the findings so as to come up with structures, and policies to assist the insurance industry to grow and enhance contribution to the GDP of the country. The study will also impart knowledge of the insurance sector dynamics to the policy makers. They will obtain guidance from this study in designing appropriate policies that will regulate the sector.

### **1.5. Research Methodology**

To triumphal the research, qualitative research methodology would be used and predominantly, contained pieces of literature, legal instruments, erudite articles, regulatory doctrines, policies, and programs, reports concerning the subject matter, and practical experiences of designated states shall be exploited as the case may be.

Legislations and the effort made by the NBE to regulate and supervise the insurance sector will be looked at. To this end, the text of the law as a primary source and text about the law as a secondary source would be implemented. In tandem with this, interviewing concerned officials from the NBE, insurance companies, and others, as the case may be, could also be applied.

## 1.6. Literature Review

There is a lack of materials specifically addressing the effectiveness, challenges and problems of the insurance regulatory and supervisory structure with respect to Ethiopia.

The work of Hailu Zeleke (2007) examines insurance industry emergence and the tortuous path it has gone through ever since the inception of insurance industry in early twentieth century in Ethiopia.<sup>12</sup> Informed by a good deal of data and empirical literature, the book examines the past and present performance of insurance business, reflects on the type and nature of insurance policies, the legal and public policy context in which the insurance industry has been operating under different regimes, identified the plethora of critical problems that the industry faces, and underscores domestic and global challenges that insurance business is likely to grapple with in the future. The author also gives some highlight on the regulation and supervision of the insurance sector in Ethiopia and state that relative to the banking sector, the insurance industry is given low emphasis by the government.

The book prepared by Group of Thirty (G30) assesses the four approaches to financial supervision currently employed across the globe (Institutional, Functional, Integrated, and Twin Peaks).<sup>13</sup> The book describes the key design issues of each supervisory model, illustrates how each has been implemented in practice, and assesses the strengths and weaknesses of each approach. The authors of the book illustrates the implications of adopting one or another of the four principle models of supervisory oversight and they state that, there is no two jurisdictions that regulate financial institutions and sectors in exactly the same manner. They also state that, the choice of a specific regulatory legal framework depends on different factors, some of which may be unique to a specific country. They further state that, there is no pure example of any model may actually exist, and blurring between approaches is prevalent.

The literature is also enriched by work from other jurisdictions, including international bodies such as the International Association of Insurance Supervisors (IAIS) and the Organization for

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<sup>12</sup>Hailu Zeleke, INSURANCE IN ETHIOPIA: Historical Development, Present Status and Future Challenges, (2007).

<sup>13</sup>Group of Thirty, (n 6), preamble

Economic Co-operation and Development (OECD). Understandably, the analysis of the issues was only somewhat related to the Ethiopian environment.

The literature review above is relevant to the current study because it tackles some of the issues of insurance sector regulation and supervision. None of the literature reviewed however delves into addressing the existing insurance sector regulation by the NBE and the challenges and problems of insurance sector regulation in Ethiopia. This study aims to fill this gap.

### **1.7. Citation Rules**

The works of others shall be duly acknowledged using the footnote citation rules of the Oxford University Standard for Citation of Legal Authorities (OSCOLA).

## CHAPTER TWO

### THE CONCEPT OF REGULATION AND SUPERVISION OF INSURANCE INDUSTRY

#### 2.1. Definition of Insurance Industry Regulation and Supervision

The terms 'regulation' and 'supervision' may be applied synonymously, but they refer to different levels of intervention. While Supervision generally relates to higher level activities such as authorizing firms to operate in the market and collecting and analyzing statistical returns, Regulation relates to the setting and enforcing of rules by which firms operate.<sup>14</sup>

Insurance regulation can be broadly defined as a mechanism to govern the conduct of the participants in insurance markets.<sup>15</sup> It is the legal framework (environment) and statutes within which insurance companies operate in a country. Insurance regulation lays the legal framework for several key functions of insurance business such as licensing, product regulation (policy terms, conditions, provisions, etc.), market conduct, financial regulation, etc.<sup>16</sup>

Insurance industry supervision is part of the executive power for on-going supervision and monitoring of the participators in the insurance market, which is normally carried out by an authority empowered to supervise insurance companies. Lawrie Savage (1998) defines insurance supervision as follows:

... a system of oversight which is intended to ensure that to the greatest degree possible, insurers will have the financial resources required to pay all claims as they become due

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<sup>14</sup>Atkins, D. and Bates, I. Risk, Regulation and Capital Adequacy New Edition (London: The Chartered Insurance Institute, 2007), 12

<sup>15</sup> Brady, U., Mellinger J.H .and Scoles, K.N., (1995). The Regulation of Insurance. Insurance In statute of America. 1-2

<sup>16</sup>Hailu Zeleke, (n12), 211

(i.e., solvency supervision) and (2) insurers will treat consumers in an equitable manner in all financial dealings (i.e., market place supervision).<sup>17</sup>

Regulation and supervision, as part of the means by which regulatory bodies attempt to improve the efficiency and safety of insurance markets, exist world-wide, and vary in different countries. With advances of globalization and liberalization, competition in insurance markets has been becoming fiercer, and the role of insurance regulation and supervision is growing. After all, how to create an effective and efficient insurance regulatory and supervisory system is a difficult issue facing regulators all over the world.

## **2.2. Rationale for Regulation and Supervision of Insurance Industry**

The necessity for regulation and supervision of insurance sector is rooted in both the legal, sociological and economic importance of insurance. One justification for regulation is the need to ensure financial security by ensuring that insurance companies have a reasonable level of capital to support the business written and enable them to withstand ‘shocks’ or unforeseen losses arising out of the business.<sup>18</sup> This challenge is encountered by the prescription of solvency limits which ensure solvency and the insurer’s ability to pay claims in the future. The consequences of an insurer failing to make good his promises as a result of fraud or commercial failure could be extremely disastrous.<sup>19</sup>

Furthermore, both the buying and selling of insurance are unlike many other forms of product purchasing.<sup>20</sup> In insurance, no tangible product is been purchased, but rather the item of the contract is a promise to provide indemnity, or a payment at a future date. It therefore becomes

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<sup>17</sup>Lawrie Savage, differences in risk based supervision; insurance and banking, Lawrie Savage and associates Inc., [www.isacanada.com/diffe.htm](http://www.isacanada.com/diffe.htm), accessed in December 28, 2019.

<sup>18</sup>Atkins, D and Bates, (n14) 13

<sup>19</sup>Isimoya, O.A. (n1), 194

<sup>20</sup> Atkins, D and Bates, (n14) 13

imperative that those who deal in such promises must be competent, ‘fit and proper’ persons and are able to fulfill their pledges when the need arises.<sup>21</sup>

An equally important justification for insurance regulation is the prevention of unwarranted and potentially destructive competition. Because an insurance company’s real costs are not known until an insurance policy matures and all claims are paid, the insurance business tends toward extreme competition in pricing.<sup>22</sup> Regulation may also be necessary as part of government policy to institutionalize certain forms of compulsory insurance or by way of national insurance. The best known examples of compulsory insurances are employers’ liability insurance and compulsory third party motor covers.

Generally, the rationale for regulation and supervision of the insurance industry is basically to ensure the growth and stability of the industry and to protect the interests of policyholders. Stability and growth of the insurance sector will partly contribute to the stability of and growth of the overall financial sector growth of any country.

### **2.3. Models of Financial Institutions Regulation and Supervision**

While no two jurisdictions regulate financial institutions including the insurance sector in exactly the same manner, the current models of financial sector regulation and supervision adopted worldwide can be divided into four categories. These include functional regulation, institutional or regulation by silos, twin peaks regulation and single or unified regulation.<sup>23</sup> The choice of a specific regulatory legal framework depends on different factors, some of which may be unique to a specific country.<sup>24</sup>

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<sup>21</sup> Ibid.

<sup>22</sup>Randall, S. Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners. Florida State University Law Review Vol. 26:625. Downloaded in [www.law-fsu.edu/journas/lawreview/downloads/263/rand.pdf](http://www.law-fsu.edu/journas/lawreview/downloads/263/rand.pdf) accessed 19/02/2020.

<sup>23</sup>Group of Thirty, (n13),23

<sup>24</sup>Ibid.

No “pure” example of any model may actually exist, and blurring between approaches is prevalent.<sup>25</sup> Ultimately, of course, the success of any regulatory approach must be measured by the ability of regulators to achieve the policy goals of regulation in real world contexts rather than by simply tallying theoretical pros and cons. Before designing any framework, a country must understand the role of the proposed regulator and the size and structure of the sector. It may also be important to take into consideration the economic, political, legal and historic considerations.

The choice of regulatory framework should ultimately be one that will be effective and efficient. It must be able to lay down rules or principles of conduct of financial services, as well as ensuring that there are high levels of compliance and supervision in the specific sector. Likewise, the effectiveness of the model in any particular jurisdiction may be influenced by uniquely local factors, so that no single model may be optimal on a “one size fits all” basis for all jurisdictions.<sup>26</sup>

### **2.3.1 Institutional Approach to Regulation and Supervision**

The institutional approach is where an organization’s legal status determines the regulatory and supervisory body which is tasked to oversee its activities from both safety and soundness oversight (prudential supervision) and conduct of business regulation perspective. Some of the jurisdictions that adopt this approach include Nigeria, Ghana, Hong Kong, Kenya and Mexico.

This approach suffers from potential inconsistency in the application of rules and regulations by different regulators. There are also challenges associated with inter agency coordination, which may include duplicity of regulation. Because the same or economically similar activity may be conducted by entities that are legally authorized and overseen as banks, insurance companies, or microfinance institutions and separate independent institutional regulators may regulate the

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<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

activity differently. This different regulatory treatment may take the form of different capital treatment or consumer protection.<sup>27</sup>

In practical terms, the Institutional Approach may be the most difficult to maintain given how much financial services firms and products have evolved from their institutional labels as banking, insurance, securities and microfinance institutions. As regulators expand the scope of business that is permissible in a regulated legal entity, that activity will likely overlap with the regulatory purview of another supervisor.

### **2.3.2. Functional Approach to Regulation and Supervision**

This is where the supervisory oversight is determined by the type of business that conducted by the firm, without regard to its legal status.<sup>28</sup> Each type of business may have its own functional regulator, so if a firm carries on different types of business, it may be answerable to different regulators regarding each business.<sup>29</sup> This approach to supervision remains quite common and appears to work well, so long as coordination among agencies is achieved and maintained.<sup>30</sup> Some of the jurisdictions that apply the functional approach include Brazil, France, Italy, and Spain.<sup>31</sup>

The clear benefit of a Functional Approach to supervision is that, at least in theory, a single, technically expert regulator will apply consistent rules to the same activity regardless of the entity in which it is conducted.<sup>32</sup> Regulatory arbitrage is avoided under this approach.<sup>33</sup>

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<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> Sunduzwayo Madise, Rationale of Regulating the Financial Services, Models of Regulation and Need for Regulatory Independence" (2014) Malawi Law Journal [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2538437](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2538437)> accessed 20 Feb. 2020

<sup>31</sup> Ibid.

<sup>32</sup> Group of Thirty, (n13), 35

One of the major challenges of functional regulation is that it can be extremely difficult to distinguish which activity comes within the jurisdiction of a particular regulator. Disadvantage of this approach is that, it forces financial institutions to deal with multiple regulators, which is often more costly in terms of time and effort.<sup>34</sup> Regulatory competition among the multiple regulators may also lead to a race to the bottom effect.<sup>35</sup>

### **2.3.3 Integrated Approach to Regulation and Supervision**

This is where a single regulator conducts both safety and soundness oversight (prudential supervision) and conduct of business regulation for all the sectors of financial services including banks, insurances, securities and microfinance institutions. This approach can be effective and efficient in smaller markets, where oversight of the broad spectrum of financial services can be successfully conducted by one regulator. This approach has the advantage of providing a unified effort to regulation and supervision without confusion or conflict over jurisdictional lines. This clarity potentially may leads to higher quality regulatory outcomes. Some of the jurisdictions which apply this approach include Canada, Germany Switzerland and Ethiopia.

Oversight of financial institutions that are involved in multiple business lines can be vastly simplified and presumably more efficient and cost effective with a single regulator.<sup>36</sup> This is due to the consistent application of rules leading to fewer jurisdictional disputes between regulators.<sup>37</sup>

In terms of challenges of the integrated approach, some observers suggest there are concerns related to having a single point of failure.<sup>38</sup> If an integrated regulator fails to identify an issue, there is no other agency to potentially fill the lacunae. Defenders of fragmented regulation

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<sup>33</sup> Regulatory arbitrage is a practice whereby firms capitalize on loopholes in regulatory systems in order to circumvent unfavorable regulation.

<sup>34</sup>Group of Thirty, (n13), 35

<sup>35</sup> Ibid.

<sup>36</sup>Ibid. 36

<sup>37</sup> Ibid.

<sup>38</sup>Ibid.

additionally maintain that overlapping jurisdiction potentially may increase the likelihood of a supervisor recognizing a problem or issue, due to lack of checks and balances.<sup>39</sup>

### **2.3.4 Twin Peaks Approach to Regulation and Supervision**

This approach is one in which there is a separation of regulatory functions between two regulators.<sup>40</sup> One performs the safety and soundness supervision function (prudential supervision) and the other, focuses on conduct of business regulation. Some of the jurisdictions which have adopted this model of regulation include Australia, Netherlands, South Africa and the United Kingdom.

Where the two objectives of regulation are divided among separate regulators, tensions may remain, especially when prudential and systemic stability concerns are seen to override consumer protection issues in the case of institutional failures.<sup>41</sup> Such decisions concerning which goals take precedence are ultimately subjective, based on the institutional positions of the respective actors and regulatory agencies.<sup>42</sup> This approach may be the ideal means of ensuring that issues of transparency, market integrity, and consumer protection receive sufficient priority.

## **2.4. The Concept of Separate Insurance Industry Regulatory and Supervisory Body**

A separate insurance industry regulator and supervisor is structured on institutional model. Many countries who adopt this framework continue to deal with how to structure its institutional and regulatory framework.

Some of the benefits of having a separate insurance industry regulatory and supervisory body include first, a separate regulator keeps the traditional functional distinctions between financial institutions like banks and insurance companies and it have a more clear focus on the objectives

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<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

and rationale of regulation. Second, setting up a separate regulator avoids an overly bureaucratic unified regulator that has excessively concentrated power and it creates check and balance mechanism. Here, even one main advantages of unified or integrated regulator i.e., economies of scale is weak where the unified regulator is seen as supervising almost everything under the sun and thus becoming monopolistic. Such effect may also lead to inefficiencies, such as bureaucracy and possibly corruption if the regulatory and institutional framework does not provide for effective checks and balances. Third, setting up a separate regulator avoids having a single point of failure. This means, if an integrated or unified regulator fails to identify an issue, there is not another agency to potentially fill the void. Fourth, a single process for the authorization of an insurance firm and for the approval of some of their employees, using standard processes and a single database. Fifth, a more consistent and clear approach to enforcement and discipline. Sixth, a separate regulatory framework for insurance industry and other financial institutions gives a good impression that all financial institutions doesn't have similar risks. For instance, when banks and insurances are regulated by the same regulator consumers may fail to differentiate the very different risks in these two markets. Similarly, all institutions licensed by a single regulator may be assumed by the public to be receiving equal protection.

Some of the preconditions for establishing a separate regulatory and supervisory body for the insurance industry includes sound and sustainable macroeconomic policies, the necessary political will among stakeholders, cooperation and sharing of information among other financial services regulators as a country moves toward having a separate regulatory and supervisory body for the insurance industry and skilled human capital to support establishment and operation of the separate regulator, and financial resources to support establishment and operation of the separate regulator.

The shortcomings of setting up a separate regulatory body include first, associated with inter agency coordination, which may include duplicity of regulation. Because the same or economically similar activity may be conducted by entities that are legally authorized and overseen as banks, insurance companies, or micro finance institutions, the separate institutional regulators may regulate the activity differently. Second, there is also a fear that a separate regulator could lead to cultural conflict within the agency when regulators come from different

sectors. Third, setting up a separate regulatory body for each financial institutions is inefficient in allocation of regulatory resources. Fourth, it may create confusion or conflict over jurisdictional lines.

Setting up a separate regulator for the insurance industry may not be as straightforward as commonly believed. Some of the challenges that may be experienced in separating the bodies are encapsulated hereunder.

### **Legal issues**

Setting up a separate regulator for the insurance industry requires reviewing all the existing statutes of insurance sub sector to provide for the new separate regulatory framework or replacing all the comprehensive frameworks to sub sector legislations. Whichever route to setting up a separate regulator is adopted, the required legal reforms are likely to prove very involving and burdensome.

### **Human Resource Issues**

The uncertainty of Setting up a separate regulator process inevitably results in the departure of key personnel from the regulatory agencies. Once information is made available that the existing unified regulator will be separated, talented staff may opt to move to the private sector or retire to avoid the uncertainty and difficulty of the change. Often, it is the best staff, who are critical to the success of the separate regulator, who may leave for more secure pastures. After the separation, even those who opt to stay may be demoralized especially if there are difficulties being experienced in implementing a new separate regulatory organization structure.

### **Culture Issues**

Each dependent regulator under the umbrella of consolidated regulatory structure may have their own culture and means of doing business. Some may have international standards accreditation method of doing their jobs while others may not. Splitting these divergent cultures under a separate insurance regulatory and supervisory structure is a challenge which requires a well-conceived and effectively monitored change management program.

### **Systems Issues**

The separated insurance regulatory and supervisory body will have its own information technology and other infrastructure for doing its core business. Regulated insurance firms may have invested heavily in having systems that can provide data in the format required by the then consolidated regulator's system. Bringing this mixed platforms into a single way may not be possible without major confusions within and without the regulators.

## **2.6. Contextualizing Ethiopia's Existing Insurance Industry Regulatory and Supervisory Framework**

The financial services sector in Ethiopia today adopts the integrated (unified) approach of regulation. The unified or integrated model is where the financial regulation and supervision covering insurances, banks and micro finance industries is completely integrated. In the integrated model there is a single universal regulator that conducts both safety and soundness oversight (prudential supervision) and conduct of business regulation for all the sectors of financial services. The NBE is responsible for regulating and supervising the financial sectors as a whole including insurances, banks and micro finances.

According to the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008, the core functions of the NBE includes among other things, effective administration, supervision, regulation and control of insurance and reinsurance business in Ethiopia. The NBE formulates and enforces standards for the conduct of insurance and reinsurance business in Ethiopia, issues licenses to all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters, motor assessors and risk surveyors. The NBE has an Insurance Supervision Department that focused on ensuring the stability of the insurance market and it monitors the implementation of all relevant legislations, and protects the rights of investors and participants of the insurance markets.

The unified or integrated model of regulation in which the Ethiopian financial services sector is regulated has continually undergone a lot of challenges. Some of these include **poor governance, insufficient regulation to adequately cater for the services offered by the sector and low emphasis**

to the insurance sector.<sup>43</sup> This is evidenced by low level of penetration and the low contribution of the industry to economic growth.

In terms of challenges of the unified or integrated approach in which Ethiopia follows, experts on insurance industry suggest there are concerns related to having a single point of failure. If an integrated regulator fails to identify a problem related to one specific sector and issue, there is no other agency to potentially fill the gap. Defenders of a separate or institutional regulation additionally maintain that overlapping jurisdiction potentially may increase the likelihood of a supervisor recognizing a problem or issue, due to lack of checks and balances.

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<sup>43</sup>Interview with Mr. Hadush Hintsay, (n8).

## CHAPTER THREE

### INSURANCE INDUSTRY REGULATION AND SUPERVISION IN ETHIOPIA

#### 3.1. History of Insurance Industry and its Regulation and Supervision in Ethiopia

The history of insurance is dated back to ancient human society in both non-monetary and monetary economies due to the psychological nature of human being i.e. the need for security. In Ethiopia insurance service is as far back as modern form of banking service which was introduced in 1905. At the time, an agreement was reached between Emperor Menelik II and a representative of the British owned National Bank of Egypt to open a new bank in Ethiopia.<sup>44</sup> Similarly, modern insurance service, which were introduced in Ethiopia by foreigners, mark out their origin as far back as 1905 when the 1963 began to transact fire and marine insurance as an agent of a foreign insurance company.<sup>45</sup> There were a good number of foreign insurance companies undertaking insurance business in Ethiopia through agents prior to 1951. The first domestic insurance company, namely, Imperial Insurance Company of Ethiopia Ltd was established in 1951.

According to a survey made in 1955, there were one domestic insurance company and seventeen foreign companies doing insurance business through agents that were providing insurance service in the country.<sup>46</sup> In 1960, the number of insurance companies increased considerably and

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<sup>44</sup> Schaefer Charles, "the politics of banking: the bank of Abyssinia, 1905-1931", the international journal of African historical studies, vol. 25, No.2. 1992. 1

<sup>45</sup> Ibid.

<sup>46</sup> Ministry of commerce and industry, economic progress of Ethiopia, Nairobi: east African standard Ltd., 1955.

reached 33.<sup>47</sup> At that time insurance business like any business undertaking was classified as trade and was administered by the provisions of the Commercial Code.<sup>48</sup>

Insurance provisions under the Commercial Code and Maritime Codes of 1960<sup>49</sup> were the only insurance laws applicable to the Ethiopian insurance industry during the 1960's. The growth in the number of insurance companies, an expansion of insurance business and the need for a more systematic control and regulation of the insurance business in the country led to the enactment of an insurance legislation by the government. **Until 1970, there was no regulatory and supervisory body and mechanism for the insurance sector, and the insurance business in the country had been by and large uncontrolled.**

**The first significant event that the Ethiopian insurance market observes was the issuance of Proclamation No. 281/1970 to regulate and control the insurance industry in Ethiopia.<sup>50</sup> Pursuant to this Proclamation, an Insurance Council was formed which was to be chaired by the then Minister of Commerce and Industry. The Council was responsible for the formulation of general insurance policy with a view to promoting or regulating insurance business in the country. In addition, an Office of the Controller of Insurance was setup. The Office was responsible for ensuring the implementation of the insurance proclamation and regulations, undertaking supervisory functions over the insurance industry and issuing license required to undertake insurance business.**

In March 1971, the government issued Legal Notice No. 393/71 (Insurance Regulation). Some of the insurance matters covered in this insurance regulation were: submission of application for license, issuance of licenses and renewal of licenses, qualification requirements of insurance auxiliaries and actuaries, submission of annual financial statements to the Controller, issuance of shares and assignment or transfer of shares.

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<sup>47</sup> Ministry of commerce, industry and tourism, 'Results of the 1960 Survey of insurance companies operating in Ethiopia', Ethiopian Economic Review, No 3, November 1960.

<sup>48</sup> The Commercial Code of the Empire of Ethiopia, 1960, Proclamation No 166, Extraordinary, Neg. Gaz. Year 19, N0 3.

<sup>49</sup>The Maritime Code of the Empire of Ethiopia, 1960, Proclamation No 164, Extraordinary, Neg. Gaz. Year 19, No 1.

<sup>50</sup>Insurance Proclamation of the Empire of Ethiopia, 1970, Proclamation No 281/1970, Neg. Gaz. Year 30, No 2.

Legal Notice No. 393/71 (Insurance Regulation) did not, however, include exhaustive regulations on insurance matters. Another Draft Regulations on investment of insurance funds, margin of solvency and premium rates was prepared and under review by the Insurance Council in 1974.<sup>51</sup> However, before the Draft Regulations were approved and published in the *Negarit Gazeta*, the Provisional Military Administration Council (PMAC) issued another insurance proclamation, Proclamation No. 68/1975,<sup>52</sup> to establish the Ethiopian Insurance Corporation (EIC) by nationalizing all the private insurance companies.<sup>53</sup> This proclamation repealed the earlier insurance proclamation and all insurance regulations issued there under. The proclamation contains provisions pertaining to insurance auxiliaries and actuaries as well. Thus, EIC was authorized to issue license to insurance auxiliaries and actuaries. EIC had then monopolized the insurance market until 1994. As per Proclamation 68/1975, EIC had to be organized to have an Insurance Board, a general manager and deputy general manager at the top of its management structure.

After nationalization of insurance companies and establishment of EIC, the Insurance Council and the Office of Insurance Controller, which were earlier responsible for the supervision and regulation of the insurance industry were dissolved. Under the Monetary and Banking Proclamation issued in 1963 (Proclamation No. 206/63), the National Bank of Ethiopia at that time was not empowered to license and supervise insurance companies. Thus, it seems that the Insurance Board formed under Proclamation 68/1975 was probably exercising supervision of the insurance business of EIC until the issuance of another monetary and business proclamation by the Provisional Military Administration Council in 1976.<sup>54</sup>

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<sup>51</sup> Haile Michael Kumsa, 'Development of Insurance in Ethiopia', Fair Review, No.85, September 1992. 5

<sup>52</sup> Ethiopian Insurance Corporation Establishment Proclamation of the Provisional Military Administration Council, 1975, Proclamation No 68/1975, Neg. Gaz. Year 35, No 13.

<sup>53</sup> Haile Michael Kumsa, (n51). 5

<sup>54</sup>Hailu Zeleke, (n12), 76

In 1976 (nine months after the issuance of Proclamation No. 68/1975) the Provisional Military Administration Council issued another monetary and banking proclamation, Proclamation No. 99/1976,<sup>55</sup> which repealed the earlier one. As per this proclamation, the National Bank of Ethiopia was empowered to supervise, regulate and control the operations of financial institutions including insurance business.

After the change in the political environment in 1991, the transitional Government of Ethiopia (TGE) issued new insurance law i.e., Licensing and Supervision of Insurance Business Proclamation No. 86/1994.<sup>56</sup> After the enactment of the proclamation in the 1994, the number of private insurance companies began to increase and the National Bank of Ethiopia remained to be the supervisory authority of insurance industry.

According to Proclamation No. 86/1994, the principal function of the National Bank of Ethiopia with regard to insurance business in the country is to formulate policy that promotes the insurance and reinsurance business, investment of insurance funds and on such other matters as may be conducive to the attainment of sound insurance business in Ethiopia. However, the insurance industry had been significantly affected by the overall economic and other policies existed in Ethiopia.

### **3.2. Status of the Current Ethiopian Insurance Industry**

The Ethiopian insurance sector has ample scope in terms of investment, protection and so on. Thus, Insurance sector effort to rebuild to gain for economy resurgence is the most important and pressing need in Ethiopia. Though the potential for growth is strong, the insurance industry is not delivering as expected. Currently, the number of insurance companies are 17 with their branches increased to 568 following the opening of 36 new branches in 2018/19 alone.<sup>57</sup> Recently, one additional private insurance company is licensed by the national bank and is under

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<sup>55</sup>Monetary and Banking Proclamation of the Provisional Military Administration Council, 1976, Proclamation No 99/1976, Neg. Gaz. Year 36.

<sup>56</sup> Licensing and Supervision of Insurance Business Proclamation of the Transitional Government of Ethiopia, 1994, Proclamation No 86/1994, Neg. Gaz. Year 53<sup>rd</sup>, No 46.

<sup>57</sup> NBE Annual report 2018/19. <https://nbebank.com/annual-report/>, accessed January 19, 2020.

formation.<sup>58</sup> About 53.7% of the branches are located in Addis Ababa and 84.5% of total branches were privately owned.<sup>59</sup> This shows that, the capital city has better access to insurance service.

The insurance market in Ethiopia is not yet saturated and hence can accommodate additional entrants. In spite of Ethiopia's huge population that present enormous market potential, the insurance industry is relatively underdeveloped compared even to African peers such as Nigeria, Kenya and Ghana that achieve relatively higher insurance penetration and destiny.<sup>60</sup> The low level of penetration highlights the significant potential that is ready to be exploited especially in micro insurance, life insurance and agriculture insurances which are at the early stage of development and which will play a key role in boosting insurance penetration.

Even though the insurance Industry in Ethiopia has continued to register significant growth in both qualitative and quantitative with increases in the number of industry players, it is relatively underdeveloped which is exemplified by the sectors low insurance penetration (percentage of insurance premium to GDP), which stood at low insurance destiny (average per capita spending on insurance) which was birr 62.4, as at 2017/18.<sup>61</sup>

According to reports, a well-functioning insurance sector plays a crucial role in economic development not just at a macroeconomic level but also in terms of the activities of individuals and businesses.<sup>62</sup> Especially, the country's effort in terms of development and business

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<sup>58</sup>Zemen insurance company S.C is licensed on January 17, 2020. <https://nbebank.com/insurers/> accessed February 12, 2020.

<sup>59</sup>NBE Annual report 2018/19, (n57).

<sup>60</sup>Fortune Ethiopian Newspaper, "Independent Insurance Regulator Can Do Wonders for Industry", Wasihun Mekonen, Addis Ababa, March 7/2020.

<sup>61</sup> NBE Annual report 2017/18, (n57).

<sup>62</sup> The World Bank: 4th Ethiopia Economic Update, <http://documents.worldbank.org/curated/en/827261468190142554/Fourth-Ethiopia-economic-update-overcoming-constraints-in-the-manufacturing-sector>, accessed January 19, 2020.

expansions which are driven by major projects like renaissance dam, infrastructure development, transportation, urban development, human capital management, industries, aviation, export and many more activities need reliable insurance service.

The insurance sector in Ethiopia is dependent on the banking sector for much of its new business. Most Ethiopian insurance companies have sister banks and its common for these banks to refer their clients to their sister insurance companies, but this is largely restricted to credit life insurance products. Moreover, insurance companies tend to derive a large portion of their total income from investments in banks.<sup>63</sup> A World Bank project appraisal document suggested that the balance sheets of Ethiopian insurance companies are overexposed to and over-concentrated in the banking sector, with over 40% of assets exposed to the banking sector.<sup>64</sup>

Although it required a concerted endeavor of all, extra efforts should be exerted to improve performance by adopting best practices from other countries and through active participation of all actors in the industry. Accordingly, the insurance industry faces a number of challenges, such as:<sup>65</sup>

- Price wars and unethical competition: price based and unethical competition caused shift of clients seeking for low and inequitable premiums;
- Battle for soul and poor corporate governance: lack of qualified manpower together with absence of succession plan and well developed training and development program;
- Inadequate legislative and regulatory framework and inability of players to be abide by agreed norms and regulations;
- Poor public perception and awareness of insurance: poor customer satisfaction mainly due to time taking claim settlement;

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<sup>63</sup> Smith, A., & Chamberlain, D. Opportunities and challenges for micro insurance in Ethiopia: An analysis of the supply side and regulatory environments. Bellville: The Center for Financial Regulation and Inclusion. (2009).

<sup>64</sup> World Bank. (2006). Project appraisal document: financial capacity building program: Report No. 36272. Washington, DC: World Bank.

<sup>65</sup>Ethio Re-insurance Company S.C Annual strategic plan for year 2016/17.

- Unethical practices of employees, sales agents, brokers and other players in the insurance market;
- Lack of necessary data from NBE to conduct detailed analysis;
- Overdependence on traditional products and distribution channels: absence of actuaries and capacity shortage in timely designing and development of need base products;
- Significant increase in frequency and severity of motor claims manifested by high loss ratio and claim leakage;
- Underdeveloped IT infrastructure and lack of automation of work process;
- Investment portfolio mixes lack diversification as expected;
- Weak attention given for life insurance, micro insurance and other social insurance and other social insurance classes.

### **3.3. Existing Regulation and Supervision of Ethiopian Insurance Industry**

The National Bank of Ethiopia was established in 1963 by Proclamation No. 206/1963 and began operation in January 1964.<sup>66</sup> Prior to this proclamation, the Bank used to carry out dual activities, i.e. commercial banking and central banking activities.<sup>67</sup> However, Monetary and Banking Proclamation No. 99/1976 came into force on September 1976 to shape the Bank's role adoring to the socialist economic principle that the country adopted. Hence, the Bank was allowed to participate actively in national planning, specifically financial planning, in cooperation with the concerned state organs. The Bank's supervisory area was also increased to include other financial institutions such as insurance institutions, credit cooperatives and investment-oriented banks.

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<sup>66</sup> The National Bank of Ethiopia website, <https://nbebank.com/history/>, accessed January 19, 2020.

<sup>67</sup> Ibid.

Proclamation No. 99/1976 was in force till the new proclamation issued in 1994,<sup>68</sup> to reorganize the Bank according to the market-based economic policy so that it could foster monetary stability, a sound financial system and such other credit and exchange conditions as are conducive to the balanced growth of the economy of the country.

Currently, Insurance Business Proclamation No. 1163/2019<sup>69</sup> and the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008<sup>70</sup>, designate the National Bank of Ethiopia (NBE) as the policymaker, regulator and supervisor of the insurance industry in Ethiopia.

According to the National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008, the core functions of the NBE includes among other things, effective administration, supervision, regulation and control of insurance and reinsurance business in Ethiopia. The NBE formulates and enforces standards for the conduct of insurance and reinsurance business in Ethiopia, issues licenses to all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters, motor assessors and risk surveyors.

In order to play its economic and financial role, the insurance sector requires a framework of stable and liberal regulation that provides adequate incentives for efficiency and allows insurers to innovate. Insurance regulation must aim at creating a competitive market, safeguarding the stability of the sector and the solvency of individual insurers, and protecting the interests of policyholders.

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<sup>68</sup> Monetary and Banking Proclamation of the Transitional Government of Ethiopia, 1994, Proclamation No 83/1994, Neg. Gaz. Year 53<sup>rd</sup>, No 43.

<sup>69</sup> Insurance Business Proclamation, the Proclamation No. 1163/2019, Federal Negarit Gazeta, 26<sup>th</sup> Year No. 6 of 2019, ADDIS ABABA, 2020.

<sup>70</sup> The National Bank of Ethiopia Establishment (as Amended) Proclamation, the Proclamation No. 591/ 2008, Federal Negarit Gazeta, 14<sup>th</sup> Year No. 50 of 2008, ADDIS ABABA, 2008.

So far, the Regulatory body has issued new rules and requirements or modified the existing ones that could assist industry players in many respects. The Directives and Guidelines following the Insurance Business Proclamation will largely benefit the policy holders as well as the insurance industry. This includes among others the directive on Insurance Business Fraud Monitoring, Licensing, License Renewal and Product Approval for Micro-insurance Providers, Manner and Criteria of Transacting Reinsurance by Insurers, Monitoring the Nationality of Shareholders of an Insurer or Reinsurer Directive, Manner of Reporting Quarterly and Annual Returns, No Premium-No Cover, Minimum Capital Requirement, Opening of Branches, Corporate Governance etc.

These changes and the forthcoming ones are aim to improving the performance of the insurance industry in general and also show the commitments on the side of the Supervisory Authority to support the industry and protecting the policy holders. However, just like other industries, regulation and supervision of the insurance industry has not ensured the highest standard of governance. This is evidenced by low level of penetration and the low contribution of the industry to economic growth.

The NBE has an Insurance Supervision Department that focused on ensuring the stability of the insurance market and it monitors the implementation of all relevant legislations, and protects the rights of investors and participants of the insurance markets. Insurance companies are subject to current supervision. The conditions under which the license was granted must be observed the whole time the insurance company is carrying on business. It is one of the tasks of the insurance supervisory department to ensure that all requirements are met all the time. To be able to perform its tasks, the insurance supervisory department have the right to obtain detailed information about the insurance company and its business activities.

There are two types of supervision mechanisms performed by the Insurance Supervision Department of the NBE; on-site supervision and off-site supervision. On-site supervision is mainly based on historical data and performed once in two or three years.<sup>71</sup> It is a kind of full scope inspection on insurance companies. The insurance companies are obliged to give all the

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<sup>71</sup> Interview with Mr. Belay Tulu, the NBE Insurance Supervision Directorate Director, NBE Head quarter, Addis Ababa,(April 29, 2020).

information available and to enable the inspectors to look into all business documents so long as justified by the purpose of insurance supervision. The inspectors are bound to secrecy. Offsite supervision is performed by receiving regular report including monthly and quarterly financial statements, annual report etc. it includes approval of appointment of governing persons, monitor the investment plan of the insurance companies on annual basis and accepts the reinsurance arrangements of the company.

The financial soundness of an insurance company is of the main concern of the NBE.<sup>72</sup> In this respect, the supervisors have a close eye on the capital resources (solvency), the formation of technical provisions and the existence of assets (investments) necessary to meet the insured liabilities. If the supervisory department detects any irregularity it is entitled to take the necessary remedy. For example, legal requirements having been a condition for licensing have to be met in any case of a change during the course of business operations. If necessary, documents have to be submitted anew. The supervisory department may impose administrative fines to enforce compliance with its orders. In addition to this, the supervisory department may send representatives to meetings of the executive bodies of the insurance companies.

Most of this directives and methods of supervision by the regulatory body implies that, the approach followed by NBE in insurance supervision is compliance based supervision. That is, some minimum requirements (parameters) are set and the supervisory body periodically checks whether or not each insurance company complies with the minimum requirement.

The Insurance Supervision Department of the NBE is responsible for all insurance policy, regulation and supervision activities. This implies that the insurance supervisor is not independent from the Central Bank as required by the International Association of Insurance Supervisors (IAIS). As a result, membership of the IAIS has not been open to the NBE.

The Insurance Core Principles (ICPs) developed by the International Association of Insurance Supervisors (IAIS) provide a globally accepted framework of principles, standards, and guidance for the regulation and supervision of the insurance sector.<sup>73</sup> The IAIS prescribed some

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<sup>72</sup> Ibid.

<sup>73</sup> International Association of Insurance Supervisors (IAIS), <http://www.iais.org>, accessed on January 23, 2020.

parameters for quality insurance regulation.<sup>74</sup>The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e. to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.<sup>75</sup> It should at any time be able to carry out this task efficiently in accordance with the Insurance Core Principles.<sup>76</sup> In particular, the insurance supervisor should be operationally independent and accountable in the exercise of its functions and powers; it must have adequate powers, legal protection and financial resources to perform its functions and exercise its powers; it should adopt a clear, transparent and consistent regulatory and supervisory process; it should clearly define the responsibility for decision making and it should hire, train and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.<sup>77</sup>

### **3.4. Challenges and Problems in the Insurance Industry Regulation and Supervision by the National Bank of Ethiopia**

As stated in the previous part of the research, the insurance industry is one of the most instrumental means to assist Ethiopia to achieve its macroeconomic stability and growth objectives. The insurance sector today is however challenged by a lot of regulatory and supervisory inefficiencies as well as emerging trends. This can be shown by low level of penetration and the low contribution of the industry to economic growth of the country. These challenges have resulted into appeal for reform of the regulatory framework, in order to enhance its supervision. This part of the research is motivated to pay a fabulous endeavor on challenges and problems in the insurance industry regulation and supervision by the National Bank of Ethiopia.

#### **Low Emphasis to the Insurance Industry**

After the overthrow of the *Dergue* regime, a new economic policy replaced central economic planning with a market-oriented system and allowed a certain amount of space for the private

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<sup>74</sup> Ibid.

<sup>75</sup> Ibid.

<sup>76</sup> Ibid.

<sup>77</sup> Ibid.

sector. Some private insurance companies were formed during the early 1990s. Until 2020, sixteen private insurance companies, one government insurance company and one local re-insurer had been established. In addition to this, one private insurance company is licensed by the national bank and is under formation.<sup>78</sup> Yet the development of the insurance industry is nascent.<sup>79</sup> The major reason for such low-rate growth is related to the institutional framework for the regulatory organ of the industry<sup>80</sup> and the low focus given to the sector by the regulatory body.<sup>81</sup>

Insurance experts in different stages claimed also that, the insurance sector was not being given adequate attention by the regulatory body because NBE, which regulates the financial industries as a whole, focuses on banks.<sup>82</sup> Hailu Zeleke (2007), also state that relative to the banking sector, the insurance industry is given low emphasis by the government.<sup>83</sup> There are indications that the insurance sector is not given as much emphasis and concern by the government as those of the banking and microfinance sectors. This can be observed from the Ethiopian government First and Second Growth and Transformation Plan (GTP I and GTP II) which has specified several strategies to enhance efficiency and competition in the banking and microfinance sectors, while saying very little about the insurance industry.<sup>84</sup>

The low emphasis given to the insurance sector can be explained in the following ways;

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<sup>78</sup>Zemen insurance company S.C is licensed on January 17, 2020 <https://nbebank.com/insurers/>, accessed 19 January, 2020.

<sup>79</sup> Interview with Mr. Hadush Hintsay, (n8)

<sup>80</sup> Fortune Newspaper, (n60)

<sup>81</sup> Interview with Mr. Belay Tulu, (n71)

<sup>82</sup>Capital Ethiopian Newspaper, (n10)

<sup>83</sup>Hailu Zeleke, (n12), 220

<sup>84</sup> National Planning Commission, ‘The First Growth and Transformation Plan (GTP I), November 2010, Addis Ababa, (covering the period 2010/11-2014/15) and ‘The Second Growth and Transformation Plan (GTP II), September 2015, Addis Ababa, (covering the period 2015/16-2019/20).

➤ **Composition of Board of Directors of the NBE as a Problem to the Proper Growth of the Insurance Industry**

The NBE have a board of Directors composed of seven members.<sup>85</sup> The Governor and the Vice Governor of the NBE shall be permanent ex-officio members.<sup>86</sup> The Chairperson of the Board of Directors and the remaining four members shall be appointed by the Government.<sup>87</sup> Board of directors of the NBE plays a key role in economic and financial decisions. All the powers, responsibilities and functions of the National Bank provided for in the NBE establishment Proclamation shall be vested in the Board of Directors.<sup>88</sup> These powers and responsibilities includes among other things administration, supervision, regulation and control of insurance and reinsurance business in Ethiopia.

Insurance experts in different stages and occasions however claimed that, the sector was not being given sufficient attention by the NBE Board of directors.<sup>89</sup> Meseret Bezabih, the former president of the Ethiopian insurers association and the current CEO of United Insurance Company (S.C) state that, the NBE board of directors which plays a key role in economic and financial decisions of the country including the administration, supervision, regulation and control of banks, microfinance institutions, insurances and reinsurance business in Ethiopia, focuses on banks.<sup>90</sup> This problem mainly emanates from the composition of the board members.<sup>91</sup> **It is accepted that the composition of the board must be responsive to all the basic functions assigned to the NBE** including regulating, monitoring and supervising the insurance

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<sup>85</sup> The National Bank of Ethiopia Establishment (as Amended) Proclamation No. 591/2008, Art 3 (5 and 6)

<sup>86</sup> Ibid.

<sup>87</sup> Ibid.

<sup>88</sup> Ibid, Art 9

<sup>89</sup> Interview with Mr. Belay Tulu, (n71)

<sup>90</sup> Interview with Mrs. Meseret Bezabih, the former president of insurers association and the CEO of United Insurance Company (S.C), Addis Ababa, (March 05/2020)

<sup>91</sup> Ibid.

industry. All the board members of the NBE however, mainly focuses on macro-economic analysis that directly or indirectly related with banking and money circulation in the country.<sup>92</sup> Because of this, the insurance sector is not adequately governed and given least priority by the board of directors of the NBE.<sup>93</sup>

In addition to this, the low emphasis given to the insurance sector can also be seen from the misconception on the part of members of the board of directors and governors of the NBE regarding the insurance sector.<sup>94</sup> This can be seen from their misapprehension on the insurance sector as the sector have insignificant advantage to the GDP of the country and much focus should be given to the banking sector only.<sup>95</sup> Members of the board of directors and governors of the NBE have to realize that, the country's effort in terms of development and business expansions which are driven by major projects like renaissance dam, infrastructure development, transportation, urban development, human capital management, industries, aviation, export and many more activities need reliable insurance service.

It has to be noted that, the insurance industry is generally seen as the backbone of any country's risk management system, since it ensures financial security, serves as an important component in the financial intermediation chain, and offers a ready source of long term capital for infrastructural projects.

#### ➤ **Absence of Clear Vision of the Ethiopian Insurance Industry**

Having a clear vision by the NBE for the Ethiopian insurance industry provides a sense of purpose and direction for the industry. This vision will help the regulator to define its short and long term goals, and it will guide the decision the regulator makes along the way. Albeit this fact, the NBE does not have any clear vision for the Ethiopian insurance industry.

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<sup>92</sup>Interview with Mr. Belay Tulu, (n71)

<sup>93</sup> Interview with Mrs. Meseret Bezabih, (n90)

<sup>94</sup> Interview with Mr. Nigus Anteneh, the CEO of Nile Insurance Company (S.C), Addis Ababa (March 23/2020)

<sup>95</sup> Ibid.

Absence of a well-defined or formulated vision of the industry by the regulatory and supervisory body is one reason for not triumphing a modern and strong insurance sector in Ethiopia. Therefore, it is imperative to formulate a vision for the country's insurance industry. The question that should be addressed is: what should the status of the Ethiopian insurance industry be after a decade or so in terms of various aspects such as fund mobilization, insurance products and capitalization, investment portfolio, reinsurance, human resource, loss control etc.

➤ **Absence of Code of Conduct of the Ethiopian Insurance Industry**

A code of conduct helps to enhance good business practice (or to curb undue business practices such as defamation of any of the insurance companies by another), promote ethical standards, and maintain good relationship among insurers, insurance auxiliaries and the insuring public. There is no code of conduct that applies to the insurance companies in Ethiopia. Thus, it is utmost beneficial to develop a code of conduct of the insurance industry which shall be complied with by each insurers.<sup>96</sup>

This needs to be worked out through a concerted effort of the insurers, insurance associations, and the supervisory body. It should, however, be noted that the mere existence of such code of conduct is not adequate and so enforcement of its implementation is crucial to attain a healthy insurance sector; for example, sanctions should be enforced for violation of any part of the code of conduct.

➤ **Lack of Initiation by the Regulatory Body to Enact Directive or to Control Insurance Industry Rivalries by Price Undercutting**

Competition has long played an uneasy role in the insurance industry. If consumers cannot easily observe the financial health of their insurers, competition between insurers may drive premiums down to the point where the risk of failure is high.<sup>97</sup> An insurance company can provide

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<sup>96</sup> Interview with Mr. Abrham Mersha, the President of Society of Insurance Professionals (SIP) and deputy CEO of Nib Insurance Company S.C, Addis Ababa, (April 27, 2020)

<sup>97</sup>Ziv-Av D. Competition versus Regulation in the Insurance Market: A law and Economic Analysis of Policy and Institutes Master thesis (Unpublished) University of Hamburg European Master Program in Law and Economics,

protection only if an adequate insurance fund is maintained. Competition among insurers, however, could undermine the maintenance of this fund. For example, competition could force some insurers to reduce their rates to attract customers. This, in turn, would diminish the funds available to pay claims and, ultimately, a claim might have to go unpaid. To protect policyholders from such an event, the formation, investments, rates, and accounting practices of insurance companies must be regulated.<sup>98</sup>

There are seventeen insurance companies in Ethiopia competing for insurance market and labor force having different learning curve, financial strength and fixed asset, economies of scale, investment profile, market accessibility, service quality, pricing rate, customer base and related factors. The competition has been stiff in the sector which has occasioned price undercutting. This can mainly be observed in motor insurance. In other words, the industry rivals are exercising price cutting (struggling strategy). This has resulted in reduced revenue, and it may lead to mergers of insurance firms, down-sizing, and even collapse of these firms.<sup>99</sup> Pricing services is one of the most important decisions for the insurance industry since the price set determines the final profit.

Price cutting (struggling strategy) is a strategy used by insurance service providers to attract customers by cutting the premium base to be paid by customers in order to get insurance coverage. It is argued that price undercutting leads to predatory pricing that can threaten the stability of the insurance industry if the prices fall below the optimum level. It is noted that firms undercut each other's prices in order to steal demand. It is established that rates undercutting was prevalent despite the growth of the insurance industry. It was also emphasized that insurance firms ought to desist from premium undercutting, rather, come up with diversified innovative products as well as realistic premiums. This price undercutting is noted to be one of the main

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2006, 6 downloaded from [http://www.emle.org/data/Doron\\_Ziv\\_Competition\\_versus\\_Regulation\\_in\\_the\\_Insurance\\_market.pdf](http://www.emle.org/data/Doron_Ziv_Competition_versus_Regulation_in_the_Insurance_market.pdf) accessed March 13, 2020

<sup>98</sup> Anderson, A.M., Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond William and Mary Law Review Vol. 25 Issue 1 Article 3 (1983), <http://scholarship.law.wm.edu/wmlr/vol25/iss1/3>, accessed March 13, 2020

<sup>99</sup> Massey, Roger et al "insurance company failure", [www.acuarries.org.uk/files/pdf/giro2002/Massey.pdf](http://www.acuarries.org.uk/files/pdf/giro2002/Massey.pdf), accessed March 01, 2020

threats to profitability of insurance firms in Ethiopia.<sup>100</sup> This is the reason for insurance companies not gaining enough profit through pure insurance operations.<sup>101</sup> Almost all insurance companies get their profits from other investments and money deposit interest from banks. In this light, tackling uncompetitive practices such as premium undercutting is a critical issue to the sector which needs to be focused on.<sup>102</sup>

Competition regulations are aimed at protecting and maintaining competition, by prevention of collusion and market power abuse, as well as by setting guidelines for commercial conduct and fair competition.<sup>103</sup> Absence of directive that controls competition between insurance companies by price undercutting creates and highly increases the bargaining power of insurance clients. The competition in the insurance industry is highly dependent on rate cutting than service excellence. In addition, the risk management practice differs significantly within industry players. To this end, most industry players have made their focus on high premium revenue with minimum rate rather than underwriting operational effectiveness. These and related factors have given a weight to buyers bargaining power. In fact the individual clients don't pose much of a threat to the insurance industry.<sup>104</sup> Large corporate clients have a lot more bargaining power with insurance companies as they pay millions of birr for their package businesses.<sup>105</sup> Hence, a company which focuses on operational efficiency and prudent way of underwriting will face a considerable challenge even though the end result in terms of profitability and sustainability witness an encouraging result. Even though the NBE as a regulatory and supervisory body of the insurance industry know these facts, they are reluctant on promulgating directive or control this problem.

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<sup>100</sup> Interview with Nigus Anteneh, (n94)

<sup>101</sup> Ibid.

<sup>102</sup> Ibid.

<sup>103</sup> Samuel Ebiyekhimi' Idhiarhi, the Regulation of Insurance Business: The Nigerian Experience, LL.M Thesis, University of Jos, October, 2012. 82

<sup>104</sup> Interview with Nigus Anteneh, (n94)

<sup>105</sup> Ibid.

The regulation of premium rates is generally envisioned to assure that an insurer's income is adequate to cover risks with a reasonable margin without being either excessively expensive for the purchaser or unfairly discriminatory among purchasers. Rate-setting may take the form of “administrated prices” where there is full regulatory prescription of rates (rarely applied nowadays) or “prior approval” where the regulator approves insurance rates proposed by the insurers (the most common form of rate regulation).<sup>106</sup> Other forms are “file and use” rates, rates that can be charged unilaterally by the insurers but the regulator may reject at a later stage; “flex rating” where insurers are free to charge rates within a range set by the regulator; and finally “open competition” rate setting where there is a minimal governmental intervention, vesting a mere residual regulatory authority, only a veto power to reject rates if they are found as “unfair, unreasonable or excessive”.<sup>107</sup> The bottom-line is that in protection of consumers and the industry, some kind of regulation is applied to rating.

In many OECD Member countries, premium rates have to be submitted for information or even for approval.<sup>108</sup> The adequacy of premium rates is a fundamental issue and if they are not set at an appropriate level even adequately calculated technical provisions would not prevent the company from making losses.<sup>109</sup> In this respect it has to be mentioned, that never, in any country, has tariff control been exercised universally in all classes of insurance.<sup>110</sup> It has tended to be strictest in “politically sensible” classes as motor insurance.<sup>111</sup>

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<sup>106</sup> Samuel Ebiyekhimi' Idhiarhi, (n103), 82

<sup>107</sup>Ziv-Av D. (n97) 13

<sup>108</sup> Insurance Regulation and Supervision in OECD Countries, Asian Economies and CEEC and NIS Countries, OECD Study, Sponsored by the Japanese Government. <http://www.oecd.org/finance/insurance/1900939.pdf>, accessed March 01, 2020

<sup>109</sup> Ibid.

<sup>110</sup> Ibid.

<sup>111</sup> Ibid.

In the EU, the bases for the calculation of premiums and technical provisions have to be submitted but not for approval by domestic as well as foreign companies.<sup>112</sup> In other Member countries (Australia, Belgium (for life assurance only), Denmark, Luxembourg, Mexico, Norway and Turkey) they have to be submitted for approval.<sup>113</sup>

In our case, recently the new Insurance Business Proclamation, the Proclamation No. 1163/2019 give the NBE the mandate to enact and determine an economic or minimum premium rate in a manner to be specified by a directive.<sup>114</sup> The Proclamation doesn't clarify which type of insurance is to be controlled by the NBE directive, but as in the OECD countries it has tended to be strict in classes of motor insurance coverage.

➤ **Absence of Research and Development on the Insurance Sector by the NBE**

Research and development (R&D) includes activities that regulators of financial institutions and companies undertake to innovate, improve the method of regulation, identify associated problems and introduce new products and services to the market. It is often the first stage in the development process. The research and/or development is typically not performed with the expectation of immediate return. Instead, it is expected to contribute to the long-term growth of a financial industry. Regulators of financial institutions should undergo R&D activities.

Insufficiency or absence of Research and Development by the regulatory and supervisory body on the Ethiopian insurance sector is one of the many reasons for not achieving a modern and strong insurance sector in Ethiopia.<sup>115</sup> Therefore, it is imperative to increase the volume and depth of the R&D on the insurance sector.

➤ **Directives Enacted by the NBE doesn't Recognize the Current Status of the Insurance Sector**

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<sup>112</sup> Ibid.

<sup>113</sup> Ibid.

<sup>114</sup> Insurance Business Proclamation, the Proclamation No. 1163/2019, (n69), Article 58.

<sup>115</sup> Interview with Mr. Hadush Hintsay, (n8).

Directives on investment on insurance funds, manner of computing margin of solvency for insurance companies, liquidity of insurance companies etc., **doesn't recognize the current status of the sector and the high inflation rate in the country.** The regulator does not open up diversified investment opportunities for insurance companies to invest their idle cash.<sup>116</sup> Rather it puts strict legal limitation on insurance companies to invest their money to different investments. For example; the Directive on investment on insurance funds limits their investment on real estate to 10% of total admitted assets and not less than 65% of their admitted assets to buy treasury Bills or to deposit the money in banks which is totally unfair for the insurance industries.<sup>117</sup>The main reason for the regulatory body to enact this strict directive **is related to liquidity of money.**

Since Investment directive restricts the investment of the capital base unduly, this prove to be a disincentive to hold a high level of capital within the insurance companies.<sup>118</sup>This would thus tend to weaken rather than strengthen the overall financial security of insurance companies.<sup>119</sup>

In addition to this, the number of persons who sit on the insurance companies' board of directors is also not allowed to be less than nine, and there are punishing restrictions to remunerations to the board members or their involvement in any other competing company.

#### ➤ **Lack of Formal Collaboration with Ethiopian Insurers Association**

Lack of Formal Collaboration between the NBE and The Association of Ethiopian Insurers (AEI) is one of the sources of problems in low development of the insurance sector. The AEI was established by insurance companies in Ethiopia to promote their common interest. The NBE can play a critical role in creating public awareness about the products available and the benefits of Insurance. The Association of Ethiopian Insurers (AEI) is also a key player in insurance penetration by lobbying members to uphold professionalism. Albeit this fact, the NBE doesn't

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<sup>116</sup>Ibid.

<sup>117</sup> Interview with Mrs. Meseret Bezabih, (n90)

<sup>118</sup>Ibid.

<sup>119</sup> Ibid.

create formal collaboration with the Ethiopian insurers association to properly regulate and supervise the insurance sector.<sup>120</sup>

➤ **Compliance Based Supervision of Insurance Companies by the NBE as a Problem in the Insurance Sector**

Currently, the approach followed by NBE in insurance supervision is compliance based supervision. That is, some minimum requirements (parameters) are set and the supervisory body periodically checks whether or not each insurance company complies with the minimum requirement. Another supervisory approach is a risk based supervision. Risk based supervision is followed when the supervisor to monitor risks and work with institutional management and boards of directors to reduce risk when prudent levels are being exceeded.

With a risk based model the objective is to prevent problems from occurring in the first instance, rather than finding them and then endeavoring to fix them... in terms of protecting the public interest, problem avoidance is more desirable objective than problem rectification. Generally speaking, therefore, risk based supervision is more effective than the traditional compliance based approach.

The IAIS also endorses risk based supervision since it provides early warning signals. The trend in insurance supervision is, therefore, towards risk based supervision. The insurance supervisory body in Ethiopia should have to institute risk based supervision to cope with the dynamism in the insurance environment.<sup>121</sup> Risk based supervision demands sound technical competence and supervisory body needs to build up its capacity in due time. A complete shift to risk based supervision will not be desirable at this stage due to capacity problem (human resource). However a gradual shift will be necessary by adopting a mix of compliance-based and risk based supervision for some time.

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<sup>120</sup> Interview with Mr. Hadush Hintsay, (n8).

<sup>121</sup> Ibid.

## CHAPTER FOUR

### COMPARATIVE ANALYSIS OF INSURANCE INDUSTRY REGULATORY AND SUPERVISORY SYSTEMS

#### 4.1. Introduction

In spite of Ethiopia's huge population that present enormous market potential, the insurance industry is relatively underdeveloped compared even to African peers such as Nigeria, Kenya and Ghana that achieve relatively higher insurance penetration and destiny. The limitations and regulatory failures in Ethiopia are far from what is the case in other African countries where the industry operates under an independent professional regulator that gives the maximum concern to the perpetual development of the insurance business.

Insurance penetration has remained low not only in Ethiopia but in Africa as a whole. The low level of penetration and underdevelopment of the insurance sector in Ethiopia highlights the significant potential that is ready to be exploited especially in micro insurance, life insurance and agriculture insurances which are at the early stage of development and which will play a key role in boosting insurance penetration and the development of the sector.

This part of the research will interrogate the effectiveness of the existing regulatory and supervisory framework, and conducts a comparative study of the regulatory models in Kenya, Nigeria and Ghana, with a view to making comparisons with Ethiopia's insurance sector. The reason for picking of the above stated countries as a comparative base in order to assess the regulation and supervision of insurance industry in Ethiopia is because, these countries has relatively deep and more developed insurance markets than Ethiopia and it is better to take these country as a sample so as to understand and share their experience. Their experience have a great use for Ethiopia to transform its method of regulation and supervision of the insurance industry.

Similarly, the Insurance sector in these countries has stagnated over the years like that of our country. But, recent reforms in their regulatory and supervisory body of their insurance sector i.e., the establishment of separate insurance regulatory and supervisory authority or commission helps these countries in improving the role played by the insurance sector in the improvement of the overall economic development of the country.

## 4.2. Kenya

The insurance industry in Kenya is classified as a service sector. It is comprised of insurance companies, reinsurance companies, insurance brokers, reinsurance brokers, loss adjusters, loss assessors, insurance investigators, insurance agents, medical insurance providers, claims settling agents and risk managers. In recognition of the importance of the insurance sector, the Government of Kenya instituted a number of legal and institutional reforms. The Government saw the need to establish a body to regulate the insurance companies that hitherto operated as branch offices of international companies. This led to the enactment of the insurance Act CAP 487/1984 with an effective date of 1st January 1987.<sup>122</sup> This saw the formation of the Department of Insurance under the Ministry of Finance. The functions of the department were to regulate and supervise the insurance industry. In 2006 the Act was amended to create the Insurance Regulatory Authority (IRA).<sup>123</sup>

The Insurance Regulatory Authority (IRA) was created by the Insurance (Amendment) Act of 2006 and came into operation on 1st of May 2007. The Authority was established with the mandate of regulating, supervising and developing the insurance industry in Kenya that enables industry players to be innovative and entrepreneurial.<sup>124</sup> The Authority formulates and enforces standards for the conduct of insurance and reinsurance business in Kenya, issues licenses to all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters, motor assessors and risk surveyors.<sup>125</sup>

In addition, IRA in collaboration with industry players and individuals works collectively towards protecting the interests of insurance policy holders and insurance beneficiaries in any

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<sup>122</sup> The insurance Act CAP 487/1984 of Kenya

<sup>123</sup> The Insurance (Amendment) Act of 2006 of Kenya

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

insurance contract.<sup>126</sup> It promotes the development of the insurance sector and advises the government on the national policy to be followed in order to ensure adequate insurance protection and security for national assets and national properties.<sup>127</sup> In order to effectively supervise, develop and grow the insurance industry, IRA is obliged to address the challenges emerging from the external environment in a timely manner.

The authority works collectively and individually with industry players to achieve the overall development of the industry. The management of the Authority vests in the Board of Directors comprised of highly experienced professionals with most of them having a background in insurance and financial services sector. All the key financial services regulators namely Central Bank of Kenya, Retirement Benefit Authority and the Capital Markets Authority are represented in the IRA Board.<sup>128</sup>

The interests of the insurance companies are represented by the Association of Kenya Insurers (AKI), a lobby group that promotes adherence to prudent business practices by the members. In addition, AKI creates awareness about insurance and insurance products to the general public with a view to accelerating growth of the insurance sector in Kenya (AKI Bulletin, 2008).<sup>129</sup> The insurance brokers are on the other hand represented by Association of Insurance Brokers of Kenya (AIBK) which is a self-regulatory body upholding the interests of the members (AIBK, 2009).<sup>130</sup>

The Association of Kenya Insurers is also playing a key role in lobbying members to uphold professionalism. The ethics committee within the body handles issues of members' misconduct so that the image of the industry is kept high. This shows the formal collaboration between the

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<sup>126</sup> Insurance Regulatory Authority (IRA), Official Homepage, <https://www.ira.go.ke/index.php/about-us/mandate-objectives>, accessed April 2, 2020.

<sup>127</sup> Ibid.

<sup>128</sup> Ibid.

<sup>129</sup> AKI Bulletin (2008). A Newsletter of the Association of Kenya Insurers.

<sup>130</sup> Ibid.

IRA and the association. Through Common fund contributed to by all members, the body been carrying out public campaigns to increase visibility of Insurance and create awareness to the general public.

Before the Authority came into existence in 2006, the Kenyan insurance market was characterized by multifaceted problems and stiff competition. Some of the challenges were pricing regulations that are not followed by other players, fraudulent claims, cartels and monopolistic practices by hospitals and health providers. There was also the challenge of collecting outstanding premiums from delinquent brokers, lack of agent retention, lack of public awareness about the various insurance products that are offered and difficult clients who do not want to accept their policy's terms and conditions.

Other problems included broker dominance in corporate business, which lead to undercutting, policy-holders' apathy and ignorance about their rights and understanding of the difference between banking and insurance, price competition, which results in the pricing of insurance products at uneconomical premiums and terms. Certainly, a compromised justice system, lack of rights to access claims from governmental institutions (hospitals or police) and the lack of a blacklisting system to punish fraudulent agents, did not help either.

The IRA adhered to the financial inclusion agenda by promoting consumer education and fostering consumer protection. It strengthened its supervisory framework through the introduction of risk-based supervision and enhanced its institutional capacity through training of insurance agents and actuarial scholarships. It improved the ease of doing business through digitization and collaboration with relevant government agencies in combating financial crimes, especially fraud and money laundering. The Authority has also simplified and standardized insurance contracts in an effort to make it easier for policyholders and the general public to understand insurance contracts. These made the Kenyan insurance sector relatively stable and resilient. The IRA is also a member of the IAIS and, as a result, has been issuing various guidelines that align to a number of International Core Principles (ICPs).

According to IRA's annual report for 2018, among other things, the licensed insurers are fifty three (53), five (5) reinsurance companies, and two hundred fifteen (215) insurance brokers.<sup>131</sup> The Insurance industry's contribution to the Gross Domestic Product (GDP) stood at 4.9 % in 2018.<sup>132</sup>

### 4.3. Nigeria

The insurance industry of Nigeria plays a crucial role in an economy by fostering intermediation and by its mechanism of risk bearing. As such it could be argued that the insurance industry fosters economic growth. In recent years, the Nigerian insurance industry has undergone significant transformation.<sup>133</sup> The expanding economy, changing consumer trends, increased competition and an evolving regulatory framework are positive signs of market growth and development.<sup>134</sup> These factors have contributed to the Nigerian insurance industry becoming the second largest in Africa in 2015.<sup>135</sup>

Currently, the National Insurance Commission (NAICOM) is empowered to ensure the effective administration, supervision, regulation and control of insurance business in Nigeria.<sup>136</sup> By section 7 of the National Insurance Commission Act, the Commission is specifically vested with the responsibility of establishing standards for the conduct of insurance business in Nigeria, approving rates of insurance premiums to be paid in respect of all classes of Insurance business,

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<sup>131</sup> Insurance Industry Annual Report for the Year Ended 31st December, 2018, Prepared by Insurance Regulatory Authority (IRA).

<sup>132</sup> Ibid.

<sup>133</sup> Sub-Saharan Africa — the evolution of insurance regulation, [https://www.ey.com/Publication/vwLUAssets/EY-sub-saharan-africa-the-evolution-of-insurance-regulation/\\$FILE/EY-sub-saharan-africa-the-evolution-of-insurance-regulation.pdf](https://www.ey.com/Publication/vwLUAssets/EY-sub-saharan-africa-the-evolution-of-insurance-regulation/$FILE/EY-sub-saharan-africa-the-evolution-of-insurance-regulation.pdf), 2015, accessed April 2, 2020.

<sup>134</sup> Ibid.

<sup>135</sup> Ibid.

<sup>136</sup> The National Insurance Commission, NAICOM was set up by Decree No. 1 of 1997. The Decree is now the National Insurance Commission Act Cap N53 Laws of the Federation of Nigeria 2004.

approving rates of commissions to be paid in respect of all classes of insurance business, and, ensuring adequate protection of strategic Government assets and other properties.

The Commission is mandated to establish standards in the conduct of insurance business in Nigeria. No such standard is known to have yet been established other than as contained in the constituting legislation. The Commission is given extensive powers of inspection in sections 3 of the Insurance Commission Act. Section 31 endows the Commission with a mandatory inspection powers every two years over insurers, or as and when the inspectorate department of the Commission determines. The implementation of section 31 of the Insurance Act leaves much to be desired.

Since the enactment of these legislations, the Insurance sector has witnessed several other regulatory interventions and reforms aimed at enhancing the practice of insurance business and also developing the sector by achieving increased penetration of the sector given the potentials represented by Nigeria's population of over 170 million. These include licensing, capital requirement, insurance business classification, mandatory insurance for specific businesses and compulsory premium payment expressed as No premium No Cover (NPNC).

Under this legal regime the sector boasts of 59 insurance companies operating in the prescribed classes - Life, Non-life and Reinsurance.<sup>137</sup> Stakeholders believe this is attributable to NAICOM's strong drive toward regulatory compliance in insurance. The transformation in the insurance industry has increased investors' confidence and market perception and has attracted foreign insurance players into the Nigerian market.

Nigeria's insurance industry practice, before the establishment of the National Insurance Commission, was undercapitalized and weak. It was not fulfilling its role of economic transformation. After its establishment, it worked to deepen insurance market penetration. It also introduced several initiatives, including the Market Development & Restructuring Initiative with the primary objective of promoting insurance culture in the country.<sup>138</sup> It appears that in terms of

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<sup>137</sup> The National Insurance Commission website, <https://www.naicom.gov.ng/index.php/insurance-industry/insurance-companies>, accessed April 2, 2020.

<sup>138</sup> Fortune Newspaper, (n60).

products and services, the sector has developed a wide range and the regulator has led the way in opening new markets by use of the tools of regulation.<sup>139</sup>

Its focus spanned the enforcement of compulsory insurance, sensitization and modernization of the sector's agency system, eradication of unlicensed insurance institutions as well as the introduction of risk-based supervision.<sup>140</sup> It evaluates the market continually and identifies the 'drivers' and drags' of Nigeria's insurance sector and designs a periodic and strategic plan to deal with them.

#### **4.4. Ghana**

Ghana has one of the fastest-growing insurance industries in Africa.<sup>141</sup>The National Insurance Commission (NIC) was established under Insurance Law 1989 (PNDC Law 227), but now operates under Insurance Act, 2006 (Act 724), to ensure effective administration, supervision and regulation of the industry, is mandated to perform a broad spectrum of functions.<sup>142</sup> These included licensing of entities, setting of standards and facilitating the setting of codes for practitioners.<sup>143</sup> The Commission is also mandated to approve rates of insurance premiums and Commission pays, provide a bureau for the resolution of complaints and arbitrate insurance claims when disputes arise.<sup>144</sup>

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<sup>139</sup>Ebere Okonkwo FCIS, *The Use of Regulation in the Development and Enhancement of the Insurance Sector In Nigeria*, a seminar paper in partial fulfillment of requirements for the course Regulation of Financial Institutions, Nasarawa State University Keffi, p 18, 2019.

<sup>140</sup> Ibid.

<sup>141</sup> Sub-Saharan Africa — the evolution of insurance regulation, (n133), 20

<sup>142</sup> The National Insurance Commission (NIC) website, <https://nicgh.org/about-us/overview/>, accessed 10 January 2020.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

Other responsibilities include the provision of recommendation to the sector Minister for policy formulation, supervision of practitioners, enforcement of compliance and public education.<sup>145</sup> The development of strong relationships with regulators from other countries and international bodies such as the IAIS and ensuring the conformity of practitioners to internationally accepted standards are also key mandates of the Commission.<sup>146</sup>

The Insurance Act 2006 led to significant structural changes for the industry, including increased competition and, in some cases, companies engaging in undercutting pricing exercises involving unethical underwriting and marketing practices. The NIC adopted a risk-based supervision approach to address these challenges. It also revised the solvency framework and developed a risk management framework for licensed insurers (effective 1 January 2015).

Before the Commission, the Ghanaian insurance market was characterized by poor public perception of insurance that resulted in a lack of confidence in the industry. A previously existing legislation that demanded government and other agencies insure solely with State Insurance Corporation (SIC) was a drawback on industrial competition and efficiency. There were limited local private avenues for investment as well, and the number of insurance companies and insurance broking companies was too high, making it hard to regulate them.

NIC has worked to improve the efficiency of the industry and set the stage for the transformation and growth of the industry. It endeavored to increase the national penetration rate. It issued the Mobile Insurance Market Conduct Rules to regulate the sale and distribution of insurance through mobile phones. It also implemented risk-based supervision to comply with the International Association of Insurance Supervisors' (IAIS) core insurance principles.

#### **4.5. Lessons Learnt from the Analysis**

In these three countries, the insurance industry plays a more significant role in their economies compared to that of Ethiopia. The insurance industry comprised, on average, over 1.5% of their

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<sup>145</sup> Ibid.

<sup>146</sup> Ibid.

GDPs in 2017.<sup>147</sup> In Ethiopia, according to 2017/18 report, the industry makes up only 0.045% of GDP.<sup>148</sup> We have also noticed the various efforts made by the regulators to expedite the development of the insurance industry. The effect of having “an owner to the industry” plays an unparalleled role in developing the insurance industry, working to deepen market penetration of insurance and tasking it with widening coverage.<sup>149</sup>

Such “owners” of the insurance industry are also primary sources of industry data. They work relentlessly to empower the industry’s human power formally and institutionally and they devise short, middle and long-term strategic plans to tackle prevailing challenges. They are keen to identify problems and immediately implement workable solutions and also they are proactive and actively responsive to industry questions and issues. The regulators have a formal relation with insurers and other insurance industry actors association and they have a say on premium rate formulation to prevent price undercutting.

As these three African countries have proven, a professionally-led and independent insurance regulator with a clear legal framework, vision, structure and composition, can do wonders for the Ethiopian insurance industry. This is why the Ethiopian insurance industry needs to revise its laws in favor of a dedicated regulator to develop the insurance industry.

#### **4.6. Separate Regulatory and Supervisory Body for the Ethiopian Insurance Industry**

The Ethiopian insurance industry may be about a century old but it has barely developed to play a significant role within the economy. The major reason for such low-rate growth is mainly related to the institutional framework for the regulatory organ of the industry.

A separate insurance industry regulator and supervisor is structured on institutional model. For a separate regulatory body to be truly independent and effective there are key dimensions that need to come into play and align in terms of independence in the areas of regulation, supervision, the

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<sup>147</sup> Fortune Newspaper, (n60).

<sup>148</sup> Interview with Mr. Belay Tulu, (n71)

<sup>149</sup> Fortune Newspaper, (n60).

agency itself and financial matters. In other words, a common view is that a regulatory body should be operationally independent and accountable. Independence of any regulator must be looked at from four related angles which include regulatory, supervisory, institutional and budgetary independence.

Regulatory independence implies that the regulator has wide autonomy in setting at a minimum, prudential rules and regulations that follow from the special nature of financial intermediation.<sup>150</sup> Supervisory independence denotes that the supervisory agency has independence to supervise the financial sector without undue influences.<sup>151</sup> Institutional independence has to do with the agency's status outside the executive and legislative branches of government and budgetary independence relates to the regulator not being subjected to political pressure through its budgetary needs.

Some of the benefits of having a separate and independent insurance industry regulatory and supervisory body for Ethiopia includes first, a separate regulator keeps the traditional functional distinctions between financial institutions like banks and insurance companies and it have a more clear focus on the objectives and rationale of specific industry regulation, which the current regulatory body lacks.<sup>152</sup> The traditional functional distinctions between banks and insurances should be kept as this avoids the low emphasis given to the Ethiopian insurance sector and the insurance sector will have a 'separate independent owner' that gives high emphasis and focus to the industry. As scrutinized in chapter three of this thesis, the insurance industry is neglected to be effectively regulated as the NBE mainly focuses on banks. Having a separate insurance industry regulatory and supervisory body for Ethiopia avoids this major problem.

Second, setting up a separate regulator avoids an overly bureaucratic unified regulator that has excessively concentrated power in the NBE and it will create check and balance mechanism. Here, even one main advantages of unified regulator like that of the NBE i.e., economies of scale

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<sup>150</sup> Kenneth Kaoma Mwenda, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (The World Bank 2006) 19.

<sup>151</sup> Ibid.

<sup>152</sup> Interview with Mr. Belay Tulu, (n71)

is watered down where the unified regulator is seen as supervising almost everything under the sun and thus becoming monopolistic. Such effect may also lead to inefficiencies in the performance of their regulatory duty, such as bureaucracy and possibly corruption if the regulatory and institutional framework does not provide for effective checks and balances.

Third, setting up a separate and independent regulator avoids having a single point of failure. This means, if the NBE fails to identify an issue or problem related to one industry under their regulated sectors, there is no other agency to potentially fill the void. But, if Ethiopia have a separate Insurance regulatory authority or commission responsible to the Ministry of Finance and Economic Cooperation, there will be a government organization or bureau to potentially fill the gap.

Fourth, having a separate insurance industry regulator for the Ethiopian insurance industry will improve and have a single process for the authorization of an insurance firm and for the approval of some of their employees, using standard processes and a single database. Fifth, a separate regulator will have a more consistent and clear approach to enforcement and discipline. Sixth, a separate regulatory framework for insurance industry and other financial institutions gives a good impression that all financial institutions doesn't have similar risks. For instance, when banks and insurances are regulated by the same regulator consumers of these financial institutions may fail to differentiate the very different risks in these two markets. Similarly, all institutions licensed by the NBE may be assumed by the public to be receiving equal protection.

Here, we consider that having a separate insurance industry regulatory and supervisory body for Ethiopia under the Institutional Approach to supervision is under some stress due to worldwide significant changes in financial services business models. Many large financial firms are involved in a cross-section of products and services rather than in the mono-line activities of the past. But in Ethiopia, even though there are some form of informal affiliation between banks and insurances, financial integration between banks and insurance is not allowed and the highest holding of shares between themselves is only 5%.

The prerequisites for establishing a separate regulatory and supervisory body for the insurance industry includes among other things, sound and sustainable macroeconomic policies, the necessary political will among stakeholders, cooperation and sharing of information among other

financial services regulators as a country moves towards having a separate regulatory and supervisory body for the insurance industry and skilled human capital to support establishment and operation of the separate regulator, financial resources to support establishment and operation of the separate regulator.

Setting up a separate regulator for the Ethiopian insurance industry may not be as straightforward as commonly believed. Some of the challenges that may be experienced in separating the bodies are related to **legal issues**, human resource issues, cultural issues and system issues. The legal issue is related with reviewing all the existing laws of insurance sub sector to provide for the new separate regulatory framework or replacing all the comprehensive frameworks to sub sector legislations. The legal difficulties encountered in doing this may include sources of funding, ownership of assets, powers to sign foreign treaties, powers to enforce sanctions and powers to issue and amend prudential legislation. The human resource issue is related with, once information is made available that the existing regulators will be separated, talented staff may opt to move to the private sector or retire to avoid the uncertainty and difficulty of the change. The cultural and system issues are related with having a new work environment, system and condition.

## **CHAPTER FIVE**

### **CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Conclusion**

It has been discussed in this research that, while no two jurisdictions regulate financial institutions and sectors in exactly the same manner, the current models of financial regulation and supervision adopted worldwide can be divided into four categories. These include functional regulation, institutional or regulation by silos, twin peaks regulation and single or unified regulation. The choice of a specific regulatory framework depends on different factors, some of which may be unique to a specific country. Further it is stated that, there is no pure example of any model may actually exist worldwide, and blurring between approaches is prevalent. The specific way in which regulation and supervision financial institutions has been structured in each jurisdiction reflects, among other things, its unique history, politics, culture, size, economic development, and local business structure.

It has been tried to discuss the current models of financial system regulation and supervision adopted in Ethiopia and it is stated that, Ethiopia follows the unified or integrated model of financial sector regulation and the NBE is responsible for regulating and supervising the financial sectors as a whole including insurances, banks and micro finances. Accordingly, it has been tried to scrutinize the existing legal framework and practice in regulating and supervising the insurance sector in Ethiopia.

Accordingly it has been discussed that, even though the Ethiopian insurance industry may be more than a century old, it has barely developed to play a significant role within the country's economy. It is stated that, the insurance sector today is marred by a lot of regulatory inefficiencies as well as emerging trends. Major problems that entangled the development of insurance industry as discussed in the research are mainly related to the law emphasis given to the sector and this mainly emanates from the composition of the board of directors of the regulatory body. All the powers, responsibilities and functions of the regulatory body provided for in the NBE establishment Proclamation are bestowed in the Board of Directors. These powers and responsibilities includes among other things administration, supervision, regulation and control of insurance and reinsurance business in Ethiopia. Since the insurance sector is not

represented in the board, it is not adequately governed and given least priority by the board of directors of the NBE.

The other problem of the Ethiopian insurance sector emanates from the absence of a well-defined or formulated vision of the industry by the regulatory and supervisory body, absence of code of conduct enacted by the NBE that applies to the insurance companies in Ethiopia, lack of initiation by the regulatory body to enact directive or to control insurance industry rivalries by price undercutting, absence of Research and Development on the insurance sector by the NBE, directives enacted by the NBE doesn't recognize the current status of the insurance sector, lack of formal collaboration between the NBE and the Ethiopian Insurers Association, and compliance based supervision of insurance companies by the regulatory body. All these problems are evidenced by and resulted in low level of penetration and the low contribution of the insurance industry to economic growth of the country.

Actors of the insurance industry states that, the major reason for such low-rate penetration and growth is mostly related to the institutional framework for the regulatory and supervisory organ of the insurance industry and these challenges have resulted into appeal for reform of the regulatory framework, in order to enhance its supervision.

Accordingly, the researcher understands that in spite of Ethiopia's huge population that presents enormous market potential, the insurance industry is relatively underdeveloped compared even to African peers such as Nigeria, Kenya and Ghana that achieve relatively higher insurance penetration and destiny. The development in these African countries shows the effect of having a separate and independent owner of the insurance industry as it plays an unparalleled role in developing the industry, working to deepen market penetration of insurance and tasking it with widening coverage.

The researcher concludes that the Ethiopian insurance sector needs a highly qualified separate insurance regulatory body that gives high emphasis and focus to the insurance industry and Ethiopia should move from a unified model of financial institutions regulation and supervision to an institutional model.

## 5.2. Recommendations

So as to speak the concerns conferred in this research and for the development of the insurance sector, the following recommendations are made:

- A grass-root level study should be conducted to comprehend the real need of the whole insurance industry that includes all the actors of the sector.
- As it is discussed in chapter four of this study and as those three African countries i.e., Kenya, Nigeria and Ghana have proven, the laws related with the regulation and supervision of the Ethiopian insurance industry should be revised in favor of creating a dedicated, professionally-led, independent and separate insurance regulatory authority or commission responsible to the Ministry of Finance and Economic Cooperation with a clear legal framework, structure and composition to develop the insurance industry. This will solve the lack of emphasis given to the insurance sector and the sector will have an ‘owner’ that totally focus on the development of the industry.
- Since premium rate cutting or price cutting (struggling strategy) continues to remain as a challenge in the insurance sector in Ethiopia, the regulatory and supervisory body should not be reluctant on this issue and they should enact a directive that controls this uncompetitive practice as it helps the industry to be grown and safe.
- The study recommends that since there is insufficiency or absence of Research and Development by the regulatory and supervisory body on the insurance sector, it is imperative to increase the volume and depth of the R&D on the insurance sector as it will help the sector to grow and to solve the stated problems.
- The regulatory body should formulate a well-defined vision for the insurance industry that replies; what should the status of the Ethiopian insurance industry be after five years or a decade in terms of various aspects such as fund mobilization, insurance products and capitalization, investment portfolio, reinsurance, human resource, loss control etc. This will intensify the motivation and working environment in the regulatory body so as to achieve the stated vision.

- There should be legal amendment on directives on investment on insurance funds as it strictly limits the insurance companies to invest their money to different investment activities. The existing directive on investment on insurance funds limits their investment on real estate to 10% of total admitted assets and not less than 65% of their admitted assets to buy treasury Bills or to deposit the money in banks which is totally unfair for the insurance industries. So that, since the industry gets more profit on real estate business the percent should at least increased to 15% of total admitted assets and the amount to buy treasury Bills or to deposit the money in banks should be decreased to 60% of total admitted assets. Similarly, the manner of computing margin of solvency for insurance companies and liquidity of insurance companies should be amended as these directives puts strict legal limitation on insurance companies to invest their money to different investments and doesn't recognize the current status of the sector and the high inflation rate in the country.
- There should be formal collaboration between the regulatory body and Ethiopian insurers association and other bodies to properly regulate and supervise the insurance sector as they can do wonder in insurance penetration growth of the industry by lobbying members to uphold professionalism. In this collaboration, the regulatory body should create a discipline and ethics committee under the Ethiopian insurers association to handle issues of members' misconduct so that the image of the industry is kept high.
- It is recommended for the regulatory body to develop a code of conduct for the insurance industry which shall be complied with by each insurers and that should include sanctions to be enforced for the violation of any part of it.
- The insurance supervisory body in Ethiopia should have to institute risk based supervision to cope with the dynamism in the insurance environment.
- Based on the findings and conclusions, the study finally recommends that, in order to enhance Insurance penetration and growth of the industry, there is a need for concerted effort by both the insurance regulatory and supervisory body and the individual Insurance companies in implementing strategies that will ensure that the various challenges identified as hindering the growth of the industry dealt with.

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