



WALLAGAA UNIVERSITY

SCHOOL OF LAW

**The Need for Establishing a Policyholder Protection Scheme in Ethiopia's Insurance
Industry: International Lessons, and Implementation Challenges**

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Examiners Approval Sheet

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Statement of the Author

I, Motuma Jaleta hereby declare that the study entitled “The Need for Establishing a Policyholder Protection Scheme in Ethiopia’s Insurance Industry: International Lessons, and Implementation Challenges” is my original work. All information and data presented in this thesis have been obtained and reported in accordance with accepted academic standards and ethical guidelines. I acknowledge full responsibility for any failure to comply with conventional rules of citation and academic integrity.

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Abbreviations and Acronyms

FDRE: Federal Democratic Republic of Ethiopia

NBE; National Bank Of Ethiopia

IGS: Insurance Guarantee Scheme

PPS: Policyholder Protection Scheme

FSCS: Financial Services Compensation Scheme

PHCF :Policy Holders Compensation Fund

NFIS : National Financial Inclusion Strategy

GAR : Guaranteed Annuity Rate

OECD ; Organization for Economic Co-operative Development

EIC: Ethiopian Insurance Corporation

NDIC : The Nigerian Deposit Insurance Corporation

NOLHGA; The National Organization of Life and Health Insurance Guaranty Associations and

NCIGF: National Conference of Insurance Guaranty Funds

FCA :The Financial Conduct Authority and

PRA; Prudential Regulation Authority

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Abstract:

This thesis explores the need to establish a Policyholder Protection Scheme (PPS) in Ethiopia's insurance industry. Despite growth in the sector, Ethiopia lacks a formal mechanism to protect policyholders in the event of insurer insolvency. The study uses legal and comparative research methods, examining the Ethiopian legal framework and drawing lessons from countries like the United States, the United Kingdom, France and Kenya. Findings show that the absence of a PPS exposes policyholders to significant financial risks and undermines public trust. The thesis recommends creating a clear legal and institutional framework for a PPS in Ethiopia, with defined coverage limits, funding methods, and strong regulatory oversight to ensure consumer protection and financial stability.

Keywords: policyholder protection scheme, insurance industry, consumer protection, financial stability.

Chapter One

General Introduction

1.1. Background of the Study

Insurance companies, like other financial institutions, are subject to prudential regulations.¹ The regulatory framework established by governments to oversee financial institutions' prudential management cannot guarantee the prevention of insurer insolvency.² If an insurer becomes insolvent in a particular country, policyholders, also known as the insured or policy owners, may face financial repercussions. Policyholder Protection Schemes (PPSs) serve as safety nets for the insured in such unforeseen circumstances.³

Insurance is a vital component of financial systems worldwide.⁴ It facilitates risk management, promotes financial stability, and contributes to national economic development.⁵ In emerging economies such as Ethiopia, the insurance sector is expanding, but consumer protection mechanisms remain underdeveloped.⁶

One key consumer protection mechanism in developed insurance markets is the policyholder protection scheme (PPS), which acts as a financial safety net in cases where insurers become insolvent. Such schemes enhance public confidence, stabilize the insurance market, and protect vulnerable policyholders. Hence, PPSs are typically designed to safeguard the interests of individuals or entities that purchase insurance policies from companies. These schemes aim to provide financial protection and support to policyholders in the event that an insurance company

¹ *International Association Of Insurance Supervisors [IAIS], Insurance Core Principles, Standards, Guidance And Assessment Methodology* 9 (Nov. 2019), <https://www.iaisweb.org/Page/Supervisory-Material/Insurance-Core-Principles>.

² *International Association Of Insurance Supervisors [IAIS], Issues Paper On Policyholder Protection Schemes* (Oct. 2013), <https://www.iaisweb.org/Page/Supervisory-Material/Issues-Papers>.

³ *Organisation For Economic Co-Operation And Development [OECD], Policyholder Protection Schemes: Selected Considerations* 7 (2008), <https://www.oecd.org/finance/insurance/41532059.pdf>.

⁴ *International Association Of Insurance Supervisors [IAIS], Application Paper On The Composition And The Role Of The Board* 3 (Nov. 2018), <https://www.iaisweb.org/Page/Supervisory-Material/Application-Papers>.

⁵ *International Association Of Insurance Supervisors [IAIS], Issues Paper On Conduct Of Business Risk And Its Management* 4 (Nov. 2018), <https://www.iaisweb.org/Page/Supervisory-Material/Issues-Papers>.

⁶ *Access To Insurance Initiative [A2ii], Consumer Protection In Inclusive Insurance: Status And Regulatory Approaches* 5–6 (2019), <https://a2ii.org/en/publication/consumer-protection-inclusive-insurance>.

becomes insolvent or unable to fulfill its obligations.⁷ They can offer compensation to policyholders if an insurer encounters financial difficulties and is unable to make payments under their insurance policy. PPSs typically provide coverage for specific types of insurance policies, such as life, general, property and casualty, and motor insurance.⁸ In certain jurisdictions, PPSs provide financial support to insolvent insurers, enabling insurance policies to continue.⁹

Policyholder protection schemes are essential components of a fully functioning financial service safety net.¹⁰ Thus, to properly understand the need for policyholder protection schemes, it is vital to place them within the broader context of financial safety nets. A financial safety net is a framework of safeguards implemented by governments to ensure the well-being of financial customers.¹¹ This framework typically encompasses prudential regulations and supervision, lender.s of last resorts, deposit insurance, and policyholder protection schemes.¹²

There are two main types of Policyholder Protection Schemes (PPS) used internationally, based on their legal structure, funding mechanisms, and scope.¹³ These are Explicit policyholders protection scheme and Implicit policyholders protection scheme. Explicit policyholders protection scheme is established by law or regulation, with clear rules for funding, coverage, governance, and payout procedures. Implicit policyholders protection scheme in other way rely on unwritten or assumed government intervention in the event of an insurer's failure, but have no formal mechanism or legal backing.¹⁴

Despite regulatory progress, Ethiopia has not established a formal PPS, leaving policyholders unprotected in the event of insurance company failure.¹⁵ Ethiopia follow Implicit type of policyholders protection scheme. which is No legal right to compensation. Government or

⁷ International Association Of Insurance Supervisors [IAIS], *Issues Paper On Policyholder Protection Schemes* 4–5 (Oct. 2013), <https://www.iaisweb.org/Page/Supervisory-Material/Issues-Papers>.

⁸ Organisation For Economic Co-Operation And Development [OECD], *Policyholder Protection Schemes: Selected Considerations* 10–11 (2008), <https://www.oecd.org/finance/insurance/41532059.pdf>.

⁹ International Association Of Insurance Supervisors [IAIS], *Issues Paper On Policyholder Protection Schemes* 7 (Oct. 2013), <https://www.iaisweb.org/Page/Supervisory-Material/Issues-Papers>.

¹⁰ Robert R. Bliss, *Financial Sector Safety Nets: Design And Implementation* 145 (Edward Elgar Publishing 2011).

¹¹ Id 3

¹² Financial Stability Forum, 'Guidance For Developing Effective Deposit Insurance Systems' (September 2001) https://www.fsb.org/2001/09/R_0109b/ Accessed 18 May 2025.

¹³ Id 142

¹⁴ Id

¹⁵ National Bank Of Ethiopia, *Insurance Supervision Annual Report* 14–15 (2022) (Noting The Absence Of A Formal Policyholder Protection Mechanism In Ethiopia).

central bank may act based on public interest. Can create uncertainty for policyholders.¹⁶ This legal and institutional gap presents a major concern for consumer rights and systemic risk management. In light of Ethiopia's ongoing financial sector reforms, exploring the feasibility of a PPS is both timely and essential. ¹⁷This study investigates international experiences and evaluates the potential for adopting a legally sound, effective PPS in Ethiopia.

Several countries, including the United Kingdom, the United States, Kenya, and France, have implemented PPS to protect policyholders and maintain trust in their insurance sectors.¹⁸ Their experiences provide valuable insights for jurisdictions like Ethiopia, where legal frameworks remain limited in scope.

The objective of this research is to evaluate policyholder protection schemes in other regions, identify the justifications for their implementation, and identify the categories of policyholders they cater to. Additionally, the study highlights the necessity of establishing a policyholder protection scheme in Ethiopia's insurance industry, as well as the types of insurance that should be included in such schemes. This study examines the rationale behind the policyholder protection scheme. Assess the merits of establishing policyholder protection schemes in the insurance sector. In particular, it examines whether a PPS should be introduced in Ethiopia, and if it is introduced in Ethiopia, the design features of the PPSs should be.

1.2. Statement of the Problem

The insurance industry plays a critical role in promoting financial stability, facilitating risk management, and contributing to economic development.¹⁹ However, despite the sector's growing importance in Ethiopia's financial system, there is no Explicit (formal) Policyholder Protection Scheme (PPS) in place.²⁰ This absence leaves policyholders vulnerable in the event of

¹⁶ National Bank Of Ethiopia, *Insurance Supervision Annual Report* 15 (2022)

¹⁷ Ibid

¹⁸ Ibid 9

¹⁹ Organisation For Economic Co-Operation And Development (OECD), *Insurance And Private Pensions Compendium For Emerging Economies: Book 1*, At 12 (2001).

²⁰ Ibid 16

insurer insolvency, posing a significant threat to consumer confidence and overall financial sector stability.²¹

Internationally, countries such as the United Kingdom, the United States, Kenya, and France have adopted explicit policyholder protection mechanisms to compensate insured individuals when insurers fail, thus reinforcing public trust and systemic resilience.²² Ethiopia, by contrast, currently operates under an implicit protection model, in which government intervention in the event of insurance company failure is not legally guaranteed and lacks transparency or predictability and also there are general regulatory provisions that aim to protect policyholders through prudential regulation and market conduct supervision, primarily overseen by the National Bank of Ethiopia (NBE).²³

Those general regulatory provisions that aim to protect policyholders through prudential regulation and market conduct supervision, is found under insurance business proclamation 746/2012 and under this proclamation the National Bank of Ethiopia (NBE) imposes capital adequacy and solvency requirements on insurance companies to help ensure they can meet their obligations to policyholders.²⁴ The aim of this provision under insurance business proclamation is to Prevent insurer insolvency and protect policyholders by requiring insurers to hold sufficient reserves. But This kinds of policyholders protection is preventive, not compensatory. It cannot help policyholders if an insurer still fails.

The other general regulatory provisions that exist under insurance business proclamation is licensing and market conduct supervision and under insurance business proclamation The NBE licenses and monitors insurers and agents to ensure ethical conduct and consumer protection.²⁵ For the purpose of protect policyholders from fraud, misrepresentation, or unfair treatment .but Again, no guarantee of compensation if an insurer collapses. The other way is Policyholders have the right to enforce their insurance contracts in civil courts if claims are denied unjustly. but Court processes are time-consuming, costly, and ineffective in insolvency situations where the insurer has no funds to pay.

²¹ Ibid 10

²² Ibid 10

²³ Ibid 16

²⁴ Insurance Business Proclamation No. 746/2012, Arts. 30–33

²⁵ Proclamation No. 746/2012, Arts. 6–9, 39

There is no dedicated fund or legal mechanism guaranteeing compensation to policyholders in case of insurer insolvency meaning the country follows an implicit model of protection which means that while there are general regulatory safeguards intended to protect policyholders, but there is no legally guaranteed compensation if an insurer becomes insolvent. This legal and institutional gap undermines consumer rights, raises systemic risk concerns, and hampers efforts to modernize and strengthen the Ethiopian insurance sector.

Furthermore, Ethiopia is undergoing broad financial sector reforms underpinned by goals of deepening financial inclusion and aligning with global regulatory standards.²⁶ The lack of a formal PPS represents a critical omission in this reform agenda.²⁷ Without clear legal backing and structured governance for policyholder protection, the country's financial safety net remains incomplete and its insurance consumers inadequately safeguarded.

Given the international best practices and growing reliance on insurance services in Ethiopia, exploring the feasibility, design, and challenges of implementing a PPS is both timely and necessary. The absence of such a mechanism not only jeopardizes the interests of policyholders but may also weaken public trust in the sector and deter broader insurance penetration.

1.3. Objectives of the Study

1.3.1. General objectives

The general objective of this study was to examine the need to establish a policyholder protection scheme in Ethiopia Insurance Business.

1.3.2. Specific objectives

The specific objectives of this study were as follows:

- To examine whether the Ethiopia legal frame work provide for policyholders protection in the insurance sector.
- To explore weather there is a need for legal reform in the area of policyholders protection scheme

²⁶ National Bank Of Ethiopia, *Homegrown Economic Reform Agenda: A Pathway To Prosperity* 7–9 (2020)

²⁷ Id

- To explore the experience of other jurisdictions with respect to policyholders' protection schemes and draw lessons for Ethiopia.

1.4. Research Questions

This study aimed to answer the following questions:

- To what extent does the Ethiopian legal framework provide for the protection of policyholders in the insurance sector?
- Is there a need for legal reform in Ethiopia to enhance the protection of policyholders in the insurance sector?
- What lessons can Ethiopia draw from the experiences of other countries that have introduced policyholder-protection schemes?

1.5. Research Methodology

This study employs a doctrinal research methodologies. Doctrinal legal research was used to systematically examine the existing legal framework governing insurance business in Ethiopia, with particular emphasis on provisions related to policyholder protection. This involved a detailed analysis of relevant proclamations, regulations, and directives, including the Insurance Business Proclamation and its subsequent amendments, as well as official documents issued by the National Bank of Ethiopia (NBE).

The researcher has used applicable Insurance laws such as Insurance Business Proclamation No. 746/2012 and its amendments Proclamation No. 1163/2020 and Relevant directives issued by the National Bank of Ethiopia (NBE) as primary sources to assess the legal framework of PPS in Ethiopia to identify gaps in the legal framework governing the insurance business in Ethiopia, with a particular emphasis on policyholder protection. The researcher also uses Books, literatures, journals, related researches written on the topic and reports as secondary sources in order to give an Overview on the concept, form, experience of countries and issues related to PPS.

In addition, a comparative legal research methodology was adopted to analyze the design and operation of policyholder protection schemes in selected jurisdictions. The comparative analysis specifically focused on the United States, the United Kingdom, France and Kenya, as these countries represent diverse legal and regulatory frameworks with well-established policyholder protection mechanisms. The United States was selected due to its comprehensive state-based guaranty association system, which provides robust statutory protection through mandatory insurer assessments and clearly defined coverage limits. The United Kingdom's Financial Services Compensation Scheme (FSCS) offers a centralized, industry-funded model with strong regulatory oversight and consumer-focused protections. More over France legal system is similar with our sit is civil law country. Kenya's Policyholders Compensation Fund (PCF) was included as a representative emerging market example in Africa, providing insights into how policyholder protection schemes can be adapted to developing insurance sectors with unique challenges. These jurisdictions were chosen not only for their differing levels of economic development but also for their varied approaches to funding, governance, and continuity of coverage, offering a rich comparative perspective. The aim was to identify best practices, challenges, and lessons that could inform the development of an effective and contextually appropriate policyholder protection scheme for Ethiopia.

In a nutshell, the research methodology is grounded in doctrinal and comparative legal analysis, supported by a review of relevant secondary literature. This approach provides a robust foundation for evaluating the current state of policyholder protection in Ethiopia and for drawing lessons from international best practices.

1.6. Literature Review

The insurance business and sector are highly regulated in most countries owing to their importance in the financial stability of a country.²⁸ A policyholder's protection scheme is usually

²⁸ Centre For Sustainable Development (CISL), *Insurance Regulation For Sustainable Development: Protecting Human Rights Against Climate Risk And Natural Hazards* (2015) 16.

provided by a government agency to policyholders against the risk of loss arising from the failure of an insurer.²⁹

Insurers are susceptible to many forms of risk that can trigger occasional systemic crises.³⁰ Insurance provider risks can be broadly categorized into three types. The first category encompasses technical risks such as underpricing risk, which occurs when the premium is insufficient to cover claims and insurer claims, as well as unforeseen or inadequately comprehended events such as deviation risk. Additionally, reinsurance risks come into play when reinsurance coverage is insufficient. The second type of risk that insurance providers may encounter is asset or investment risk. This category encompasses market risk, which includes changes in interest, equity, and real estate prices as well as exchange rate fluctuations. It also includes credit risk, which is the risk of non-payment by the counterparties, and liquidity risk. The third category includes other risks that may arise from group/conglomerate risks due to insufficient management coordination as well as legal risks.³¹

Despite the potential risks present in the Ethiopian insurance industry, no study has been conducted to determine whether a policyholder protection scheme (PPS) should be implemented in Ethiopia and, if so, what features it should possess. The only exception appears to be a study conducted by the World Bank in April 2017, titled "Federal Democratic Republic of Ethiopia, Diagnostic Review of Financial Consumer Protection: Key Findings and Recommendations." This study assesses the legal, regulatory, and institutional frameworks for financial consumer protection, including for insurance business customers. However, it does not specifically address the need for PPS in Ethiopia. Therefore, it is necessary to conduct a study that specifically focuses on exploring the advantages and disadvantages of implementing a PPS, and determining the effective design and structure of its operating model. The current study was conducted with this objective in mind.

²⁹ International Association Of Insurance Supervisors (IAIS), 'Issues Paper On Roles And Functioning Of Policyholder Protection Schemes (Ppss)' (December 2023) <https://www.iais.org/uploads/2023/12/Issues-Paper-On-Roles-And-Functioning-Of-Policyholder-Protection-Schemes-Ppss.Pdf> Accessed 19 May 2025.

³⁰ Sebastian Schich, 'Insurance Companies And The Financial Crisis' (2009) 2009/2 OECD Journal: Financial Market Trends 123.

³¹ Udaibir S Das, Nigel Davies And Richard Podpiera, *Insurance And Issues In Financial Soundness* (IMF Working Paper WP/03/138, 2003) 9.

This study is informed by the experiences of other countries, the performance of the insurance business in Ethiopia, and the financial policies and strategy documents. Additionally, interviews conducted with officials from the National Bank of Ethiopia (NBE) and legal departments regarding the necessity of establishing a policy and strategy to regulate the insurance business have been taken into account. It is the aim of this study to make a unique contribution to the existing body of knowledge on the legal aspects of regulating financial institutions, particularly in the context of Ethiopia by focusing on the need introduce policyholder protection scheme in Ethiopia.

1.7. Significance of the Study

This study addresses a critical gap in the existing literature by examining the necessity and feasibility of introducing a policyholder protection scheme in Ethiopia's insurance industry. Despite the profound implications such a scheme would have for consumer protection, financial stability, and public trust in the insurance sector, the topic has received little scholarly or policy attention in Ethiopia.

By systematically analyzing the current legal and regulatory framework, as well as drawing comparative lessons from international best practices, this research provides valuable insights for policymakers, regulators, and industry stakeholders. The findings are intended to inform the legislative process and guide the development of effective laws and regulations that safeguard the interests of policyholders and beneficiaries of insurance policies.

Moreover, the study raises awareness among key stakeholders-including policyholders, the National Bank of Ethiopia, and both private and public insurance companies-about the importance of robust policyholder protection mechanisms. By highlighting the risks and vulnerabilities present in the current system, the research encourages proactive engagement and informed decision-making within the industry.

Finally, this thesis serves as a foundational reference for future academic inquiry and policy development on insurance regulation and consumer protection in Ethiopia. It offers a comprehensive resource for researchers, students, and practitioners interested in financial sector

reform, and sets the stage for further studies on related topics in the Ethiopian context and beyond.

1.8. Scope of the Study

This study focuses on the need to establish a policyholder protection scheme in Ethiopia. It will attempt to address issues related to policyholders' protection schemes in the insurance sector. In the Ethiopian insurance business, the Proclamation defines insurance and insurance companies. Insurance refers to an undertaking by an insurer to indemnify another person, in exchange for consideration called premium, against damage, destruction, loss, or liability with respect to a certain risk or peril to which the object of the insurance may be exposed or to pay a sum of money or other values depending upon the occurrence of a certain event.³² In other words, insurance companies are licensed by the NBE to undertake insurance businesses and insurance companies owned by the government.³³ Therefore, this research will only focus on insurance companies that participate in the insurance business, as defined under the proclamation.

1.9. Structure of the Study

This study examined the necessity of implementing a policyholder protection scheme in Ethiopia. The study consists of four chapters: the first chapter introduces the paper, the second chapter offers a comprehensive overview of the policyholder protection scheme, the third chapter delves into the background and performance of the insurance sector in Ethiopia and the outlines the legal framework of the policyholder protection scheme in Ethiopia as well as other countries' experiences, finally the fourth chapter, the conclusion and recommendations.

³² The Insurance Business (Amended) Proclamation. Number 746/2012 Art.2(16)

³³ Insurance Business (Amendment) Proclamation. Number 1163 (2) (41)

Chapter Two

General Overview of Policyholders Protection Schemes

2.1. Chapter Introduction

This chapter examines the importance of policyholder protection schemes in the insurance industry and their function in safeguarding policyholders' interests. The nature and types of policyholder protection schemes, their funding methods, the level of compensation provided by policyholder protection schemes, and the challenges associated with policyholder protection schemes are discussed. From the discussions in this chapter, it is possible to identify the factors that need to be considered when designing policyholder protection schemes. Prior to discussing policyholder protection schemes, this chapter emphasizes the significance of financial safety nets in the financial sector, particularly in the insurance industry, and their key components, which play a crucial role in maintaining stability.

2.2. The Concept of Policyholders Protection Scheme

As with any other business venture, insurance companies face the possibility of failure. When an insurer fails, it may be financially unable to meet all its debts and become insolvent. An insolvent insurer is often unable to satisfy contractual obligations for covered claims, leaving policyholders and beneficiaries to bear costs that otherwise should have been covered by their insurer.³⁴ Thus, there is a need to put arrangements in place to protect policyholders. This can take several forms. This thesis focuses on one such arrangement. The Policyholder Protection Scheme (PPS) is also known in some cases as the Insurance Guarantee Scheme (IGS). Before delving into the concerns surrounding the function of policyholders' protection funds in the insurance industry, it is essential to provide a concise explanation of the financial safety net and the reasons for its necessity in the insurance sector.

³⁴ Emmett J. Vaughan & Therese M. Vaughan, *Fundamentals Of Risk And Insurance* 355–56 (11th Ed. 2014)

The insurance industry plays a vital role in safeguarding individuals, businesses, and economies from various risks and uncertainties. However, insurance companies are not immune to financial instability. Financial safety nets have been established to mitigate such risks and ensure stability within the industry.³⁵

A financial safety net is a system of protection for insurance customers through government legislation.³⁶ It is a multidimensional policy scheme that is alleged to balance the costs and benefits generated by protecting insurance customers from being blindsided by insurer insolvency, limiting aggressive risk-taking by insurers, preventing and controlling damage from insurer runs, detecting and resolving insolvent insurers, and allocating across society whatever losses occur when an insolvent insurer is closed.³⁷ A financial safety net usually includes prudential regulations and supervision, lenders of last resorts, failure resolution, and policyholder protection funds.³⁸

Generally, the benefits of financial safety nets are stability in the insurance market, economic resilience, and policyholder protection³⁹. Financial safety nets contribute to the stability of the insurance market by preventing systemic risk.⁴⁰ By enforcing solvency regulations and providing support in the case of insolvency, these safety nets reduce the likelihood of contagion effects that could disrupt a wider financial system.⁴¹ The insurance industry plays a fundamental role in supporting economic growth and stability. Financial safety nets help maintain the integrity of the insurance sector, ensuring that it is capable of absorbing shocks and honoring its commitments. Resilience contributes to overall economic stability and facilitates post-disaster recovery.⁴²

Similarly, financial safety nets prioritize the interests of policyholders by ensuring that their claims are honored, even in challenging circumstances. This protection fosters trust in insurance

³⁵ Int'l Ass'n Of Ins. Supervisors, *Application Paper On Policyholder Protection Schemes* 5 (2013), <https://www.laisweb.org/uploads/2022/01/131118-Application-Paper-On-Policyholder-Protection-Schemes.Pdf>

³⁶ Julien Bengui, Javier Bianchi, Louphou Coulibaly, "Financial Safety Nets" [2017] P 14-17

³⁷ Ibid

³⁸ FSF, *Guidance For Developing Effective Deposit Insurance Systems*" [2001] <http://www.idi.org.commarch> 27 2022.

³⁹ Org. For Econ. Co-Operation & Dev., *The Role Of Insurance Guarantee Schemes In Addressing Systemic Risk In Insurance* 4–5 (2013), <https://www.oecd.org/finance/the-role-of-insurance-guarantee-schemes.pdf>

⁴⁰ Ibid 5

⁴¹ Supra Note 40

⁴² Ibid 35

products and encourages individuals and businesses to obtain coverage, thereby promoting financial resilience at a societal level.⁴³

As can be observed from the above paragraph, a range of regulatory and supervisory measures is normally established to ensure the financial and managerial soundness of insurance companies, and supervisory authorities are expected to do their best to avoid the failure of supervised companies.⁴⁴ The Insurance Core Principles (ICPs) also call for jurisdictions to put in place sound regulatory and supervisory frameworks that reduce the risk of harm to consumers by helping to maintain fair, safe, and stable insurance markets for the benefit and protection of policyholders' interests and contribute to the stability of the financial system.⁴⁵

Despite these preventive measures, however, some insurance companies may encounter serious financial difficulties, and despite all the possible supervisory measures, they can become insolvent.⁴⁶ Jurisdictions have different ways of protecting policyholders from the inability of an insurer to pay claims when they become due, for example, because of insolvency. In other words, several regulatory arrangements are put in place to protect policyholders in the event that the insurance company fails.

These arrangements can be divided into two groups: those included in the winding-up procedure and those outside of it.⁴⁷ The former type of arrangement is used in most jurisdictions but typically varies considerably in detail across jurisdictions, largely depending on the idiosyncrasies of the judicial insolvency procedures of respective jurisdictions, as well as the specificity in the insurance regulatory frameworks. In addition to these measures, policyholder protection schemes (or guarantee funds) have been explicitly established to provide protection for policyholders outside the winding-up procedure.⁴⁸

⁴³ Ibid

⁴⁴ Int'l Monetary Fund, *Financial Soundness Indicators: Compilation Guide* 3–5 (2006), <https://www.imf.org/External/Pubs/FT/Fsi/Guide/2006/Pdf/Guide.Pdf>

⁴⁵ IAIS, *Insurance Core Principles*, October 2011, Introduction, Paragraph 1

⁴⁶ Ibid

⁴⁷ European Ins. & Occupational Pensions Auth., *Report On Insurance Guarantee Schemes In The Eu* 17 (2018), https://www.Eiopa.europa.eu/Sites/Default/Files/Publications/Reports/Report_On_Insurance_Guarantee_Schemes.Pdf

⁴⁸ International Association Of Insurance Supervisors 2012 As Amended 12 October, With ICP 9.P 104.

Policyholder Protection Schemes (PPS) act as consumer safety nets, providing last-resort protection by paying claims in full or in part when insurance companies are unable to fulfil their contractual commitments. This special regulatory arrangement is set up to protect policyholders' interests in the event of insurance company insolvency. They protect people from the risk that claims will not be met if their insurer becomes insolvent.⁴⁹ A policyholder protection scheme is a mechanism established by governments or regulatory bodies to safeguard insurance policyholders' interests in the event of insurer insolvency or financial instability. These schemes typically provide a safety net to ensure that policyholders continue to receive coverage and benefits even if their insurers fail. Policyholder protection schemes may include various measures such as state guarantee associations, reinsurance arrangements, regulatory oversight, and policy transfer mechanisms. The primary goal is to mitigate the financial impact on policyholders and ensure that they receive the benefits they are entitled to under their insurance policies even if their insurer faces financial difficulties.

It is generally accepted that supervisory authorities should try everything else to prevent an insurance company from going bankrupt.⁵⁰ However, when a company becomes insolvent, all outstanding claims on its assets are determined and satisfied in the manner and order prescribed by the law in different jurisdictions, which is part of an effective resolution regime.⁵¹ This shows a typical order of priority for claims on a company's assets.

There are some important protection mechanisms independent of the policyholder protection scheme, none of which is fully satisfactory.⁵² These are (a) prudential regulation and risk management; (b) preferential treatment of policyholders in winding-up proceedings; and (c) ex-post government interventions.

Prudential regulation and risk management are measures put in place with the intention of preemptively averting potential issues rather than offering a solution for addressing consequences after the fact.⁵³ The rationale behind this proactive approach is that it is more

⁴⁹ 1 <https://www.bipar.eu/en/page/insurance-guarantee-schemes-igs>

⁵⁰ Sekiguchi, *Insurance Regulation And Supervision In Asia*. Paris: OECD, P. 367.

⁵¹ United Nations Comm'n On Int'l Trade Law (Uncitral), *Legislative Guide On Insolvency Law* 102–04 (2005), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf

⁵² *Iid*

⁵³ *Ibid* 41

judicious and cost-effective to avoid a crisis or minimize its effects, rather than deal with the aftermath. Although it is a critical component, it cannot guarantee immunity from failure.⁵⁴

The preferential treatment of policyholders in winding-up proceedings is an essential policyholder protection system put in place in many jurisdictions.⁵⁵ But during the winding up proceedings, policyholders with outstanding claims at the time of insolvency (or with claims emerging during the proceedings) will suffer from a shortage of liquidity if claims cannot be paid for many months or even years.⁵⁶ Ex-post government intervention is also unsatisfactory. Decisions to intervene are made on an ad hoc basis, so policyholders can never be sure that the government will intervene in a particular case.⁵⁷ Larger companies (too large to fail) are more likely to be rescued than smaller ones. In ex-post schemes, a third party always pays for the failing company. At least, if the government has to rescue a company during a general crisis, such as the financial and economic crisis, it will not be able to force other companies that are not able to contribute to reimbursing the state intervention. The taxpayer remains the payer.

Consequently, the necessity of a policyholder protection scheme has become apparent, which serves as a financial safety net implemented by various nations to safeguard policyholders within the insurance framework. The next section delves into the attributes and classifications of policyholder protection schemes.

2.3. Nature And Types of Policyholders Protection Scheme

2.3.1. Government And Private Agencies Insurance Guarantee Scheme

Policyholder protection schemes differ across countries.⁵⁸ Policyholder protection scheme institutions can be established by the government or by independent private agencies⁵⁹. That is,

⁵⁴ Ibid

⁵⁵ Robert W. Klein, *Insurance Guarantee Funds: Policy And Operational Issues* 6 (Nat'l Ass'n Of Ins. Comm'rs, 2005), <https://Content.Naic.Org/Sites/Default/Files/Inline-Files/Insurance-Guarantee-Funds-Klein.Pdf>

⁵⁶ EUROPEAN INS. & OCCUPATIONAL PENSIONS AUTH., *REPORT ON INSURANCE GUARANTEE SCHEMES IN THE EU* 18–19 (2018), https://www.eiopa.europa.eu/sites/default/files/publications/reports/report_on_insurance_guarantee_schemes.pdf

⁵⁷ Michael R. Powell, *Insolvency And Guarantee Fund Arrangements: Consumer Protection In The Insurance Industry* 15 (Int'l Ass'n For The Study Of Insurance Economics, Geneva Papers Working Paper No. 38, 2002)

⁵⁸ OECD, *The Role Of Insurance Guarantee Schemes In Addressing Systemic Risk In Insurance* 7 (2013), <https://www.oecd.org/finance/the-role-of-insurance-guarantee-schemes.pdf>

⁵⁹ Ibid 8

the government may establish insurance guarantee institutions under its control and management to safeguard policyholders' interests. On the other hand, they can be established by private entities. In some countries, government-run entities, such as deposit insurance corporations or insurance guarantee funds, provide protection to policyholders if an insurer becomes insolvent or unable to pay claims. Private agencies, such as credit rating agencies or insurance brokers, may offer services to help individuals and companies assess insurers' financial stability and reliability. Most often, policyholder protection schemes are commonly managed by government agencies or public-private partnerships.⁶⁰

A PPS can be integrated into an existing organization or established as a separate entity. The insurance industry typically shoulders the implementation and ongoing expenses associated with PPS, regardless of whether it is administered by the public or private sector. It is common for some of these costs to be indirectly passed on to policyholders through premiums.⁶¹

2.3.2. Coverage and Compensation Limits

Policyholder protection schemes typically offer policyholders either full or limited coverage. Full coverage typically involves reimbursing policyholders for the full amount of their claims in the event that an insurance company becomes insolvent or is unable to fulfill its obligations. Limited coverage may involve partial reimbursement or coverage of up to a certain maximum amount in the event of insurer insolvency. This means that compensation may be subject to certain limits or caps in the case of limited coverage. This may vary depending on jurisdiction. The aim is to ensure that policyholders receive a fair portion of their outstanding claims even if the insurer becomes insolvent.

Some schemes may also have limitations regarding the types of policies covered or the specific circumstances under which coverage applies. The level or extent of compensation may vary depending on insurance policy type. By definition, policyholder protection funds (i.e., general funds) should cover a broad range of insurance products. The various insurance divisions are divided into two sectors: Life Insurance (Health Insurance) and Non-Life Insurance (property and casualty). Given the different nature of the two industries (especially the former is usually a

⁶⁰ IAIS: Issues Paper On Policyholders' Protection Scheme, October 2013 Pp 9

⁶¹ Ibid

long-term enterprise, while the latter is usually a short-term one) and reflects the segregation policy in most countries, the existing funds are only one out of two sectors. A life insurance policy will compensate a deceased person with a sum of money. The payment is known as the profit of death. Most people buy life insurance to protect those who depend on them. Others buy life insurance to leave their spouse, children, grandchildren, or charities a cash gift when they die.⁶² Overall, the aim of both full and limited coverage under policyholders' protection schemes is to provide a safety net for policyholders in the event of insurer failure, helping maintain confidence in the insurance industry and protecting consumers from financial losses.

2.3.3. Funding Methods

The financing structure of policyholder protection schemes has significant implications. The levies imposed on the industry are likely to be passed on to and ultimately borne by customers. The burden of guarantee fund assessments is shared by all policyholders through increased insurance rates, and taxpayers bear the burden through premium tax offsets and deductions for income tax. In addition, insurer owners contribute to this burden.⁶³

Policyholder protection schemes are typically funded through various methods to ensure their financial stability and their ability to provide compensation to policyholders in the event of an insurer's insolvency. Specific funding methods may vary, depending on the jurisdiction and design of the guarantee fund.

One common method of funding guarantee funds is premium assessments imposed on insurance companies operating within the jurisdiction. Insurance companies are required to contribute a certain percentage of their written premiums or premiums to guarantee funds. Assessments are typically calculated based on the insurer's market share or the premiums they collect within the jurisdiction.

The funding model can be an ex-ante, ex post, or hybrid approach. Initially, the government may provide part of the funding. The clarity of responsibility for funding, including the government's

⁶² Mike Smith, Life Insurance: The Different Types Of Policies, Virginia Cooperative Extension Publication 354-143, Virginia Polytechnic Institute And State University, 2005, Pg1

⁶³ Barrese, J. And Nelson, J. (1994) 'Some Consequences Of Insurer Insolvencies', Journal Of Insurance Regulation 13: 3–18.

role, is an important part of the PPS structure. Eventually, however, the PPS will likely apply a levy to its members. The levy could be a fixed amount or be assessed based on the insurer's risk profile.

With ex-ante funding arrangements, insurers pay assessments to accumulate and maintain a fund that can be used in the event that an insurer becomes insolvent. Using this method, funds can be built slowly and available immediately.⁶⁴ This method may help mitigate moral hazard, as all relevant insurers (including the insolvent insurer) contribute to the funding. It may also reduce the potential adverse knock-on effects of levying funds on the industry after the event (i.e., their impact on capital). Ex-ante funding arrangements provide opportunities to smooth the assessments paid by insurers over the course of a business cycle.⁶⁵ With ex ante funding, it is difficult to predict exactly how much funding will be needed to cover future insurer insolvencies. Collecting funds in advance results in (a) an opportunity cost of tying up funds that could be used for other purposes and (b) increased administrative and governance costs associated with maintaining a permanent fund.⁶⁶

With ex-post funding arrangements, solvent insurers pay assessments after insolvency occurs. Using this method, solvent insurers have access to funds until levies are required.⁶⁷ This means that until required, they form part of the insurers' assets, can be used for purposes other than funding the PPS, and do not incur costs to maintain a permanent fund. As there is no permanent fund, this negates the risk of funds potentially being used for other purposes and, thus, is not available to the PPS when needed. As assessments are paid after an insolvency has occurred, assessments of solvent insurers can be less predictable because they are not based on a predetermined formula. With ex-post funding, the insolvent insurer does not contribute to the ex-post fund that compensates for its own policyholders.⁶⁸ If insolvency is a result of a systemic problem (such as an underperforming stock market), then some insurers may also be in a

⁶⁴ IAIS: Issue Paper On Policyholder Protection Schemes, 16 October 2003 Pp 13.

⁶⁵ Ibid

⁶⁶ Ibid

⁶⁷ WHITE PAPER On Insurance Guarantee Scheme EUROPEAN COMMISSION, Brussels, COM(2010) 370 Pp10

⁶⁸ Ibid

weakened condition and may not have the funds needed to pay some or all of the assessment upon them.⁶⁹

In some jurisdictions, PPS funding arrangements use a combination of both ex-ante and ex-post funding. Under both methods, in setting the assessment amount, the number and capacity of insurers must be considered. The funding of PPSs is not based on scenarios in which there is system-wide financial catastrophe. Assessing funding needs When considering capacity and/or the appropriate funding mechanism for a policyholder protection scheme, it is essential to understand the nature of the claims that arise. Under covered products (life products versus non-life products) as well as the form of the last-resort mechanism (claims payment or business continuity through portfolio transfer).

2.3.4. Types of Policyholders Protection Schemes

There are two primary methods for providing protection to policyholders, which are explicit and implicit schemes. These approaches have several distinct features and consequences.

2.3.4.1. Explicit policyholder protection schemes

An explicit scheme involves the establishment of specific mechanisms or funds, often by regulatory authorities, to compensate policyholders directly for covered claims in the event of insurer insolvency.⁷⁰ Explicit schemes are typically supported by legislation or regulatory frameworks that outline the rights and obligations of policyholders, insurers, and scheme administrators. The existence and operation of an explicit scheme is usually transparent, with clear guidelines and procedures for policyholders to access compensation. Guarantee funds or compensation schemes, in which policyholders are reimbursed for covered claims up to certain limits, are examples of explicit policyholder protection schemes.

⁶⁹ Int'l Ass'n Of Ins. Supervisors, *Application Paper On Policyholder Protection Schemes* 12 (2013), <https://www.laisweb.org/uploads/2022/01/131118-Application-Paper-On-Policyholder-Protection-Schemes.Pdf>

⁷⁰ OECD, *The Role Of Insurance Guarantee Schemes In Addressing Systemic Risk In Insurance* 9 (2013), <https://www.oecd.org/finance/The-Role-Of-Insurance-Guarantee-Schemes.Pdf>

2.3.4.2. Implicit policyholder protection schemes

An implicit scheme relies on market forces and regulatory oversight to indirectly protect policyholders' interests during insurer insolvencies.⁷¹ In an implicit scheme, insurers are incentivized to maintain financial stability and solvency in order to avoid reputational damage and loss of market confidence.⁷²

Regulatory authorities play a crucial role in implicit schemes by monitoring insurers' financial health, enforcing prudential regulations, and intervening when necessary to address solvency concerns.⁷³ The priority of claims in insolvency proceedings, in which policyholders' claims are given preferential treatment over other creditors' claims, is an example of an implicit policyholder protection scheme.⁷⁴

While explicit schemes provide direct compensation to policyholders through established mechanisms, implicit schemes rely on broader market dynamics and regulatory oversight to safeguard policyholder interests.⁷⁵ Both types of schemes aim to ensure that policyholders receive the coverage and benefits they are promised, even in the event of insurer insolvency, albeit through different approaches.

2.4. The Merits and Challenges of Adopting Policyholders Protection Fund

Developing a policyholder protection scheme in the insurance industry is crucial. Given that policyholders make payments in advance for future promises, insurance companies' financial stability is paramount.⁷⁶ The implementation of a policyholder protection scheme is essential to shield policyholders from potential insurer panic.⁷⁷

The main purpose of the IGS is to protect consumers, which is important for most jurisdictions, as some insurance products are important to the social system. Governments want to ensure that

⁷¹ OECD, *The Role Of Insurance Guarantee Schemes In Addressing Systemic Risk In Insurance* 9 (2013), <https://www.oecd.org/finance/the-role-of-insurance-guarantee-schemes.pdf>

⁷² Ibid

⁷³ Joanne M. Davis, *Insurance Regulation In The United States* 134–36 (2015)

⁷⁴ Peter R. Kenadjian, *Insurance Law: Cases And Materials* 512 (3d Ed. 2014)

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⁷⁶ Peter J. Singer, *Insurance Law And Regulation* 112 (2017)

⁷⁷ Graham Moss & Elena Tegos, *Insurance Guarantee Schemes And Policyholder Protection* 15

policyholders are protected from significant wealth losses due to an insurer's failure. By protecting the policyholder, the industry gains consumer confidence and provides stability to the financial system, albeit indirectly. Policyholders who are confident that their funds are secure will stop short of surrendering their accounts. However, at the same time, funding IGS is adding costs to a healthy part of the insurance industry and could potentially jeopardize other players of the sector.⁷⁸ The adoption of a policyholder protection scheme has advantages and disadvantages.

2.4.1. Merits of Adopting Policyholders Protection Schemes

Different countries in the world, including developed as well as countries with an underdeveloped insurance industry, are adopting the insurance guarantee scheme as they are convinced that they have a great contribution to the insurance industry as well as to the financial sector in general. The following are some of the advantages of adopting an insurance guarantee scheme, especially explicit insurance guarantee.

2.4.1.1. Protecting Policyholders

The trust of a person purchasing a casualty insurance policy that the insurance company will readily pay an indemnity if a casualty occurs is fundamental.⁷⁹ The primary objective of policyholder protection funds is to protect the interests of policyholders, especially individual or nonprofessional policyholders, in the event of bankruptcy of an insurance company.⁸⁰ The funds are expected to serve as the final safety net for policyholders when bankruptcy occurs, despite all possible supervisory measures.

Policyholders are creditors for insurance companies. Creditors usually extend credit after checking the credibility of a debtor and are responsible for their credit decisions; that is, they have to submit themselves to negative consequences.⁸¹ However, it is difficult to expect

⁷⁸ Insurance And Resolution In Light Of The Systemic Risk Debate © The Geneva Association ISBN 978-2-9700339-6-7 Published By The Geneva Association (The International Association For The Study Of Insurance Economics), Geneva.Feb 2012 Pp 45.

⁷⁹ Luigi Guiso Trust And Insurance. The Geneva Papers On Risk And Insurance - Issues And Practice (2021) 46:509–512 <https://doi.org/10.1057/S41288-021-00241-7> Pp 509

⁸⁰ Insurance And Resolution In Light Of The Systemic Risk Debate A Contribution To The Financial Stability Discussion In Insurance.Pp 45

⁸¹ Robert W. Clark, *Insurance Law In A Nutshell* 45 (4th Ed. 2017)

nonprofessional policyholders, typically individuals, to assume full responsibility.⁸² This is because there is a considerable amount of information asymmetry between policyholders and insurers regarding the insurers' financial soundness.⁸³

The financial and managerial situations of insurance companies are much more technical and complex than those of ordinary companies.⁸⁴ Non-professional policyholders cannot be expected to sufficiently verify the credibility of an insurance company. Moreover, their financial capacity is limited. Therefore, if such policyholders are given full responsibility as creditors of insurance companies, they would refrain from obtaining insurance, which would deter the development of the insurance market. This argument provides a rationale for the establishment of special regulations and supervision for insurance companies, which are intended to provide a monitoring function for policyholders to protect them from the negative consequences of their credit decisions.

2.4.1.2. Maintenance of Public Confidence

The insurance industry is built on the public's confidence in business, which is, in fact, vulnerable. Policyholder protection funds can help maintain the public's confidence in the insurance business and thereby help sustain the sound development of the industry. Non-professional policyholders not only have limited abilities to appropriately evaluate the financial soundness of insurance companies but also have little incentive to do so. Because of the technical and complex nature of insurance companies' financial situation, the cost of gathering sufficient information to make a wise decision is significantly high. Under these circumstances, each policyholder is inclined to rely on the efforts of someone else engaged in the same type of transaction. More practically, most nonprofessional policyholders select insurance companies based on a belief in the financial soundness of the company and the industry as a whole, beliefs that do not necessarily have a firm ground.

Against this backdrop, suppose an insurance company goes bankrupt, and its policyholders suffer losses. Without the ability to appropriately assess the risks of individual companies, the public

⁸² Michael Faure, *Consumer Protection In Insurance* 98 (2015)

⁸³ Georges Bennet & Michelle Williams, *Information Asymmetry In Insurance Markets* 52 (2018)

⁸⁴ James M. Anderson, *The Complexity Of Insurance Company Financial Management* 23 (2014)

may lose confidence in the soundness of other insurers. Knowing the possibility of damage in the event of a company's insolvency, the public may be discouraged from seeking insurance, which would again affect the industry as a whole and lower social welfare. More dynamically, the bankruptcy case of a given insurer may cast doubt on the soundness of other insurers, and induce a run on them. Such a run has been observed in some countries, particularly in companies with poor reputations. A run could put the remaining insurers in a serious liquidity crisis and possibly force them to go bankrupt. Policyholder protection funds can protect policyholders against damages caused by the insolvency of an insurance company, maintain the public's confidence in the industry at large, prevent a contagion of bankruptcy, and thereby contribute to the sound development of the insurance industry.

2.4.1.3. Development of Competitive Markets

Establishing policyholder protection funds contributes to the development of competitive markets. Policyholder protection funds prepare a smooth exit mechanism for incompetent insurers from the market, which supports marketplace dynamics. Competitive markets experience failure. An insurance company's failure significantly affects policyholders. They would suddenly face the risks that they thought had been transferred to a third party. They may be able to obtain insurance from another insurer, but the coverage could be more expensive. They may also suffer financial damage, as repayments during liquidation proceedings could be substantially less than the face value of the claims. Even in the event that policyholders do not suffer financial losses, they are likely to suffer from a shortage of liquidity, as liquidation repayments take time (sometimes years).

A policyholder protection fund can significantly alleviate the difficulties that policyholders might face in the event of an insurance company's failure. Without such a safety net, supervisory authorities are inclined to try to prevent insurance companies from failing at any cost. This is especially true for a larger insurance company because of the huge number of policyholders that would be affected by its failure and the associated enormous social impact. This is sometimes described as a "too big to fail" situation. Insurance authorities would be inclined to place more stringent regulations to minimize such a failure and mobilize all possible supervisory measures to rehabilitate companies when they are found to be distressed, steps that could work effectively

to restrict competition in the market. Policyholder protection funds make it possible to handle bankruptcy cases without exposing policyholders to the risks of severe losses. With a safety net, the supervisory authority may allow a financially impaired insurer to go bankrupt without taking extraordinary measures that often disturb the efficient functioning of the market. Therefore, policyholder protection funds can help develop dynamic and competitive insurance markets.

2.4.1.4. A Level Playing Field Across Sectors

Finally, policyholder protection funds are an important tool for preparing a level-playing field for insurance companies and banks. In recent years, the insurance and banking sectors converged. Cross-selling has become increasingly common in many countries. At the product level, banks sell financial derivatives that effectively provide guarantees against certain risks, and insurance companies, especially life insurance companies, offer products with significant savings elements. Insurance companies and banks compete directly. This development in the financial markets creates momentum towards the convergence of regulation of the two financial industries, although it is not obvious at this moment. Such a movement may be found in the recent trend of creating consolidated financial supervisory authority as well as consolidated supervision. In the same context, it is argued that insurance policyholders should be protected by a safety net system as bank depositors and that insurance companies should have a similar back-up as deposit insurance in order to compete with banks.

2.4.2. Challenges Of Policyholders Protection Schemes

Even though the policyholders' protection fund offers tremendous advantages in the insurance system, if not properly managed, it can cause a financial crisis. The following subsections outline some of the drawbacks associated with insurance policyholders' protection schemes.

2.4.2.1. Potential Costs of PPS

The establishment of a PPS involves costs that can be categorized as direct or indirect. The direct costs of a PPS include operational/administrative expenses and guarantee costs. Operational/administration expenses consist of the initial setup costs and the costs of running the scheme, such as staff salaries and investment costs. Indirect costs are related to the potential

negative consequences of having PPS in place, such as the likelihood of moral hazard behavior.⁸⁵ Such costs can deter some jurisdictions from establishing PPS.

If the scheme is funded on an ex-ante basis, the total cost can be fairly low. In some situations, especially when the PPS is funded, ex-post guarantee costs are the costs of compensating policyholders and the costs of using power to enable the continuation of insurance policies. These costs are usually borne by the industry; however, in some cases, they might be passed on to policyholders.

The cost largely depends on the design features of the PPSs (such as scope, coverage limits, and funding approach) and the shortage in the event of a failure (i.e., the total amount of loss). The features of a PPSS are quite favorable for policyholders (i.e., providing more protection) and/or where the failure of an insurer, due to its size or the size and concentration of the market in which it operates, has a large impact and the costs for the industry could be significant.

2.4.2.2. Moral Hazards

Governments and financial sector regulators favor insurance guarantee schemes because they want to ensure financial stability and protect policyholders against insurer failure.⁸⁶ Nevertheless, concerns have been expressed that such an arrangement could lead to irresponsible behavior and imprudent risk-taking among insurance institution managers. Specifically, by providing coverage for market participants, the financial consequences of adopting riskier tactics are mitigated, which could encourage excessive risk taking.⁸⁷ The provision of such guarantees may incentivize insured institutions to take on additional risks, as the government or insurance guarantee agencies guarantee coverage for some or all policyholders, thereby eliminating the need for institutions to account for the assets they hold or the likelihood of their failure..⁸⁸ In its nature, the insurance sector needs due diligence in management, failing to do so will cause failure. As previously stated, supervision and monitoring insured institutions are essential to

⁸⁵ Grace, M., R.W. Klein, And R.D. Phillips (2003), "Insurance Company Failures: Why Do They Cost So Much?" Wharton Financial Institutions Center Working Paper 03-32.

⁸⁶ Columbarium, Olike Chioma, Alice Chinwe Obasikene, "Deposit Insurance And Moral Hazard: A Theoretical Discourse" [2018] Vol. 03, IMF Law Journal <Http:// Wwww. Iadi.Net > 15 February 2020

⁸⁷ Nicholas J. Ketcha Jr, „Deposit Insurance System Design And Considerations" [2012] P 1,5

⁸⁸ Anthony M. Santomero, "Deposit Insurance: Do We Need It And Why" [1997] P 34 Http://Wwww.Africa Journal.Net

control moral hazard and risk-taking, thereby ensuring financial stability and protecting policyholders. The PPS arrangement removes market discipline and encourages excessive risk-taking.

2.4.2.3. Complexity

One of the significant challenges in implementing a Policyholder Protection Scheme is the complexity of its design, administration, and coordination with existing regulatory frameworks.⁸⁹ This complexity arises from several factors: Multiple types of insurance products (e.g., life, general, microinsurance), each requiring different rules for coverage, compensation limits, and prioritization; Coordination issues between the protection fund, insurance regulator, insolvency administrators, and possibly the courts;⁹⁰ The need to balance policyholder interests with industry sustainability and prevent moral hazard (where insurers take excessive risks knowing the fund exists).⁹¹ If not well managed, this complexity can lead to delays in compensation, misunderstandings among stakeholders, and loss of public trust in the scheme.⁹² Managing and administering schemes can be complex, particularly in terms of determining eligibility criteria, assessing claims, and ensuring the equitable distribution of funds.

2.4.2.4. International Coordination

Coordinating schemes across different jurisdictions can be challenging, particularly in cases involving multinational insurers.

In today's globalized financial and insurance markets, many insurers operate across national borders, often through branches, subsidiaries, or cross-border services.⁹³ This creates significant

⁸⁹ International Association of Insurance Supervisors (IAIS). *Guidance on the Establishment of Policyholder Protection Schemes*. IAIS, 2013, p. 7.

⁹⁰ W. Jean Kwon & Michael Skully. *Insurance and Reinsurance in a Global Market*. Routledge, 2004, p. 137.

⁹¹ Barth, James R., Tatom, John A., and Yago, Glenn. *The Future of Insurance Regulation in the United States*. Milken Institute, 2009, p. 95.

⁹³ Skipper, Harold D., and W. Jean Kwon. *Risk Management and Insurance: Perspectives in a Global Economy*. Wiley-Blackwell, 2007, p. 298.

challenges for national-level policyholder protection schemes, which are usually limited to domestic jurisdictions.⁹⁴ The problem arises when: A foreign-based insurer operating in a local market fails—raising questions about which country’s PPS is responsible for compensating policyholders. The home and host countries have different levels of protection, leading to unequal treatment of policyholders and There are no clear legal or operational frameworks for cooperation between regulators and protection schemes across borders.⁹⁵ These coordination gaps can delay compensation, lead to legal uncertainty, and diminish trust in both local and international insurance systems.⁹⁶

⁹⁴ Schwarcz, Daniel, and Steven L. Schwarcz. *Regulation of Insurance Companies*. Foundation Press, 2015, p. 422.

⁹⁵ Moss, David, and Kenneth Abraham. *Insurance Law and Policy: Cases and Materials*. Foundation Press, 2020, pp. 687–688.

⁹⁶ *id*

Chapter Three

The Insurance Industry in Ethiopia, Policyholder Protection under Ethiopia's Insurance Business Proclamation No. 746/2012, International Experiences and Comparative Lessons

3.1. Chapter Introduction

This chapter offers a comprehensive analysis of the insurance sector in Ethiopia, tracing its historical evolution and assessing its present condition. It evaluates the operational performance of insurance companies within the country, highlighting key trends, challenges, and opportunities that define the industry. By examining factors such as market penetration, regulatory frameworks, and financial stability, the chapter provides a foundational understanding of Ethiopia's insurance landscape. This sets the stage for a deeper discussion on the necessity of protective mechanisms for policyholders, ensuring their interests are safeguarded amid industry fluctuations and potential company insolvencies and what look like the Policyholder Protection under Ethiopia's Insurance Business Proclamation

Additionally, the chapter explores the rationale behind implementing policyholder protection schemes and insurance guarantee funds, drawing insights from three diverse jurisdictions: the United States, the United Kingdom, France and Kenya. These case studies serve as comparative models, illustrating how such mechanisms enhance consumer confidence, stabilize financial systems, and mitigate risks associated with insurer failures. By analyzing these international examples, the chapter underscores the potential benefits of adopting similar frameworks in Ethiopia, aligning with global best practices while addressing local market peculiarities. The discussion ultimately advocates for structural reforms to strengthen the Ethiopian insurance sector and protect its policyholders.

3.2. The Origin and Developments of Insurance Industry in Ethiopia

The emergence of modern insurance in Ethiopia can be traced back to the Bank of Abyssinia, which was established in 1905 as the first Ethiopian Bank.⁹⁷ The bank had been acting as an

⁹⁷ Prof. Arnaldo Mauri, "The Short Life Of Banking In Ethiopia" [2010] 11

agent for a foreign company.⁹⁸ A branch of foreign insurance company known as “Boise fire insurance company” was opened by an Australian in Addis Abeba in 1923. For the first time in Ethiopia, the company paid compensation to the client in 1929 for damage to his store caused by the fire.⁹⁹ No local insurers or domestic investors were involved during this period. Hence, no local rules or regulations governing insurance businesses were considered or envisaged. The first domestic insurance company was the Imperial Insurance Company of Ethiopia, established in 1951. Emperor Haile Selassie was the shareholder of the company.¹⁰⁰

The enactment of the Commercial Code of Ethiopia and the Maritime Code of Ethiopia in conjunction with the Ethiopian Civil Code added more substances and directions to address the Ethiopian insurance business. Prior to 1960, the conduct of the insurance business was not formally and comprehensively conducted or regulated. Before the 1970s, there was no comprehensive and detailed insurance business legislation enacted by the Ethiopian Government.¹⁰¹ In 1970, the Proclamation was promulgated to license and regulate insurance businesses in Ethiopia. This empowered the Ministry of Commerce and Industry to regulate the insurance sector’s activities. Fifteen local insurance companies were licensed, and two discontinued their businesses. However, after the military government came to power in 1974 following the Ethiopian revolution, a corporation came into existence by taking over all the assets and liabilities of the 13 private insurance corporations that were nationalized in 1975 amalgamated to create the Ethiopian insurance Corporation (EIC).¹⁰²

Following the fall of the Derg regime in 1991, the country’s financial sector underwent significant reforms as part of the economic policy change.¹⁰³ It re-established the National Bank

⁹⁸ Hailu Zeleke ‘Insurance In Ethiopia Historical Development, Present Status And Future Challenges’ (2007) Page 41

⁹⁹ D.Guruswamy “The Effect Of Uncollectable Premium Connected With Credit Terms Of Insurance Service Companies In Ethiopia” International Journal Of Current Research And Review (Ijcurr) Vol.04 Issue February 2012.P.125

¹⁰⁰ Ibid Page 42

¹⁰¹ Imperial Ethiopian Government. 1970. NEGARIT GAZETA, Proclamation, No. 281/1970, Insurance Proclamation, 30th Year, No.2. Addis Ababa: Berhanena Selam Printing Press.

¹⁰² Mr. Bereket Sorsa And Durga Rao (2018) “The Effects Of Demographic Factors On Demand For Life Insurance In Ethiopia “IJAR, Volume 6 (3), Pp 1383-1384, ISSN 2320-5407. <Http://Www.Journalijar.Net/ Accessed On June 2020.

¹⁰³ Tony Addison And Alemayew Geda (2001)” Ethiopia’s New Financial Sector And Its Regulation” World Institute For Development Economics Research (WIDER) Of The United Nations University, Helsinki. Discussion Number 2001/55.Page 2

of Ethiopia (NBE) as a central bank and financial market regulator and opened the banking and insurance sectors for domestic private investment by enacting monetary and banking, licensing and supervision of banking business, and licensing and supervision of the insurance business.¹⁰⁴ In 2012, the country's economic development forced the lawmaker to issue a new proclamation No. 746/2012 (amendment to proclamation no. 86/1994) to ensure the reliability of the insurance sector's stability.¹⁰⁵ This proclamation provides national banks with huge monitoring and supervision power. Recently, Proclamation No.746/2012 was amended by Insurance Business Proclamation No.1163/2020, which clearly stipulates what constitutes the insurance business and provisions to regulate other related issues.

3.3. Performance Analysis of the Insurance Industry in Ethiopia

The insurance industry has risen to prominence in the realm of financial services in recent years, particularly in developing economies, where it had previously experienced limited growth prior to the advent of globalization. Insurance is a tool to spread the loss caused by a particular risk over a number of people who are expected to it and who agree to ensure themselves against that risk.¹⁰⁶ Compared to most countries, Ethiopia has taken a cautious approach towards the liberalization of its insurance sector, and the sector has been closed for foreign investment with an underdeveloped insurance system.¹⁰⁷ Following the privatization of the insurance industry, the number of insurance providers remained static for a considerable period. Specifically, there were only nine insurers for nearly eight consecutive years from 1999/2000 to 2006/2007. Currently, there is one government-owned insurer and 18 private insurers, with the recent addition of 37 branches operating in the country.¹⁰⁸

The government-owned insurer dominated the sector for a long period in terms of market share, number of branches, capital strength, and types of insurance products it provides. The state-

¹⁰⁴ Proclamation No.83/1994: Licensing And Supervision Of Insurance Business. Addis Ababa: Berhanena Selam Printing Press.

¹⁰⁵ The Insurance Business Proclamation (As Amended). Proclamation Number 746/2012, Preamble.

¹⁰⁶ Financial Performance Of Insurance Industry In Ethiopia Demis H Gebreal, Dr. Sujatha Selvaraj & Daniel Tolo. International Journal Of Research In Commerce, It & Management. Volume No. 7 (2017), ISSUE NO. 06 (JUNE) ISSN 2231-5756 Pp 53

¹⁰⁷ Demarso, Y. K., & Abba, B. A. (2020). Trade Competition Among Insurers In Ethiopia: A Critical Analysis. Beijing Law Review, 11, 444-463. <https://doi.org/10.4236/blr.2020.112.p458>

¹⁰⁸ Ibid

owned insurer, the Ethiopian Insurance Corporation (EIC), alone accounts for 27.9% of the insurance sector's total capital in the 2017/2018 financial year.¹⁰⁹ General insurance dominates Ethiopia's insurance sector; out of the 17 insurers, eight carry only a general insurance business, and the remaining nine insurers carry on both general and long-term insurance businesses.¹¹⁰ Currently, there are no insurance providers in the country that specialize solely in life insurance. As the sector is dominated by the general insurance business, most gross premiums were derived from general insurance over a long period. Accordingly, the general insurance business, which accounted for 93% of the total gross written premiums in 2013, dominated the sector. The remaining 7% of the country's gross written premium is derived from the long-term (life) insurance business in the same year.

From 2012 to 2016, the industry-average annual growth rate was 20% in terms of the gross written premium. At the end of 2015/2016 the industry registered Gross written premium of Birr 6.43 billion, of which Birr 6.09 billion is from non-life and the remaining Birr 333 million is from life insurance.¹¹¹

According to a 2017 report by the National Bank of Ethiopia, the insurance industry has played a vital role in the development of the Ethiopian economy, and the contribution of the sector to economic growth and the level of national wealth is characterized by rapid growth. Between the years of 2012 and 2017, the premium generated in the Ethiopian insurance industry is increased tremendously from year to year; for instance, Ethiopian insurance companies have collected a total premium of Birr 7.5 billion from both life and non-life (general insurance business). The premium generated by life insurance constituted only Birr 400 million, or 5% of the total premiums, while the general insurance premium amounted to over Birr 7.1 billion or 95% of the total premiums. The premium of general insurance for the year 2015/16 was Birr 6.2 billion and as stated above, the amount increased to Birr 7.1 billion.¹¹²

¹⁰⁹ [www.Nbe.Gov.Et](http://www.nbe.gov.et), 2017/18

¹¹⁰ Opportunities And Challenges For Micro Insurance In Ethiopia Analysis Of Supply, Demand And Regulatory Environment. Anna Smith, January 15,2010 Pp 32

¹¹¹ The Annual Reports Of Bunna Insurance 2015/16 Pp.3

¹¹² 2016/17 Annual Report Of Africa Insurance And National Bank Of Ethiopia).

This shows that the premium generated by general insurance in 2016/17 increased by 14.5 percent. Similarly, the number of branch offices operating with the stated insurance companies increased from 414 in 2015/16 to 482 in 2016/17.

According to a 2018 report by the National Bank of Ethiopia, the number of insurance companies remained at 17, and their branches increased to 532 following the opening of 40 new branches in 2017/18 alone. About 53.6 percent of the insurance branches were situated in Addis Ababa, and 84 percent of the total branches were privately owned. Insurance companies increased their total capital by 26.4 percent to Birr 5.5 billion of which the share of private insurance companies was 72.1%, and that of public insurance companies was 27.9 percent.¹¹³ Within the same fiscal year, the total capital of insurance companies reached Birr 5.5 billion witnessing an increase of Birr 1.2 billion compared to the same period last year. The gross written premiums of the insurance industry reached Birr 8.4 billion witnessing almost 12% growth compared to the previous year's result.

General insurance (GI) continued to dominate the sector, accounting for Birr 7.9 billion or 94.5% total premiums, with motor vehicle insurance continued to claim the largest share constituting 51.8% of total insurance premiums and 54.8% of the gross written premiums under General Insurance class of business. The industry-wide loss ratio for general insurance reached 63%. On the other hand, long-term insurance accounted for Birr 460 million or merely 5.5% of the total premiums written, but witnessed a relatively low 50% loss ratio. The industry's net earned premium and net claims incurred for the period ended June 2018 reached Birr 6 billion and Birr 3.7 billion respectively, with an overall loss ratio of 62%. The retention ratio remained at 72%, which showed a marginal reduction from the previous year's similar period, that is, 74.9% while the net claims incurred has increased to Birr 3.6 billion from Birr 3.3 billion compared to the preceding year. The total assets of insurers as of June 30, 2018, have reached Birr 16 billion, witnessing an increase of Birr 2.4 billion compared to the figure in the preceding year.¹¹⁴

The National Bank of Ethiopia's (NBE) report for the period between 2013/2014 and 2017/2018 indicates that insurance companies are experiencing growth in terms of the number of branches

¹¹³ The NBE Annual Report Of 2017/2018.P 49

¹¹⁴ Ethio Re Annual Report Of 2017/18, P XIII-XIV

opened each fiscal year as well as an increase in premium growth in billions per year. In addition, insurances compete highly to make more branches to make themselves accessible and to increase their number of customers. These insurance activities still show sound and profitable businesses in the country. As per National Bank Establishment Proclamation No.591/2008, the NBE has given huge power to regulate insurance companies and monitoring and supervisory roles. Insurers are mandated to report their activities to the supervision department of the National Bank. The NBE monitors and supervises their activities to audit their business and follow up whether business activity is in a sound business practice, which has a great contribution to the soundness of the sector.

3.4 Policyholder Protection under Ethiopia’s Insurance Business Proclamation No. 746/2012

3.4.1 Objectives and Regulatory Structure of the Proclamation

The Proclamation’s preamble explicitly recognizes the insurance sector’s vital role in economic development, risk management, and financial intermediation. It states the necessity of a comprehensive legal framework to ensure the reliability and stability of the insurance sector (Preamble, Proclamation No.¹¹⁵ 746/2012). The National Bank of Ethiopia (NBE) is established as the sector’s primary regulator, with broad powers to license, supervise, and intervene in the operations of insurers (Article 3).¹¹⁶

3.4.2 Solvency and Technical Provisions: Foundations for Policyholder Protection

A central pillar of policyholder protection is the financial soundness of insurers. The Proclamation mandates that insurers maintain:

- **Adequate technical provisions:** These include actuarial reserves for long-term insurance, reserves for unpaid claims, and reserves for unearned premiums).¹¹⁷

¹¹⁵ Insurance Business Proclamation No. 746/2012, Fed. Negarit Gazeta, 18th Year, No. 10 (Ethiopia).

¹¹⁶ Proclamation No 746/2012 supra note 115 Art 3

¹¹⁷ Proclamation No 746/2012 supra note 115 Art 2 and 36

- **Margin of solvency:** Defined as the excess of admitted assets over admitted liabilities, this requirement is designed to ensure that insurers have sufficient assets to meet their obligations to policyholders .¹¹⁸

By enforcing these requirements, the Proclamation aims to minimize the risk of insurer insolvency and, by extension, protect policyholders from loss due to insurer failure.

3.4.3 Regulatory Supervision and Intervention Mechanisms

The Proclamation grants the NBE extensive supervisory and intervention powers, including:

- **Licensing and supervision:** All insurers must be licensed by the NBE, which is empowered to issue directives and monitor compliance .¹¹⁹
- **Appointment of a receiver:** In the event of financial distress, the NBE can appoint a receiver to take control of a “problem insurer” for restructuring or liquidation.¹²⁰ These mechanisms allow for early intervention, aiming to restore troubled insurers to financial health or, if necessary, manage their orderly exit from the market to safeguard policyholder interests.

3.4.4 Claims Settlement and Policyholder Rights

The Proclamation provides several provisions aimed at ensuring fair treatment of policyholders, especially in the claims process:

- **Definition of policyholder rights:** The law recognizes the policyholder as the person entitled to claim benefits under an insurance policy (Article 2, Definitions).
- **Obligations of insurers:** Insurers are required to honor claims in accordance with the terms of the insurance contract.
- **Claims assessment:** The use of loss adjustors and assessors is mandated to ensure objective and fair evaluation of claims (Article 2, Definitions).

¹¹⁸ Id

¹¹⁹ Proclamation No 746/2012 supra note 115 Art 3 and 4

¹²⁰ Proclamation No 746/2012 supra note 115 Art 31

- **Dispute resolution:** The Proclamation provides for mechanisms to resolve disputes between insurers and policyholders, promoting transparency and accountability.

3.4.5 Priority of Policyholder Claims in Insolvency

In cases of insurer insolvency, the Proclamation empowers the NBE or an appointed receiver to take control of the insurer's assets and manage the settlement of claims (Article 31, Definitions). While this process is intended to maximize recoveries for policyholders, the law does **not** guarantee full compensation if the insurer's assets are insufficient. Policyholders become creditors in the liquidation process, and their claims are settled from the available assets according to the priority established by law.

3.4.6 Absence of an Explicit Policyholder Protection Fund

The Ethiopian insurance business Proclamation does not provide for an explicit policyholder protection fund or guarantee scheme. Such schemes act as a financial safety net, ensuring that policyholders are compensated up to certain limits even if the assets of the failed insurer are inadequate. In Ethiopia, the absence of such a mechanism means that policyholder protection relies primarily on regulatory oversight, solvency requirements, and the effectiveness of the receivership process.

3.4.7 Critical Assessment and Policy Implications

The Proclamation establishes a robust framework for indirect policyholder protection through prudential regulation, supervision, and intervention. However, the lack of a dedicated policyholder protection scheme presents several challenges:

- **No guarantee of compensation:** There is no statutory guarantee that policyholders will be fully compensated in the event of insurer insolvency.
- **Reliance on regulatory capacity:** The effectiveness of protection depends heavily on the NBE's ability to supervise and intervene promptly.

- **Potential for loss of public confidence:** In the absence of a visible compensation mechanism, public trust in the insurance sector may be undermined, especially during periods of financial instability.

3.5 The Experience of Some Countries on Policyholders' Protection Scheme

3.5.1 Why do countries adopt policyholders' protection schemes?

A growing number of jurisdictions have adopted protection schemes not only for depositors, but also for investors and/or policyholders.¹²¹ In some cases, sector-specific schemes are established to protect financial consumers in their respective markets against the risk of losses, but there is also an increasing trend for an existing deposit insurer to be given a mandate for the protection of investors or policyholders.¹²² This is because in most jurisdictions, banking is more dominant and critical to financial stability than investment or insurance.¹²³ Therefore, deposit insurance is usually established before any protection scheme is implemented for investors or policyholders.¹²⁴ Moreover, there is no evidence of the reverse, in which an investor compensation scheme or insurance guarantee scheme is later mandated to extend protection to depositors.¹²⁵

¹²¹ International Association Of Insurance Supervisors (IAIS), *Issues Paper On Policyholder Protection Schemes*, 2013, P. 5. Available At: <https://www.iaisweb.org> (Accessed May 2025).

¹²² International Association Of Deposit Insurers (IADI) & International Association Of Insurance Supervisors (IAIS), *Joint Paper On Deposit Insurance And Policyholder Protection*, 2013, Pp. 4–5. Available At: <https://www.iaisweb.org> (Accessed May 2025).

¹²³ International Association Of Deposit Insurers (IADI), *Core Principles For Effective Deposit Insurance Systems*, 2014, P. 6. Available At: <https://www.iadi.org> (Accessed May 2025).

¹²⁴ International Association Of Deposit Insurers (IADI), *Deposit Insurance And Policyholder Protection Schemes: A Joint Issues Paper By IADI And IAIS*, 2013, P. 6. Available At: <https://www.iaisweb.org> (Accessed May 2025).

¹²⁵ International Association Of Deposit Insurers (IADI) & International Association Of Insurance Supervisors (IAIS), *Joint Issues Paper On Deposit Insurance And Policyholder Protection Schemes*, 2013, P. 6. Available At: <https://www.iaisweb.org> (Accessed May 2025).

Countries have adopted policyholders' protection schemes to safeguard insurance consumers and maintain confidence in the insurance industry.¹²⁶ There are several key reasons for this. Policyholder protection schemes help to maintain stability in the insurance sector by mitigating the impact of insurer insolvency.¹²⁷ They provide a safety net for policyholders, ensuring that they receive compensation for covered losses even if their insurer fails. By implementing policyholder protection schemes, countries demonstrate their commitment to protect consumers' interests.¹²⁸ This fosters trust and confidence in the insurance market, encouraging individuals and businesses to purchase insurance. Policyholder protection schemes often have regulatory requirements that insurers must meet to ensure solvency and financial soundness.¹²⁹ These regulations help prevent insurer misconduct, fraud, and mismanagement, thereby promoting a fair and transparent insurance marketplace.¹³⁰ Many countries have legal frameworks that mandate the establishment of policyholder protection schemes to fulfill international standards or obligations. Compliance with these laws ensures that insurance markets operate in accordance with the best practices and global norms.¹³¹ Overall, policyholder protection schemes play a crucial role in maintaining the stability, integrity, and trustworthiness of the insurance industry and ultimately benefit both policyholders and insurers.

Many countries in the world have good experience in adopting and managing policyholders' protection schemes to protect their policyholders in the insurance sector. However, it is impossible to discuss the whole country's experience, and I have chosen four countries, three from countries with developed financial systems and long-term experience, that is, the USA, UK and France insurance guarantee schemes. In other way Kenya is one of the fastest growing African countries. These countries have experienced a long time and a well-developed insurance guarantee system.

¹²⁶ International Association Of Insurance Supervisors (IAIS), *Issues Paper On Policyholder Protection Schemes*, 2013, P. 4. Available At: <https://www.iaisweb.org> (Accessed May 2025).

¹²⁷ International Association Of Insurance Supervisors (IAIS), *Issues Paper On Policyholder Protection Schemes*, 2013, Pp. 4–5. Available At: <https://www.iaisweb.org> (Accessed May 2025)

¹²⁸ International Association Of Insurance Supervisors (IAIS), *Issues Paper On Policyholder Protection Schemes*, 2013, P. 5. Available At: <https://www.iaisweb.org> (Accessed May 2025).

¹²⁹ Id 5-6

¹³⁰ Id 6

¹³¹ Id

A. USA Insurance Guarantee

The first policyholder protection scheme was the US insurance guarantee system, which has been established as a formal insurance guarantee since the 1940s.¹³² In the 1950s, certain states had established security funds to provide assistance for disabled workers covered by insolvent workmen's compensation insurers, and a few others had made similar provisions for policyholders of insolvent automobile insurers.¹³³ In the late 1960s, Congress considered creating a federal fund similar to the FDIC to protect all property-liability policyholders. State regulators and insurers objected to federal regulation and cooperated to create a model law in which at least 47 states had been enacted in some form by 1974.¹³⁴ Most states did not enact life and health insurance guarantee fund laws until after the Baldwin-United insolvency in 1983 and Executive Life insolvency in 1990. All states enacted life and health insurance guarantee fund laws in late 1992.¹³⁵ In United States each state has two guaranty associations, one for life insurance and the other for property liability insurance, with both associations being incorporated in national organizations.¹³⁶

The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and the National Conference of Insurance Guaranty Funds (NCIGF) were created to support the activities of their member guaranty associations, which were established by state legislatures to protect insurance policyholders whose insurance carriers become insolvent.¹³⁷ NOLHGA's members are principally concerned with protecting consumers of failed lives, annuities, and health insurers. NCIGF members are principally concerned with protecting consumers of failed

¹³² National Organization Of Life And Health Insurance Guaranty Associations (NOLHGA), "History Of Guaranty Associations," Available At: <https://www.nolhga.com/about/main.cfm/location/guarantyassociations> (Accessed May 2025).

¹³³ Ibid

¹³⁴ National Association Of Insurance Commissioners, "Post-Assessment Property And Liability Insurance Guaranty Association Model Act," Model Laws, Regulations And Guidelines (Kansas City, MO: National Association Of Insurance Commissioners, October 2007), Vol. III, Pp. 540-1 Through 540-20 For The Text Of The Model And Citations To Analogous State Laws.

¹³⁵ Spencer L. Kimball And Noreen J. Parrett, "Creation Of The Guaranty Association System," Journal Of Insurance Regulation, Vol. 19, Winter 2000, Pp. 259-273.

¹³⁶ National Conference Of Insurance Guaranty Funds (NCIGF), "About State Property And Casualty Guaranty Funds," <https://www.ncigf.org> (Accessed May 2025).

¹³⁷ NOLHGA And NCIGF JOINT COMMENTS OF NOLHGA AND NCIGF IN RESPONSE TO FIO'S REQUEST FOR PUBLIC INPUT. December 16, 2011, Pp 1

property and casualty insurers. Both organizations coordinate the protection provided by their members when an insurer enters receivership proceedings.¹³⁸

In the United States, for life and health, within the scope of NOLHGA, although the state laws set the maximum limits of coverage and the types of policies covered, the majority of the member funds are consistent with the Model National Association of Insurance Commissioners Act.¹³⁹

We can see from the above points that NOLHG and NCIGF are government agencies, give limited coverage, it is explicit, membership to insured banks is not compulsory, and it was established due to the great financial crisis of the 1940s.

B.UK Insurance Guarantee

Following the dissolution of the Financial Services Authority (FSA), the United Kingdom introduced a new regulatory framework designed to foster a more robust, proactive, and risk-aware culture in financial regulation, thereby ensuring that the financial services industry is better equipped to manage future crises.¹⁴⁰ The FSA is replaced by two regulatory bodies: The Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).¹⁴¹ The FCA also serves as the supervisor for the action of all regulated and approved companies and individuals, while the Bank of England and Financial Policy monitor the PRA.¹⁴² The FCA has three primary duties: protecting the consumer, enhancing the integrity of the UK financial system, helping competitive markets, and promoting significant competition in the interest of the

¹³⁸ Ibid

¹³⁹ National Organization Of Life And Health Insurance Guaranty Associations (NOLHGA), “State Laws And The NAIC Model Act,” <https://www.nolhga.com/Policyholderinfo/Main.Cfm/Location/Guarantylaws>; National Association Of Insurance Commissioners (NAIC), *Life And Health Insurance Guaranty Association Model Act*, Model #520 (Accessed May 2025).

¹⁴⁰ Financial Conduct Authority (FCA), *A New Approach To Financial Regulation: The Blueprint For Reform*, HM Treasury, 2011. Available At: https://assets.publishing.service.gov.uk/Government/Uploads/System/Uploads/Attachment_Data/File/81411/Consult_Finreg__New_Approach_To_Financial_Regulation.Pdf (Accessed May 2025).

¹⁴¹ HM Treasury, *A New Approach To Financial Regulation: The Blueprint For Reform*, Cm 8232, June 2011. Available At: https://assets.publishing.service.gov.uk/Government/Uploads/System/Uploads/Attachment_Data/File/81411/Consult_Finreg__New_Approach_To_Financial_Regulation.Pdf (Accessed May 2025).

¹⁴² Bank Of England, *About The Prudential Regulation Authority (PRA)*, <https://www.bankofengland.co.uk/prudential-regulation>; Financial Conduct Authority (FCA), *Who We Are*, <https://www.fca.org.uk/about/the-fca> (Accessed May 2025)

consumer.¹⁴³ Meanwhile, PRA has a general aim to promote the safety and soundness of the company it regulates.¹⁴⁴ Regarding insurance matters based on regulation, the PRA has the primary goal of ensuring a sufficient degree of protection for those who are or may become policyholders.¹⁴⁵

The UK has put in place a protection scheme to compensate policyholders in the event of an insurer default.¹⁴⁶ The scheme was formerly known as the Policyholders Protection Scheme, and was replaced by the Financial Services Compensation Scheme ("FSCS") in 2001.¹⁴⁷ FSCS is a compensation scheme set up under the Financial Services and Markets Act 2000, which acts as a statutory fund of last resort for customers of financial services firms authorized by the Financial Conduct Authority ("FCA") and/or Prudential Regulation Authority ("PRA").¹⁴⁸

In addition to insurance policies, FSCS also covers claims related to deposits, investment business, insurance broking and home finance.¹⁴⁹ On insurance policy protection, FSCS is applicable to life and general insurances, and excludes re-insurance and marine, aviation and credit insurance as they are related to commercial risk.¹⁵⁰ The FSCS mainly covers policyholders who are individuals and small businesses.¹⁵¹ Large businesses are generally excluded, unless under certain exceptions, for example, for claims related to compulsory insurance.¹⁵² The FSCS is an independent body established under the Financial Services and Markets Act 2000 (FSMA).

¹⁴³ <https://www.fca.org.uk/about/the-fca> Accessed On February 4th 2021

¹⁴⁴ Ibid

¹⁴⁵ <https://www.theglobaltreasurer.com/2013/04/30/breaking-down-the-new-fca-and-preregulatory-regimes/> (Accessed On February 4th 2021).

¹⁴⁶ Financial Services Compensation Scheme (FSCS), *Insurance Protection*, <https://www.fscs.org.uk/what-we-cover/insurance/> (Accessed May 2025).

¹⁴⁷ Financial Services Compensation Scheme (FSCS), *History Of FSCS*, <https://www.fscs.org.uk/about-us/history/> (Accessed May 2025).

¹⁴⁸ Financial Services Compensation Scheme. (2017a) Annual Report And Accounts. Available From https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/635321/FSCS_Annual_Report_2016-17_Print.Pdf [Accessed February 2020]

¹⁴⁹ Financial Services Compensation Scheme. (2017b) Annual Report And Class Statements. Available From: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/635831/FSCS_Class_Statement_s_2016-17_Web.Pdf [Accessed February 2020]

¹⁵⁰ Financial Services Compensation Scheme (FSCS), *What We Cover – Insurance*, <https://www.fscs.org.uk/what-we-cover/insurance/> (Accessed May 2025).

¹⁵¹ Financial Services Compensation Scheme. (Updated) Q&As About Insurance. Available From: <https://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-insurance/> [Accessed, February 2020.

¹⁵² Financial Services Compensation Scheme. (Updated) Q&As About Insurance. Available From: <https://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-insurance/>. [Accessed February 2020.

FSCS does not charge individual consumers to use its services. It is funded by the financial services industry on a pay-as-you-go basis.¹⁵³

In addition to general insurance and life insurance, the FSCS covers several types of policies, including motor, home, pet, travel, and payment protection insurance (PPI). Moreover, long-term insurance products, such as life insurance and pensions, are also covered.¹⁵⁴

The main objective of the FSCS is to obtain continuity of cover for a policyholder with long-term insurance by transferring the policyholder to the new insurance provider.¹⁵⁵ In the UK, compensation depends on the type of policy implemented by insurance policyholders. The FSCS is funded on a “pay-as-you-go” (i.e. raising levies as problems arise) and raises annual levies from approved companies depending on the cost anticipated to the incurred coming year. The levy consists of two cost elements: management expenses and compensation.¹⁵⁶

C. France

France operates an explicit and legally established policyholder protection mechanism known as the Fonds de Garantie des Assurances de Personnes (FGAP), which translates to the Personal Insurance Guarantee Fund.¹⁵⁷ This scheme is a statutory safety net designed to protect policyholders of life, health, and accident insurance in the event of an insurer’s insolvency.¹⁵⁸ This scheme is a statutory safety net designed to protect policyholders of life, health, and accident insurance in the event of an insurer’s insolvency.

The FGAP was created under the French Code des Assurances, with its operations supervised by the Autorité de Contrôle Prudentiel et de Résolution (ACPR), a regulatory body affiliated with the Banque de France.¹⁵⁹ It plays a crucial role in maintaining stability and public trust in the

¹⁵³ Prudential Regulation Authority. (2018) Prudential Regulation Authority Rulebook. Available From: [Http://Www.Prarulebook.Co.Uk/Rulebook/Content/Part/214537/13-02-2018](http://www.prarulebook.co.uk/Rulebook/Content/Part/214537/13-02-2018) [Accessed February 2020].

¹⁵⁴ Ibid

¹⁵⁵ [Http://Www.Prarulebook.Co.Uk/Rulebook/Content/Chapter/214567/16-01-2020#21456](http://www.prarulebook.co.uk/Rulebook/Content/Chapter/214567/16-01-2020#21456). Accessed On February 5th 2021

¹⁵⁶ Article 223 Management Expenses Part XV Financial Service And Markets Act 200

¹⁵⁷ Organisation For Economic Co-Operation And Development (OECD), *Policyholder Protection Schemes: Selected Considerations*, OECD Publishing, 2013, At 9–10, Available At: [Https://Www.Oecd.Org/Daf/Fin/Insurance/Policyholderprotectionschemes.Pdf](https://www.oecd.org/daf/fin/insurance/policyholderprotectionschemes.pdf).

¹⁵⁸ *French Business Law*, “Chapter III: Guarantee Fund For Policyholders,” [Https://French-Business-Law.Com](https://french-business-law.com)

¹⁵⁹ *Policyholder Protection Schemes: Selected Considerations*, OECD, At 9–10 (2013), [Https://Www.Oecd.Org/Daf/Fin/Insurance/Policyholderprotectionschemes.Pdf](https://www.oecd.org/daf/fin/insurance/policyholderprotectionschemes.pdf).

French insurance market, especially in the life and retirement sectors, which involve long-term savings and future benefits. Unlike some schemes that focus on reimbursing policyholders in cash, the FGAP emphasizes the continuity of insurance coverage.¹⁶⁰ When an insurer fails, the scheme facilitates the transfer of policies to a solvent insurer to ensure that policyholders continue receiving the benefits promised under their original contracts.¹⁶¹

The scheme is financed through mandatory annual contributions from all licensed life and personal insurance providers operating in France.¹⁶² These contributions are determined as a fixed percentage of the insurers' premium income. The FGAP currently focuses on personal insurance and does not cover property or general liability insurance.¹⁶³ France's model has proven to be a resilient and preventive mechanism, aiming not only to protect consumers but also to support the orderly resolution of troubled insurance firms. The system promotes confidence in insurance as a long-term financial product and aligns with broader EU goals for financial consumer protection and market stability.¹⁶⁴

D. Kenya

In the 1990s, when many insurance companies collapsed, policyholders were unable to recover their claims.¹⁶⁵ Consequently, through legal notice no. 105 of 2004, the government established the Policy Holders Compensation Fund (PHCF) to partially relieve policyholders from the suffering they suffer when insurance firms collapse and boost consumer confidence in the insurance industry.¹⁶⁶

Kenya's PCF is a State Corporation under the Ministry of Finance (now the National Treasury), through which the government plans to develop the financial sector by promoting the insurance

¹⁶⁰ Ibid

¹⁶¹ Ibid

¹⁶² *French Business Law*, "Chapter III: Guarantee Fund For Policyholders Against The Failure Of Life And Health Insurance Companies," <https://French-Business-Law.Com>

¹⁶³ European Insurance And Occupational Pensions Authority (EIOPA), *Report On The Cross-Border Failures And Guarantee Schemes In The EU* (2021), P. 15.

¹⁶⁴ Ibid

¹⁶⁵ *Republic Of Kenya, Report Of The Presidential Commission On The Review Of The Insurance Industry In Kenya*, At 23–24 (2003), Available At <https://www.ira.go.ke> (Last Visited May 30, 2025).

¹⁶⁶ Njenga (N 1) 37; Olotch (N 6) 47.

business and safeguarding the interests of policyholders.¹⁶⁷ To demonstrate its commitment, the government made provisions for the initial funding with a clear statement that the decision to establish PCF was twofold: to relieve policyholders from suffering following the collapse of an insurer and to promote confidence in the insurance industry.¹⁶⁸

The PHCF was established under the 2004 Insurance (Policy Holders Compensation Fund) Regulations.¹⁶⁹ Under this scheme, when an insurance company goes into liquidation, the individual policyholders in that company are entitled to K.shs. 100000 compensations from the PHCF.¹⁷⁰ Though aimed at providing some sort of relief to policyholders in the event of the liquidation of an insurance company, the K.shs. 100000 cap is arguably small.¹⁷¹ Additionally, the PHCF only compensates for individual policyholders and not for corporate policyholders.¹⁷²

However, the establishment of the fund was a welcome development, as it was in keeping with international best practices in the field of insurance.¹⁷³ International best practice provides for the establishment of a fund to provide some protection to policyholders in the event that an insurance company becomes insolvent.¹⁷⁴

Notable amendments in 2010 included the expansion of the regulatory and supervisory powers of the Insurance Regulatory Authority.¹⁷⁵ The notable amendments in 2010 included the expansion of the regulatory and supervisory power of the Insurance Regulatory Authority, and the 2010 amendments sought to spell out the functions of the board of the Policy Holders Compensation Fund.¹⁷⁶ One of the core functions set out in the amendment is to monitor the risk profile of any

¹⁶⁷ Policyholders' Compensation Fund (Kenya), *About Us*, <https://Pcf.Go.Ke/About-Us/> (Last Visited May 30, 2025).

¹⁶⁸ *Ibid*

¹⁶⁹ Insurance (Policy Holders Compensation Fund) Regulations, 2004, Kenya Gazette Supplement No. 17 (Legislative Supplement No. 11), Legal Notice No. 105 (Kenya).

¹⁷⁰ Policyholders' Compensation Fund (Kenya), *Frequently Asked Questions*, <https://Pcf.Go.Ke/Faqs/> (Last Visited May 30, 2025); See Also Insurance (Policy Holders Compensation Fund) Regulations, Legal Notice No. 105 Of 2004 (Kenya).

¹⁷¹ *Ibid*

¹⁷² Arnold O B Mwangi "Ombe, „A Feasibility Study Of The Insurance (Motor Vehicles Third Party Risks) (Amendment) Bill 2010 And Its Impact On Kenya'S Insurance Industry" <Available At [Http://Ssrn.Com/Abstract=1857906](http://Ssrn.Com/Abstract=1857906)> Accessed 24 February 2014.

¹⁷³ *Id* 99

¹⁷⁴ *Ibid*

¹⁷⁵ Insurance (Amendment) Act, No. 13 Of 2010 § 3 (Kenya), Amending The Insurance Act, Cap. 487 (Kenya).

¹⁷⁶ *Ibid*

insurer.¹⁷⁷ Additionally, the 2013 amendments emanating from budgetary proposals affecting the insurance industry made during the 2012/2013 budget expanded the role of the PHCF to include participation in the liquidation of insurance companies.¹⁷⁸

The major causes that led to the collapse of insurance companies“ prior to the establishment of PCF include poor industry regulation framework, poor financial management shareholders also doubling in as the management increases the risks that come with poor governance and financial indiscipline, and lack of upholding of business ethics.¹⁷⁹ Transitional changes at the Ministry of Finance, where insurance was previously a department under the Ministry of Finance and later, with the enactment of the Insurance Act, CAP 486, the Office of the Commissioner of Insurance, was established in 1986.¹⁸⁰

According to the Insurance Act and the Insurance (Policyholders Compensation Fund) Regulations ¹⁸¹ the PCF has two strategic objectives that outline the purpose for which it was set out to achieve: to protect policyholders of an insolvent insurer by providing them with compensation for unsettled claims and to promote confidence in the insurance industry by safeguarding the interests of policyholders.¹⁸² All of these initiatives aim to safeguard and introduce professionalism and stability in the industry. With the government acknowledging the impossibility of eliminating risk altogether, it was necessary to introduce additional regulations and establish a Policyholder Compensation Fund.

¹⁷⁷ Geoffrey Njenga, *Reforming The Insurance Regulatory Framework In Kenya*. 2014, School Of Law, University Of Nairobi, Nairobi, Kenya.Pp.36.

¹⁷⁸ Ibid

¹⁷⁹ Republic Of Kenya, *Report Of The Presidential Commission On The Review Of The Insurance Industry In Kenya* 17–18 (2003), <https://www.ira.go.ke> (Last Visited May 30, 2025).

¹⁸⁰ Insurance Act, Cap. 487 § 3 (Kenya) (Establishing The Office Of The Commissioner Of Insurance); See Also Insurance Regulatory Authority (Kenya), *History Of IRA*, <https://www.ira.go.ke/index.php/about-us/our-history> (Last Visited May 30, 2025).

¹⁸¹ Insurance Act, Cap. 487 § 179 (Kenya); Insurance (Policyholders Compensation Fund) Regulations, Legal Notice No. 105 Of 2010 (Kenya).

¹⁸² Ibid

The Policyholder Compensation Fund (PCF), was established on September 24, 2004, by the Minister for Finance through powers conferred to the Minister by the Insurance Act.¹⁸³ The Fund commenced its operations on January 1, 2005.

The Policyholders' Compensation Fund (PCF) was established on September 24, 2004, pursuant to the provisions of Section 179 (1) of the Insurance Act through the Gazette Notice 105 of 2004. The purpose of the fund is to provide compensation to the policyholders of an insolvent insurer.¹⁸⁴ The decision to establish the fund was a key initiative in the reform of the insurance sector, which was characterized by the collapse of several insurance companies. To enable the Fund to commence its operations on January 1, 2005, the government provided it with seed capital of Kshs 35 million.¹⁸⁵ A pre-funded model for the Fund was adopted that required insurers and policyholders to equally contribute a levy of 0.5% on gross direct premiums. Up to June 2010, the maximum compensation payable by the Fund on any one claim lodged by a Policyholder was KShs (Kenyan shilling) 100,000.00.¹⁸⁶

Thereafter, the law was amended to require the board to determine the amount of compensation to a policyholder in consultation with the Minister for Finance.¹⁸⁷ The administration of the Fund is vested in a Board of Trustees while the Retirement Benefit Authority (RBA) is appointed as its Managing Trustee. Membership is compulsory.¹⁸⁸ The corporation collects flat rate fees and additional premiums adjusted based on risk. Moreover, the extent of coverage is limited; it is not full coverage and KDIC is only mandated up to 100,000.00 Kenyan shilling (Kshs) to each depositor of member institution and the fourth Kenya Adopt explicit deposit insurance scheme.¹⁸⁹

¹⁸³ Insurance Act, Cap. 487 § 179(2) (Kenya); See Also Insurance (Policyholders Compensation Fund) Regulations, Legal Notice No. 105 Of 2004 (Kenya).

¹⁸⁴ Policyholders Compensation Fund | 2012-2017 Strategic Plan

¹⁸⁵ Policyholders' Compensation Fund (Kenya), *About Us*, <https://Pcf.Go.Ke/About-Us/> (Last Visited May 30, 2025).

¹⁸⁶ Ibid.

¹⁸⁷ Insurance (Amendment) Act, No. 13 Of 2006 § 60 (Kenya), Amending Insurance Act, Cap. 487 § 179(6) (Kenya).

¹⁸⁸ [www.Phcf.Co.Ke](http://www.phcf.co.ke)

¹⁸⁹ Ibid

3.6 Key Lessons from International Experiences

3.6.1 The Importance of a Statutory Protection Scheme

A central lesson from all three jurisdictions is the necessity of a dedicated, statutory policyholder protection scheme. Both the U.S. (through state guaranty associations) and Kenya (through the Policyholders Compensation Fund) have established legal mechanisms that guarantee compensation to policyholders if an insurer fails. The U.K.'s Financial Services Compensation Scheme (FSCS) and France similarly provides a statutory safety net. For Ethiopia, enshrining such a scheme in law would provide clarity, predictability, and assurance to policyholders, thereby strengthening trust in the insurance sector.

3.6.2 Clear Coverage Limits and Scope

International experience shows that policyholder protection schemes work best when coverage limits and the scope of protection are clearly defined by law. The U.S. sets specific per-policy and aggregate limits; the U.K. distinguishes between compulsory and non-compulsory insurance; and Kenya sets a maximum payout per claim. Ethiopia should carefully determine coverage limits that balance adequate consumer protection with the financial sustainability of the fund.

3.6.3 Sustainable and Equitable Funding Mechanisms

A key factor in the success of these schemes is a sustainable funding model. In the U.S. and Kenya, funding comes from mandatory assessments on insurers, often calculated as a percentage of premiums. The U.K. uses industry levies. Ethiopia can adopt a similar approach, ensuring that the cost of protection is shared fairly among market participants and does not rely on government bailouts.

3.6.4 Strong Regulatory Oversight and Governance

Effective policyholder protection schemes depend on robust regulatory oversight. In all three jurisdictions, independent authorities oversee the schemes-state insurance departments in the U.S., the FCA in the U.K., and the Insurance Regulatory Authority in Kenya. Ethiopia should

ensure that its scheme is governed and supervised by an independent, competent authority with clear powers for intervention, monitoring, and enforcement.

3.6.5 Mechanisms for Continuity of Coverage

The U.S. and U.K. models demonstrate the value of mechanisms that ensure continuity of coverage, such as transferring policies to solvent insurers or providing temporary coverage. This reduces disruption for policyholders and maintains market stability. Ethiopia should consider including provisions that allow for the seamless transfer or continuation of policies where possible.

3.6.6 Public Awareness and Transparency

Another lesson is the importance of public awareness and transparency. In Kenya, ongoing education and communication have helped build trust in the compensation fund. Ethiopia should invest in publicizing the scheme, clarifying its benefits and limitations, and providing accessible information to policyholders.

3.6.7 Adaptability and Local Context

Finally, each country's scheme is tailored to its unique market context and regulatory environment. Ethiopia should design its policyholder protection scheme to address local challenges, such as low insurance penetration, limited public awareness, and the evolving regulatory landscape, while drawing on international best practices

Chapter 4

Conclusion and Recommendations

4.1 Conclusion

The absence of an explicit Policyholder Protection Scheme (PPS) in Ethiopia represents a significant gap in the country's financial consumer protection framework. Despite the insurance sector's growing importance in supporting economic development and financial inclusion, Ethiopian policyholders remain vulnerable to the risks of insurer insolvency, with no legal guarantee of compensation or continuity of coverage.

Comparative experiences from jurisdictions such as the United Kingdom, the United States, Kenya, and France demonstrate that PPSs are critical mechanisms for maintaining consumer confidence, ensuring market stability, and reinforcing the soundness of financial systems. These countries have established clear legal mandates, well-defined coverage limits, sustainable funding mechanisms, and robust governance structures to administer compensation schemes effectively.

Ethiopia's current reliance on an implicit model rooted in regulatory discretion and assumed state intervention lacks predictability, transparency, and enforceability. While the National Bank of Ethiopia has implemented commendable prudential and market conduct regulations, these are preventive tools and do not substitute for a statutory scheme that guarantees protection post-insolvency. As Ethiopia advances its financial sector reforms, the lack of an explicit PPS presents a critical omission in its efforts to align with global standards.

4.2 Recommendation

Based on the findings of this research and the comparative analysis of international experiences, it is recommended that Ethiopia establish an explicit Policyholder Protection Scheme (PPS) to safeguard the interests of insurance consumers, especially in the event of insurer insolvency. The existing legal and regulatory framework, particularly the Insurance Business Proclamation No. 746/2012, does not provide a comprehensive or explicit mechanism for protecting policyholders, which exposes consumers to significant financial and legal risks.

The United States and the United Kingdom provide valuable models of well-institutionalized schemes. In the U.S., the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) operates at the state level to protect policyholders of insolvent insurers through coordinated, legally enforceable mechanisms. Similarly, the UK's Financial Services Compensation Scheme (FSCS) automatically compensates eligible policyholders and is overseen by the Prudential Regulation Authority (PRA), ensuring both regulatory independence and financial sustainability. These jurisdictions demonstrate the importance of having a legally mandated, independent, and adequately funded PPS backed by strong regulatory oversight.

France offers an example of a state-supported but industry-funded guarantee scheme, operating under public-private coordination, while Kenya, as a developing country with regulatory challenges similar to Ethiopia's, has taken recent steps to establish a policyholder compensation fund under its Insurance Act (CAP 487). Kenya's experience shows that even in resource-constrained settings, a phased and flexible implementation is possible when supported by a clear legal mandate and sector engagement.

Ethiopia should adopt a blended approach tailored to its economic and regulatory context, involving:

- **Amending the Insurance Business Proclamation** to include explicit provisions for the creation, governance, and scope of a PPS;

- **Empowering the National Bank of Ethiopia (NBE)** to either directly administer or oversee the fund through an autonomous entity;
- **Setting appropriate compensation limits** to ensure affordability for the industry while protecting the most vulnerable policyholders;
- And **ensuring transparency, stakeholder involvement**, and alignment with international best practices.

By drawing on USA,UK,France and Kenya experiences while considering domestic realities, Ethiopia can establish a PPS that strengthens consumer confidence, supports market stability, and aligns with its broader financial sector development goals.

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