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Change: Joining the dots

Budget 2013

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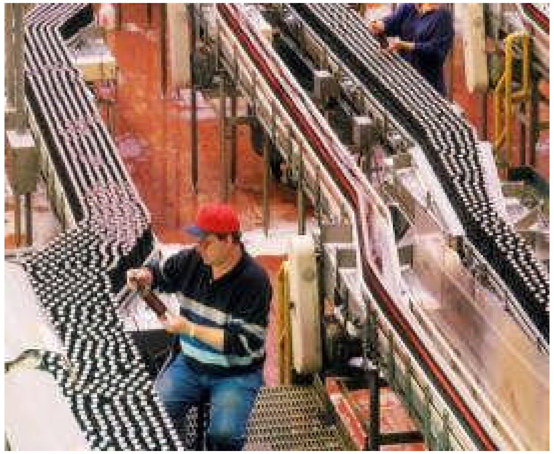

Winners:

EAC citizens

Foreign owned banks

Insurance policyholders

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Sector reforms

Priority sectors to grow the economy

Financial services

Promoting EAC Integration through Financial Sector Reform

Keeping up with the drive towards implementing the East African Common Market Protocol, proposed financial sector reforms will open up ownership of insurance companies and brokerage firms to EAC citizens by allowing EAC residents to fall under the local ownership umbrella. While this may not result in radical restructuring of ownership in Kenya, reciprocation by the other EAC member states would be beneficial to Kenyan insurers seeking to expand into the region.

With respect to the capital markets, amendments have been proposed to allow persons licensed by any EAC capital market regulator to issue securities in Kenya. Regional fixed income securities may now be issued and traded in Kenya, increasing the capital raising options for entities in the member states.

Financial services reforms to accellerate EAC integration and growth in the sector.

Opening our borders

The Cabinet Secretary proposes to amend the law to remove restrictions on foreign ownership of insurance agencies to encourage foreign owned banks operating in Kenya to conduct bancassurance.

The benefits to the industry would include:

- utilising existing branch networks of the banks as distribution channels,
- developing new products drawn from experience in other markets in which the banks operate and
- potentially increasing the insurance penetration rate.

Intervention

The Insurance Regulatory Authority (IRA) will now be required to appoint a competent insurance professional when intervening in the management of a troubled institution. This will facilitate efficient and faster resolution of compensation to policyholders. Additionally, the Policyholders Compensation Fund's mandate will be expanded to include participation in the liquidation process of insurance companies.

This is expected to instil policyholder confidence and improve compensation processes. The insurance industry has experienced significant delays in compensating the policyholders of troubled insurers.

Insider trading

The Capital Markets Act will be amended to bring the offence of insider trading under strict liability. Any party that intentionally or unintentionally trades on material non-public information will have been deemed to commit an offence of insider trading under the Act. The lower burden of proof is expected to increase deterrent measures and further increase confidence in the capital markets.

Legislative reviews

The cabinet secretary has proposed that the current Insurance Act be overhauled and aligned to international best practice and the Constitution by 30 September 2013. The review will target having two legislations, one for the establishment of the Authority and the other covering industry regulatory issues. Similarly, the RBA Act is to be reviewed by 31 December 2013.

The set timelines may be ambitious based on the progress of on-going proposed reviews to the Companies Act and Banking Act. Review of the Insurance Act has also been on-going. A draft Insurance Bill released by the Insurance Regulatory Authority (IRA) in April 2011 is currently being discussed by industry players.

Significant improvements in the Draft Insurance Bill 2011 include:

- Risk based approach for supervision and investment strategies,
- Life and general insurance businesses to be undertaken by different companies,
- Enhanced corporate governance,
- Medical insurance providers to be registered as insurers and
- Standard minimum capital requirements to be replaced with requirements based on risk profile.

Central Bank to get more teeth

The Central Bank of Kenya will get enhanced capacity to intervene in the event of malpractice or weak governance in micro finance institutions. The regulator will be in a position to move promptly into troubled microfinance institutions to forestall the depending of a financial crisis. Penalties under the Banking Act will be increased to make the regulator more effective in enforcing existing regulations.

Focus on funding priority growth sectors

In line with Vision 2030 and the Jubilee manifesto, the Bill introduces measures to grow the priority sectors of agriculture and housing. It establishes an agribusiness fund, with initial funding of Kshs 2 billion for lending to farmers. The fund is to grow to Kshs 20 billion by the end of four years. Lending from the fund will be through the commercial banks to take advantage of their wide reach through their branch networks.

In recognition of the capital intensive nature of real estate developments, the Secretary proposes to encourage the pooling of funds through incentives to Real Estate Investment Trusts.

Infrastructure

Emphasis on infrastructure to accelerate growth

The budget for 2013/2014 allocates Kshs 288.5 billion to infrastructure, a 9% increase compared to Kshs 265 billion in the 2012/13 budget which shows the emphasis that government consistently places on infrastructure.

The increased investment in infrastructure is aimed at:

- increasing access to regional markets through faster railway transport and development of the Kisumu inland port and

Infrastructure was allocated a total of Kshs 288.5 billion representing 18% of the total expenditure estimates, a 9% increase over the prior fiscal year

- improving the road connectivity across the country to boost trade and investment and reduce the cost of doing business by investing in cheaper and greener energy generation.

There is also a continued drive to increase electricity penetration and develop modern ICT infrastructure.

Standard gauge railway

The allocation toward this project is Kshs 22 billion to begin construction. While this clearly demonstrates plans to undertake capital works on the project this year, the Kshs 22 billion is not sufficient to cover the whole project. It is therefore important to understand what this amount means within the wider context of the total project cost and the overall construction plan.

To supplement other funding sources, a railway development levy of 1.5% on all imported goods has been introduced. The levy is expected to increase the cost of imported goods in the short run but should reduce their cost in the long run once the railway is operational.

Power transmission

Kshs 23.8 billion has been allocated towards enhancing power transmission. It is expected that substantial investment in key transmission projects, such as the Mombasa Nairobi network, as well as the wider regional interconnector programme will continue as East Africa converges to a common power pool. Additionally, in tandem with expected growth in generating capacity the transmission network will require new investments to bring planned power generators/plants on grid.

LAPSSET

Although the budgetary allocation of Kshs 3.7 billion toward the LAPPSET corridor appears modest, particularly against an anticipated cumulative capital requirement of USD 23 billion over 7-8 years, it is not a surprise. Notably, the LAPPSET corridor comprises many sub-components of infrastructure cutting across a number of sub-sectors. It is therefore expected that the procurement of this entire corridor will involve complex structuring with significant contribution from the private sector and other development partners. The current allocation will go towards the construction of the first three berths and associated infrastructure.