

Kenya microinsurance landscape

Market and regulatory analysis

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Abbreviations

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|------------------|---|
| AGRA | Alliance for a Green Revolution Africa |
| AMFI | Association of Microfinance Institutions |
| ASCA | Accumulated savings and credit association |
| ATM | Automatic teller machines |
| BRITAK | British American Insurance Company Limited (Kenya) |
| CAK | Co-operative Alliance of Kenya |
| CBK | Central Bank of Kenya |
| CCK | Communications Commission of Kenya |
| CFC | CFC Life Assurance Limited |
| CGAP | Consultative Group to Assist the Poor |
| CIC | Co-operative Insurance Company of Kenya |
| CPI | Consumer price index |
| FAO | Food and Agriculture Organization |
| FGDs | Focus group discussions |
| FOSAs | Front office service activities |
| FSD Kenya | Financial Sector Deepening Trust Kenya |
| GDP | Gross domestic product |
| HHI | Herfindahl-Hirschman Index |
| HMO | Health maintenance organisation |
| IAIS | International Association of Insurance Supervisors |
| ICEA | Insurance Company of East Africa Limited |
| IDRC | International Development Research Centre |
| IGAD | Intergovernmental Authority for Development |
| ILO | International Labour Organization |
| ILRI | International Livestock Research Institute |
| IRA | Insurance Regulatory Authority |
| KADET | Kenya Agency for the Development of Enterprise and Technology |
| KARI | Kenya Agricultural Research Institute |
| KCB | Kenya Commercial Bank |
| KENFAP | Kenya National Federation of Agricultural Producers |
| KERUSSU | Kenya Rural SACCO Society Union Limited |
| KHC | Kenya Horticultural Council |
| KPCU | Kenya Planters Co-operative Union Limited |
| KPOSB | Kenya Post Office and Savings Bank |

| | |
|---------------|---|
| K-Rep | Kenya Rural Enterprise Programme |
| KSh | Kenyan Shilling |
| KTGA | Kenyan Tea Grower’s Association |
| KUSCCO | Kenya Union of Savings and Credit Co-operatives Limited |
| KWFT | Kenya Women Finance Trust |
| MI | Microinsurance |
| MFI | Microfinance Institutions |
| MPND | Ministry for Planning and National Development |
| NACHU | National Housing Co-operative Union Limited |
| NCPB | National Cereals and Produce Board |
| NGO | Non-governmental organisation |
| NHIF | National Hospital Insurance Fund |
| NSE | Nairobi Stock Exchange |
| NSSF | National Social Security Fund |
| PPP | Purchasing power parity |
| ROSCAs | Rotating savings and credit associations |
| SACCOs | Savings and credit co-operatives |
| SIDA | Swedish International Development Cooperation Agency |
| SMMEs | Small, medium and micro enterprises |
| UNCDF | United Nations Capital Development Fund |
| UNDP | United Nations Development Programme |
| USD | United States Dollar |

Executive summary

This report considers the opportunities, challenges and overall scope for the development of the microinsurance market in Kenya. As a comprehensive microinsurance diagnostic, this report covers the demand-side, supply-side and regulatory dimensions of the market. This includes discussions of the relevant macro- and socio-economic, agricultural, health and financial sector contexts. The intention of this diagnostic is to catalyse a process in Kenya through which all stakeholders can collaborate to realise the microinsurance opportunity to its fullest potential. These stakeholders include potential clients, microinsurance providers, intermediaries, the Kenyan government and donor/multi-lateral agencies.

The Insurance Regulatory Authority (IRA) of Kenya commissioned this report, and the International Labour Organization (ILO), United Nations Capital Development Fund (UNCDF) and Financial Sector Deepening Trust Kenya (FSDK) provided funding. The report forms part of a series of country studies funded by the ILO and the UNCDF aimed at supporting country-level microinsurance development processes and developing cross-cutting insights for their design and implementation.

Market opportunities:

Kenya has a growing reputation for financial sector innovation. While this originated in the banking and payment systems space, it has not yet developed into a coordinated financial sector development process. Kenya's success in financial sector innovation has been the result of the entrepreneurial interest of both local and international market players in the low-income market as well as regulatory authorities who encourage and accommodate innovation. Although there has been some innovation in the insurance space, this sector remains largely under-developed. However, early signs of innovation in the microinsurance sector, combined with a payment systems revolution and a regulatory environment supportive of development, bode well for the development of the Kenyan insurance market.

Potential target market in excess of 11 million people. While many Kenyans are poor, 53% Kenyans have incomes between US\$ 2 and US\$ 10 per day¹, representing 10.8 million adults (PovCalNet, 2010). This is an important factor when considering the delivery of low-income insurance products in an environment where the primary restriction on market potential is income availability. In addition, current and potential microinsurance aggregators could extend cost-appropriate microinsurance products to individuals below the US\$ 2 a day mark, expanding the potential target market further.

Based on discussions with the providers (underwriters) of various innovative microinsurance models, a conservative estimate of the voluntary microinsurance market is 150,000-200,000 policyholders. If the users of *formal* credit life insurance policies—through banks as well as through savings and credit co-operatives (SACCOs) and microfinance institutions (MFIs)—are added to this number, the estimate increases to 650,000-700,000² users, totalling slightly more than 3% of the Kenyan adult population. A significant expansion of the current microinsurance market is possible if the following distribution opportunities are realised:

¹Calculated at purchasing power parity using data obtained from PovCalNet.

² It is likely that the majority of these individuals' usage of insurance products is not currently being picked up by FinAccess as it does not currently measure the usage of credit life insurance.

- *Reaching unserved formally employed market:* Of the 2 million adults that are formally employed, only 30% of individuals currently use any form of insurance, including compulsory insurance products such as the National Hospital Insurance Fund (NHIF) and the National Social Security Fund (NSSF). This implies that up to 1.4 million individuals have regular incomes in the form of a salary to enable the purchase of a microinsurance product. Furthermore, a portion of these individuals may work for large employers, enabling premium deductions through a payroll mechanism (the “check-off” system as it is referred to in Kenya).
- *Cross-selling of insurance products to the banked, MFI and SACCO markets:* 85% (or 3.9 million) of Kenyan adults that have bank accounts do not currently have any form of insurance product. This category of individuals is probably where the biggest immediate opportunity in terms of the extension of the microinsurance market lies. Not only are these individuals more easily accessible in terms of their networked nature, but bank accounts (through debit order deduction) also provide an easy premium collection mechanism. In addition, 81% (1.7 million) of SACCO members and 90% of MFI clients say that they do not have any kind of microinsurance product. While many of these individuals may be unaware that they are covered by a credit life insurance product on their loan with a SACCO or MFI, these markets provide significant potential for the sales of voluntary microinsurance products.
- *Serving welfare society³ members with formal insurance products:* 96% (4 million) of adults that belong to a society that provides some type of welfare function currently do not have any form of insurance. While insurance will be unable to fully replace the social function fulfilled by welfare societies, findings from the focus group discussions which inform this study indicate that payouts from welfare societies are unable to full cover the costs of funerals. While welfare societies (groups that provide some welfare function) provide an indication of the most important risks people are willing to pre-fund, they also provide groups of people to whom different types of insurance products could be sold.
- *Many other networks, including trade associations, remain:* There are an estimated 680,000 Jua Kali⁴ members in Nairobi alone. Besides Jua Kali associations and their network federation, there are a number of other trade associations with thousands of members with specific livelihoods. Besides having certain livelihood risks in common, these groups provide distinct networks opportunities.

The above distribution categories merely highlight opportunity. It may not be easy or quick to realise the microinsurance opportunity amongst these groups of people. However, if companies approach product development innovatively and with commitment, it is possible that an expansion of up to three times of the current conservative estimate of size of the microinsurance market is possible, increasing insurance penetration from the current 3% to 10% of Kenyan adults. If only 1 million M-PESA users and 1 million Kenyans with bank accounts who are currently uninsured buy insurance through these channels, market size will increase by more than three-fold to 10% of Kenyan adults.

³ An informal community-based organisation used to manage certain risks such as the expenses associated with burials or hospitalization.

⁴ An association for informal artisans and manufacturers.

Key findings:

1. Regulation poses barriers, but these are not insurmountable given regulatory reform process.

Revision of dated act provides opportunity for microinsurance. The current Insurance Act (Cap 487) was enacted in 1986 and although it has been amended since, has not changed substantially. The Insurance Regulatory Authority (IRA) was established in 2007 and has since been growing its resources and staff capacity as a professional industry supervisor. The IRA is placing increasing emphasis on the professionalisation of the Kenyan insurance industry. This includes significantly increased capital requirements, which insurance companies have had to comply with from June 2010. A new Insurance Act is currently being drafted and will seek to move the Kenyan industry to international best practices. It is not clear what the exact content and nature of the Act will be, but it will include doing away with the category of composite insurance companies. In anticipation of this change, a number of companies have already started to split their composite business into life and general companies.

Case-by-case exemptions has not provided market with sufficient certainty. A case-by-case exemption approach has been used to facilitate the development of bancassurance, where certain banks have been given exemptions from the restrictions in the Banking Act to allow the establishment of insurance agencies. Furthermore, the case-by-case approach has also been used to allow the development of alternative distribution models where these distributors (e.g. MFIs, cooperatives, etc.) are typically not registered as agents. While a case-by-case exemption approach allows for the facilitation of microinsurance development until regulatory changes have caught up, it also creates uncertainty and an unlevel playing field. Thus, for example, while some banks have already established insurance agencies, others are not even aware of this being an option and are not exploring this route of cross-selling insurance products to their traditional banking market.

Price and expenditure controls restrictive in a microinsurance environment. The Kenyan insurance regulatory environment is characterised by capped management expenses, as well as commission caps. Caps on management cost may simply not be realistic if the intention is the development of new microinsurance product lines. Apart from being a deterrent to innovation and the research and development associated with this process, it can also be easily circumvented through the careful structuring of costs. Furthermore, commission caps may not always facilitate the growth of a microinsurance market due to low premium values, which imply a much higher percentage commission required (to cover absolute costs) than for conventional insurance. However, this does not imply that an informed and cautious approach to intermediation costs is not important. Clients need to be provided with value for their money and an informed approach to controlling intermediation costs may be one way to help achieve this.

Flexible and low-cost intermediation regime required for microinsurance. The creation of a flexible and low-cost intermediation regime would entail enabling the distribution of insurance by all registered financial institutions, including banks, MFIs and SACCOs, on an official basis by amending the relevant laws. Bancassurance is currently being allowed on a case-by-case basis, with both the Central Bank and the IRA involved in this exemption process. The same regulatory restrictions that prohibit bancassurance also apply to MFIs.

While the SACCOs and Co-operatives Act do not directly prohibit the distribution of insurance through these entities, the regulatory position on their distribution or administration of insurance has not been made clear and communicated to the market. Regulation by *ad hoc* exemption to allow for the development of more microinsurance models tends to discriminate against the smaller and more innovative players, thereby stifling market development. It would be better, therefore, to create a deliberate regime that allows all distribution players to enter a level playing field.

Furthermore, the distribution of health insurance by agents needs to be facilitated. Currently, the distribution of insurance products used to cover private health costs are restricted to medical insurance providers (MIPs). These intermediaries have to meet broker, rather than simplified agent, requirements. The current agent regime (especially the delegation of supervision over the quality and training of agents to insurers) encourages the development of a microinsurance market and this approach could to be extended to more product categories such as health.

2. Microinsurance offers an opportunity for the under-developed insurance sector to expand.

Small insurance market focused on corporate and asset markets. The Kenyan insurance industry is small. Total gross insurance premiums generated in 2008 were KSh55 billion (US\$ 730 million or 2.6% of GDP), of which gross premiums for general and long-term business consisted of KSh35 billion (US\$ 460 million or 1.7% of GDP) and KSh20 billion (US\$ 270 million or 0.9% of GDP), respectively. Currently, voluntary insurance serves only 3.6% of the adult population⁵, while only 1% of adults have life insurance. Furthermore, the industry has not grown much during last ten years. Overall insurance penetration only increased marginally between 2006 and 2008 from a lower base of 2.5% to 2.6%, largely tracking GDP growth.

Cannibalistic competition does not translate into pressure to grow. The current insurance market's narrow focus on the corporate market and inability to expand to retail markets points to the existence of an invisible barrier. This barrier is the result of both a lack of familiarity with the retail market along with its distribution challenges and the fact there are still profits to be made in the limited corporate market. Regulatory hurdles to low-cost and more efficient distribution have also contributed to this barrier between the corporate and retail markets. Currently, insurance companies are competing for the same market share, undermining the future growth of their market.

The insurance sector has not kept pace with the rapid expansion of banking and payment services. Given the under-developed nature of the insurance sector, microinsurance (or extending insurance products to the low-income market) offers Kenyan insurance companies the opportunity to grow the market to serve more people and break out of the current cycle of cannibalistic competition in which they find themselves. The bulk of growth possibility lies in the retail and, in particular, life insurance markets. To exploit this opportunity, the insurance industry will have to solve the distribution problem (as discussed below).

⁵ This increases to 7.3% if compulsory insurance products like third party vehicle, National Hospital Insurance Fund (NHIF) and National Social Security Fund (NSSF) is included.

3. Focusing on anchor risks can help overcome distrust in the insurance industry.

Failures undermine trust in industry. Kenyans have high levels of distrust in insurance, insurers and their intermediaries. The situation has not been helped by the failure of a number of insurance companies in Kenya over the last decade. Seven insurance companies have been liquidated or placed under statutory management in recent history starting with the liquidation of Kenya National Assurance Company (1996) and followed by Access Insurance, Stallion Insurance, Liberty Insurance, Lakestar Insurance, United Insurance and Standard Assurance Kenya Limited. Invesco Assurance Company was placed under statutory management three years ago, but underwent a change in ownership structure and will not be liquidated.

Take-up achieved for anchor risks. Despite the apparent high levels of distrust towards insurance, Kenyans have been more willing to take up insurance when:

- a particular risk is viewed as having a high mitigation priority; and
- a risk is attached or has the potential to be attached to a type of service delivery or tangible product associated with the risk. An example is health services provided through cover from the NHIF or other private health insurance products.

Anchor risks are risks that meet both of the above conditions. Where take-up has been achieved, it has mostly been around specific anchor risks. The clearest anchor risks in Kenya seem to be health risks, life risks (particularly funeral) and the risks associated with agricultural production. Consideration of these anchor risks needs to inform product design for the low-income market.

4. Health risk has been the growth and innovation point for microinsurance in Kenya.

Focus on health insurance. Health insurance products are generally viewed as difficult products to make work for the low-income market, due to the difficulty of claims management and high levels of administration expenses. However, a number of health insurance products have been designed and rolled out for the low-income market in Kenya. This is partly the result of high levels of expressed demand for this product (particularly by MFIs and their clients), as well as insurance companies' willingness to experiment with this product. The strong interest in health insurance also emerged as a prominent theme from the focus group discussions which were conducted for this study.

NHIF provides basis for innovative partnerships. The presence of a government health insurer, the National Hospital Insurance Fund (NHIF), with the goal of extending into informal markets as far as possible has assisted in the design of health cover that meets the needs of the low-income market. The NHIF provides compulsory health cover for formal sector workers and voluntary cover for informal sector workers. In 2005, NHIF reported having a total of 1.5 million contributors, with coverage extending to 6 million dependents. Some media reports have estimated NHIF coverage to be as high as 8 million Kenyans. Although contribution levels to the NHIF were recently increased to allow for out-patient cover, it still has great potential to reach many Kenyans. Kenyans' positive experiences with health insurance have been aided by the presence of the Fund as the following statement from the focus group discussions confirms:

It is easy to use as one just presents a card at a nursing home or a health centre and the government pays the bill. When my wife was admitted in maternity ward in Kenyatta National Hospital, NHIF cleared the KSh46,000 for the KSh320 that I pay every month. I have faith in the Fund. I simply got my employer to sign a certificate which was accepted by the hospital.

Absence of regulation created space for innovation, but leaves risks unattended. The absence of health insurance-specific regulation has allowed private health insurers to experiment with health insurance products in a space unrestricted by regulatory definitions. Furthermore, the absence of minimum benefit regulation has allowed insurance companies to tailor benefits and products according to people's affordability constraints. However, the industry and its clients will be at risk if regulation is not introduced to address health insurance-specific risks (e.g. passing of risk to health providers in the form of capitation agreements).

What does the above imply for health microinsurance in Kenya going forward?

- *Health insurance regulations should facilitate delivery to the poor.* The above implies the need to have a cautious approach to the regulation of health insurance. The current and potential variety of health microinsurance products have evolved in the absence of health-insurance specific regulation. While it is necessary to manage the risks in this sector, care should be taken not to lose the value that has been developed in the products on offer.
- *Bundling with health cover may offer opportunity to diversify microinsurance cover.* Given health's prominence and popularity as anchor risk it may be useful to consider whether it offers a platform to include cover for other risks. Given that regulation currently treats health insurance products as a category of general insurance, this will require consideration of the issues around composite insurance products that may straddle the life and general insurance divide. In adding other products to the offering, care should obviously be taken to avoid undermining the core value offered by health products.
- *If functioning efficiently, NHIF offers best vehicle to extend health cover to the poor.* The NHIF is currently the largest single risk pool in Kenya and offers health cover to as many as 8m Kenyans. Given the in- and out-patient benefits which it now provides, and even with increased premium costs, it is likely to be the best vehicle to extend access to health services to low-income Kenyans. However, NHIF still leaves a large number of unforeseen expenses or losses associated with health events uncovered. This provides an opportunity for private insurance companies to underwrite benefits such as hospital cash plans (to cover loss of income, transportation costs, etc.), disability insurance and even life cover that can be bundled with NHIF cover. These partnerships, such as the partnership between Cooperative Insurance Company (CIC) and NHIF, have the greatest potential to cover a large number of Kenyans for health events.

5. Funeral as anchor life risk offers distinct opportunities for insurance companies and community-based organisations.

Funerals are culturally significant events. The demand-side analysis has shown that Kenyans attach much cultural significance to funerals. This translates into a financial burden for the family of the deceased as there are many immediate expenses associated with death in the family, including transportation of the body to the ancestral land, the coffin and food for mourners for the duration of the mourning period. In addition, families also have to cope with the loss of income when a breadwinner passes away. In the focus groups conducted for this report, participants viewed funerals as a source of pressure not only for the family, but also for the greater community. Members of the community come together and try to raise funds for the various costs associated with the burial.

Informal mechanisms cannot fully cover funeral costs. At the moment, two main types of informal mechanisms are used to deal with funeral expenses: welfare groups⁶ and Harambees⁷. However, more often than not, the focus group research conducted for this study suggests that the various informal social and risk pooling groups and strategies are proving insufficient to cover the costs associated with funerals. As emerged from the focus group discussions, payouts from welfare groups or other groups with a welfare function are insufficient to cover the immediate costs associated with death. Costs for funerals range from KSh150,000-200,000 (US\$ 1,990-US\$ 2,654), but welfare groups tend to contribute only KSh20,000 -KSh50,000 (US\$ 264-US\$ 663) in the case of death of a member. Apart from welfare group payouts proving insufficient to cover costs, the social significance and power of funeral post-payment mechanisms (Harambees) is gradually being eroded, with Kenyan households being asked to contribute to these events on a much too frequent basis.

In addition to these constraints, informal entities are unable to provide funds to deal with the financial impact of death beyond the cost of the funeral, e.g. the loss of a breadwinner's income or immediate debts which have to be settled.

Regulation excludes service-based funeral cover from formal insurance space. The regulatory definition of insurance explicitly excludes⁸ funeral cover where the benefits are provided in-kind through the service rather than in cash. As result, this sector is not monitored and little information is available on the current funeral services market and whether they offer insurance-type products to pay for their services. Such funeral policies form an important part of the microinsurance market in other jurisdictions and the industry conversations suggest that this is also an area of increasing interest in Kenya.

⁶ Or other groups such as ASCAs or rotating savings and credit associations (ROSCAs) which also fulfil a welfare function.

⁷ A Harambee is an ex post risk management tool used assist with the settlement of large hospital bills and funeral costs beyond what the immediate family can manage. A harambee is an event which is organised by the family with the assistance of friends and relatives with the purpose of collecting funds to deal with the impact of a particular risk event. The role of the event organisers and attendees is to contribute financially and to identify a guest of honour such as a businessman, Member of Parliament, senior civil servant or church leader with a wide network of friends to attend the event. Friends and relatives typically contribute small amounts that vary from KSh200 (US\$ 2.65) to KSh500 (US\$ 6.63). The success of harambees is viewed as being dependent on the social class of the deceased and "herein lies their limits for the poor" (Cohen and Sebstad, 2003). Due to the low returns associated with a single harambee, a series of harambees may be held in preparation for a larger event. The aim is to increase the total amount of funds collected. Funds raised from smaller harambee(s) are used to pay for the final and very large harambee.

⁸ A number of products, services and entities are explicitly excluded from the definition of insurance in the Insurance Act.

What does the importance of funerals in Kenya mean for the industry and regulator?

- *Costs associated with death offer opportunities for insurance industry.* In recognition of the above dynamics, some funeral insurance products are now emerging that target members of welfare groups. Companies are recognising the inherent market potential in meeting the immediate direct as well as the important indirect expenses associated with death, and they are starting to work with funeral parlours to provide products which address this need.
- *Regulation excludes key part of potential microinsurance market.* The exclusion of funeral products which offer in-kind benefits from the formal regulatory definition of insurance leaves a potentially significant component of the Kenyan microinsurance market unregulated. This places a significant barrier on the development of the formal microinsurance sector by cutting one of the potential anchor risks from the formal insurance market. Including such insurance in the regulated space will assist to facilitate partnerships between insurers and funeral parlours, which may provide an important entry point for insurers into the low-income market. Partnering with funeral parlours may also help to overcome the general level of distrust in insurance by making insurance benefits more tangible.

6. Agriculture offers microinsurance opportunities around value chains and networks.

Because of low-income Kenyans' extensive involvement in agricultural production and the small-scale nature of farming, they have large agricultural risk management needs and are vulnerable to a number of factors (including weather and disease) which influence agricultural production. While a clear need for agricultural risk mitigation exists, the fragmented and inefficient nature of the Kenyan agricultural sector may present significant complications for the delivery of insurance on a traditional basis. Inefficient farming practices means that meagre incomes are produced (i.e. limited surplus income is generated that can be paid towards risk management through insurance) and also complicates the underwriting of crop outputs on the traditional multi-peril basis (i.e. difficult to judge/assess impact of particular risk event).

From a distribution point of view, a fragmented agricultural landscape means that it is challenging and expensive to access the large number of small farmers. There are, however, indications that the agricultural value chain and input providers, in particular, may provide useful opportunities for aggregation. These channels can also be used for non-agricultural insurance products such as life or health cover.

The diagnostic reveals some innovative microinsurance experiments designed to overcome these challenges. These models demonstrate three key features:

- *Products cover input costs.* While the ultimate agricultural risk remains the inability to produce (or even sell) expected outputs, the insurance benefit could be stated to cover either the output loss or input costs. Products which cover the input cost cover farmers for the loss of **funds spent on the purchase of inputs** when they do not realise the expected production or output. This would otherwise have led to an inability to purchase inputs for the next season. Covering agricultural inputs may present a more modest benefit to the client, but also one that is easier to manage. It does not seek to indemnify the overall loss, but simply to place the farmer in a position to survive the

current loss and replant in the next season. Importantly, the input benefit is also more closely aligned (than traditional output cover) with the interest of the input provider (as sales channel) as it not only helps the provider to earn a sales commission on insurance but also ensures a future client base for its product.

- *Client aggregation through the involvement of value chain or input providers.* Microinsurance models, such as British American Insurance Tea Growers' model and the Syngenta agro-dealers models, have already started to take advantage of the opportunities offered by the agricultural value chain or input providers.
- *Product pay-outs triggered by parametric measures.* The use of insurance products with pay-outs calibrated relative to certain parametric ranges has assisted to simplify the risk management and administration associated with these products. These products, generally crop or cattle insurance products, will pay out to all policyholders in a specific geographic area, irrespective of their individual losses, when certain conditions are reached in the proxy or index. The index is selected to closely correlate with actual losses, e.g. crop or livestock losses, and is based on historical patterns, and should be objective and easily observable.

What opportunities are there for Kenyan insurers thinking about agricultural microinsurance?

- *Kenyan government a key player in agricultural input markets.* The Kenyan government is heavily involved in the supply-side and value chain processes of the agricultural sector. This means that in thinking about how input value chains can be used in the distribution of microinsurance to farmers, whether it be agricultural or other microinsurance products, the Kenyan government provides an entry point.
- *Use agricultural value chains and networks to distribute also other products.* Both input and output chains may be interested in facilitating risk cover to its clients/producers. Furthermore, different agricultural sub-sectors are networked into different private and voluntary industry bodies, representing the needs of the various sub-sectors at a national level. For instance, the horticultural industry has organized itself as the Kenya Horticultural Council (KHC), the livestock industry as the Kenya Livestock Breeders Organization (KENFAP) and the tea industry as the Kenyan Tea Grower's Association (KTGA).

7. Banks and emerging network of payment system agents offer potential distribution channels.

Although the premium collection problem has largely been solved in Kenya, insurers have to better utilise financial institutions and, specifically, the network of payment system agents for actively selling insurance products.

Banks, MFIs and SACCOs provide opportunities for quick gains. The financial sector in Kenya has expanded rapidly in recent years and has not yet been fully utilised for the active sales of insurance policies. Although there are signs that bank insurance agency models are starting to emerge, this opportunity is not yet being used by all insurers, largely because of the provisions in the Banking Act which prohibit trade in other services (including insurance).

Despite this prohibition, the IRA, in conversation with the Central Bank, has made exceptions to award insurance agency licenses to certain banks. Although the biggest immediate potential for the extension of microinsurance lies in the banking sector client base, MFIs and SACCOs also offer distinct distribution opportunities. The diagnostic reveals that several MFIs are still underwriting their insurance risks on an informal basis. The formalisation of this business alone will grow the formal microinsurance market by a significant margin.

M-PESA has the potential to revolutionise the insurance sector. The entry of mobile payments models such as M-PESA has solved both problems of premium collection and claims payments, thereby removing a significant constraint on insurance distribution. Given the lower cost of transactions and its physical proximity to clients through its extensive agent network, it will allow insurers to move to monthly premiums, thereby making insurance more affordable. Furthermore, the presence of extensive mobile networks allows insurers to communicate with clients on a low-cost basis through regular text messages.

Ultimately, the adage remains: insurance has to be sold. This is particularly true for low-income consumers who may not be familiar with complex insurance products and who may have an inherent distrust of insurance companies. In addition to providing a payments solution, networks such as M-PESA have created vast agency networks with immense potential to sell other financial products such as insurance. At the time of the study, however, payment system networks such as M-PESA were not yet utilising their agency forces to sell other financial products and articulated their core function as providing a payment platform, rather than an agency function. As a result, such agents do not receive any training on financial services and only on the system itself. In their current form, payment system networks will therefore not be the silver bullet which will unlock the Kenyan microinsurance market. The development of a microinsurance market will require extensive engagement with clients during the sales process and this can only be provided by sales agents who have some background and training on insurance. The introduction of M-KESHO, a product partnership between Equity Bank and M-PESA, may have signalled a shift to an agency rather than pure payments role. Given the increased competition for agents, the commissions earned from insurance sales may become an attractive incentive in the future.

What can be done to allow for better distribution of microinsurance products in Kenya?

As discussed earlier, a flexible and low-cost intermediation regime is required for microinsurance. This regime should allow distribution of insurance by all registered financial institutions, including banks, MFIs and SACCOs, on an official basis by amending the relevant laws.

1. Introduction⁹

Kenya is classified as a low-income country, but its politicians are verbalising aspirations to soon become a lower-middle income country. A relatively large percentage of its population is considered poor (40% earn less than US\$ 1.25 per day). It is a country characterised by smallholder farmers, small traders and manufacturers and people generating livelihoods on a small and generally vulnerable scale. In recent years, Kenya's financial sector, especially in banking, microfinance and savings and credit co-operatives, has increasingly realised the potential of the "small Kenyan" as a viable target market. Players in this sector have created a wide variety of products and services to meet their needs. Although the insurance sector has recently also started to realise the potential of the "small" (but not unimportant) Kenyan, this has not happened on nearly the same scale as in other parts of the financial sector.

International experience has shown that insurance can play an important role in helping the poor manage their risks by protecting the assets and incomes of low-income households when financial losses occur. This can help prevent them from falling further into poverty in the first place, or falling deeper into poverty, as a result of having to take children out of school to work, utilise savings, sell hard-earned assets, or obtain credit or other expensive means of post-event risk-management available to them. This does not, however, imply that microinsurance (and particularly formal microinsurance) is the appropriate risk-management tool for all low-income individuals. Some may never be able to afford microinsurance, whilst others may opt for other risk-management mechanisms at their disposal. For those at very low levels of income, microinsurance may not be able to fully replace the need for government-funded social protection.

Objectives of this study. This document considers the scope for, and opportunities and challenges to, the development of the microinsurance market in Kenya. The review covers demand-side, supply-side and regulatory dimensions of the market, including the relevant macro- and socio-economic, agricultural, health and financial sector contexts. It was commissioned by the Insurance Regulatory Authority (IRA) of Kenya and is funded by the International Labour Organization (ILO), United Nations Capital Development Fund (UNCDF) and Financial Sector Deepening Trust Kenya (FSD Kenya). It forms part of a series of country studies funded by the ILO and the UNCDF aimed at supporting country-level microinsurance development processes and to develop cross-cutting insights on designing and implementing such processes. This document seeks to provide the information basis for dialogue amongst the key microinsurance stakeholder categories, including potential clients, providers, intermediaries, government and donor/multilateral agencies.

Structure. The rest of the document is structured as follows:

- **Section 2** defines microinsurance within the context of this study and explores the potential market for microinsurance in Kenya.
- **Section 3** sketches the Kenyan macro- and socio-economic context.

⁹ Throughout this document, unless direct US\$ references are quoted, a 6-month average interbank exchange rate of KSh75.36 per US\$ as on 30 June 2010 (as obtained from www.oanda.com) is applied to convert Kenyan Shilling (KSh) amounts to USA Dollars (\$).

- **Section 4** highlights the nature of the agricultural sector and, at a high level, its implications for microinsurance.
- **Section 5** discusses the basic structure and financing of the health sector.
- **Section 6** provides an overview of financial sector trends with particular emphasis on the rapidly expanding banking sector.
- **Section 7** analyzes the insurance regulatory framework. It also considers other regulation that may be of indirect relevance to the insurance sector.
- **Section 8** scopes the supply and distribution of insurance in Kenya.
- **Section 9** provides a review of the evidence on the potential demand for microinsurance in Kenya.
- **Section 10** concludes the report with the salient market features as well as the opportunities and challenges associated with microinsurance expansion.

2. Defining microinsurance¹⁰ and the potential target market

Before we commence with the analysis of the Kenyan market, we briefly consider issues relating to the definition of microinsurance. This is not only important for clarifying terminology, but also to recognise that microinsurance may be defined differently depending on the objective the definition is seeking to achieve.

Kenya will benefit from a more explicit definition of microinsurance. This does not necessarily have to be a regulatory definition but one that will facilitate a clear industry discussion and an alignment of expectations and objectives. If a specific regulatory environment for microinsurance is required, a regulatory definition will be required.

2.1. Definition

Insurance accessible to the low-income market. Microinsurance is defined by the International Association of Insurance Supervisors (IAIS) (2007) as “insurance that is accessed by [or accessible to¹¹] the low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices (which should include the Insurance Core Principles). Importantly, this means that the risk insured under a microinsurance policy is managed based on insurance principles and funded by premiums”. This definition excludes social welfare and emergency assistance by governments, “as this is not funded by premiums relating to the risk, and benefits are not paid out of a pool of funds that is managed based on insurance and risk principles”.

This definition of microinsurance builds on three concepts: “insurance”, “accessible to/accessed by” and “low-income population”:

Insurance: Microinsurance forms part of the broader insurance market and is distinguished by its particular low-income market segment focus. While definitions vary, insurance generally denotes a contract whereby an insurer, in return for a premium, undertakes to provide specified benefits¹². Risk is transferred from the policyholders to the insurer and the insurer guarantees the insurance benefit if the premiums are paid. Benefits may include one or more sums of money that may be fixed or indemnify a specific expense or loss, services or other benefits, including an annuity. Benefits may also be provided in-kind (e.g. replacing a product or providing a service such as a funeral service).

Accessible to: Microinsurance products need to be accessible to the low-income population. FinMark Trust defines financial inclusion as the position where consumers, particularly low-income consumers, can access and use on a sustainable basis, financial services that are appropriate to their needs. Financial inclusion is determined by factors that may either exclude or discourage (i) individuals from using available formal financial services or (ii)

¹⁰ This section draws heavily on a similar section in the following document: Hougaard, C., Chamberlain, D. & Aseffa, Y., 2009. *Towards a strategy for microinsurance market development in Zambia: A market and regulatory analysis*. July 2009. Centre for Financial Regulation and Inclusion (Cenfri) research for the ILO, UNCDF, FinMark Trust Zambia and FinMark Trust South Africa: Cape Town.

¹¹ Authors' own insertion.

¹² Note that, sometimes, these benefits need not be a pay-out, but can take the form of a defence made on your behalf by the insurer.

financial service providers from offering such services to the low-income market¹³. Financial inclusion is determined by both market and regulatory forces.

Appropriate products. It is important to note that financial inclusion is also defined in terms of *appropriate products*. It is, therefore, not merely about extending any product to the poor, but products that present value to them and they are able to use. In the case of microinsurance, this means that consideration should not only be given to the sales side but also to the claims side, as that is where the value of the product is delivered.

The low-income population: While it is accepted that microinsurance targets low-income consumers, specific definitions of what is described as low-income will vary from country to country. Definitions of microinsurance (regulatory or otherwise) depend on the local context and the objectives it seeks to achieve. The following should be taken into account:

- *Relative and absolute poverty.* Microinsurance is not necessarily restricted to those below the national or sometimes international poverty line. Such poverty lines are typically defined to isolate the most vulnerable segments of society and trigger government intervention as a final resort. There may be many other low-income households that are not below the poverty line but still earn a low income, are vulnerable and are not served by the formal financial sector. As result, a significant proportion of the Kenyan population may fall within the potential target market for microinsurance
- *Limits of the insurance mechanism.* The lowest income segments in a country may be beyond the reach of a commercial insurance product that requires contributions in the form of premiums. These segments are likely to remain the responsibility of the government's social protection efforts. In some cases, subsidies may extend the reach of the insurance mechanism if this is seen as the best mechanism to deliver support to a particular low-income market.
- *Making markets work for the poor.* The focus of microinsurance is on extending the protection that the commercial insurance mechanism offers to the widest possible market. If only 1% of adults have life insurance, it is understandable that commercial insurers will focus their scarce resources on exploring the next 5% and not simply jump to the bottom 5%. In the case of microinsurance, they may also jump to specific client groups that can be reached through aggregators such as Microfinance Institutions (MFIs). The aim of microinsurance is to accelerate this exploration and push out the frontier of commercial insurance provision to the lowest possible income levels. In setting microinsurance definitions this would argue against setting definitions too strictly or at too low income levels as they need to fit with the commercial reality and entice insurers down-market.
- *Subsidies.* A strict income limit for microinsurance is usually only required when subsidies are provided and government wants to restrict subsidies to a very specific segment of society. If subsidies are not applied it may not be necessary to be too restrictive in the definition of the target market.

Translating all of the above, this suggests that the potential target market for microinsurance will fall somewhere between those (mostly high-income clients) who **already**

¹³ See Bester, Chamberlain & Hougaard (2008) for a more detailed discussion on the financial inclusion framework and the factors that impact on inclusion.

have insurance and those who are simply **too poor** as is illustrated in Figure 1, below. Given current market realities (particularly distribution challenges) there are limits beyond which the commercial insurance industry cannot yet reach. This is illustrated by the line showing the potential current frontier. This is not an exact or fixed line but serves to raise the question about what coverage could be realistically expected from the commercial insurers in the short- to medium-term. It may be possible for insurers to jump beyond this frontier for select pools of clients that are easily accessible through groups such as MFIs.

Figure 1 below illustrates the concept of an access frontier using Kenya’s demographic data. It is important to note that this diagram is merely an illustration of how the size of the microinsurance target market in Kenya could be approximately estimated and not an exact representation.

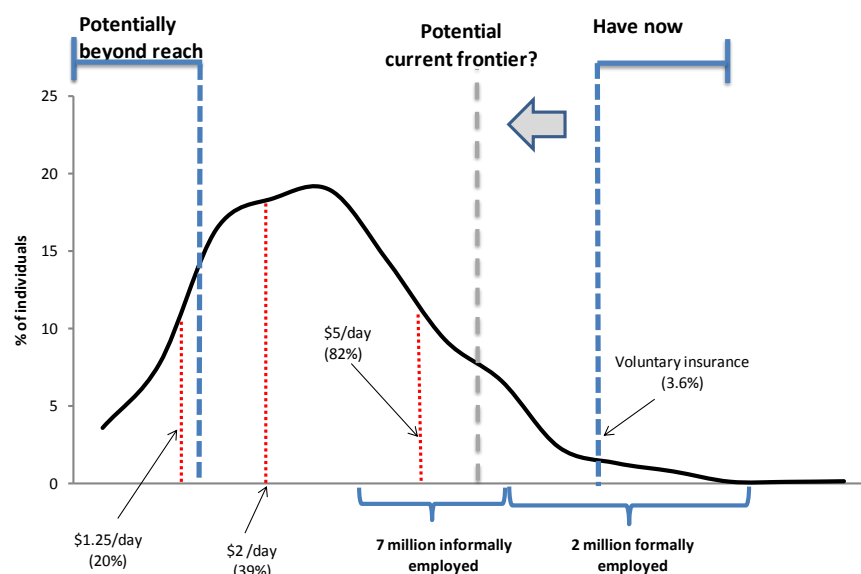


Figure 1: The insurance access frontier in Kenya

Source: authors’ representation from FinAccess 2009; World Bank, 2005; data points from various other sources

No Kenyan microinsurance definition yet. Industry consultations have revealed that there is no consistent industry or regulatory definition of microinsurance in Kenya. Several stakeholders tended to define microinsurance to be linked and potentially limited to the clients of MFIs (Microfinance Institutions). This is natural as MFIs offer some of the early entry points for microinsurance but, at the same time, microinsurance can extend well beyond the MFI sector. Some players have also been hesitant to define bancassurance¹⁴ as microinsurance as bank clients are not perceived as “poor enough” to qualify for microinsurance. However, as this study will show banks have *reached* deeply into the low-income market and a large proportion of bank clients should therefore be considered as part of the MI target market. There has also been tendency to avoid including credit life under MI

¹⁴ Bancassurance is the selling of insurance through the bank as distribution channel. Internationally, banks have become major distribution channels for insurance and revenue from insurance sales a large source of income for banks. While some of the insurance products sold by banks are intended to cover its own credit risk (e.g. credit life insurance), other products such as pure life insurance and motor and vehicle insurance provides cover the client’s asset and life risks. Bancassurance is not legal in all countries.

due to the negative perception of its value. While there may be legitimate concerns about the value that credit life offers, it will remain as the of the largest touch points with low-income consumers. One of the best potential outcomes for the microinsurance market is to improve the value of credit life rather than to exclude it from discussions. The fact remains that only 1% of Kenyan adults currently report to have a life insurance policy¹⁵ (FinAccess¹⁶, 2009). MFIs currently only serve 3.4% of adults (FinAccess, 2009). The result is that a significant component of the target market will have to be reached outside of MFI networks. In addition, bank and broader credit client bases provide opportunities for reaching the low-income market.

Implications for this study. Even if a regulatory definition is not required, it may be useful for the industry and regulator to develop a shared perspective on what microinsurance will mean in Kenya. This will enhance the discourse and facilitate coordinated efforts to develop this market. Instead of following a particular income definition, this study will consider the scope for the expansion of the insurance sector as a whole, with particular emphasis on the informal market (those not employed in the formal sector and therefore not falling in the traditional target market of financial services in Kenya). This will provide a basis for local stakeholders to discuss what the definition should be for Kenya.

The remainder of this document will explore the realities of the current microinsurance frontier and the opportunities and challenges to extending beyond it.

¹⁵ Please note that this will exclude most credit life policies as it was not explicitly explored in FinAccess and people may not be aware that they are paying for this type of cover.

¹⁶ FinAccess is a nationally representative household survey conducted throughout Kenya on an annual basis. This survey measures the usage of financial services and products.

3. Macro- and socio-economic context

Large, rural and young population. In 2009, Kenya's population of 38.6 million people (Kenya Population and Housing Census, 2009) accounted for approximately 4% of Africa's total population and was the seventh largest population in Africa. This means that, at the time, Kenya had the second largest population in the East African community, trailing Tanzania's 42.5 million people. 67.7% of the population live in rural areas, 43% of the population are under the age of 15 and 53% are between the ages of 15 and 64 (Kenya National Bureau of Statistics, 2009). Kenya is comprised of eight provinces with the capital city Nairobi carrying the status of a full administrative province. The most densely-populated provinces (Rift Valley, Eastern and Nyanza) are located in the central and eastern parts of the country¹⁷.

Recent slowdown in economic growth due to political violence, financial crisis and severe drought. Spells of economic and political volatility have been a recurring feature of the Kenyan economy over the last decade. These, together with environmental challenges such as droughts, have undermined consistent economic development. As a result, these challenges have created an environment where individual members of the Kenyan society are faced with significant risks¹⁸. Kenya recently experienced a slow-down in economic growth directly linked to political instability arising from the disputed general elections held in December 2007¹⁹. The post-election turmoil, reinforced by the global financial crisis and a prolonged drought, had a noticeable effect on several macroeconomic indicators:

- Economic growth²⁰ declined from a high of 7.1% in 2007 to 1.7% in 2008, recovering slightly to 2.5%, 2009. This compares negatively with the 8-10% East African average real Gross domestic product (GDP) growth rates²¹ that were experienced from 2006-2008.
- The headline consumer price index increased from 9.8% in 2007 to 26.2% in 2008 before subsiding to 15% in 2009. The rapid inflation during 2007 and 2008 has mainly been attributed to an increase in food prices driven by increased agricultural input costs and disruptions to the value chain during the post-election violence (Economic Survey, 2009). When removing food inflation from the consumer price index (CPI) (underlying inflation), the CPI basket increased from 5.7% (2007) to 11.1% (2008)²².
- Real average wage earnings declined between 2005 and 2008²³ with the largest erosion of 16.2% recorded during 2008 (Kenya National Bureau of Statistics, 2009).

¹⁷ This is possibly due to the fact that there are high rates of soil fertility in these provinces.

¹⁸ For more information on risks faced, see focus group discussions results in Section 9.2.

¹⁹ Political unrest led to more than 600 000 people being displaced and hundreds of casualties following the 2007 election where President Mwai Kibaki was re-elected. The results of the election were widely disputed, both locally and internationally.

²⁰ Measured in real Gross Domestic Product (GDP) terms at market prices.

²¹ East Africa average is an unweighted average of Tanzania, Uganda, Ethiopia and Sudan GDP growth rates.

²² Increases in CPI excluding food have mainly been attributed to the high prices of petroleum products and electricity among other non-food items.

²³ Real average wage earnings declined by 5% (2005), 3% (2006) and 2.2% (2007).

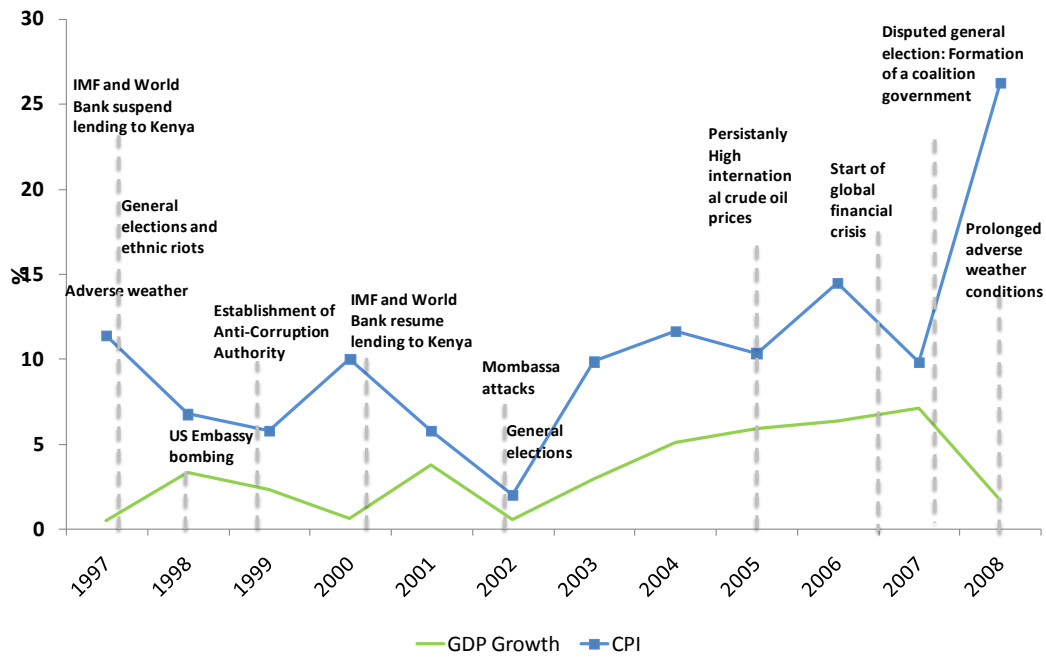


Figure 2: Historical map of Kenyan CPI and GDP

Source: World Bank development indicators

Immediate and future growth prospects improved, but fragile. The end of a severe drought has eased pressure on the weather-driven agricultural and electricity sectors, with favourable conditions expected to continue (Odhiambo, 2010). Political stability has improved since the formation of a coalition government between the Orange Democratic Movement (ODM) and the Party of National Unity (PNU). However, fears of the collapse of the unity government and continued flared ethnic tensions still remain (BBC, 2010).

Services sector the largest contributor to GDP, but agriculture remains important. The composition of the Kenyan economy, as depicted by Figure 3 (below), is dominated by the services sector at 62%, followed by agriculture and industry accounting for 22% and 16%, respectively.

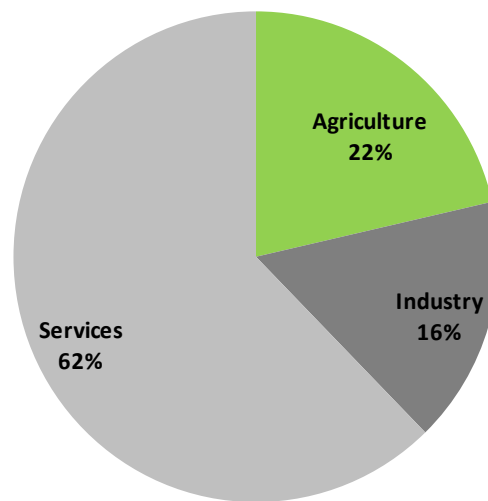


Figure 3: Structure of the Kenyan economy, 2009

Source: Kenya National Bureau of Statistics

Though not the largest economic sector, the agricultural sector remains critical to the economy, contributing 60% to total employment. The agriculture sector is covered in greater detail in Section 2.

Well established stock-exchange. The Nairobi Stock Exchange (NSE) started operations in 1954 and currently has 47 listed companies hailing from the agriculture (3), commercial and services (12), financial and investment (15) and industry and allied (17). As of 2 July 2010, the NSE market capitalisation stood at KSh1,103 billion (US\$ 14.6 billion) (NSE Bulletin, 2010). Of this amount, the listed finance and investment companies²⁴ accounted for KSh421 billion (US\$ 5.6 billion) (38% of total). Total market capitalisation of listed insurance companies²⁵ stood at KSh17 billion (US\$ 230 million) compared to KSh403 billion (US\$ 5.35 billion) of banks.

Financial sector growing share of the economy. Financial intermediation, as defined in the national accounts²⁶ (recorded under services, Figure 3), increased its contribution to GDP at market prices from 3.5% in 2004 to 4.7% in 2008, with the largest increases in contribution (1.2%) measured between the 2005-2007 period.

Rapidly expanding telecommunications sector. At the end of 2009, Kenya's four mobile phone operators²⁷ had a combined subscriber base of 19.4 million. This represented a 19% increase in mobile phone usage and an increase in mobile penetration²⁸ between 2008 (43.6%) and 2009 (49.7%). In addition, the mobile network coverage expanded to include 84.5% of the population living in 34% of the country. The use of fixed-line data and wireless data increased to nearly 2 million subscribers and this usage is predicted to continue to

²⁴ Banks, insurance companies and other investment houses.

²⁵ Only three insurance companies listed: Jubilee, Pan Africa and Kenya Reinsurance.

²⁶ Financial intermediation, as depicted in the national accounts, is commonly referred to as the financial sector.

²⁷ Licensed mobile phone operators: Safaricom, Airtel (Zain), Orange Kenya and Yu.

²⁸ Mobile penetration is calculated using the total number of cell phone users divided by the whole population.

expand with the landing of the fourth undersea cable in June 2010 (Communications Commission of Kenya (CCK), 2010).

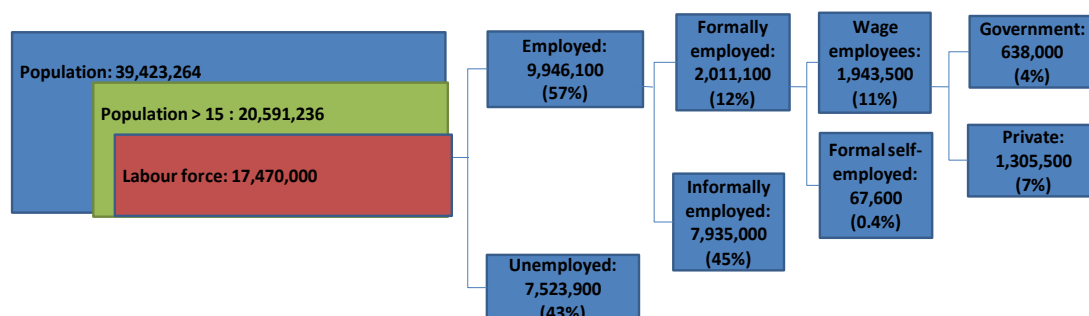


Figure 4: Breakdown of population and employment²⁹

Source: Kenya National Bureau of Statistics, 2009

Large, mostly informally employed labour force. The labour force³⁰ constitutes 17.5 million of the 20.6 million people above the age of 15. When small-scale farming and pastoral activities are excluded, the number of employed individuals, 9.9 million, accounts for 57% of the labour force. Of these, only 2 million are employed in the formal and/or modern sectors, with the government and private sectors accounting for 0.64 million and 1.3 million, respectively (see Figure 4, above).

Bulk of potential microinsurance target market employed in informal sector. The majority of economically active individuals in Kenya earn their living from the informal sector. Many individuals thus find themselves outside a formal, waged, employer-facilitated financial services provision environment. To date, the predominant focus of insurance companies has been the provision of services to a formally employed market. However, there is a large informal market which needs to have access to insurers through alternative structures.

²⁹ The projected population figures were obtained from the Statistical Abstract 2009 using Census 1999 data.

³⁰ Labour force consists of employed and unemployed economically active persons in the working age between 15- 65

| Country | Population (%) living on <\$1.25/day | Population (%) living on <\$2/day |
|---|--------------------------------------|-----------------------------------|
| Kenya (2005) | 19.7 | 39.3 |
| vs. East Africa and South Africa | | |
| Ethiopia (2005) | 39.0 | 76.7 |
| Uganda (2005) | 51.5 | 75.0 |
| Tanzania (2000) | 88.5 | 96.4 |
| Burundi (2006) | 81.3 | 93.2 |
| Rwanda (2000) | 76.6 | 90.0 |
| South Africa (2000) | 26.2 | 42.4 |

Table 1: Absolute poverty measures in Kenya and a cross-section of countries³¹

Sources: World Bank, Povcalnet

Relatively low absolute poverty levels. When assessing poverty using the World Bank defined poverty lines³², Kenya, in comparison to South Africa and its neighbours in East Africa (see Table 1), has the lowest proportion of the population living below the US\$ 2 (39.3%) and US\$ 1.25 (19.7%) a day poverty lines. Geographically, the highest incidence of poverty, as measured by percentage of the population living in poverty, can be found in the Rift Valley, Coast, Nyanza and Western province (World Bank, 2010). See Appendix D for a map of Kenyan poverty.

Social safety net reserved predominantly for the formally employed. The Kenyan government currently offers its citizens two³³ payroll deducted social protection safety nets: (1) National Hospital Insurance Fund (NHIF)³⁴ and (2) National Social Security Fund (NSSF) (FSD Kenya, 2007). In addition, on a limited (non-universal) scale the government offers two non-contributory, poverty-targeted cash transfer programmes: (1) the Orphans and Vulnerable Children Cash Transfer³⁵ (OVC-CT) and (2) the Hunger Safety Net Programme³⁶ (HSNP).

³¹ This information is based on the most recent data for each country (as indicated in the table) and the survey dates therefore differ across countries. All data has been adjusted for Purchasing Power Parity.

³² The \$1.25 per day poverty line is derived from the average local poverty line of the 15 poorest countries in the world. The \$2 per day poverty line is derived from the median of all developing country poverty lines.

³³ A possible third social transfer mechanism is the Civil Service and Private Pension Scheme. However, this is considered a government employment benefit as opposed to a pure social protection mechanism.

³⁴ NHIF is a compulsory (for the formally employed) health insurance policy. The NHIF has recently expanded its reach beyond the formally employed by offering a voluntary non-employment based cover (see Section 5). However, the majority of NHIF recipients remain formally employed.

³⁵ OVC-CT provides cash transfers to poor families taking care of orphans and vulnerable children. Funding is sourced from the Government of Kenya and development partners (UNICEF, Swedish International Development Cooperation Agency (SIDA) and DFID).

³⁶ Hunger Safety Net Programme (HSNP) is an unconditional cash transfer programme targeted at the chronically food insecure in the arid and semi-arid land areas of Kenya.

4. Agricultural sector context³⁷

In this section, we discuss the importance of the agricultural sector within the microinsurance context. Firstly, as discussed below, this sector is a source of income for a majority of Kenyans who are potential microinsurance clients. Secondly, as a client aggregator, agricultural networks may provide the necessary distribution channels and networks for microinsurance products through groups such as co-operatives and other industry-related bodies. Thirdly, the unique combination of income and the asset risk that is to be addressed provides for the development of innovative and agriculture-specific microinsurance products.

Agricultural sector has recently experienced political, economic, and weather shocks. During the last few years, the sector has endured a number of shocks, namely the 2007/2008 post-electoral political violence, the international economic recession from 2008 to 2009, high input prices (particularly fertilizer) and a prolonged drought to which Kenya was subject in 2008 and 2009. The combination of these factors resulted in a major reduction in agricultural production, which ultimately led to a contraction of 5.4% in the year 2008—down from a growth rate of 2.2% in the previous year (Economic Survey, 2009).

Kenyan agricultural sector continues to play a significant role within the economy. Despite these negative shocks, the sector continues to be one of the largest contributors to the economy. This can be viewed by the sector's contribution to economic growth, job creation and food security. According to the Kenya Statistical Abstract (2009), the sector directly accounts for 22% of GDP and an additional 27% "through linkages with manufacturing, distribution and other service related sectors" (Ministry of Finance, 2010). Furthermore, it is estimated that 45% of government revenue and 60% of export earnings are derived from agriculture (Ministry of Finance, Kenya: 2010).

Horticulture, tea and livestock are largest elements of agricultural GDP and employment. As seen in Table 2, horticulture (including fresh cut flowers, fruits and vegetables), tea and livestock are the largest contributors to Kenyan agricultural GDP. In 2008, horticulture contributed 30.7%, tea 31% and livestock 13.8% to the agricultural GDP, together contributing more than 75% to total agricultural GDP (Kenya National Bureau of Statistics, 2009). It is also clear that horticulture (particularly cut flowers) and tea are also the country's highest agricultural export earners.

³⁷It must be noted that there were limitations with regards to the availability of relevant and current information on this sector. This made the information gathering process a difficult one as there are no centralized and coherent sources of non-scientific, social and economic information on the sector. While there are research networks and journals, the information and data available is outdated and irrelevant. This led to a reliance on a wide variety of sources of information with varied perspectives and views of the agricultural sector.

| | | 2007 ³⁸ | 2008 ³⁹ |
|-------------------------|-------------------|--------------------|--------------------|
| Cereals | Maize | 4.5% | 4.7% |
| | Wheat | 1.7% | 1.5% |
| Horticulture | Cut flowers | 24.13% | 20.6% |
| | Vegetables | 12.5% | 9.0% |
| | Fruit | 1.00% | 1.2% |
| Permanent Crops | Coffee | 5.09% | 3.8% |
| | Tea | 24.6% | 31.0% |
| Livestock | Cattle and calves | 7.5% | 7.5% |
| | Dairy | 4.8% | 4.7% |
| | Chicken | 1.4% | 1.6% |
| Industrial crops | Sugar cane | 6.5% | 6.9% |

Table 2: Agricultural sub-sector contributions to agricultural GDP

Source: Kenya Statistical Abstract Table 59a, incorporating authors own calculations

Agriculture a source of income for majority of population. The agricultural sector is a source of livelihood for a large portion of the population. FinAccess 2009 show that agricultural-related activities are a source of income for 87% (18 million) of the adult population (persons over the age of 16). Furthermore, agricultural-related activities are the *main*⁴⁰ source of income for 44% (9 million) of the adult population. These agricultural-related activities include farm employment and the selling of produce such as cash crops and food crops.

³⁸ For the year 2007, the total in this table is 93.72% as a number of crops have been excluded including temporary crops such as pulses, permanent crops such as sisals and contribution of rice and other cereals and other ancillary contributors to agricultural GDP.

³⁹ For the year 2008, the total percentage is 92.5% , instead of 100% as a number of crops were excluded as with the year 2007

⁴⁰ FinAccess differentiates between a source of income and a main source of income.

| Agriculture-at-a-glance | |
|---|-------------------|
| Contribution to GDP | 27% ⁴¹ |
| Contribution to government revenue | 45% ⁴² |
| Contribution to exports | 60% ⁴³ |
| Persons dependent on agriculture as "a" source of income - with participants having other sources of income | 87% ⁴⁴ |
| Persons dependent on agriculture as the main source of income | 44% ⁴⁵ |
| Contribution by smallholders to agricultural production | 70% ⁴⁶ |
| Contribution by smallholders to marketed output | 50% ⁴⁷ |

Table 3: Agriculture at a glance: Kenyan agricultural sector statistics

Sources: Kenya National Bureau of Statistics, 2009; Ministry of Finance, 2010; FinAccess, 2009; and Alliance for a Green Revolution Africa (AGRA), 2010

Smallholder farming accounts for majority of production. Small-scale farmers account for 70% of total Kenyan agricultural production and 50% of marketed output (AGRA, 2010). Many of them typically work on land of an acre or less and find it difficult to produce efficiently at such a small scale. Growing families and meagre incomes from produce sales create difficult conditions for small-scale farmers. Table 4 provides more information on smallholders' contributions to different agricultural sub-sectors in Kenya. To get their produce to urban markets, smallholder farmers rely on local brokers and re-sellers who purchase produce from the farmers and transport them to the nearest markets where they resell them on their behalf. It is estimated that brokers and resellers typically deduct up to a quarter of the wholesale value as a fee for this service (DrumNET/International Development Research Centre (IDRC), 2010).

⁴¹ Kenya Statistical Abstract 2009

⁴² Ministry of Finance Kenya, 2010

⁴³ Ministry of Finance Kenya, 2010

⁴⁴ FinAccess 2009

⁴⁵ FinAccess 2009

⁴⁶ AGRA, 2010

⁴⁷ AGRA,2010

| Crop | Small holder population as a percentage of total group | Smallholder contribution to total production |
|--------------|--|--|
| Tea | - | 65% ⁴⁸ |
| Horticulture | 80% ⁴⁹ | 5-13% ⁵⁰ |
| Maize | 75% ⁵¹ | - |
| Dairy | 99% ⁵² | 70-80% ⁵³ |

Table 4: Smallholder sector contributions to various agricultural sectors

Sources: Mbithi, 2008; Meridian, 2010; East African Dairy Development, 2008; Amde et al, 2009; Mitiambo, 2010

Co-operatives play important role in agriculture. Co-operatives play an important role in the agricultural sector and particularly in the coffee and dairy sectors. These will be of interest from an insurance distribution perspective. Table 5: provides more information on the number of co-operatives in different agricultural sub-sectors. These co-operatives are categorized as dairy, coffee, multi-purpose and other agricultural. Co-operatives are also important entities as they are involved in the distribution, and marketing, of agricultural produce. According to the International Co-operative Alliance, co-operatives in Kenya have “70% of the coffee market, 76% dairy, 90% pyrethrum, and 95% of cotton” (2010).

| Societies | No. of co-operative societies | No. of members |
|--------------------|-------------------------------|----------------|
| Coffee | 549 | 672,000 |
| Dairy | 264 | 306,000 |
| Multi purpose | 1 923 | 130,000 |
| Other agricultural | 1243 | 121,000 |

Table 5: Agriculture sector co-operatives

Source: Kenya National Bureau of Statistics, 2009.

Government is significant player in agricultural sector. There are a number of industry-specific boards which oversee the regulation and development of each sector. Major agricultural sub-sectors have specific regulators, for example, the tea industry is overseen by the Tea Board of Kenya and the coffee industry by the Coffee Board of Kenya. Government also uses these boards to implement agricultural pricing policy. This was illustrated by the role that the National Cereals and Produce Board (NCPB) played in price management. Most of the dealings of the NCPB are with medium to large-scale agricultural producers with very little interaction with the smallholder sector as only 2% of them deal with the board (World Bank, 2009). The Kenyan government is also heavily involved in the supply side and value-

⁴⁸ (Amde et al, 2009).

⁴⁹ (Mbithi, 2008).

⁵⁰ (Mitiambo, 2010).

⁵¹ (Meridian, 2010)

⁵² (East African Dairy Development,2008)

⁵³ (East African Dairy Development,2008)

chain processes of the agricultural sector. Kenya Seed is also the largest seed company and accounted for 90% of the market share within the formal seed sector in 2008.⁵⁴

Private/voluntary industry associations networked by sub-sector. Different agricultural sub-sectors are networked into different private and voluntary industry organised bodies, representing the needs of the various sub-sectors at a national level. For instance, the horticultural industry has organised itself as the Kenya Horticultural Council (KHC), the small-scale farmers industry as the Kenya National Federation of Agricultural Producers (KENFAP), the livestock industry as the Kenya Livestock Breeders Organization (KLBO), while the tea industry has organised its members into the Kenyan Tea Grower's Association (KTGA).

⁵⁴ Farm Chemicals International: <http://www.farmchemicalsinternational.com/news/marketupdates/?storyid=1563>.

5. Health sector context

As with the agricultural sector, it is important to have a good understanding of the structure and nature of the health sector as this informs what is possible in terms of the provision of health insurance products. Here we focused on two areas: the nature of health service delivery, as well as aggregate sources of health funding.

5.1. Health services

Private sector facilities make up a large proportion of health services infrastructure. Public sector health facilities are dominated by dispensaries and health centres, while private sector facilities are dominated by clinics and nursing homes (small- to medium-sized hospitals). While the largest number of hospitals are based in the public sector, Table 6 indicates that approximately 25% of Kenya's hospitals are based in the private sector, while the remaining almost 25% are faith-based organisations. In total, the public sector manages about 41% of Kenya's health infrastructure, with the private sector accounting for 43% and faith-based organisations accounting for the remainder (Barnes et al., 2009). In interpreting these numbers, it is, however, important to bear in mind that the number of facilities does not reflect their workload and the services provided. Private sector health facilities have grown dramatically during the last two decades (Barnes et al., 2009). Possible reasons for this include poor service delivery by public health facilities, the implementation of user fees in public facilities and certain health sector liberalisation reforms in the 1980s that allowed for the licensing and registration of private health sector providers, as well as the removal of restrictions on the employment of public sector workers in the private sector (Muthaka, 2004 as quoted in Barnes et al., 2009).

| Facility type | Ministry of Health | Faith-based organisations | Private | Total |
|----------------|--------------------|---------------------------|---------|-------|
| Hospital | 158 | 74 | 68 | 300 |
| Nursing homes* | 0 | 0 | 191 | 191 |
| Health centres | 459 | 172 | 21 | 652 |
| Dispensaries | 1,503 | 546 | 203 | 2,252 |
| Clinics | 0 | 0 | 1,734 | 1,734 |
| Total | 2,120 | 792 | 2,217 | 5,129 |

Table 6: Distribution of health facilities by type and provider category in Kenya in 2006

Source: Kenyan Ministry of Medical Services (2006), as used in Barnes, J., O'Hanlon, B., Feeley, F., McKeon, K., Gitonga, N. & Decker, C., 2009.

* Nursing homes are mainly small to medium-size private hospitals (Level 3 facility)

Private sector services used by significant proportion of population. In 2003, the Kenyan Ministry of Health completed an analysis on the household expenditure survey to better understand where Kenyans access health services. The survey asked respondents what type of medical care and health providers they accessed during the last four weeks and the Ministry of Health annualised this to show relative usage of different providers (Barnes, et. al., 2009). The use of private services by the urban Kenyan population is much higher than in rural areas. Table 7 shows that almost 30% of Kenya's urban population used private health facilities in 2003 (increasing to about 35% for the Nairobi area) compared to 17% of the rural population during the same period.

| Province | Public | Private | Faith-based organisation | Chemist | Others | Total |
|---------------------|--------|---------|--------------------------|---------|--------|-------|
| Nairobi | 34.6 | 34.6 | 8.3 | 18.6 | 3.9 | 100 |
| Central | 69.1 | 18.0 | 10.5 | 2.3 | 0.0 | 100 |
| Coast | 56.3 | 27.0 | 2.6 | 12.5 | 1.6 | 100 |
| Eastern | 66.4 | 18.4 | 10.2 | 4.6 | 0.4 | 100 |
| North Eastern | 79.8 | 17.1 | 0.0 | 2.5 | 0.6 | 100 |
| Nyanza | 60.1 | 12.4 | 2.9 | 20.9 | 3.7 | 100 |
| Rift Valley | 55.4 | 20.4 | 8.7 | 12.3 | 3.2 | 100 |
| Western | 47.8 | 15.5 | 3.4 | 30.5 | 2.9 | 100 |
| Cluster type | | | | | | |
| Urban | 45.5 | 29.0 | 4.8 | 18.7 | 2.0 | 100 |
| Rural | 59.5 | 16.8 | 6.8 | 14.3 | 2.7 | 100 |

Table 7: Health service usage by province and type in 2003 (%)

Source: Ministry of Health (2003) as used in Barnes, J., O'Hanlon, B., Feeley, F., McKeon, K., Gitonga, N. & Decker, C., 2009.

Large proportion of health staff employed in private sector. In contrast to the infrastructure, Table 8 indicates that the majority of Kenyan health staff is employed within the private sector. Almost 75% of doctors and two thirds of nursing officers and enrolled nurses are working in the private sector. This, combined with already low staff-population ratios, lead to a situation where the public sector is severely under-resourced. The total number of doctors in Kenya equates to a ratio of 1.5 doctors per 10,000 of the population as compared to a higher average of 2 per 10,000 for the region (WHO, 2008). Furthermore, Kenya has very few dentists. However, the nurse-to-population ratio (including nursing officers and enrolled nurses) equates to about 12 per 10,000, slightly more than the 10 per 10,000 average for the region (WHO, 2008).

| Category | Total registered (2007) | Public sector (2008) | Public sector % of total | Private sector* | Private sector % of total |
|-----------------------------|-------------------------|----------------------|--------------------------|-----------------|---------------------------|
| Doctors | 6,271 | 1,605 | 26% | 4,666 | 74% |
| Dentists | 631 | 205 | 32% | 426 | 68% |
| Pharmacists | 2,775 | 382 | 14% | 2,393 | 86% |
| Pharmaceutical technologist | 1,680 | 227 | 14% | 1,453 | 86% |
| Nursing officers | 12,198 | 3,013 | 25% | 9,185 | 75% |
| Enrolled nurses | 31,917 | 11,679 | 37% | 20,238 | 63% |
| Clinical officers | 5,797 | 2,202 | 38% | 3,595 | 62% |

Table 8: Estimates of total health staff working in private and public health sectors in 2007, 2008

Source: Kenyan Ministry of Medical Services (2008) as used in Barnes, J., O'Hanlon, B., Feeley, F., McKeon, K., Gitonga, N. & Decker, C., 2009.

*Estimate ignores changes in numbers during 2008.

5.2. Health financing

Low contribution of pooled funding to total healthcare expenditure. Households fund 29% of Kenya's total health expenditure (THE) on an out-of-pocket basis. Less than 10% of total health expenditure occurs on pooled basis, with the majority of health expenses being funded directly, either by government, households or non-governmental organisations (NGOs). Only 5.4% of total health expenditure derives from private health insurance (collected through employers), with the National Hospital Insurance Fund (NHIF) contributing less than 4% to THE. The largest financing agent of health expenditure in Kenya is the government, funding 39% of THE.

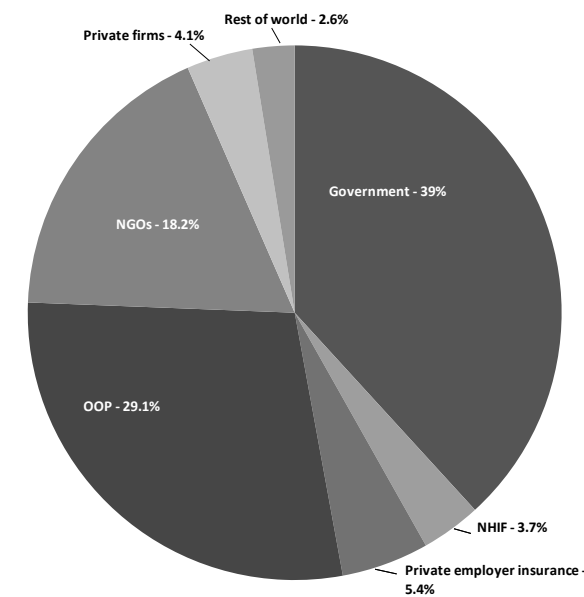


Figure 5: Financing agents' relative contributions to total health expenditure (THE) in 2005/06

Source: Government of Kenya, 2009.

Gradual move to universal health insurance coverage. The Kenyan government has started to develop an all-inclusive health financing strategy. The main objectives are to reduce inequality in terms of access to health services by different segments of the population, especially the poor (Ministry of Public Health and Sanitation and Ministry of Medical Services, 2009). The reform initiative began in earnest in 2007 with the Ministry of Health mandating the planning department with the responsibility of engaging stakeholders in developing a medium- to long-term health financing strategy in line with Kenya's vision 2030.⁵⁵ Historically, the health financing system in Kenya has been funded largely by general tax revenues. From the 1980s, revenue sources became tighter and there was a move towards cost sharing initiatives. This, however, had a significant impact on widening the accessibility gap between the poor and the well-off. It is against this background that the government is considering reforms that will guarantee universal access.

⁵⁵ Kenya Vision 2030 is an economic development plan released by the Kenya government in 2006 to develop certain economic sectors that have lagged behind or are viewed as potential drivers of growth.

NHIF currently provides compulsory health cover for formal sector workers, voluntary cover for informal sector workers. The NHIF provides hospitalisation cover for formal sector workers (contributions to the fund are compulsory) and informal sector workers are able to purchase hospitalisation cover for the fund on a voluntary basis.

Contributions determined by income. The fund operates under the social principle that “the rich should support the poor, the healthy should support the sick, and the young should support the old”, with a core mandate to provide medical insurance cover to all its members and their declared dependents (NHIF, 2005). Membership to the NHIF is open to all Kenyans who are older than 18 years and earn a monthly income greater than KSh1,000 (US\$ 13). Monthly contributions to the fund range from KSh30 (US\$ 0.40) to KSh320 (US\$ 4) depending on income for those formally employed, while those in the informal sector are required to pay a flat rate of KSh160 (US\$ 2).

Cover limited to inpatient care through accredited providers. NHIF provides inpatient coverage of up to KSh396,000 (US\$ 5,255) per year for the main member, spouse and family. Comprehensive medical cover is available at 400 accredited government, private and mission health providers across the country. NHIF does not exclude any disease, and coverage includes maternity cases.

In excess of 2m members covered, including both formally and informally employed. Up-to-date official data on membership levels are not available. As of 2005, NHIF reported having a total of 1.5 million contributors, with coverage extending to 6 million dependents (NHIF, 2005). The Association of Kenyan Insurers (AKI) reported that NHIF membership had increased from 205,698 in 1998 to 1,371,554 in 2006 (Wamai, 2009). However, recent media reports put the estimate at 2.1 million members split between 1.8 million formally employed (spread across 41,000 employers) and 300,000 self-employed, voluntary members (Mbogo, 2010). If these figures are accurate and it is assumed that for each member an additional three dependents are covered, the fund could cover up to 8.4 million Kenyans. However, it remains that only a small proportion of the estimated 9 million formally employed Kenyans who can afford monthly contributions of KSh30 (US\$ 0.40) or more are enrolled in the programme.

NHIF facilitates health microinsurance innovation with partners, while also exploring other ways of extending cover. The availability of the NHIF has catalysed innovation in the delivery of health microinsurance in partnership with commercial insurers. These partnerships combined NHIF cover with other insurance cover and extended its distribution to the informally employed through co-operatives and other networks. This will be discussed in more detail in Section 8.2. Independent of its partnerships with private insurers, the NHIF has established a dedicated microinsurance department that will continue to explore other strategies to extend its coverage in the informal sector.

High but reducing administration costs. The NHIF, as the entire medical insurance sector in Kenya, suffers from high administration costs. Administrative costs range from 20% of premiums for private insurers to 40% for the NHIF. However, the NHIF has been successful in reducing its costs from previous very high levels of 60% of total premiums. This is, however, still high when compared to other social health schemes globally whose administrative expenses typically range between 3-6% (Barnes et al., 2009).

Pilots to include outpatient cover. As noted above, the NHIF only provides inpatient cover. In December 2009, the fund launched a pilot outpatient scheme to complement the inpatient cover. This initiative might be seen as a response on the part of NHIF to medical insurance trends which show that outpatient services account for 60% of medical cover utilisation in Kenya (Mbogo, 2009). Low-income earners are expected to be the biggest beneficiaries from the initiative which will most likely reduce the burden of outpatient care. Private insurance companies also expect to gain as they might see the utilisation burden of their covers reduce as all privately insured persons must also have NHIF cover. The NHIF reports that the contribution structure for the new scheme will be similar to the inpatient cover with contributions ranging between KSh30 (US\$ 0.40) and KSh320 (US\$ 4.25). The pilot project was expected to run for 6 months from December 2009 and it involves 250,000 outpatients in Nairobi and another 50,000 in Mumias.

| Old Rates (KSh) | | New Rates (KSh) | | % Increase |
|---|--------------------------|---------------------------------------|--------------------------|------------|
| Income group | Premium | Income group | Premium | |
| 1,000 – 1,499 (US\$13 – 20) | 30 (US\$0.4) | Less than 5,999 (Less than US\$80) | 150 (US\$2) | 400 |
| 1,500 – 1,999 (US\$20 – 27) | 40 (US\$0.5) | | | 275 |
| 2,000 – 2,999 (US\$27 – 40) | 60 (US\$0.8) | | | 150 |
| 3,000 – 3,999 (US\$40 – 53) | 80 (US\$1) | | | 88 |
| 4,000 - 4,999 (US\$53 – 66) | 100 (US\$1.3) | | | 50 |
| 5,000 – 5,999 (US\$66 – 80) | 120 (US\$1.6) | | | 25 |
| 6,000 – 6,999 (US\$80 – 93) | 140 (US\$2.1) | 6,000 – 7,999 (US\$80 – 106) | 300 (US\$4) | 114 |
| 7,000 – 7,999 (US\$93 – 106) | 160 (US\$2.1) | | | 88 |
| 8,000 – 8,999 (US\$106 – 120) | 180 (US\$2.4) | 8,000 – 11,999 (US\$106 – 159) | 400 (US\$5.3) | 122 |
| 9,000 – 9,999 (US\$120 – 133) | 200 (US\$2.6) | | | 100 |
| 10,000 – 10,999 (US\$133 – 146) | 220 (US\$2.9) | | | 82 |
| 11,000 – 11,999 (US\$146 – 159) | 240 (US\$3.2) | | | 67 |
| 12,000 – 12,999 (US\$159 – 172) | 260 (US\$3.5) | 12,000 – 14,999 (US\$159 – 199) | 500 (US\$6.7) | 92 |
| 13,000 – 13,999 (US\$172 – 186) | 280 (US\$3.7) | | | 79 |
| 14,000 – 14,999 (186 – 199) | 300 (US\$4) | | | 67 |
| 15,000 and above (US\$199 and above) | 320 (US\$4.3) | 15,000 – 19,999 (US\$199 – 266) | 600 (US\$8) | 88 |
| | | 20,000 – 24,999 (US\$266 – 332) | 750 (US\$10) | 134 |
| | | 25,000 – 29,999 (US\$332 – 398) | 850 (US\$11.3) | 166 |
| | | 30,000 – 49,999 (US\$398 – 664) | 1,000 (US\$13) | 213 |
| | | 50,000 – 99,999 (US\$664 – 1328) | 1,500 (US\$20) | 369 |
| | | Over 100,000 (Over 1328) | 2,000 (US\$27) | 525 |
| Voluntary/Self Employed | 160 (US\$2.1) | Voluntary/Self Employed | 500 (US\$6.7) | 213 |

Table 9: Comparison of old and new NHIF rates

Source: NHIF website

NHIF ability to provide cover limited by restrictions on contribution increases. Based on the concluded pilot test for out-patient services, NHIF has increased the value of monthly contributions (or premiums). Minimum contributions have been increased from KSh30 (US\$ 0.40) to KSh150 (US\$ 1.99) per month. This implies a 400% increase for the lowest

contribution level. The number of income categories which determine contributions were decreased from 17 to 11, increasing the size of income bands. The contribution for self-employed individuals increased from KSh150 (US\$ 1.99) to KSh500 (US\$ 7). The increases have been met with some resistance from doctors and private insurance companies. The doctors argue that increasing the contributions might lead to the exclusion of the poor, while insurance companies fear that the increased contributions will 'eat' into their premiums and ultimately erode their client base. The NHIF has not been allowed to increase contributions since 1998 and contends that the revision will increase its financial reserves, with the surplus being invested in scaling-up free medical care to the poorest of the poor.

6. Financial sector context

Although this study does not directly focus on the banking, microfinance and savings and credit co-operative (SACCOs) sectors, a quick overview is still useful given the significant role these institutions can play in the distribution of microinsurance. These entities have led the way into the low-income market and industry interviews conducted for this study reveal that a number of banks, MFIs and SACCOs are already proactively extending insurance products to their low-income clients and/or members.

6.1. Banking sector

Banking sector emerges from a series of bank failures. Five banks were placed under liquidation between 2003 and 2006, with others placed under statutory management. The Central Bank responded appropriately to these challenges by encouraging consolidation within the banking sector. As a result, stability has been restored to the sector with no banks being placed under liquidation or statutory management since 2007 (Central Bank of Kenya (CBK), 2003/09).

Rapidly growing traditional banking infrastructure. The Kenyan banking landscape consists of 43 banks, two mortgage finance companies, 123 foreign exchange bureaus and 930 branches. The branch network has seen significant growth in recent years, boasting a 20.5% increase from 772 branches in 2008 to 930 in 2009 (CBK, 2009). As shown in Table 10 below, the increase in Kenya's branch and Automatic teller machines (ATM) infrastructure places it ahead of its East African neighbours, in line with Nigeria, but still lagging behind South Africa (a regional outlier). In addition, the introduction of M-PESA is rapidly transforming this sector and is discussed below.

| Country | Per 100,000 of the population | |
|---------------------------------------|-------------------------------|------|
| | Branches | ATMs |
| Kenya (2004) | 1.4 | 1 |
| Kenya (2008) ⁵⁶ | 2.4 | 3.8 |
| <i>vs. selected African countries</i> | | |
| Tanzania (2004) | 0.6 | 0.2 |
| Zambia (2003) | 1.5 | 0.7 |
| Ethiopia (2001) | 0.4 | - |
| Uganda (2004) | 0.5 | 0.7 |
| South Africa (2002) | 6 | 17.5 |
| Nigeria (2004) | 2.4 | 1.6 |

Table 10: Branch and ATM penetration in Kenya and selected Eastern and Southern African countries

Sources: World Bank regulators survey, 2001, 2002, 2003 and 2004; CBK Revised Annual report, 2009

Growing usage of banking products. Banks have seen rapid growth in both the value of deposits and the number of account holders over the last five years. Deposits have increased from KSh573.5 billion (US\$ 7.6 billion or 40% of GDP) in June 2006 to KSh953.7 billion (US\$ 12.66 billion or 45% of GDP) in June 2009 corresponding to a 19% yearly average growth in

⁵⁶ 2008 data was obtained from the Central Bank of Kenya's revised 2009 Annual report

deposits (CBK, 2006/09). The percentage of adults with bank accounts increased from 14% to 22% (4.6 million adults⁵⁷) for the same period (FinAccess 2006/09).

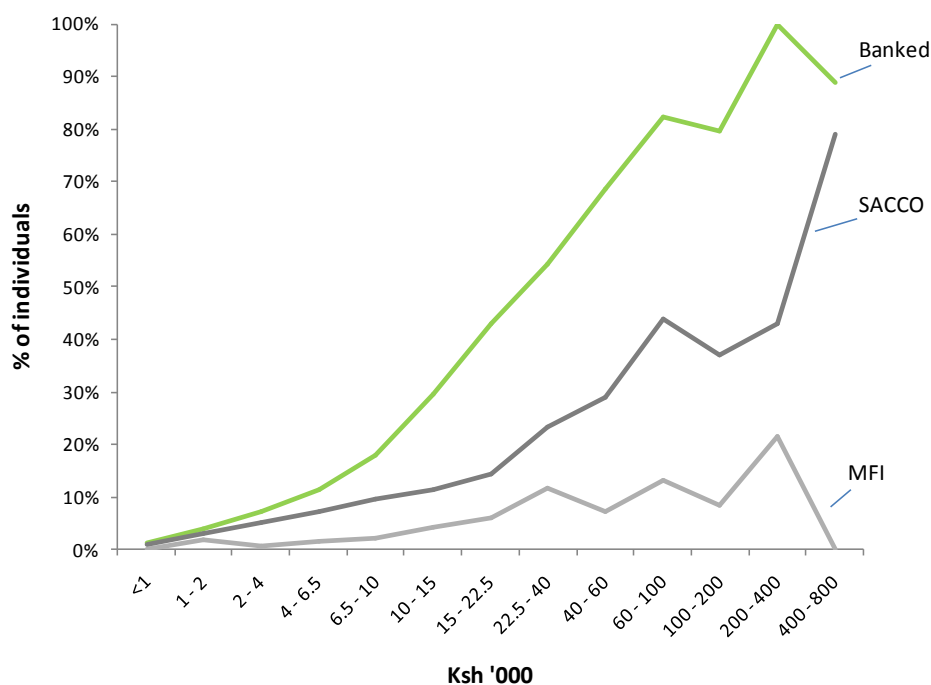


Figure 6: Bank, MFI and SACCOs clients across income categories

Source: Authors representation of FinAccess 2009 data

The representation above, Figure 6, divides the Kenyan adult population into 14 income categories where the lowest-income category represents individuals earning less than KSh1,000 (US\$ 13) per month and the highest income category represents individuals earning more than KSh800,000 (US\$ 10,600) per month⁵⁸.

Banks reaching younger and low-income market. As discussed below, banks reach a younger population than MFIs. However, although banks have actively extended into the low-income market during the last few years, SACCOs have gone much further in serving low-income clients than MFIs and banks. 15% of bank clients (approximately 660,000 adults) earn less than KSh6,500 (US\$ 87) compared to 23% for SACCOs (approximately 460,000 adults) and 16% for MFIs (approximately 110,000 adults). 44% of bank clients are younger than 30 compared to 24% for MFI and 21% for SACCO users.

New generation of banks leading the way. A number of commercial banks, emerging from the microfinance arena, have shown success in extending financial services to the previously unserved:

⁵⁷ Data reflects adults' usage during May 2009.

⁵⁸ Income is derived using the expenditure approach. Thus, individuals are asked how much money they spend and save during any given month.

- **Equity Bank** was registered in 1984 as a building society and, over time, became a fully fledged commercial bank in December 2004. As at 2010, Equity had 4.1 million accounts, accounting for more than half of all bank accounts in Kenya (Equity Bank, 2010).
- **Kenya Rural Enterprise Programme (K-Rep) Bank** was established in 1999 and was founded by K-Rep Group limited (incorporated locally in 1987) that also houses the K-Rep Development Agency (a microfinance development agency). In 2008, K-Rep Bank had 58,578 loan clients and 125,314 deposit clients (MixMarket, 2010).
- **Family Bank**, formerly the Family Finance Bank Society, was established in 1984, and converted to a commercial bank in May 2007. During 2009, Family Bank had 57,000 deposit accounts with balances less than KSh100,000 and another 18,000 with balances greater than than KSh100,000 (CBK, 2009).

M-PESA transforming the banking sector. In addition to the introduction of these new banks, the introduction of M-PESA is transforming the banking and broader financial sector. Since its launch in 2007, M-PESA has grown to an active client base in excess of 9.5 million (as of March, 2010), which is serviced by an agency force of more than 17,500. The focus was initially only on geographic transfers and bill payments but the recent partnership with Equity (M-Kesho)⁵⁹ will extend this to full banking services. The fact that Equity is also one of the seven registered bank insurance agencies, (see discussion in Section 8.1) means that insurance⁶⁰ will be actively distributed through this channel. The combination of Equity, the largest and fastest growing bank (by customers) with the largest agency and payment system network, M-PESA, is likely to dominate development in the banking and financial sector. However in the future this may raise some concerns with regard to competition.

Biggest impact of M-PESA on financial services distribution yet to come. The M-PESA technology has not accommodated automatic deductions to date⁶¹. Accordingly, insurers looking to use M-PESA for premium collection are challenged to develop products that will incentivise their clients to voluntarily make premium payments every month. Despite this limitation, M-PESA is already impacting the insurance sector. Several microinsurance schemes are utilising this payments channel (see Section 8.2 for more details). At a cost of KSh30 (US\$ 0.40) per transfer, M-PESA payments are less expensive than bank transfers making this an attractive choice for small premium payments. M-PESA agents have so far not been involved in the selling of any financial services as M-PESA views its competitive advantage to be the payment system rather than the intermediation potential of the agency force. The tie-up with Equity may signal a change in strategy, and it may only be a matter of time before M-PESA starts acting on the distribution potential of such a large agency force. Adding insurance to the other products intermediated could make this a very attractive value proposition for agents and Safaricom⁶².

⁵⁹ M-Kesho is a bank account offering designed by M-Pesa and Equity Bank. The offering allows individuals to access bank account (and insurance) services from Equity Bank using Safaricom's M-Pesa platform.

⁶⁰ Over and above the life insurance component currently linked the M-Kesho product offering

⁶¹ M-PESA has been positioned as a money transfer/payment system and has thus not facilitated debit order transaction.

⁶² One of Kenya's leading mobile service and communication providers

6.2. Microfinance institutions (MFIs)

The microfinance industry in Kenya consists of several regulated and unregulated players operating in various institutional forms⁶³. The Microfinance Act (2006) (see Section 7.3 for more details) defines MFIs as any legal entity providing credit. Three broad types of microfinance institutions have emerged:

- **Deposit taking MFIs:** deposit taking microfinance institutions (as defined in the Microfinance Act, 2006) are allowed to take (a) deposits from the public, and (b) lend or extend credit. Since June 2010, the Kenyan Central Bank (CBK) has issued two deposit taking microfinance licences⁶⁴. In addition, banks⁶⁵ conducting microfinance business are grouped under the deposit taking MFIs category (but regulated as banks) (Matu, 2008).
- **Registered Credit-only MFIs:** Non-deposit-taking microfinance institutions⁶⁶ include MFIs which do not engage in deposit taking business but operate as legal, registered entities⁶⁷.
- **Informal, unsupervised organisations:** Informal institutions (as defined by Omino, 2005) such as rotating savings and credit associations (ROSCAs), club pools and finance services associations (FSAs).

Unless otherwise stated the rest of the discussion in this section focuses on non-bank deposit-taking and credit-only MFIs. Banks conducting microfinance business are considered in section 6.1 and microfinance organisations in the form of SACCOs are discussed separately in section 6.3.

According to the Kenyan Central Bank, the number of microfinance institutions in Kenya is largely unknown (CBK, 2009). The 36 retail MFI members registered with the Kenyan Association of Microfinance Institutions (AMFI)⁶⁸ remains the only reliable estimate of the deposit-taking and credit-only MFIs operating at any significant scale.

⁶³ These players include but are not limited to commercial banks, development finance institutions, the national post and savings bank, deposit taking MFI, non deposit taking institutions in various forms such as companies, NGOs, savings and credit cooperatives, SACCOs, ROSCAs, ASCAs and money lenders (CBK, 2009).

⁶⁴ CBK issued licenses to Kenya Women Finance Trust and Faulu Kenya.

⁶⁵ Four commercial banks undertake MFI business: Equity Bank, Family Bank, K-Rep Bank and Co-operative Bank.

⁶⁶ MFIs are still allowed to accept cash collateral tied to loan contract.

⁶⁷ Currently non-deposit taking MFIs (depending on nature) can be registered under any of the following Acts: The Non Governmental Organization Co-ordination Act, The Building Societies Act, The Trustee Act, The Societies Act, The Co-operative Societies Act, The Companies Act, The Banking Act and The Kenya Post Office and Savings Bank Act.

⁶⁸ See appendix for full list of members.

| # | Country | Borrowers |
|----|--------------|-------------------------|
| 1 | Ethiopia | 1,840,788 |
| 2 | Kenya | 1,093,515 ⁶⁹ |
| 3 | South Africa | 722,559 |
| 4 | Ghana | 354,293 |
| 5 | Nigeria | 348,750 |
| 6 | Tanzania | 270,069 |
| 7 | Uganda | 262,106 |
| 8 | Mali | 218,291 |
| 9 | Senegal | 217,891 |
| 10 | Cameroon | 165,470 |

Table 11: Top ten MFI countries by number of borrowers

Source: MIX market⁷⁰ 2008

Second largest microfinance market in Africa. In 2008, Kenya's boasted the second largest MFI market in Africa judged by number of borrowers (see Table 11). With over 1 million MFI loan clients⁷¹, Kenya only lags behind Ethiopia which is in first place with 1.8 million borrowers. Kenya is followed by South Africa in third place with 0.7 million clients. Using the larger MFI sample of all AMFI members⁷² (but excluding commercial bank members of AMFI), the CBK estimates MFI loan clients to be higher at 1.3 million with total loans distributed in 2008 of KSh47.5 billion (US\$ 630 million). Total deposits tallied KSh15.8 billion (US\$ 230 million) for the same period (CBK, 2009).

New Microfinance Act (2006) extends products offered by MFIs. The Microfinance Act (2006, operational from 2 May 2008) allows credit-only MFIs that meet specific criteria to register as deposit-taking MFIs⁷³. Such MFIs are able to extend their product offering and gain access to additional funds for on-lending and compete more directly with the commercial banks. To date, the CBK has only issued deposit-taking licences to Faulu Kenya and Kenya Women Finance Trust (KWFT⁷⁴) (CBK, 2009).

Small, but growing use of deposit taking MFIs (excluding commercial banks) and credit only microfinance institutions (MFI) services. MFI usage doubled between 2006 and 2009 from 1.4% to 3.4% of the adult population, respectively⁷⁵. This consisted of an increase in MFI savings clients from 1.5% to 3.2% and an increase in credit clients from 0.8% to 1.8% (FinAccess, 2006/9). The CBK expects the microfinance industry to play a pivotal role in

⁶⁹ The number of borrowers includes the loan books of commercial banks undertaking microfinance business. It should be noted that microfinance forms part of these banks larger credit portfolio that does not only include MFI business, potentially inflating the true results.

⁷⁰ Mix market data for Kenya is based on 15 reporting microfinance institutions: (1) Bimas, (2) Equity Bank, (3) Faulu, (4) Jamii Bora, (5) K-Rep, (6) KADET, (7) Kenya Post Office and Savings Bank (KPOSB), (8) KWFT, (9) MCL, (10) Micro Africa, (11) Opportunity Kenya, (12) PAWDEP, (13) RAFDOPE, (14) Riverbank and (15) SMEP

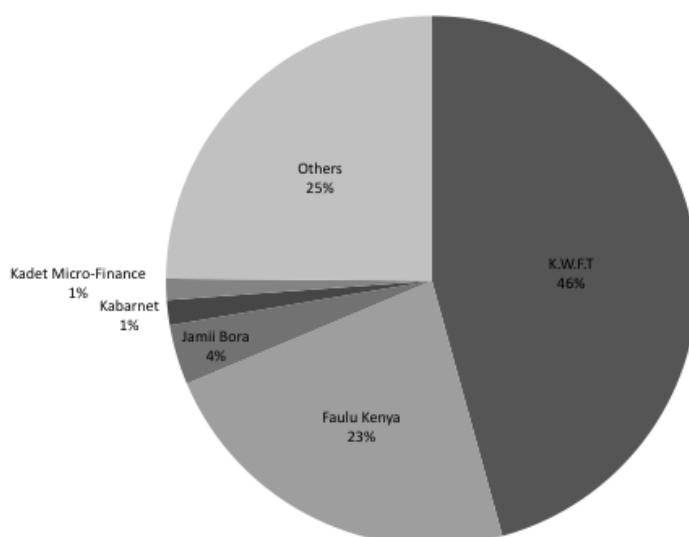
⁷¹ MIXIT data includes banks conducting MFI business. It should be noted, that when respondents were asked if they had a loan with an MFI, only 1.97% of the Kenyan adult population (405,899) reported having a loan with an MFI (FinAccess, 2009).

⁷² 36 Members in total, see Appendix for list of members.

⁷³ National deposit taking MFI would need to provide minimum capital of KSH 60 million, and regional MFIs KSH 20 million.

⁷⁴ Faulu Kenya was founded in 1992 as a programme of Food for the Hungry International (FHI), a Christian relief and development organisation based in Phoenix, Arizona in the USA and has grown to become an MFI that offers both savings and credit.

⁷⁵ Figures represent adult population over the age of 18 years old.



deepening financial markets and enhancing access to financial services and products (CBK, 2010).

KWFT and Faulu dominant players in non-bank MFI⁷⁶ market. Kenya Women’s Finance Trust (KWFT) and Faulu Kenya (both deposit taking MFIs) jointly serve 69% of non-bank MFI⁷⁷ customers. Figure 7, below, lists the five largest MFIs by their share of MFI customers: KWFT (46%), Faulu Kenya (23%), Jamii Bora (4%), Karbarnet (2%), Kadet (1%), with the remaining players servicing the remaining 25% of MFI users.

Figure 7: Breakdown of MFI players by market share

Source: FinAccess 2009

6.3. Savings and credit co-operatives (SACCOs)

Largest co-operative movement in Africa. According to the Co-operative Alliance of Kenya (CAK), the national apex body for the co-operatives movement in Kenya, the Kenyan co-operative market is the largest in Africa and the seventh largest in the world with more than 12,000 registered co-operative societies with 7 million members (Munfane, 2010). While comprehensive SACCO census data was not available at the time of this study, a recent data collection effort by FSD Kenya of the audited statements of the largest 155 SACCOs estimates their total liabilities to be KSh97 billion (FSD Kenya, 2009).

There are different types of organisations that attempt to network and structure the Kenya co-operative industry in different ways:

- **The National Apex body (CAK):** The Co-operative Alliance of Kenya (CAK) was registered at the end of 2009 as the Apex Organisation for the Co-operative Movement of Kenya under the Co-operative Societies Act, CAP 490 of 2004. The function of the body is as

⁷⁶ MFI in this context relates to deposit-taking MFIs and credit-only MFIs.

⁷⁷ Percentage of the formal, non-bank MFI customers.

custodian to the movement, promoting the development and improved networking and governance in the sector⁷⁸. The CAK has members across all other tiers.

- **National Co-operative Organisations:** Registered National Co-operative Organisations have primary and secondary co-operatives as their members and/or shareholders, and operate to support co-operatives by providing services such as banking, insurance, savings and credit to the movement⁷⁹ (Wanyama, 2009). These organisations include the following: the Co-operative Bank of Kenya, Co-operative Insurance Company of Kenya (CIC), Kenya Union of Savings and Credit Co-operatives Ltd (KUSCCO), Kenya Rural SACCO Society Union Ltd. (KERUSSU), National Housing Co-operative Union Ltd (NACHU), Co-operative College of Kenya, Kenya Planters Co-operative Union Ltd (KPCU) and New Kenya Co-operative Creameries Ltd (New KCC).
- **Secondary co-operatives/co-operative unions:** Secondary co-operatives⁸⁰ are organisations whose members consist of primary co-operatives⁸¹ (representative bodies that have individuals as members with the aim of promoting a common economic or social interest). The societies' primary goal is to promote the welfare and economic interest of the primary co-operatives and thus the members of the primary co-operatives.
- **Primary co-operative societies:** Primary co-operatives memberships are restricted to individual members⁸². As in the case of secondary co-operatives, the main objective of the organisations must relate to the promotion of the welfare of the members. In addition, the Co-operative Act requires the incorporation of certain principles in their by-laws⁸³.

Co-operatives not well networked. Despite the best efforts of these organisations to organise the co-operative industry into a clear structure, co-operatives are not well networked. The best connected organisations are the National Co-operative Organisations and, specifically, the Co-operative Insurance Company of Kenya (CIC) and Co-operative Bank of Kenya, which are not co-operatives in themselves, but have large numbers of co-operatives as their shareholders and clients. The fact that these organisations already offer banking and insurance services may, however, mean that they would be less inclined to act as intermediaries of such services provided by other insurers to their shareholders and clients. Despite the lack of strong networks, co-operatives may still be attractive as intermediaries as there are a number of individual co-operatives with significant membership.

SACCO usage skewed to lower end of market. As depicted in Figure 6, almost 70% of SACCO clients earn less than KSh15,000 (US\$ 200) per month. In addition, 23% of their clients earn less than KSh6,500 (US\$ 86) per month – the highest percentage when compared to MFIs (15.5%) and banks (14.7%). Furthermore, 2.5% of SACCO clients earn less than KSh2,000 (US\$ 26) per. The relatively higher ratio of low income clients of SACCOs adds to their appeal as distribution channels for microinsurance.

⁷⁸ Functions include: Lobbying and advocacy, awareness campaigns and innovation, facilitating agricultural extension services, institutional development, creating a national co-operative resource centre, developing an information communication technology system.

⁷⁹ It should be noted that SACCOs do not exclusively bank and/or insure with National Co-operative Organisations such as Co-operative Bank and Co-operative Insurance Company of Kenya (CIC).

⁸⁰ Secondary co-operatives societies are usually referred to as federations. However, this is not the case in the Kenyan context.

⁸¹ The Co-operative Societies Act (Amended), 2004 restricts Co-operative Unions membership to primary co-operatives.

⁸² The Co-operative Societies Act (Amended), 2004 sets the minimum number of members to 10 individuals

⁸³ Co-operative society has to incorporate in its by-laws the following co-operative principles; (i) voluntary and open membership, (ii) democratic member control; (iii) economic participation by members; (iv) autonomy and independence; (v) education, training and information; (vi) co-operation among co-operatives, and; (vii) concern for the community in general.

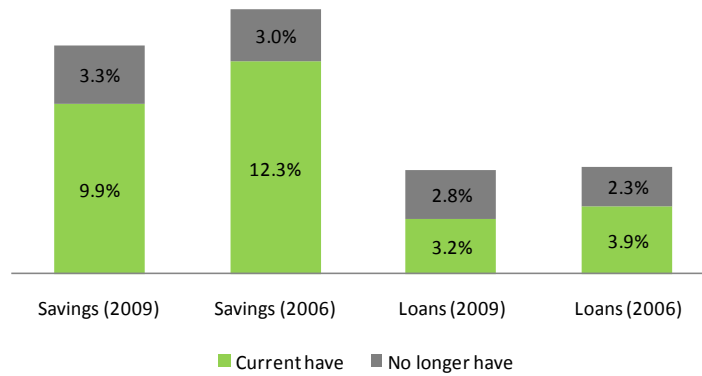


Figure 8: Percentage of adults (16 and above) using SACCO loan and savings services

Source: FinAccess (2009)

SACCOs losing ground to MFIs and Banks. SACCO usage decreased significantly from 13.1% to 9% of adults for the period 2006 to 2009⁸⁴. This corresponds with the aggressive expansion in the banking and MFI markets and suggests that SACCOs are losing ground to these entities. This observation is also supported by the fact that SACCO membership is biased towards older age categories – as members age they may be exiting the market. In addition, SACCOs have been traditionally associated with formal employment (which has been relatively static or even declining) and the agricultural sectors, of which key subsectors such as coffee have been struggling and decline (Ferrand, 2010).

Emergence of Front Office Services Activity (FOSA) extends additional functionality. SACCOs offer front office services similar to those of banks. These services include cheque and salary deposits, bill payments, cheque cards and ATM services⁸⁵. In 2009, membership data of 131 of the most prominent SACCOs⁸⁶ with FOSA activities estimates their membership size at 1.1 million with asset worth KSh 142 billion (US\$ 2 billion) (FSD Kenya, 2009). The ability to offer these extended services may allow SACCOs to better compete against banks and MFIs.

6.4. MFI, SACCO and Bank usage

Drawing together the above discussion, there are some interesting features of the client portfolios of banks, MFIs and SACCOs (and their overlap), which are of relevance to the insurance sector and are worth considering.

Figure 9 (below), maps the share of adults over 16 who make use of MFIs, SACCOs and banks. Overlapping areas indicate multiple usages of financial services providers

⁸⁴As percentage of the adult population older than 18.

⁸⁵ The SACCO Societies Act 2008 provides for the licensing, regulation, supervision and promotion of savings and credit cooperatives. Under this Act, regulation is to come into place to oversee and govern the operations of front office service activities (FOSAs).

⁸⁶ Kenya has an estimated 220 SACCOs with FOSA activities (Mbogo, 2010)

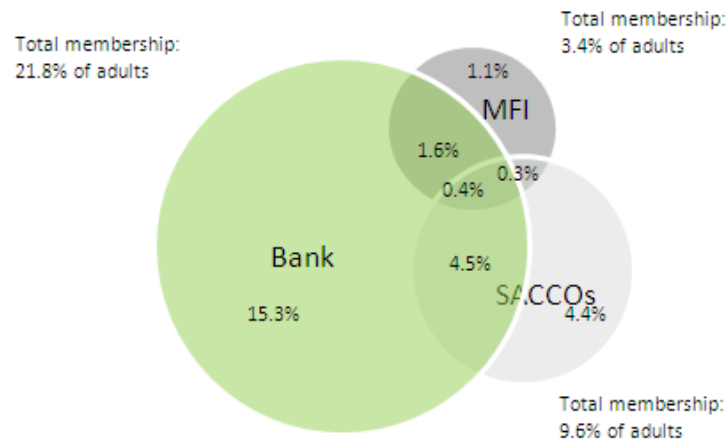


Figure 9: Comparative client bases of banks, MFIs and SACCOs (percentage of adults 16 years and older)

Source: FinAccess, 2009

Banking channel the largest aggregator. In total, banks, MFIs and SACCOs serve about 27% of the adult population. The banking sector remains the largest client aggregator, reaching 22% of adults. MFIs are the smallest client aggregators reaching 3.4% of adults. SACCOs are the second largest client aggregator reaching 9.6% of the adult population.

MFIs and SACCOs offer limited additionality over banks. Importantly, the large degree of overlap with bank clients mean that MFIs and SACCOs offer limited additional clients in terms of clients that can be reached only through them. However, it is worth noting that this will be less true in rural settings where bank reach is limited and MFIs and SACCOs product offering differs from that of banks and may still offer alternative distribution opportunities for insurers who are not in partnership with banks. About a quarter of bank clients can be reached through MFIs and SACCOs.

Banks reach younger population. Figure 10 (below), maps the distribution of MFI, bank and SACCO membership/accounts across age brackets. Banks have been successful at capturing a younger market with 44% of bank clients younger than 30 compared to 24% for MFI and 21% for SACCO users. See Figure 6 in Section 6.1 for comparison across income categories.

The above should illustrate that it is important not to take an undifferentiated approach to considering the potential role of banks, SACCOs and MFIs role in microinsurance. SACCOs, MFIs and banks are all offering somewhat different products. This has implications for their relationships with clients and their potential for intermediating microinsurance.

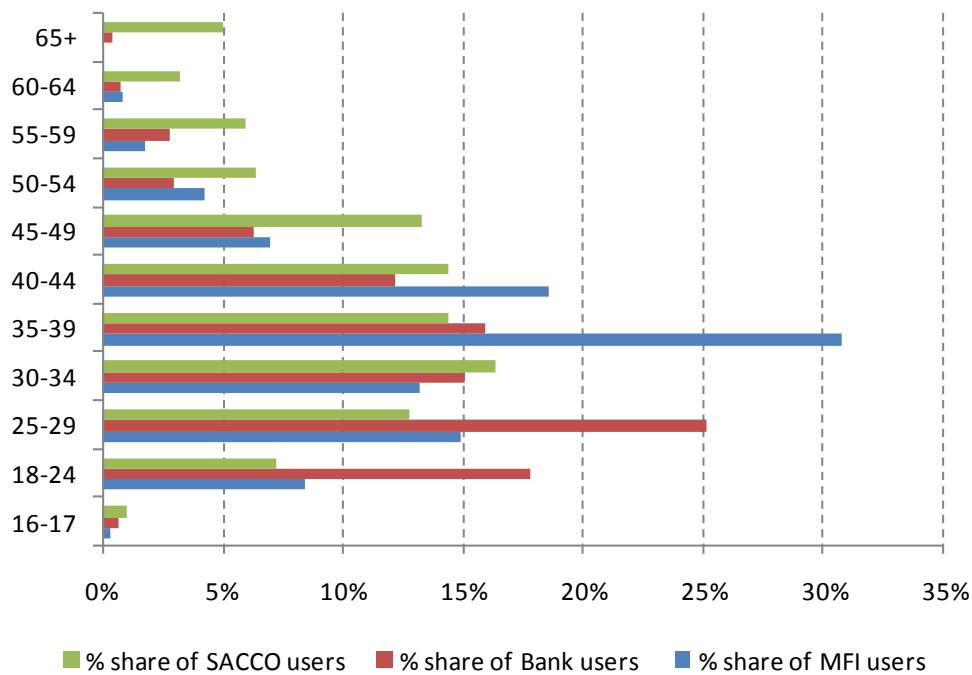


Figure 10: Breakdown of SACCO, MFI and Bank users by age category

Source: FinAccess 2009

Limited insurance penetration. Only a small proportion of the client bases of banks, MFIs and SACCOs already have insurance, implying significant remaining distribution opportunities for insurers. As at 2009, 81% (1.7 million adults) of SACCO members, 85% (3.9 million) of the banked market and 90% of MFI clients (0.7 million) still did not have any insurance⁸⁷.

⁸⁷ As noted earlier the FinAccess questionnaire did not explicitly capture credit life as a product, which will understate the insurance penetration.

7. Regulatory framework

This section provides an overview of the regulatory framework that governs the delivery of insurance and considers the impact that such regulation may have on the development of microinsurance in Kenya. The regulatory scheme for microinsurance in Kenya, which includes all legislation impacting on the delivery of insurance, includes a number of acts and their regulations beyond the Insurance Act. The Banking Act, the Microfinance Act, the Co-operative Societies Act and the Savings and Credit Co-operative Societies Act all form part of the regulatory scheme and help determine the larger regulatory environment for microinsurance. In addition, the newly approved Proceeds of Crime and Anti-money laundering Act identifies insurance companies as reporting entities under the Act.

Furthermore, the discussion of the regulatory framework will explore the impact of various pieces of legislation by placing them into the categories proposed by the regulatory scheme:

- Prudential regulation;
- Institutional and corporate governance regulation;
- Market conduct regulation (intermediation and consumer protection); and
- Other regulation (i.e. regulation outside the insurance fold of relevance to insurance providers).

We start the discussion by briefly considering the financial inclusion policy context.

7.1. Inclusion policy context

Consideration of the general inclusion policy environment provides an important backdrop for the developments in the insurance regulatory scheme.

Policy commitment to financial inclusion captured in Vision 2030. Kenya Vision 2030 is an economic development plan released by the Kenyan government in 2006 to develop certain economic sectors that have lagged behind, or that are viewed as potential drivers of growth. This document makes explicit reference to financial inclusion as a policy objective and provides the policy support for the individual financial supervisors acting in support of financial inclusion. The specific financial inclusion objectives articulated in Vision 2030 are to decrease the share of the population without access to finance from 85% to below 70% and to streamline informal finance organisations, Savings and Credit Co-operatives (SACCOs) and microfinance institutions (Ministry for Planning and National Development (MPND), 2007). The government also promises to provide policy support for individual financial supervisors acting in support of financial inclusion.

Regulatory changes enact policy commitment to financial inclusion. In recent years, a number of changes in the broader financial sector policy and regulation have occurred to facilitate development and inclusion. In several cases this allowed for second-tier financial sector players to offer retail financial services, as in the case of MFIs which have been granted deposit-taking licenses, as well as the use of non-traditional financial intermediation channels to extend these services to the low-income market, as in the case of M-PESA. Most recently, the Banking Act was amended in December 2009 to create a space for agent banking, with the regulations for this category of services already having been issued. The

main idea with agent banking is to extend the reach of the formal banking sector through non-bank outlets, thereby allowing for a reduction in distribution costs. Furthermore, the Microfinance Act (enacted in 2006) became operational in 2008 and allows microfinance institutions that have been successful in their application for a license to become deposit-taking entities, thereby facilitating greater intermediation potential. The Savings and Credit Co-operatives Societies (SACCOs) Act of 2008 sets out prudential guidelines for deposit-taking SACCOs, thereby allowing SACCOs, if successful in their application for a licence under this Act, to take deposits from members. Collectively, these changes have shown a strong policy commitment to market development and a willingness to manage the challenges that occur as result of this.

Insurance policy on inclusion lagging behind. While the discussion below will show that the IRA is supportive of development, the insurance regulatory framework has lagged behind the other sectors in the explicit accommodation of development within the regulatory framework. To date, the focus has largely been on modernisation and development has only been accommodated on an exemption basis rather than fully integrated into the regulatory framework. However, this may reflect the pragmatic approach to development that Kenyan regulators have demonstrated over the last decade where market developments generally preceded the development and implementation of more time-consuming regulatory changes. Furthermore, the IRA is still a new institution and the Act that governs its actions is dated and does not fully support its mandate. It is therefore to be expected that the IRA's focus will initially be on getting its house in order before pursuing specific objectives such as development. Bringing in market development at this early point may, however, be timeous and allow for the formal factoring in of the inclusion objective into regulatory choice. This may avoid overly cumbersome regulatory structures that are not tailored to the availability of domestic resources.

7.2. The Insurance Act

IRA recently capacitated to fulfill a more extensive insurance oversight function. The Insurance Act CAP 487 was enacted in 1986 and its implementation commenced on 1 January 1987 (henceforth referred to simply as the Insurance Act). It is supplemented by the Insurance Regulations issued by the Minister of Finance. The Insurance Act established the Office of the Commissioner of Insurance as the regulator of the insurance industry and stipulated the mandate and functions of the office. The office was created as a Department in the Ministry of Finance and was mandated to supervise the insurance industry (IRA, 2008). The Insurance (Amendment) Act of 2006⁸⁸ increased the supervisory capacity of the regulator by establishing it as a separate and independent entity outside the Ministry of Finance. However, it is important to note that while the amendments to the old act in 2006 allowed for the establishment of the IRA and small changes here and there, it was not significantly changed. The bulk of the act still dates back to 1986 and reflects a dated view of the insurance industry. The Insurance Regulatory Authority was established during 2007 and since then has been growing its resources and staff capacity as a professional industry supervisor. According to the latest IRA annual report, the organisation has a total of 62 employees (IRA, 2008). The department is headed by a Chief Executive Officer (CEO) who reports to an eleven member Board of Directors.

⁸⁸ Enacted on 30 December 2006 and became effective on 1 May 2007.

Development mandate supports microinsurance. In addition to regulating and supervising the insurance industry, the amendments added the mandate of market development to the Insurance Regulatory Authority's list of tasks. The Act phrases the development mandate as to "promote the development of the sector"⁸⁹. This development mandate has shaped the way that the IRA has managed the development of the insurance industry and, in particular, how it has navigated the short-comings in the existing insurance legislation. The IRA has shown its support for the development of a microinsurance market in various ways, including exempting insurance companies and non-traditional intermediaries from the different parts of the Insurance Act to allow for the implementation of innovative microinsurance models. These exemptions have generally been provided on an *ad hoc* and case-by-case basis, with the exemption not being generalised to the market (see discussion below on the impact of this exemption approach).

New Act will embed IRA's drive to modernise the industry. The IRA is placing increasing emphasis on improving the soundness and stability of the Kenyan insurance industry. This has largely been driven by low levels of regulation and oversight after the Insurance Act was first implemented, resulting in several company failures and industry problems before the establishment of the independent IRA. The greater emphasis on stability includes significantly increased capital requirements, which insurance companies have had to comply with by 14 June 2010. A new Insurance Act is currently being drafted and will seek to move the Kenyan industry to international best practices. It is not clear what the exact content and nature of the Act will be, but it will include doing away with the category of composite insurance companies⁹⁰. In anticipation of this change, a number of companies have already started to split their composite business into life and general companies. In addition it is expected that the new Act will increase operating requirements and place increasing pressure on insurers to bring their operations in line with international best practices, thereby increasing the compliance burden and cost. As a result, there may be concerns as to the extent to which development can be accommodated within the new framework. The IRA has stated its intention to accommodate microinsurance within the new framework but no specific suggestions have yet been made on how this will be done. It is not clear when the revision process will be completed or when the draft bill will be submitted to parliament. As a result, the rest of this discussion will focus largely on the current legislation and make reference to directions proposed in the new legislation where these have been communicated.

De facto application often different from current de jure position. In several cases, there is a gap between what is contained in legislation and what is required in practice. The difference between de jure and de facto application complicates a regulatory analysis but, more importantly, also creates some complications for microinsurance development and, where relevant, we note this.

In the remainder of this section, we highlight the areas of the Act with the largest implications for the development of a microinsurance market in Kenya.

⁸⁹ Section 3A(e).

⁹⁰ Insurance companies that underwrite both long-term and short-term insurance

Definitions

The definition section of the Insurance Act contains a number of issues relevant for microinsurance. These are considered below.

Insurance definition excludes large part of potential microinsurance market. The Insurance Act defines “insurance business” as “the business of undertaking liability by way of insurance (including reinsurance) in respect of any loss of life and personal injury and any loss or damage, including liability to pay damage or compensation, contingent upon the happening of a specified event” (Section 2). A number products, services and entities are explicitly excluded from the definition of insurance (Section 2). These include:

- Funeral parlours providing benefits in-kind (and other incidental benefits);
- Benefits provided by employee associations;
- Benefits provided by friendly societies⁹¹ or trade unions; and
- Other benefits in-kind.

There are a number of reasons why the exclusion of these markets from the definition of insurance may be problematic. In-kind benefits such as those offered through funeral parlours form an important part of the microinsurance market in other jurisdictions and the industry conversations suggest that this area is also of increasing interest in Kenya. Similarly, benefits provided through member-based aggregators such as trade unions and friendly societies have also been found to play an important role⁹². By excluding these from the formal definition of insurance a large part of the potential microinsurance market is therefore left outside of the regulatory protection net. While the benefit-in-kind risk may be lower than the risk associated with the offering of cash benefits, it still presents an insurance risk. Excluding these benefits from any form of regulation raises concerns about consumer protection. In addition, the products offered by these institutions will directly compete with products offered by regulated insurers, raising questions about unfair competition for the regulated sector. One of the reasons these entities may have been excluded from regulation is insufficient capacity to oversee their activities. While this is recognised as an obstacle, it would be better to have an informed understanding of their activities and the risks they pose to the larger insurance environment, based on which a risk-based approach to supervision can then be developed.

Separate definition for industrial life policies. The Act identifies a category of smaller value insurance business, so-called “industrial life business” (Section 2). This is defined as having premiums “which are payable, at intervals not exceeding two months in each case, to collectors sent by the insurer to each owner of a policy, or to his residence or place of work”. These policies provided life and/or funeral cover and the product line is a historic remnant of insurance cover provided decades ago. It is not currently being used by Kenyan insurance companies. Interestingly, industrial life policies sought to achieve the same objectives that

⁹¹ A friendly society (often also called a mutual society) is a mutual association which, in many cases, provide risk benefits for its members for specific events. This is quite an old regulatory concept and, although not actively used in all cases, the institutional category can be found in the insurance regulation of many countries.

⁹² Examples where insurance products are offered to labour union members and the union is able to share in the profits generated through these sales (whether it is through distribution involvement or underwriting) include PASI in Brazil and Lesaka, a South Africa-based insurance administrator partly owned by one of the biggest labour unions in South Africa.

microinsurance is currently pursuing and sets the precedent for accommodating lower-premium policies in the regulatory framework.

Group underwriting limited to pre-existing groups, with no explicit protection afforded to these policies. There is one reference in the Act (Section 2), as well as a few references to group policies in the regulations to the Act. “Group Life Insurance and Group Business” is defined in Section 2 as “insurance on the lives of groups of persons formed for purposes other than that of purchasing a group life insurance policy” (emphasis added). While the regulations refer to groups, no further definitions or explanations of acceptable group structures are provided in the regulations. Apart from the definition contained in the definitions section (Section 2), there are no further references to group life or group policies contained in the Act. A strict legal interpretation of the Insurance Act would therefore not allow voluntary group schemes where the group is established mainly for the purpose of obtaining insurance. In practice, however, this restriction does not seem to be enforced. Besides the definition for group policies, which seem to exclude voluntary group policies, there are no provisions dealing with consumer protection or intermediation of group policies. Group structures are particularly relevant as microinsurance schemes tend to be structured as group policies. Group structures do not refer to sales strategies but rather to the way in which membership is defined and underwriting is done. These can take many different forms ranging from closed groups (where the membership is determined by something other than obtaining insurance), looser group structures (e.g. clients of a cell phone network or retail payments system) to groups dedicated to obtaining insurance (e.g. mutual insurers where someone becomes a member of the group simply by purchasing a policy). Given the small premiums and the efficiencies required, group structures are necessary as means of managing the risk in a cost-efficient manner. However it also raises some questions that regulation needs to consider. These include, for example, the contractual relationship (whether this is between the insurer and the client or between the intermediary and the client), whether restrictions should be placed on membership, when and how groups may be moved between insurers, communication and disclosure to clients if this is not done directly by the insurer, etc.

Box 1: The relationship between group underwriting and term of cover

Microinsurance mostly based on group underwriting: The individual underwriting process is expensive and therefore simply not feasible for low-income, low-premium policies. As a result, insurers targeting the low-income market often assess the profile of groups rather than of individuals. This allows them to economise on risk pooling costs by reducing the costs associated with adverse selection and by avoiding expensive, individual medical underwriting. Combined with the fact that these are new markets on which data is often not available, this implies that insurers do not have as accurate an understanding of the risk profile of the group (or the individuals in the group) as they would have had in the case of individual underwriting. Due to this uncertainty, they are generally not willing to commit to a long-term price guarantee or contract. Group policies therefore tend to be written on a short-term contract basis, with policies sold on a one-year or even one-month renewable basis. In such a set-up the insurer has the option not to renew the contract or to adjust the price on each renewal in line with the risk experience of the group.

Group underwriting requires short contract terms for risk management: Given that individual underwriting is unlikely to be viable for small premium policies, the conclusion is that microinsurance will by default be short term. This was observed in the sample countries (Colombia, India, Philippines, South Africa and Uganda). Any regulatory restriction on minimum insurance policy

contract duration, for example the minimum term of five years in the life microinsurance definition in India, may, however, influence insurers' ability to manage risk in this way."

Source: Bester, H., Chamberlain, D., Hougaard, C., et al., 2008.

Health and medical insurance deemed to fall under general insurance. The Act defines "general insurance business" as "insurance business of any class or classes not being long term insurance business" (Section 2). Given that health or medical insurance is not classified as long-term business in the definition of this category of business, it therefore falls under the category of general insurance. In terms of medical insurance as a separate class of business, the Third Schedule to the Insurance regulations which sets out the classes of general insurance under the Personal Accident Insurance class (Serial No. 09) contains a sub-class (No. 091) "Health/Medical Expenses Insurance (where separate policies are issued)". This class of business is not reported separately to the Insurance Regulatory Authority and is clustered together with personal accident insurance business. Apart from the mention in the Third Schedule to the insurance regulations and reference to "medical insurance brokers" (see discussion below), medical insurance is not differentiated from other categories of general insurance business in the Act or Regulations from other categories of business. No specific definition for health or medical insurance business is provided in the Act. The Act also does not distinguish between indemnity and capital health insurance⁹³.

Restriction on salaried agents. Section 2 (definitions section) of the Insurance Act defines an "agent" as "a person, not being a salaried employee of an insurer who in consideration of a commission, solicits or procures insurance business for an insurer or broker" (emphasis added). The implication of this definition is that insurance companies are not able to appoint agents on a salary basis as employees of the company. In many jurisdictions which have been successful at unlocking the low-income insurance market, for example South Africa, Brazil and Colombia, salaried agents have been used to distribute microinsurance products. The provision of a basic salary has ensured that these agents receive a minimum income which they are able to increase with commission on products. In practice, however, some companies may deviate from the strict regulation definition of an agent by initially appointing agents on a fixed remuneration basis for a specified period (3-6 months), after which agents start earning commission.

Prudential regulation

Increase in minimum capital requirements from June 2010. Until recently, minimum entry capital for long-term insurance companies was set at KSh50 million (US\$ 660,000), while minimum capital for general and composite insurers was set at KSh100 million (US\$ 1.3 million) and KSh150 million (US\$ 2 million), respectively. From 14 June 2010, however, long-term insurers are required to hold minimum capital of KSh150 million (about US\$ 2 million), while general insurers and composite insurers are required to have capital of KSh300 million

⁹³ Health indemnity cover refers to insurance products which indemnify the beneficiary against the expenses associated with a specific health event. The level of cover is calibrated relative to the costs of the health services received. Its purpose is to leave the beneficiary in the same position as before the occurrence of the health event. Typically, the insurance company pays the cover directly to the health service provider. Capital health insurance, in contrast, provides a pre-determined level of cover relative to a specific event, e.g. hospital cash plans which pay a specific amount for every day in hospital. Its purpose is to help the beneficiary deal with the expense of the health event and may or may not cover the actual cost of the event. The cover is typically paid to the client rather than the service provider.

(about US\$ 4 million) and KSh450 million (about US\$ 6 million), respectively (Insurance Circular No. IC & RE 11/2009). This increases the regulatory burden and entry barriers significantly. The media and various industry stakeholders widely acknowledge that the increased capital requirement was an attempt to facilitate consolidation, but that this may have failed with little consolidation occurring (Wahome, 2010). Compared to other jurisdictions in Africa, these requirements are considered high and potentially excessive relative to the risks underwritten (see Table 12 below). The increased regulatory burden created would increase the need to consider a special dispensation to accommodate microinsurance. As noted in Section 8.2, the insurance industry only serves a very small proportion of the population. Only 1% of adults have life insurance. While there may be a need to improve the size and stability of individual insurers, it could be questioned whether consolidation is relevant when the market only serves such a small percentage of the population. Consolidation by itself may not necessarily address the fundamental industry problems (e.g. the barriers locking in the insurance industry to cannibalistically compete for the same small market instead of expanding the market). If the size of insurers is an issue, facilitating growth may be an alternative approach to consider.

| Country | Minimum capital requirements |
|--------------|---|
| India | US\$ 25m |
| Colombia | US\$ 3 - US\$ 4.2m (depending on business line) |
| South Africa | US\$1.3m for life U\$ 1.4 for general |
| Uganda | US\$ 580k (double for composite) |
| Ethiopia | US\$ 300k general US\$ 400 for life US\$ 700k for composite |
| Zambia | US\$185k |
| Kenya | US\$ 3m for life US\$ 4m for general US\$ 6m for composite |

Table 12: Comparative minimum capital requirements for insurers in selected developing countries

Sources: Hougard et al, 2009; Insurance Circular No. IC and RE 11/2009

It must be noted that entry barriers are often not determined by risk but by concerns over regulatory capacity (therefore explicitly limiting the number of firms entering the market through high capital requirements). Whereas this may be a legitimate concern there may again be other means of better managing this risk. It must also be explicitly recognised that limiting entry for this reason may undermine the objective of market expansion.

Gradual move away from composite insurers. As mentioned earlier in this section, a new Insurance Act is currently being drafted and it is anticipated that the new Act will do away with the composite insurance licence. In the future, companies wishing to write both long-term and general insurance business will have to obtain two separate insurance licences. In anticipation of this change, a number of insurance companies have already started to split their composite business into two separate companies. In addition to separating the legal entities, regulation will also require the separation of all management structures. More than separating the legal entities, the separation of management structures will undermine innovative combinations of life and general insurance capacities and increase the cost of developing composite offerings in this space.

Detailed legislative management creates rigidities and increases compliance burdens. The Insurance Act sets out a number of rules which direct the management insurance business. While the principles it seeks to achieve may not be a problem, the detailed legislation may create unnecessary rigidities and compliance burdens. For example, limits on management expenses are set in a very complicated manner with a number of variables that have to be taken into account to determine the ultimate management expense limit to which a specific category of business is subject. This is discussed in more detail below.

Statutory deposits and solvency margin. A deposit needs to be held at the Central Bank of Kenya in Kenyan Government Securities to the value of KSh5 million (US\$ 66,000), or 5% of admitted assets, whichever is the highest (Section 32). The same rule applies to both long-term insurance and general insurance (graduation to build up these deposits was allowed when the Act was first introduced.) The deposit is deemed to be part of the assets of the insurer (Section 38). The deposits can only be used to discharge policy obligations. The Commissioner can require the deposit to be increased to up to 20% of premiums received in previous financial year (in case of general insurance) and 10% in case of long term insurance (Section 40). Furthermore, insurance companies are required to keep a solvency margin which in the case of long-term insurance business is required to total “admitted assets of not less than his total admitted liabilities and ten million shillings or five per centum of the total admitted liabilities, whichever is higher” (Section 41 (1)). In the case of general insurance companies, the solvency margin required is “assets of not less than the aggregate value of his admitted liabilities and ten million shillings, or fifteen per cent of his net premium income during his last preceding financial year, whichever is the greater” (Section 41(2)).

Local asset requirements may limit profitability. The Insurance Act requires insurance companies to keep a minimum amount of assets in Kenya (Section 28). Section 48 (1) of the Insurance Act states that, with some exceptions, “the assets of an insurer shall, with sufficient regard to considerations of security, liquidity and income, be invested in Kenya in such a manner that the insurer thinks fit” (emphasis added). However, the Commissioner (with the approval of the Minister) may (given a number of considerations) “authorize the assets of an insurer to be invested outside Kenya” (Section 48(2) – emphasis added). Long-term insurance companies are required to invest their admitted assets in the following manner (Section 50(1)-(4)):

- 20% of total admitted assets in securities (including government, prescribed statutory body, local authority or any other prescribed organisation’s securities), with 50% of these securities required to be government securities;
- “a further proportion”, equal to no less than 65% of total admitted assets invested in a range of permitted assets in Kenya, including securities, mortgages on property in Kenya, debentures secured by a mortgage on unencumbered immovable property in Kenya, shares of stock exchange listed companies, property, loans on life insurance policies and deposits in banks or other financial institutions licensed under the Banking Act; and
- the balance of admitted assets may be invested in “investments in Kenya as the insurer thinks fit.”

General insurance companies are subject to the following requirements in terms of the investment of their admitted assets (Section 50(2)-(4)):

- 10% of total admitted assets in securities (including government, prescribed statutory body, local authority or any other prescribed organisation’s securities), with 50% of these securities required to be government securities;
- “a further proportion”, equal to no less than 30% of total admitted assets invested in a range of permitted assets in Kenya, including securities, mortgages on property in Kenya, debentures secured by a mortgage on unencumbered immovable property in Kenya, shares of stock exchange listed companies, property, loans on life insurance policies and deposits in banks or other financial institutions licensed under the Banking Act; and
- the balance of admitted assets may be invested in “investments in Kenya as the insurer thinks fit.”

These local asset requirements, coupled with limited availability of local assets, may lead to a situation where insurance companies generate sub-optimal investment profits, limiting their overall profitability. Although this was not a view directly expressed by insurance companies, limits on returns within the domestic environment generally lead to constrained profitability.

Commissions to intermediaries capped. Different commission rates are prescribed according to class of business (Section 73(2)). The commission caps are set out in the Eleventh Schedule to the Act. Interestingly, the maximum commission rate for industrial life policies with monthly premiums is set at 15% in the first year and 10% for renewals, which is higher than for other classes of business. This recognises the need to allow for proportionally higher commissions (even though absolute amounts may still be small) on smaller premium policies particularly where premiums are collected more frequently and often in cash.

| Category of insurance business | Maximum commission |
|---------------------------------------|--|
| Individual life - term | 10% |
| Individual life - whole | 50% of first year's premium, 20% of 2nd year's premium, 5% of 3rd year's premium up to 10th year |
| Group life | 2.5% of renewal premiums |
| Motor private | 10% |
| Household content - theft | 20% |
| Household structure - fire | 20% |
| Household - other (e.g. flooding) | 10% |
| Personal accident (including medical) | 20% |

Table 13: Maximum commission rates according to different categories of insurance business

Source: Summary based on Eleventh Schedule to Insurance Act

Management expenses capped. In addition, the Act places limits on management expenses (Section 70, read with Schedule 10). If management expenses exceed the amounts prescribed under the Act in Schedule 10, the insurer is taxed on the amount of management expenses that exceed the prescribed limits. The schedule uses four variables to calculate the amount of management expenses allowed:

- A general distinction between (1) long-term business (excluding industrial life), (2) industrial life and (3) general insurance business.
- The base amount on which the administration cost percentage is determined is gross premium income, with management expense caps differentiated by class of policies.
- The third variable is duration of conducting the business – the longer you have conducted business, the smaller the amount you are allowed for management expenses. This would accommodate the higher costs of start-up operations and new product lines.
- The final variable is size of premium turnover.

The management expense limits allow higher expense caps for the following categories of business:

- Industrial life;
- Smaller insurance policies; and
- New established insurance companies/business.

The level of detail in which the management expense limits are stipulated causes unnecessary compliance complexity and is difficult to enforce. Also specifying management and commission caps in detail dictates a particular balance of remuneration between different parties in the value chain which may not reflect the reality of microinsurance. For example, in group policies the distribution costs may be high as the intermediary often takes on the administrative load while the management expenses can be lower. The result is different kinds of arbitrage and structuring to try and fit models into the regulatory structure or avoid the restrictions. While the precedents of more flexibility set for industrial life and smaller insurance policies are positive for the regulatory treatment of microinsurance, the remaining rigidities may undermine innovation.

IRA able to scrutinise premium rates through file and use system. The premium rates of life insurers are required to be approved by an actuary. Furthermore, a file-and-use system⁹⁴ applies (Section 74) with insurance companies having to file all insurance premiums with the Insurance Commissioner before being able to sell products at these premium rates. While general insurers are required to file a schedule of their rates of premium with the Insurance Regulatory Authority, an actuarial certificate is not required (Section 75). All rate changes and deviations must be filed with the Commissioner and the Commissioner can order changes of rates charged. The file and use system also applies to product information and policy wording, with Section 30(d) of the act requiring all companies applying to register as insurers to provide “a copy of each of the proposal and policy forms, endorsements and any form of written matter describing the terms or conditions of or the benefits to or likely to be derived from policies or intended to be used by the applicant”. Although this may read as if product information is only required to be submitted upon registering as an insurer, a later circular⁹⁵ makes it clear that insurers and reinsurers are required to submit all policy wording for approval to the Insurance Regulatory Authority. Given fears of insurance companies trying to win market share by explicit undercutting of premiums, the focus to date has mainly been on avoiding premiums that are too low, rather than those that are too high.

⁹⁴ A file and use system is one where insurance companies are only required to file a specific change to a policy, a new policy or even information on premiums with the regulator. They do not have to wait for the regulator to approve this change before they are able to roll out the change or new policy. If the regulator is in any way unhappy with the new policy change, this will be communicated to the insurance company after it has been reviewed.

⁹⁵ Circular No. IC & RE 08/2008

Compulsory reinsurance with Kenya Reinsurance Corporation (KRC). All Kenyan insurers are required to “reinsure with the KRC such proportion of each policy of insurance issued or renewed in Kenya by the insurer, in such proportion and in such manner and subject to such terms and conditions as prescribed” (Section 145). The Fifteenth Schedule to the Insurance Act requires insurance companies to place 18% of reinsurance for general business placed in the international reinsurance market with the Kenya Reinsurance Corporation. According to changes made to this rule (Rule 11 of the Fifteenth Schedule), the requirement ceases to apply on 1 January 2011, or the date on which the Kenya Reinsurance Corporation is privatised. For long-term insurance business, the Fifteenth Schedule requires insurance companies to reinsure 25% of each long-term insurance policy issued in Kenya with the Kenya Reinsurance Corporation. According to an amendment to the Fifteenth Schedule⁹⁶, 20% of each long-term policy has to be reinsured by the Corporation, provided that the percentage shall be reduced by 5% every year thereby ceasing to apply on 1st January 2011. However, this was recently revised. According to a circular⁹⁷, given the Authority’s assessment of available reinsurance capacity within Kenya, all reinsurance treaties for long-term businesses written in Kenya are required to be locally placed from 1 January 2009.

Differentiated compliance regime for industrial life policies. As noted above, different parts the Act combine to create a different compliance regime for industrial life policies. This includes a separate definition, with these policies viewed as small- and regular-premium policies with higher management expenses, different commission caps and (discussed below) different consumer protection treatment. This sets an important and relevant precedent for the potential treatment of microinsurance.

Institutional and corporate governance regulation:

Only companies can register as insurers. The Act is very specific that only authorised persons can conduct insurance business in Kenya (Section 19) and that only “a body corporate incorporated under the Companies Act” is able to register as an insurance company (Section 22). The Companies Act does not include co-operatives and friendly societies in its definitions of different companies and these entities would therefore not be able to register as insurance providers. Registration is granted to insurance companies under Section 31 by the Board of the Insurance Regulatory Authority.

Local ownership requirements. Furthermore, companies wishing to register must be a company with one third Kenya shareholding (Section 22). No person may own more than 25% of the shareholding of an insurer (Section 23 – inserted in 2009).

Minimum levels of corporate governance specified in Act and Circular. The board of an insurance company is required to have at least 5 members and “the Commissioner must be satisfied that all members of the board have knowledge and experience in matters relating to insurance, actuarial studies, accounting, finance or banking” (Section 27A). Furthermore, at least a third of board members are required to be Kenyan (Section 27). Recently, Circular IC & RE06/2008 communicated that the Commissioner will “not approve any director of an insurance company under section 27A of the Insurance Act without evidence of corporate

⁹⁶ By L.N 372/95.

⁹⁷ Circular IC & RE 02/2008

governance training” and that the Commission will “accept as evidence a certificate issued by the Centre for Corporate Governance (CCG) or any other equivalent institution”.

Minister allowed to exempt any party from the Act. According to Section 181 of the Act, “The minister may, by notice in the Gazette, subject to such terms and conditions as he may on the advice of the board specify, exempt any person from any of the provisions of this Act”. This is an extraordinary stipulation as far as typical financial sector acts are concerned.

Intermediation, market conduct and consumer protection regulation:

Act provides for two intermediation categories. The Act distinguishes between two categories of intermediaries: brokers and agents. Whereas agents are typically tied to one insurance company, brokers are intermediaries that are able to place insurance business with the insurance company that provides a product that best suit their client’s needs. Brokers are typically required to serve the client’s needs, rather than that of the company and therefore tend to be subject to greater entry (also education) and compliance requirements. However, as will be discussed below, regulatory changes in Kenya have recently redefined the role of the agent relative to that of the broker, bringing these two definitions closer.

Onerous entry and capital requirements for brokers. A number of relatively onerous entry and capital requirements apply to the intermediary category of brokers. Only registered companies (under the Companies Act) with paid-up capital of no less than KSh1 million (US\$ 13,000) can act as brokers (Section 153(2)). Furthermore, brokers are required to have professional indemnity insurance (Section 151(1)(a)). According to Section 153(1), brokers are required to have a bank guarantee “as may be prescribed”. Certain revisions were made to Section 153 and regulation 39 of the Insurance Act during 2006, with changes becoming effective on 1 January 2007⁹⁸. This included increasing the required guarantee for insurance brokers from KSh1 million (US\$ 13,000) to at least KSh5 million (US\$ 66,000), with the guarantee required in the form of a government bond purchased from the Central Bank of Kenya. Guarantees from commercial banks are not considered acceptable. The Circular makes allowance for existing insurance brokers to top up their guarantees within 18 months from 15th June 2006. New brokers are required to raise the full guarantee of KSh5 million (US\$ 66,000) before registration. Only Kenyan citizens or companies are allowed to register as insurance brokers (Section 153(4)).

No specific education requirements for brokers. The Act is not specific about the educational requirements for brokers and simply mentions that a broker will be registered if, amongst other things, “the knowledge, skill and experience of the applicant or, in the case of a corporate person, the knowledge, skill and experience of the principal officer in Kenya, are adequate” (Section 153(1)(d)).

Compliance requirements for agents considered light. No explicit training requirements for agents are mentioned in the Act, except that the Commissioner can refuse an application for registration if he is of the opinion that the person “does not have sufficient knowledge, skill and experience to satisfactorily discharge his duties and functions” (Section 152(i)). Otherwise what is required is a letter of appointment from the insurer for whom he

⁹⁸ Circular IC & RE 04/2006

proposes to function as an agent certifying (1) that the person has been appointed as an agent by the insurer, and (2) “that the insurer is satisfied that the applicant has the knowledge and experience necessary to act as an agent” (Section 151(1)(b)). This, in effect, constitutes a substantial outsourcing of the selection and qualification of agents to the insurers. Agents are not required to hold any capital or guarantees. Agents can collect premiums on behalf of an insurer if authorised to do so by the insurer (Section 156(3)). The registration fees for an agent is only KSh1,000 (US\$ 13) compared to KSh10,000 (US\$ 132) for a broker (Regulation 37).

Agents can act for more than one insurer. Certain revisions were made to the Insurance Act (Section 154) during 2006 and became effective on 1 January 2007. This included allowing insurance agents to represent more than one insurer. However, in Circular IC & RE 04/2006, the Insurance Regulatory Authority cautions that “it is important to note that this does not open the gates for agents to place business wherever they want. Insurance agents must be appointed by their principals in the normal manner and the Commissioner must authorize the agents to represent such principals through endorsement of the principals’ name in the agents licence. Any insurer found dealing with an insurance agent for whom they are not duly authorized shall be penalized.”

Regulation makes agent distribution more attractive relative to brokers. Despite the constraints imposed this amendment presents a significant change in scope of activities allowed to be conducted by agents. This is quite unusual relative to other jurisdictions where agents by definition are usually tied to one particular insurer. Combined with the lower entry and compliance requirements for agents, this development may open up cost-effective opportunities for the development of microinsurance but may also be seen as creating an unlevel playing field relative to brokers. It has certainly undermined the attractiveness of the broker category as can be seen in the move away from brokers to agents noted in Table 18.

Category of medical insurance providers (MIPs) created to deal with medical-only brokers and health maintenance organisations (HMOs). Medical insurance providers are defined in the definition section (Section 2) as “an intermediary, other than a broker, concerned with the placing of medical insurance business with an insurer for ... commission”. All the provisions in the Act applicable to brokers also apply to them (Section 150A). The Act is quite specific that medical insurance brokers are viewed as a category of intermediary specific to persons “engaged in the business of undertaking liability by way of insurance in respect of funding private medical care” (Section 150A(1), emphasis added). This section implies that any intermediary wanting to distribute insurance products which fund private medical care would have to be a medical insurance provider, subject to the same requirements as brokers. If someone wanted to intermediate health insurance products, as well as other insurance products they would therefore be required to register as both a MIP and a broker or agent. However, intermediaries that are involved in the distribution of an insurance product with a National Health Insurance Fund (NHIF) component (a public health insurance fund) would not be required to be medical insurance providers as the regulation is restricted to private medical care.

No guidance on sales process. The Insurance Act, its regulations and circulars issued under the Act provide no information or guidelines on how the sales process should be conducted, i.e. what minimum information should be provided to clients and how this information should be conveyed.

Insurance Act places no limits on bancassurance, but prohibited by Banking Act. There is a general consensus in Kenya that distribution of insurance products by banks is not officially allowed. The Insurance Act does not contain any sections which could be interpreted as a prohibition on bancassurance. Rather, as discussed later in this section, the Banking Act contains a section which is interpreted as not allowing banks to be involved in the distribution of insurance products. Nevertheless, this is one of the constraints dealt with through exemptions. Seven bank insurance agencies have been licensed by the Insurance Regulatory Authority, with the proper exemptions from the Central Bank, during the last two years. Interestingly, the precedent set through these exemptions has not been generalised in regulation beyond these specific exemptions.

The Insurance Act contains various provisions dealing with consumer protection:

No misleading statements in proposals, policies. Section 80 (1) of the Act states that proposals (which may be interpreted to include the sales process) for insurance or insurance policies “shall not contain anything inaccurate or incomplete or likely to mislead a proponent or policy”. Furthermore, the Act (Section 81(1)) is clear that “a policy of life assurance shall not be avoided by reason only of an incorrect statement made in a proposal or other document on the faith of which the policy was issued or reinstated by the insurer”.

Anyone found guilty of using misleading advertisements, promises, forecasts and statements used to induce or attempt to induce people into buying insurance “shall be guilty of an offence and liable to a fine not exceeding five thousand shillings” (Section 164 (1)).

Policy Holders Compensation Fund to protect policyholders against impacts of bankrupt insurers. The Minister must establish such a fund “to provide compensation to policy holders of an insurer that is wound up” (Section 179(1)), with its affairs to be managed and administered by a board to be appointed by the Minister (Section 179(2)). The Act gives strong guidance on the designations of the board members (Section 179(4)). The fund is capitalised by monthly contributions “to be paid by every policyholder and insurer, in such amount and at such times as the Minister may prescribe” (Section 179).

Customer complaints desk required in all insurance companies. As stated in Insurance Circular 8/2008: “In order to improve service delivery to the policyholders, claimants and members of the public it has been found necessary for all insurance companies to establish a customer care/complaints desk which should be prominently located. These desks should be manned by well-trained officials on matters of insurance and public relations.”

Grace period for non-payment of industrial life more generous than for ordinary life. Section 91 of the Insurance Act provides different grace periods for policyholders to catch up with premium payments on their industrial life policies, without having the policy cancelled in this period. Grace periods increase with the number of years that the policyholder has paid for the policy. In the case of less than one year, the policyholder is given four weeks, for two years of payment, the policyholder is given eight weeks and for three years of payment the policyholder is given twelve weeks. Furthermore, Section 91(4) states that if premiums have been paid for more than three years and the policyholder is behind on premium payments “the insurer shall, without requiring any application from the policy holder, grant a paid-up policy for an amount not less than that calculated in accordance with the rules”, with the policyholder being able to submit a claim on the paid up policy. The grace periods provided

to industrial life policies are more generous than those provided to ordinary life policies. According to Section 90 of the Insurance Act an ordinary life policy will not be cancelled due to non-payment of premiums only if premiums have been paid for three or more years (Section 90(1)(a)) or the surrender value of the policy is greater than the sum of accumulated debts owed to the insurer under the policy and the amount of overdue premium (Section 90(1)(b)).

Cooling-off period for industrial and ordinary life policies. Section 87(1) provides a cooling-off period of 28 days on the purchase of an industrial life or ordinary life policy where the sum assured is less than KSh10,000 (US\$ 132). This allows the policyholder to cancel the policy and receive the first premium back if, for any reason, he or she has decided that the policy is no longer needed.

Special dispute resolution process for claims on small life policies. Section 112 (1) of the Act establishes a special dispute resolution process for insurance policies with a value of less than KSh100,000 (US\$ 1,320). In short, should any dispute on these policies arise, the dispute can be settled by the Commissioner without reference to any court. Furthermore, the decision of the Commissioner “shall be final and shall not be called into question in any court” (Section 112(2)). This sets a precedent for microinsurance, should the rationale for this accelerated dispute resolution process be the more vulnerable position of the purchasers of small-value policies.

No cover before insurer has received premium. The Act is very explicit about the fact that cover cannot commence before the insurer has received the premium for a product and states that “No insurer shall assume a risk in Kenya in respect of insurance business unless and until the premium payable thereon is received by him or is guaranteed to be paid by such person in such manner and within such time as may be prescribed, or unless and until a deposit of a prescribed amount, is made in advance in the prescribed manner” (Section 156). This position poses a dilemma for MFIs and other distribution channels where the collection and aggregation of insurance premiums may take some time, while clients (in most cases) require immediate cover.

7.3. The Microfinance Act, 2006

The Microfinance Act, 2006 was enacted at the end of December 2006 with the purpose of regulating deposit-taking microfinance institutions⁹⁹ and came into operation with effect from 2 May 2008. The Act gives¹⁰⁰ the Central Bank of Kenya the power to issue and revoke deposit-taking licences.

In its current form, the Act does not explicitly prohibit deposit-taking microfinance institutions from engaging in insurance related activities (Part II – Licensing Provisions 14.

⁹⁹ Deposit-taking microfinance institutions is defined as Part 1 (2) paragraph 488 as (a) a microfinance business in which the person conducting the business holds himself out as accepting deposits on a day-to-day basis; and (b) any other activity of the business which is financed, wholly or to a material extent, by lending or extending credit for the account and at the risk of the person accepting the deposit, including the provision of short-term loans to small or micro enterprises or low income households and characterised by the use of collateral substitutes.

¹⁰⁰ Under Part 11 (6) and 9 (1)

(1)). However, the Act mentions various prohibited activities¹⁰¹ and insurance could be viewed as falling under the prohibited activity of “wholesale or retail trade” (Part II – Licensing Provisions 14 (1)). This means that under current regulations, if MFIs want to engage in insurance business, including underwriting and distribution, a special exemption will be required.

7.4. The Banking Act, 1989

The Banking Act first came into force during November 1989 shortly after the first post-independence banking crises¹⁰². The purpose of the Act is to regulate banks, where banking business is defined as accepting and deploying deposits¹⁰³. Since its inception, various amendments (with the last amendments in 2009)¹⁰⁴ have been made to the Act.

The Banking Act’s relevance to microinsurance is limited to Part III - Prohibited Business, (Section 12 (a) of the act) which places certain restrictions on banks with regards to trading and investment. This restriction is interpreted to prohibit banks from engaging in insurance intermediation. It stipulates that:

“An institution shall not in Kenya (a) engage, alone or with others, in wholesale or **retail trade**, including import and export trade, except in the course of the satisfaction of debt due to it; and any trading interest carried on by an institution at the Act shall be disposed of by the institution within such time as the Central Bank may allow” (emphasis added).

7.5. Co-operative Societies Act (Amended), 1997

The Co-operative Societies Act (No. 12 of 1997, as amended in 2004) creates an institutional framework for the governance and supervision of co-operatives. According to section 4 (a) and (b), a co-operative is a society whose core purpose is the promotion of the economic interests and welfare of its members and, secondly, whose by-laws are merged with co-operative principles. Examples of such principles include autonomy and independence as well as the democratic control of the society by its members. A minimum of ten persons are required for a society to be registered as a primary society (Section 5(a)).

Co-operatives overseen by Commissioner of Co-operative Development. The Commissioner of Co-operative Development, a staff member of the Ministry of Co-operative Development and Marketing, is the supervisor of co-operatives in Kenya. The Minister of Co-operative Development and Marketing plays a more judicial role within the Kenyan co-operative environment. For instance, Section 62 (2) states that if any person feels unfairly treated by the Commissioner, they are able to raise this matter with the Minister.

¹⁰¹ Including the issuing of third party cheques, the opening of current accounts, foreign trade operations, trust operations, investing in enterprise capital, wholesale or retail trade, the underwriting or placement of securities and the purchasing of land not required for deposit taking activities.

¹⁰² Kenya experienced its first post-independence banking crises in 1983 with several local banks developing acute liquidity problems (CBK, 2010)

¹⁰³ This definition of banking business is slightly more lenient than other examples of banking regulation (e.g. South Africa) where banking business is defined deposit-taking without necessarily deploying the deposits.

¹⁰⁴ The latest amendment, 2009, permits banks to appoint agents to take deposits and perform certain activities on behalf of the bank.

No explicit mention of insurance or prohibition on intermediating insurance. While the Co-operative Societies Act provides an institutional base for co-operative societies, it does not mention insurance anywhere in the Act. The Act's core focus is on the governance and institutional frameworks necessary for the development of co-operatives. In essence, the key requirement for the registration of a co-operative is the embodiment of the co-operative principles as highlighted in the Act. Section 22 of the Kenyan Insurance Act states that no person shall be registered as an insurer under this Act unless the person is a body corporate or incorporated under the Companies Act. Clearly this prohibits co-operatives from writing insurance as co-operatives are registered under the Co-operative Societies Act, and do not have the institutional structure of a company. However, there are no explicit provisions in the Act that seem to prohibit co-operatives from intermediating insurance.

7.6. Savings and Credit Co-operatives Act, 2008

The Savings and Credit Co-operatives (SACCOs) Act (or SACCOs Act), No. 14 of 2008, is the legislation governing savings and credit co-operative societies that are registered as primary co-operatives under the Co-operative Societies Act (Amended) of 1997. While the institutional and corporate governance requirements for SACCOs are determined by the Co-operative Societies Act, the SACCO Societies Act is focused on the prudential requirements for deposit-taking co-operatives. In order to carry out deposit-taking activities as a SACCO society, a society is required to be registered as a SACCO society under the Co-operatives Act and hold a valid license which has been issued under the SACCO Societies Act.

Deposit taking as defined in the Preliminary (Section 1) of the SACCOs Act means:

- A SACCO business which conducts the business of accepting deposits on a day-to-day basis.
- Any other activities of a SACCO business namely lending and extension of credit and the provision of short-term loans to members.

Furthermore, the Preliminary (Section 1) of the SACCOs Act goes on to state that SACCO business refers to financial intermediation and related activities that are carried out by a co-operative society which has co-operative principles as its base. The SACCO Act (Preliminary, Section 1) states that these financial intermediation activities can include:

- “receipt of withdraw-able deposits, domestic money transfer services;
- loans, advances and credit facilities;
- receipt of non-withdraw-able deposits from members” which can be used “as collateral against borrowings and domestic money transfers”.

*SACCO Societies Regulatory Authority supervises SACCO societies*¹⁰⁵. The Act establishes the SACCO Societies Regulatory Authority which is tasked with overseeing all registered SACCOs.

SACCO Societies Act places no limits on ability of SACCOs to intermediate insurance. While the Act describes financial intermediation activities that are carried out by a co-operative such as loans and credit facilities, the act does not specifically refer to insurance. Similar to the Co-operative Societies Act, the Act's scope does not cover or include aspects of

¹⁰⁵ Section 4 (1)

insurance in the definition of the activities of SACCO societies. There are no provisions in the Act that seem to prohibit SACCOs from intermediating insurance.

7.7. Proceeds of Crime and Anti-money Laundering Act, No. 9 of 2009

The Proceeds of Crime and Anti-money Laundering Act, no 9 of 2009, was approved by the Kenyan Parliament during December 2009 and assented to by the President on 31 December 2009. It comes into operation on 1 July 2010. In terms of that Act, insurers engaged in “underwriting and placement of life insurance and other investment related insurance” are “reporting institutions” subject to the provisions of the Act and the Insurance Regulatory Authority is a supervisory body mentioned in the First Schedule. The duties of reporting institutions are set out from Sections 44-48 of the Act. However, the regulations implementing the Act must still be prepared by the new Financial Reporting Centre which will be established on 1 July by the Act, but whose Director and staff are yet to be appointed.

In the meantime minimum client identification and other duties are contained in Sections 44-48. According to these minimum client identification and other duties, the most onerous obligations on insurance companies include monitoring and reporting all suspicious or unusually large transactions (Section 44(1) and (2)) and taking “reasonable measures” to establish or verify the identity of someone wishing to enter into a business relationship or a transaction (Section 46(1)). The “reasonable means” includes obtaining requiring their client to provide a document¹⁰⁶ which allows for the establishment of the “true identity of the applicant” (Section 46(1)). Furthermore, insurance companies are required to conduct due diligence on all existing customers and establish and verify their true identities (Section 46(2)). While not unreasonable for their current clients, the know-your-client (KYC) requirements as contained in the Act may make it difficult for insurance companies to move downmarket. Not infrequently, low-income Kenyans experiences challenges in obtaining the relevant identity card and therefore find it difficult to prove their identities.

7.8. Payment systems regulation

A National Payment System Bill has been submitted to Parliament, but not yet passed. In the interim, non-banking retail payment services are growing dramatically. At present, they are supervised by the Central Bank of Kenya under their general authority under Section 4A of the Central Bank of Kenya Act to oversee payment systems. Should the Bill be passed, it is expected to open up the space for non-bank entities to facilitate payments. This holds implications for lower-cost and wider reach insurance sales and premium collection.

¹⁰⁶ This includes a birth certificate, a national identity card, a driver’s license, a passport or “any other official means of identification as may be prescribed” (Section 46(1) (a)).

8. Market players and performance

Limited formal insurance penetration. Total gross premiums for 2008 stood at KSh55 billion (US\$ 730 million or 2.6% of GDP), of which gross premiums for general and long-term business consisted of KSh35 billion (US\$ 460 million or 1.7% of GDP) and KSh20 billion (US\$ 270 million or 0.9% of GDP), respectively. This compares favourably to insurance penetration¹⁰⁷ in neighbouring countries such as Uganda (0.6% of GDP), Ethiopia (0.9% of GDP) and Tanzania (0.9% of GDP) but less favourably to more developed African countries such as South Africa (15.3% of GDP), Namibia (8.1% of GDP), Mauritius (4.9% of GDP) and Botswana (3.9% of GDP)¹⁰⁸.

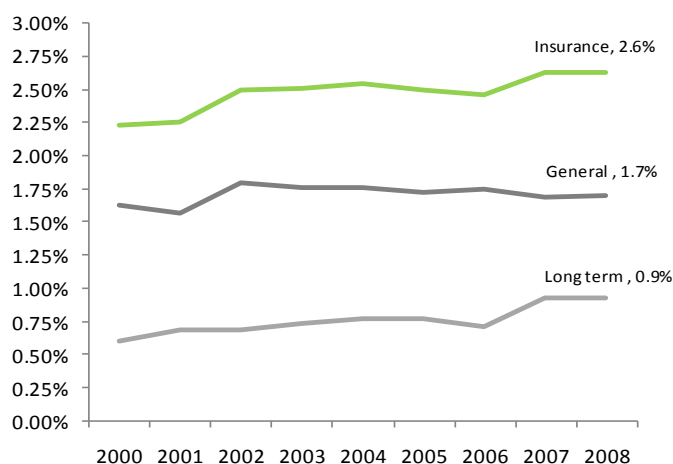


Figure 11: Insurance penetration (gross premiums/GDP) between 2000 and 2008

Source: IRA 2008

Limited growth in risk premiums. Insurance penetration only increased marginally between 2006 and 2008, from 2.5% to 2.6%, largely tracking GDP growth. This growth was driven largely by increases in investment premiums and mainly by the superannuation product line¹⁰⁹ of life insurance business. Investment and pension-related premiums make up an estimated 21% of total premiums and 60% of long term premiums. General insurance premiums have shown negative growth in penetration between 2002 (1.8%) and 2008 (1.7%).

Formal players. At the end of 2008, 42 insurance companies were licensed to operate in Kenya. Of these, seven operated under long-term licenses, 17 were composite companies, 19 general insurers and two were local reinsurance companies.

Recent failures in the insurance sector. Several insurance companies have been liquidated and/or placed under statutory management in recent history starting with the liquidation of Kenya National Assurance Company (1996) and followed by Access Insurance, Stallion Insurance, Liberty Insurance, Lakestar Insurance, United Insurance and Standard Assurance Kenya Limited. Invesco Assurance Company, placed under statutory management three

¹⁰⁷ Data obtained from Ngulube, Munich Re Group 2009, Swiss Re Sigma, 2007

¹⁰⁸ It should also be noted that insurance penetration (gross premiums/GDP) in developed countries also varies significantly (e.g. UK (16%), France (10%) and New Zealand (5.1%)), (insurance Australia, 2009)

¹⁰⁹ Superannuation is a product line capturing pension related insurance premiums

years ago, has undergone a change in ownership structure and will not be liquidated (Nyabiage, 2009).

Industry and solvency. A basic analysis of performance indicators based on 2008 IRA data compares local trends to international best practices. Appendix B contains tables for the 10 largest life and general insurance companies, analysing 13 key ratios for Kenyan insurers against internationally accepted standards. Here, we highlight the implications of these ratios for the solvency and performance of the industry.

In 2008 the general insurance industry, on average, obtained a return on equity (ROE) of 17%. This is slightly below the top ten general insurance companies' un-weighted average return on equity of 20% (see Appendix B). The general insurance industry, as a whole, is therefore profitable. Some additional insights from the general insurance solvency tables include:

- The industry average net claims ratio of 61% compares well to the accepted international maximum of 70%. However, three of the top 10 general insurance companies (Lion of Kenya, Kenindia and Insurance Company of East Africa Limited (ICEA)) exceed the accepted international maximum. The industry wide change in equity ratio of 8% falls within the accepted international maximum of 10 -50%. However, four of the top ten insurance companies (APA, Jubilee, UAP and Heritage All) had a change in equity in excess of the minimum of 10%.
- The industry average of net trade debt to equity of 37% falls within the international best practice range of a maximum of 50%. However, seven of the top ten insurance companies (APA, Jubilee, Kenindia, AIG, Heritage All, Lion of Kenya and CIC) exceed this threshold.

The long-term insurance solvency table in Appendix B indicates the following:

- On average, the long-term insurance industry realised a ROE of 10%. The top eight long-term insurance companies (for which data was available) realised an average unweighted return of 72%¹¹⁰. This number is skewed by the massive ROE realised by ICEA and Heritage Insurance during 2008 – 350% and 52%, respectively. If these companies ROE's are excluded, the unweighted ROE for the remaining four companies decreases to 21%.
- The industry change in equity for 2008 totalled 4% - the top ten long-term insurance companies experienced the same average change in equity during this period.
- The average and top ten company solvency ratios are far greater than the internationally accepted minimum ratio of 4.5%, totalling 17% and 12.7%, respectively, in 2008. Three companies fall below the international standard: ICEA, Jubilee and UAP. Overall, average and top solvency ratios in Kenya indicate a lack of solvency problems and a relatively stable industry.

Widely distributed market with no dominant market players in either life or general. In terms of total insurance premiums, the market for both general and life insurance (see Table 14, below) is widely distributed with no dominant market leader. Using HHI¹¹¹ and CR4¹¹²

¹¹⁰ Data was not available for UAP and Madison.

¹¹¹ Herfindahl Hirschman Index

measures, neither of these markets can be considered to be concentrated at the level of total premiums. The HHI for the general insurance market is less than 0.04 and for life less than 0.11. HHI levels of around 0.18 would start to raise competitive concerns. The four largest general insurance firms control 34% of the market while the four largest life firms control 58% of the market. In both these cases, market share is relatively evenly distributed amongst the four largest firms. If considering specific product lines, the concentration levels will be higher (as companies tend to specialise in specific product areas) but still below levels that would trigger competitive concerns. Despite recent efforts to consolidate the market for insurance by increasing capital requirements,¹¹³ insurers have been slow to merge, opting to rather recapitalise individually.

| | General Insurers | (%) Share of market |
|----|------------------|---------------------|
| 1 | APA | 8.3 |
| 2 | Jubilee | 7.9 |
| 3 | Kenindia | 7.7 |
| 4 | UAP Provincial | 6.8 |
| 5 | AIG (K) | 5.7 |
| 6 | Heritage All | 4.8 |
| 7 | Lion of Kenya | 4.3 |
| 8 | ICEA | 3.8 |
| 9 | First Assurance | 3.7 |
| 10 | Co-operative | 3.6 |
| | Total | 56.5 |

| | Long term Insurers | (%) Share of market |
|----|--------------------|---------------------|
| 1 | British American | 18.4 |
| 2 | ICEA | 14.8 |
| 3 | Pan Africa | 13.2 |
| 4 | Jubilee | 11.6 |
| 5 | Old Mutual | 8.6 |
| 6 | Kenindia | 5.8 |
| 7 | Co-operative | 5.6 |
| 8 | CFC Life | 5.1 |
| 9 | Madison Insurance | 4.8 |
| 10 | UAP | 3.1 |
| | Total | 90.9 |

Table 14: Top ten general and life insurers, 2008, by gross premiums collected (% of total)

Source: IRA 2008

Largest insurers active in microinsurance market. During the in-country visit, the team met with 12 insurance companies (see Appendix for meeting list) accounting for 49% of the general insurance and 80% of life insurance business¹¹⁴. The industry consultation revealed seven¹¹⁵ insurance companies explicitly offering microinsurance products¹¹⁶. It should be noted, that all insurers¹¹⁷ interviewed showed some interest in conducting microinsurance business. As discussed in Section 2 there is no shared definition of microinsurance. It may, therefore, be that there are insurers offering products in the microinsurance space even though they are not formally labelled as such.

Growing microinsurance contribution to premium portfolio. In addition, for some of those already active in microinsurance, this could already make a significant contribution to policy numbers and even total premiums. In the case of Co-operative Insurance Company (CIC), microinsurance is reported to already contribute 20% of total premiums (Kuria, 2010). CIC collected 5.6% and 3.5% of the total life and general direct premiums collected, respectively (IRA, 2008). In terms of number of policyholders, the contribution would be much more

¹¹² Four firm concentration ratio

¹¹³ Insurance companies were given 3 years (ending 15 June, 2010) to increase minimum capital to KSh300 million (US\$3,980,000) (general), KSh150 million (US\$1,990,000) (life) and KSh450 million (US\$5,970,000) (composite)

¹¹⁴ Size of market was calculated using the relative contribution to total gross premiums for the year ending 2009.

¹¹⁵ CIC, BRITAK, UAP, Pioneer, ICEA, Kenya Orient and APA.

¹¹⁶ It should be noted that insurance companies selected for interviews were selected on the basis of their relative size and interest in microinsurance.

¹¹⁷ See appendix for full list of insurance companies interviewed.

significant. This reflects the commercial potential of microinsurance, particularly given the current small retail life base in the traditional industry.

Largest product lines still made up of traditional insurance. As depicted by Figure 12 (below), traditional lines of insurance - individual life, motor, pension - remain the largest product lines. It should be noted that product lines relevant for microinsurance, such as personal accident and group life have grown significantly since 2006, growing by 47% and 60% respectively.

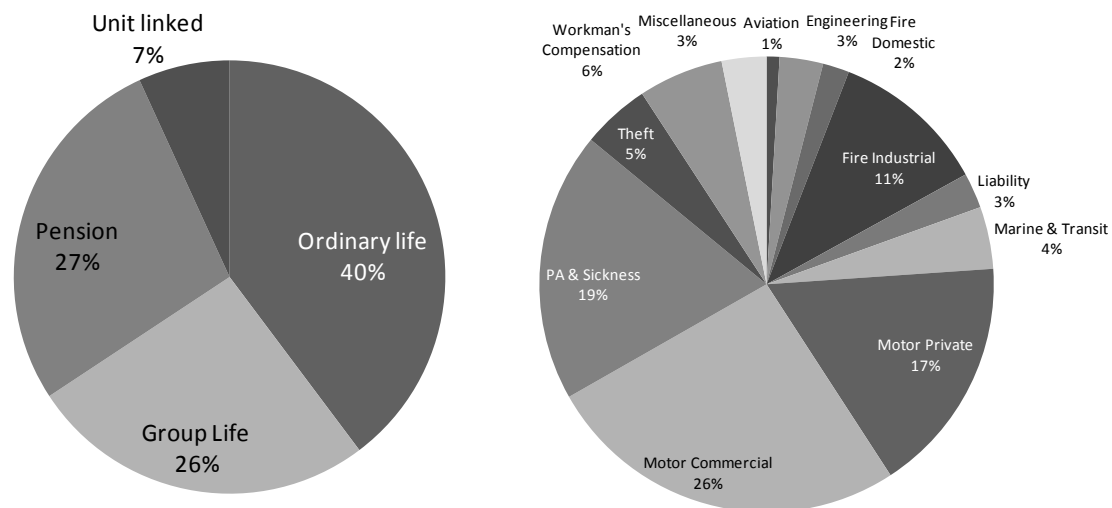


Figure 12: Breakdown of general and life insurance premiums by category

Source: IRA 2008

Medical insurance players. The Kenyan private health insurance terrain is relatively complex and served by different players. Each player in the industry offers a unique set of products and is thus subject to unique market dynamics. In addition, not all players currently comply with regulation. There are currently four main categories of medical funding providers:

- Registered general insurance companies:** In 2008 there were 15 general insurers offering medical insurance products in Kenya. Between them, gross medical insurance premiums totalled KSh4.7 billion (US\$ 60 million), an amount 11% higher than the previous year's collections and representing 12.7% of total general insurance premiums during this period (AKI, 2008). The high medical insurance premiums during the last few years can be attributed to a number of factors, including the conversion of self-funded and third-party administration schemes into insurance plans, the shifting of insurance business from medical insurance providers (MIP) to underwriters, inflation of medical costs and growth in the corporate and individual market (Barnes et al., 2009). The three biggest players in 2008 were Jubilee, APA and UAP (in that order), collecting 62% of total medical gross premiums between them.
- Health maintenance organisations registered as medical insurance providers (MIPs):** Health maintenance organisation (HMOs) provide managed care services to registered insurance companies and their clients in Kenya and, in some cases, provide access to health services directly to clients and carry health risks themselves. The 1990s witnessed the collapse of a number of high-profile HMOs, a situation which necessitated the

introduction of a regulatory category of medical insurance providers (MIPs) in the Insurance Act. This category of provider have to comply with the full set of requirements to which brokers are subject and are only allowed to intermediate insurance products which fund private health services. In addition to new regulatory changes, the spectacular collapse of some HMOs led to the erosion of market confidence in health insurance and reduced the bargaining power of insurers with health service providers.

- **Private hospitals offering hospital plans:** Private hospitals offer a range of medical health financing plans to corporate and individual clients. One such scheme is provided by Avenue Group Healthcare, a Nairobi-based provider that offers different in-patient and out-patient cover options for corporate clients only, (Avenue Group, 2009). Avenue offers three types of cover, namely (i) exclusive inpatient cover (annual fee starts from KSh6,300 (US\$ 83)) (ii) exclusive outpatient cover (annual fee starts from KSh9,600 (US\$ 127)) and (iii) composite cover solutions (inpatient and outpatient – annual fee of KSh23,500 (US\$ 310)). One criticism of private hospital plans is that they are not all-inclusive, a situation that has prompted the Kenya Healthcare Federation (an association of private healthcare providers) to partner with the government in introducing a new financing plan that will make healthcare accessible to millions of Kenyans in the low-income bracket.
- **Employers with third-party managed funds:** Large employers such as parastatals and banks run self-funded schemes that service a large pool of lives, approximately 1.9 million lives (Barnes et al., 2009). The management of some of the schemes has been outsourced to third-party administrators (TPAs), such as AAR Holdings, whereas some employers have chosen to retain the management of such funds. The conversion of TPAs/self managed funds into risk-pooling mechanisms presents opportunities to grow healthcare insurance coverage.
- **Community-Based Health Financing Schemes (CBHFs):** CBHFs are collective, voluntary, self-managed groups in which individuals and family members pool their health risks and are able to draw benefits from the pool once an emergency health need arises (Gitau, 2010). Healthcare benefits include health education/prevention care, outpatient care, inpatient care and HIV/AIDS care. CBHFs may also offer additional benefits over and above healthcare such as advice on agricultural activities and providing civic education to members. CBHFs have been active in Kenya since 1998 and their activities are coordinated by the Kenya Community Based Health Financing Association (KCBHF) a body registered in 2002. In a recent survey, USAID counted a total of 30 registered CBHFs of which ten were considered operational (USAID, 2006). Membership numbers vary, with the smallest CBHF having 14 members and the largest having 2,100 members. Monthly premiums average about KSh100 (US\$ 1.30) and the monetary coverage this provides is not stipulated, with decisions on the disbursement of funds made internal to the group.

Box 2: Afya Yetu Initiative (AYI)

AYI is a Kenyan NGO that was founded in 2006 that provides support services to community-based health financing (CBHFs) organisations in the Nyeri, Kirinyaga and Murang'a districts of Kenya. AYI's target population includes farmers and active population in the informal sector of the local economy in these areas. The support services provided by Afya Yetu include:

- Creating awareness of CBHFs and empowering the population through sensitising, information and communication (SIC);
- Participatory design of the preferred packages/products, services and premiums with the CBHF

scheme members;

- Offering training and capacity building seminars to a) Executive Committees of CBHFs b) Executive committee of the CBHF network c) CBHF scheme members and d) Hospital Staff;
- Encouraging networking between CBHF schemes, networking with the Kenya Community Based Health Financing Association (KCBHF) and networking with National Hospital Insurance Fund (NHIF);
- Provision of technical support to CBHFs such as advice, data collection, interpretation and analysis of data and design of appropriate analytical tools;
- Methodology support which involves conducting feasibility studies and aiding in the operationalisation, commissioning and risk monitoring of a scheme.

Financial support to CBHFS. Ayi, however does not pay allowances to scheme officials or pay hospital bills for CBHF patients. During 2010, AYI provided support services to 19 CBHFs in Kirinyaga and Nyeri districts covering a total of 13,224 beneficiaries.

Source: Gitau, M., 2010. *Profile of Afya Yetu Activities*.

Emerging medical insurance issues:

Intermediation commission viewed as increasing health insurance costs unnecessarily. The private insurance sector suffers from high administrative costs attributable to high commissions paid out to brokers and agents which on average constitute 20% of premiums (Barnes et al., 2009). The stifling intermediation costs are prescribed under Kenyan law which allows for brokerage/agency costs of up to 20% of premium contributions. The high administration costs, coupled with high claims rates, have generally led to low underwriting profits. For the 2008 financial year, the private health insurance sector registered a profit of only KSh33 billion (US\$ 440 million), up from KSh7 billion (US\$ 90 million) in 2007. This amount, however, masks the fact that about half of the medical insurance players (seven companies) in the sector registered underwriting losses. This state of affairs has made it difficult for insurance companies to extend coverage through the innovation of pro-poor products.

| KSh (millions) | 2007 | 2008 | Growth rate |
|---------------------------------|--|---|-------------|
| Gross Premiums | 4,250 (US\$ 56 million) | 4,712 (US\$ 63 million) | 10.9% |
| Net Earned Premium | 3,573 (US\$ 47 million) | 4,168 (US\$ 55 million) | 16.6% |
| Incurred Claims | 2,763 (US\$ 37 million) (Claims ratio: 77.3%) | 3,082 (US\$ 41 million) (Claims ratio: 73.9%) | 11.6% |
| Total Expenses | 803 (US\$ 11 million) (Expense ratio: 22.5%) | 1,052 (US\$ 14 million) (Expense ratio: 25.3%) | 31.1% |
| Underwriting/Profit Loss | 7 (US\$ 92,000) (Profit ratio: 0.2%) | 33 (US\$ 430,000) (Profit ratio: 0.8%) | 344.5% |

Table 15: Comparative performance of private health insurance industry, 2007 and 2008

Source: Association of Kenya Insurers Annual Reports for 2007 and 2008

Absence of efficient management information systems (MIS). Private medical insurers still largely rely on paper-based management systems. Electronic management information

systems are being introduced at a very slow rate. This has led to high administration costs, operational inefficiencies and poor data management practises (Barnes et al., 2009).

Services mainly funded on fee-for-service basis, with capitation approached on experimental basis. Most of the insurance companies reimburse providers using a fee-for-service model as opposed to fixed reimbursement (capitation model). Under the latter, the provider assumes some of the risk and is less likely to over-service clients. The fee-for-service model has been identified as a major driver of medical inflation as it incentivises providers to offer service. The wide predominance of this practise has been attributed to the fact that the industry has not dealt effectively with risk-sharing and regulation thereof. It is, however, encouraging that some insurers and providers are slowly starting to negotiate fixed reimbursement arrangements for some inpatient care services.

Informal players. For the purpose of this discussion, informal insurance is defined as insurance products offered by entities that are not registered with the IRA. Informal does not necessarily mean illegal. In some cases, specific products or entities may be explicitly exempted from regulation and, in others, it may simply not be covered in regulation. Two types of informality are considered here: firstly, individuals pooling risk in informal mutual groups and, secondly, formal organisations offering insurance products that are not registered with the IRA. Four categories of informal insurance in Kenya were identified during the course of the study:

- community-based risk pooling such as welfare societies
- funeral parlours¹¹⁸;
- self-insured credit life providers; and
- self-insured health providers such as private hospitals or MIPs carrying risk.

The risk mitigation role of these is discussed below.

Extensive use of community-based risk pooling. Kenya has a large informal financial services market for savings, credit and insurance (see Table 16 below). Of the 42% of adults that belong to informal societies and savings groups, more than 50% (FinAccess, 2009) indicate the purpose of the group is to mitigate risks (e.g. funeral expenses). An example of such community groupings (amongst others) are welfare groups, usually registered with the Ministry of Gender, Children and Social Development¹¹⁹. The sophistication levels of welfare groups vary, but extend to the pooling of risk for the event of death and hospitalisation.

Adjustments to traditional societies allow risk mitigation. While not their primary goal, accumulated savings and credit associations (ASCAs) and ROSCAs have adapted to help their members manage risk. According to a study conducted by the Centre for Development Studies, the second most reported reason for belonging to informal groups is to cope with unexpected emergencies (Malkamaki et al., 2010). ROSCAs are traditional savings and credit arrangements that typically consist of a group of individuals who make regular contributions to a common pool. This pool is then paid out to each of the individuals in turn, either in a pre-determined order, or on the basis of a lottery or auction (Bhattamishra, 2008). Some

¹¹⁸ In the case of funeral insurance offered as benefits-in-kind by funeral parlours it is technically excluded from the definition of insurance in the Insurance Act (see discussion in Section X). As will be discussed later this segment is an important part of the potential microinsurance market and is therefore considered here.

¹¹⁹ Registration with the Ministry is required in order for a welfare group to open a bank account.

ROSCAS allow payouts to be prioritised to members that have experienced a risk event thus allowing for risk mitigation. ROSCAs are used for the purposes of savings by 33% of Kenyans (see Table 16, below). ASCAs vary from ROSCAs in that pooled funds are not paid out to one member in a rigid, ordered fashion (Ferrand, 2010). Unlike the case for ROSCAs, the pooled contributions are not paid out, allowing the members to instead use the accumulated savings to extend loans. Such loans could be extended to members to mitigate risk events. In Kenya, 9% of adults contribute savings to an ASCA and 2% of adults have received loans from an ASCA.

| Types of informal products | Adults that currently have (%) |
|---|--------------------------------|
| ROSCAs - savings | 33% |
| ASCASs-loan | 2% |
| ASCAs - savings | 9% |
| Informal societies and group savings ¹²⁰ (excl. ASCAS and ROCSAs) | 42% |

Table 16: Informal financial instrument used to mitigate risk

Source: FinAccess 2009

Self-insurance in the funeral services industry. Currently, the provision of benefits in-kind is excluded from the definition of insurance in regulation (see discussion in Section 7.2). Funeral homes providing such benefits are, therefore, not regulated under the Insurance Act. No reliable estimates are available on the size of self-insurance in this market, but the potential size is highlighted by commercial insurers'¹²¹ increasing interest in assisting funeral homes to underwrite the risk pool, as well as the growing prominence of funeral insurance in the low-income market.

Evidence of self insurance in the MFI and SACCO environment. Some MFIs have credit life underwriting from registered insurers. However, evidence from industry interviews suggests that self-insurance (particularly for credit life) practices are common in both the MFI and SACCO environment.

Box 3: KUSSCO Risk Management Services

Kenya Union of Savings and Credit Co-operatives Limited established KUSSCO Risk Management Services. The fund provides SACCOs the opportunity to pool risks among member SACCOs by contributing premiums and claiming for risk events from a common fund.

Risk events covered. The risk management fund provides life cover to SACCO members that will (1) settle loan balances in the event of death or disability, (2) provide additional pay-out to cover funeral expenses, (3) payment of the members total savings/deposit balance at the time of death.

SACCOs entitle to rebates. SACCOs are entitled to rebates where total claims by the society do not

¹²⁰ Savings or community groups as defined in this category include merry go rounds, savings and lending groups, chamas, investment clubs, clan/welfare groups to which must be contributed regularly.

¹²¹ During the in-country visit, the consulting team met with at least one insurance company who was in the process of underwriting the life book of a funeral home.

exceed 45% of the total charge paid.

Success to date. According to KUSCCO, more than 1,000 SACCOs (approximately 18% of all SACCOs in Kenya) have joined the fund.

8.1. Distribution

Interviews with industry stakeholders revealed insurance distribution through a variety of entities including traditional brokers and agents, newly established banking agencies, MFIs¹²², SACCOs and other less formal groups¹²³. We highlight some of the interesting trends and initiatives below.

Shift in distribution away from broker dominated market. Since 2006, there has been a dramatic shift away from brokers to agents. This is reflected in Table 16, showing a drop in registered brokers over this period from 201 to 149 and, at the same time, an increase in registered agents from 2,665 to 3,355. This was largely due to legislative changes in 2007 that undermined the attractiveness of the broker as intermediary category relative to the appeal of the agent category.

| Insurance intermediaries | 2006 | 2007 | 2008 |
|-----------------------------|------|------|------|
| Insurance brokers | 201 | 190 | 149 |
| Medical insurance providers | 21 | 24 | 21 |
| Insurance Agents | 2665 | 3085 | 3355 |

Table 17: Number of insurance intermediaries for 2006, 2007 and 2008

Source: IRA 2006, 2007 and 2008

Growing distribution of insurance through MFIs and SACCOs. During industry consultations, several examples of insurance distribution through MFIs and SACCOs emerged. Insurers indicated that there exist high levels of competition for the loan books of larger MFIs. MFIs and SACCOs that distribute microinsurance benefits from a reduction in credit risk (for credit-tied insurance products) and are able to access an additional revenue stream through the sale of insurance policies.

The two largest MFIs, Faulu and KWFT, have now moved beyond offering only credit life to include voluntary insurance not linked to credit. The potential for expanding distribution through these channels remains high, with 81% of MFI clients and 68% of SACCO members being uninsured (FinAccess, 2009). Their voluntary insurance has largely focused on addressing the health expense needs of their clients:

- Faulu Kenya offers a comprehensive untied, voluntary, comprehensive health insurance policy distributed through Faulu branch network and underwritten by Pioneer Assurance.

¹²² MFIs and SACCOs can potentially register as brokers or agents but we state them separately here to distinguish them from the more traditional brokers and agents that are typically dedicated to insurance distribution. No MFIs or SACCOs have, to date, registered as an insurance broker or agent.

¹²³ Two examples of insurance distribution through less formal groups emerged: Savings and internal lending community (SILC) structures with assistance of Catholic Relief Services (CRS) and a possible partnership between CIC and the Jua Kali Association.

- KWFT offers its clients the opportunity to sign-up with the Bima ya Jamii. KWFT is currently the largest distributor of this voluntary health insurance product. In addition to KWFT, Bima ya Jami is distributed through other MFIs and SACCOs.

Establishment of bank insurance agencies leads the way for bancassurance. Given the successful entry of banks into the low-income market (see Section 6.1), it presents the single biggest channel opportunity to the insurance sector. 22% of adults have a bank account while only 7% has some kind of insurance (see section 8.2)). This presents banks with the opportunity to access an additional revenue stream while promoting customer retention. As noted in Section 7.4, bancassurance is not permitted under the Banking Act but has been facilitated by recent case-by-case exemptions provided by the Central Bank of Kenya (CBK) for the establishment of bank agencies. Currently, seven bank insurance agencies have been licensed to distribute insurance. Some promising developments in the bancassurance industry are outlined below:

- As in the case of distribution through MFIs and SACCOs, examples exist of bank agencies going beyond credit life insurance to voluntary, unbundled product offerings.
- At least one example exists, Equity Insurance Agency, where the banking agency plays the role of an administrator (see Box 4). The bank designs products in-house based on existing knowledge of its customers' needs and then approaches insurers for underwriting.

Box 4: Equity Insurance Agency

Equity Insurance Agency Limited is the insurance agency of Equity Bank, Kenya's largest bank by client base with over 4.1 million accounts (Equity, 2010). Equity Insurance Agency (a separate legal entity) was established in 2008 with special permission from the Central Bank of Kenya (CBK). Equity Bank's client base consists predominantly of low-income earners and this has translated into a largely low-income focus for the product offering of the agency.

Agency performs the function of product design and administrator. Equity Insurance Agency is responsible for the development, design, marketing, sales and premium collection of its insurance policies. In some cases, the product is designed before an underwriter is approached to underwrite and calculate the risk premium.

Types of insurance policies. Equity distributes at least eight categories of insurance products: (1) comprehensive (individual, group and/or family) in-and-outpatient medical insurance policies, (2) motor insurance, (3) agricultural livestock insurance, (4) personal accident policies, (5) funeral insurance policies, (6) household content and fire, (7) cargo transit insurance and (8) insurance policies for third party liability.

Success to date. Take-up has been significant with more than 47,000 policies sold up to March 2010 to-date and a total of KSh1.1 billion (US\$ 14 million) gross premiums collected for the year ending 2009.

The recent tie-up between Equity and Safaricom to create the M-Kesho bank account offering opens up significant new opportunities for insurance distribution. At the time of launch, M-Kesho offered clients a personal accident insurance product linked to the account. The insurance was however not actively sold to clients using Safaricom agents.

Sources: Equity Bank, 2010. *Equity Bank, History and Background*. Last modified: May 2010. Available at: <http://www.equitybank.co.ke/about.php?subcat=7> (accessed May 2010); Njau-Mbugua, W. 2010. General Manager: Insurance, Equity Insurance Agency. *Personal Interview*. March.

The use of agricultural value chains. The use of distribution through agricultural retail chains has emerged in at least two examples:

- British American Insurance Company Limited (Britak) distributes life and medical insurance product to tea farmers linked to the Kenya Tea Development Agency (KTDA) through Majani Brokers, a wholly-owned subsidiary of the Kenya Tea Development Agency¹²⁴. More details on this product are provided in Table 20 and Box 6.
- UAP distributes the agricultural input insurance product Kilimo Salama¹²⁵ (translated as “safe agriculture”) through agricultural input retailers. This product was developed in partnership with the Syngenta Foundation. More details is provided in Box 5.
- Kenya Malt Company, the sister company of East African Breweries (EABL), provides insurance cover underwritten by Heritage, ICEA, UAP and Lion of Kenya to farmers who sell their barley to Kenya Malt.

Box 5: The Syngenta Foundation and UAP agricultural insurance product - Kilimo Salama

The Syngenta Foundation¹²⁶ in partnership with UAP Insurance, developed a weather-index based agricultural input insurance product, Kilimo Salama (Safe Agriculture). The product was launched under the Agricultural Index Insurance Initiative¹²⁷ and insures farmers’ seed¹²⁸ and/or fertilizer inputs from adverse weather conditions (flood and/or droughts).

Policy, premium and benefits: The policy insures agriculture seed/fertilizer against failed harvest by compensating farmers for adverse rain fall specific to the weather station relevant to the policy holder. The policy premium is calculated as a percentage¹²⁹ of the cost of the insured seed/fertilizer (5% of seed value).

Delivery channels, premiums collection and claims: The insurance policy is delivered to farmers through agro-dealers who sign up new policy holders, their selected insurance product and appropriate weather station through the use of a camera phone¹³⁰ capable of scanning bar codes and allowing for paperless policy registration and activation¹³¹. Agro-dealers are responsible for collecting the premium and transferring the premium to the insurer using the M-PESA mobile money transfer service. Payouts are triggered by data generated through automated weather stations and paid to

¹²⁴ Kenya Tea Development Agency Limited (KTDA Ltd) was incorporated in June 2000 as a private company under Cap 486 of the Laws of Kenya becoming one of the largest private teas management Agency. The Agency was previously a parastatal. (Kenya Tea Development Authority) that was formed in 1964 through a Legal Notice No. 42 of 1964 and took over the functions of the then Special Crops Development Authority (SCDA) to promote and foster the growing and development of tea growing among the indigenous tea farmers. (KTDA, 2010)

¹²⁵ Product was designed by the Syngenta Foundation and underwritten by UAP

¹²⁶ The Syngenta Foundation for sustainable agriculture is a non-profit organization established by Sygenta. The foundations focus specifically on providing assistance in the Kenyan agricultural sector.

¹²⁷ A partnership between UAP Insurance and Syngenta Foundation for Sustainable Agriculture.

¹²⁸ Product currently covers maize and wheat seeds.

¹²⁹ Total cost of the cover is 10% of the value of the seed. The premium is partly paid by the agro-business (5%) and the other half by the farmer (5%).

¹³⁰ Camera phone with data connection is provided to the agro dealer by Syngenta at a cost.

¹³¹ The use of this technology reduces the transaction cost to that of an SMS (Ksh5)

farmers using M-PESA.

Performance to date: Kilimo Salama was piloted in 2009 and is currently in its second phase of roll-out. The product has achieved moderate take-up levels to-date.

Additional examples of weather-index based weather insurance by Equity Bank/APA Insurance are included in Appendix F.

The potential use of mobile phone and mobile payment systems. As noted earlier, Kenya is one of the leading markets in the world for the use of mobile-enabled financial services. All financial service providers are currently exploring this area. Two examples are:

- While mobile payments systems such as M-PESA have largely been used for premium collection¹³² and claims settlement, the latest developments in agent banking and the recent partnership between Equity Bank and Safaricom (bearing in mind that roughly 80% of M-PESA clients do not have insurance and its network consists of 17,500 agents), has highlighted the potential role for these networks in distributing insurance¹³³.
- In addition, there are also other initiatives looking to utilise the power of mobile phones for distribution. A good example of this type of distribution is the Orient Insurance Safari Bima product. The personal accident insurance product is distributed through airtime vendors and mobile-enabled sales agents. Potential policy holders can sign up for personal accident insurance using a premium-rated short code from their cell phones that enables them to pay for the insurance policy with the air-time equivalent value. It should be noted, that while the product relies on a very innovative distribution mechanism, take-up to date has been limited, with very few claims to demonstrate the value of the product.

Box 6: British American Insurance Company (Britak) Ltd. and Kenya Tea Development Agency's Health and Funeral Insurance product, Kinga ya Mkulima

British American Insurance Company (Britak), in partnership with the Kenya Tea Development Agency¹³⁴, developed and launched a hospital and funeral microinsurance policy at the end of 2007. The product was designed to reach up to 500,000 small-scale tea growers through existing (tea industry-specific) agricultural value chains.

Policy, premium and benefit: The policy insures tea growers (with the option to include a spouse) against death and hospitalisation to the value of either KSh100,000 or KSh200,000 at a yearly premium of KSh1,020 or KSh2,040, respectively, for cover for the tea grower or KSh1,860 or KSh3,720, respectively, for cover which includes the spouse. The policy provides a KSh100,000 or KSh200,000 pay-out in the event of death, less any hospitalisation benefits received in the same policy year term. Hospitalisation benefits are capped at KSh20,000 or KSh40,000 per annum, depending on the level of

¹³² During the in-country visit, several insurance companies mentioned using M-PESA to collect insurance premiums, these included: Britak, UAP and Old-Mutual

¹³³ The M-Kesho account will carry a life insurance component

¹³⁴ Kenya Tea Development Agency Limited (KTDA Ltd) was incorporated in June 2000 as a private company, becoming one of the largest private tea management agencies in Kenya. Before its conversion to a private company, the Agency was a parastatal (Kenya Tea Development Authority) that was formed to promote and foster the growth and development of tea production amongst local tea farmers (KTDA, 2010).

cover selected.

Delivery channel and premium collection: Britak entered into a partnership with Majani Insurance Brokers, a fully-owned subsidiary of Kenya Tea Development Agency, to distribute this product. Majani works with representatives (“agents”) within the community to sell the product on a voluntary basis to small tea farmers. Premiums are collected (deducted from tea crop earnings) on a monthly or yearly basis by local tea factories responsible for purchasing the crop.

Performance to date: Kinga ya Mkulima has experienced significant take-up since its launch in late 2007 with 45,000 households and 78,000 lives covered in the first quarter of 2010 (Wandera, 2010).

Source: Wandera, S.. 2010. Managing Director, British America Insurance Company (Kenya). Personal Interview. 15 March.

8.2. Products and take-up

Insurance take-up lags that of other financial services and mobile phones. Despite the high level of innovation noted in the previous section, insurance take-up (7%) significantly lags the use of other financial services such as banks (23%), SACCOs (10%) and M-PESA (28%). In addition, 47% of Kenyan adults (9.6m) own a mobile phone, but only 15% of mobile users have some kind of insurance cover. When excluding NHIF and NSSF insurance usage figures, for the listed financial services categories, the percentage of individuals with insurance decreases even further.

| Financial service | % of adult population | % of Financial service group insured | % of Financial services group insured (excl NHIF and NSSF) |
|-------------------|-----------------------|--------------------------------------|--|
| Insurance | 7.3% | 100% | 100% |
| Banks | 23.3% | 27.0% | 14.3% |
| MFI | 3.8% | 18.8% | 9.5% |
| SACCOs | 10.2% | 32.5% | 19% |
| ROSCAS | 33.2% | 7.4% | 3.6% |
| M-PESA | 27.6% | 18.8% | 9.4% |
| Cell phones | 46.6% | 14.8% | 7.6% |

Table 18: Financial services and mobile phone usage, adult population over 16

Source: FinAccess 2009

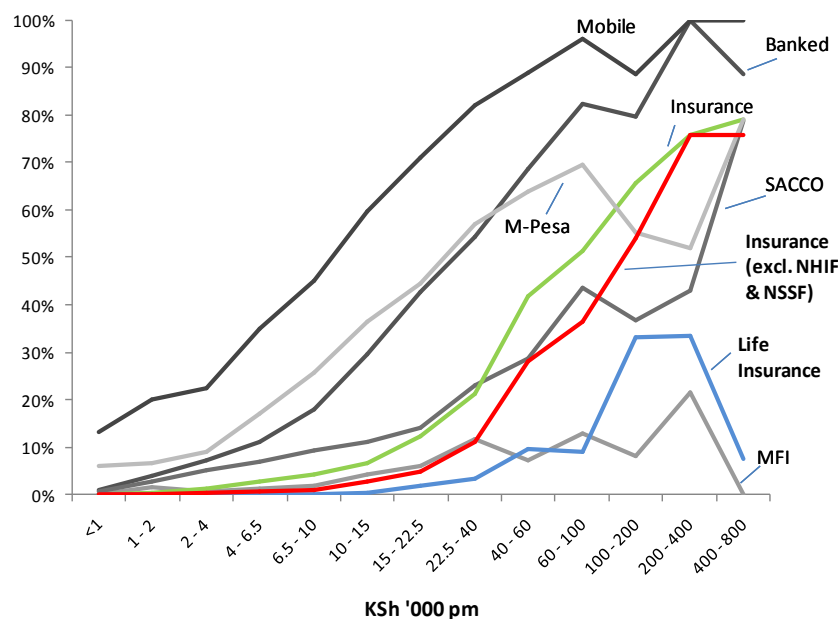


Figure 13: Financial services usage by income group

Source: FinAccess 2009

Insurance penetration already reaching into lower-income categories. When one considers the usage of insurance compared to bank accounts, cell phones, M-PESA, MFI and SACCOs across income distribution, it is interesting to note that, even at its current very limited penetration, insurance already exceeds MFIs in its penetration into the low-income market.

While showing some penetration into the low-income market, insurance usage mostly picks up at income levels of KSh40,000 (US\$ 530) and higher. As Figure 1 demonstrates, mobile and bank-based channels offer significant distribution opportunities for insurance into the low-income market.

Voluntary insurance usage limited. When compulsory insurance policies (i.e. excluding NSSF and NHIF¹³⁵) are excluded, insurance usage decreases to 3.6% of adults or an estimated 0.74 million individuals. When car insurance¹³⁶ usage is also excluded, insurance usage decreases to 2.9% or 0.6 million adults. Figure 13 (below) breaks down insurance usage by insurance type. The largest insurance usage category is NHIF (4.8% or 1m adults), followed by NSSF (3.2% or 0.66m individuals). Only 1% of adults report having life insurance.

¹³⁵ It should be noted, that even though NHIF is a compulsory medical insurance product for the formally employed, a voluntary NHIF policy is available to those outside of the formal employment market. This product has been very successful with more than 500 000 policies sold to date.

¹³⁶ The Insurance (Motor Vehicle Third Party Risk) Cap 405 requires all motor vehicles to carry third party insurance

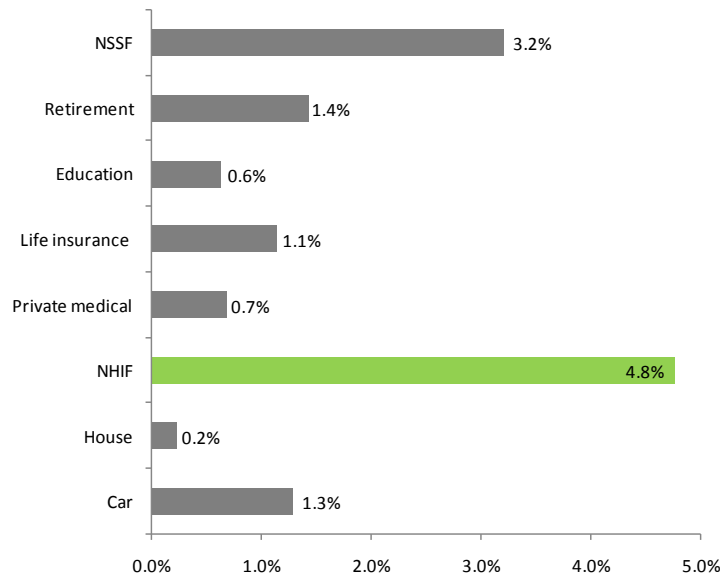


Figure 14: Breakdown of insurance usage,¹³⁷ adult population over 16

Source: FinAccess 2009

Credit life not reflected in survey data. Credit life insurance was not tracked separately in the FinAccess survey but could have been reported as part of the life insurance figure. However, only 1% of adults reported having life insurance, suggesting that credit life take-up is not picked up by the survey. Experience from other countries shows that people are often not aware that they have credit life insurance, or that it is regarded as precondition to the loan rather than an insurance product. For this reason, demand-side surveys often underestimate credit life uptake.

Emergence of techno-savvy agricultural insurance products. Microinsurance products in the form of livestock, crop and agricultural input insurance has emerged with underwriters making use of satellite imaging, weather data, cell phone registration and point of sales (POS) devices and M-PESA for premium collection and/or payouts to overcome the traditional barriers to agriculture insurance. The examples below provide more information on the use of technology or other interesting approaches on agricultural insurance products:

- The International Livestock Research Institute (ILRI), in partnership with Equity Bank and UAP, with initial funding from DFID and FSD Kenya has developed an index-based livestock insurance policy that uses satellite imagery to determine potential losses of livestock forage.
- The Syngenta Foundation, in partnership with UAP, has developed an agricultural input insurance product that uses agro-dealers to distribute insurance products. During the registration process, agro-dealers use a mobile device to register new policies (see Box 5 for details).
- In addition, FSD Kenya, World Bank and the Rockefeller Foundation are in a partnership that is supporting various pilot projects on index-based weather insurance. The initiative has supported a diverse range of crop¹³⁸ insurance products. The products typically

¹³⁷ It should be noted that FinAccess survey does not ask individuals if they have a personal accident or credit life policy. Thus the usage of these products were not recorded.

¹³⁸ Examples of crops covered include maize, wheat, coffee and bananas.

cover the input costs and expected income by farmers. Under this initiative partnerships have emerged between APA and Equity Bank, CIC and K-Rep and APA with Agricultural Finance Cooperation (AFC). More players are at different stages of the product development cycle (Mbaka, 2010). See Appendix E for examples of supported products.

Public/private partnerships created opportunity for health microinsurance. A public-private partnership in health insurance has emerged between the NHIF and CIC (see **Error! eference source not found.** below) that has created a unique opportunity for health microinsurance. More partnerships with the NHIF are in the pipeline. This partnership serves the purpose of providing private insurers with access to existing medical service provider agreements and a large risk pool, while assisting the NHIF in further extending its product offering to the unemployed.

Box 7: Bima ya Jamii

Bima ya Jamii, the fruits of a partnership between Swedish Cooperative Centre,¹³⁹ Co-operative Insurance Company of Kenya Limited¹⁴⁰ (CIC) and The National Hospital Insurance Fund (NHIF)¹⁴¹, is a medical insurance product sold through SACCO societies, welfare Groups and microfinance institutions¹⁴².

Policy, price and benefits: The policy provides (1) comprehensive family medical insurance with no age restriction at over 400 NHIF approved hospitals (coverage dependent on nature—government, mission and private—of hospital), (2) loss of income (KSh2,000 (US\$ 27)) per week for duration of the main member’s hospitalisation, (3) permanent disability (KSh100,000 (US\$ 1,320)), (4) accidental death cover (KSh100,000 (US\$ 1,320)) and (5) funeral expenses (KSh30,000 (US\$ 400) and the option to extend these funeral benefits to additional family members (at a cost of KSh270 (US\$ 4)) for spouse and KSh 210 (US\$ 3) per child per year). The policy premium is KSh3,650 (US\$ 48) per family which can be broken down into KSh1,920 (US\$ 25) for the NHIF component and KSh1,730 (US\$ 23) for the accidental death and funeral riders.

Delivery channel, premium collection and claims: CIC enters into distribution relationships with organised groups, who collect cash or credit-financed premiums from their members. CIC disperses the risk premium (and required documents) of the medical component to the NHIF. Members’ medical expenses are covered directly by the NHIF (partially or in-full depending on institution) and cash benefits (e.g. permanent disability, loss of income) paid directly to the policy holder through the SACCO, MFI account or M-PESA.

Performance to date: The product has performed well with 56 groups acting as aggregators and more than 19,000 active policies.

¹³⁹ SCC is a non-profit, non-governmental organisation that was established to provide development support to cooperatives and other pro-poor organisations. It was founded in 1958 by the Swedish Cooperative Movement with a vision of a world free from poverty and injustice.

¹⁴⁰ CIC was established in 1978 and is the preferred underwriter of the co-operative movement in Kenya.

¹⁴¹ The NHIF was established in 1966 as a parastatal organisation reporting to the Ministry of Health. The NHIF has a mandate to provide medical insurance cover to all its members and their declared dependants. The NHIF membership is open to all Kenyans who have attained the age of 18 years and have a monthly income of more than KSh1,000. NHIF membership is compulsory for the formally employed.

¹⁴² As of April 2010, the policy was distributed through 56 groups.

During 2009, a number of new medical insurance products were launched. This includes Equihealth Insurance, a microinsurance product offered by Equity Insurance Agency and underwritten by UAP insurance (see Box 8). The product is unique in that it offers different levels of cover (going down to the microinsurance level) at different premium levels. Furthermore, it is also unique in its reliance on capitation for the financing of both in- and out-patient cover. 2009 also saw the CFC Life/Liberty Health partnership (both of whom are subsidiaries of the Standard Bank Group) launching 'Blue', a product offered in two tiers that promises full cover, treatment and medication for chronic conditions such as asthma, diabetes, hypertension and HIV/AIDS.

Box 8: Equihealth Insurance

In 2008, Equity Bank partnered with UAP Provincial Health Insurance and launched a microinsurance product called Equihealth on a pilot basis in Nairobi. The pilot project was successful and the product was officially launched in 2009. The product is underwritten as a four-tier system in which clients are able to choose from different premium levels (according to affordability) with different benefits attached to them. The premium payments are financed by Equity Bank and the person seeking insurance need not be a customer of the bank. The premium payments range from KSh6,700 (US\$ 89) to KSh 19,200 (US\$ 250) per annum, with coverage ranging from KSh75,000 (US\$ 990) to KSh1,000,000 (US\$ 13.20). Equihealth covers inpatient and outpatient care and provides sickness, injury, maternity, dental, optical, HIV/AIDS, pre-existing and chronic conditions and birth defects benefits. Table 19, below, describes each of the four tiers in detail in greater detail

| Tier Name | Mango | Passion | Melon | Apple |
|-------------------------------------|--|----------------------|----------------------|--------------------------|
| Premium (per annum) KSh | 6700 (US\$ 88) | 8,500 (US\$ 113) | 16,000 (US\$ 210) | 19,200 (US\$ 255) |
| In - Patient Cover Limit KSh | 75000 (US\$ 995) | 150,000 (US\$ 1,990) | 500,000 (US\$ 6,600) | 1,000,000 (US\$ 13,270) |
| Outpatient Cover Limit KSh | 20000 (US\$ 265) | 20,000 (US\$ 265) | 35,000 (US\$ 460) | 50,000 (US\$ 660) |
| Supplementary Benefits | Provides supplementary benefits within the main cover for pre-existing and chronic conditions. HIV/AIDS, maternity, dental, inpatient ophthalmology and 24hour access to a wide panel of hospitals | | | |

Table 19: Equihealth insurance offering

Source: Equity Insurance Agency Product Brochure, 2010

High up-take of life/funeral insurance products despite stigma surrounding death. During interviews with various stakeholders, a general perception that individuals do not talk about or prepare for death emerged. However, focus group discussions (see Section 9) revealed a willingness to discuss and prepare (where possible) for the eventualities of death. In addition, several life cover products emerged¹⁴³:

¹⁴³ In addition, it is common practice for life-insurance companies in Kenya to provide last expense (funeral cover) as a product rider (Mbaka, 2010)

- Life insurance cover sold by CFC Life Assurance offers individual life cover up to KSh100,000 (US\$ 1,327), with the option of adding a accidental death or personal disability cover. Monthly premiums start at KSh2,500 (US \$33).
- Last expense by Pan Africa is funeral insurance product offered to groups where membership exceeds 20 members. Members have the option of insuring family members and monthly premiums start at KSh1,000 (US\$ 13) and cover at KSh50,000 (US\$ 663).

Bancassurance and MFI insurance offering moving beyond credit life. Large MFIs and banks are moving beyond offering their clients compulsory tied credit life cover¹⁴⁴ to offering voluntary, untied life, medical and personal accident insurance. The MFI, Faulu Kenya, offers its members a comprehensive (in- and out-patient) medical insurance policy underwritten by Pioneer. Annual premiums start at KSh7,000 (US\$ 93) and the policy covers the whole family.

Annual premiums reduce affordability. An interesting feature of the Kenyan microinsurance products is that most are based on annual insurance premiums. With a few exceptions, premiums are pre-paid on an annual basis. Yearly premiums may be suitable for low-income individuals with cyclical and/or seasonal income such as those in the agricultural and/or tourism sectors. However, this form of payment is not ideal for the working-poor who rely on small sums of money on daily, weekly or monthly bases. Most MFIs offering insurance products have responded to the reduced-affordability effect of annual premiums by financing the yearly premiums and collecting payments monthly. Interest is charged on this which increases the eventual premium paid by consumers.

The table below summarises some of the information on microinsurance products we obtained through our consultations. Note that it is not an exhaustive list of all products in the market, nor does it contain all the details for each product as these were not always available. Rather, it gives an indication of the types of microinsurance products available in Kenya. From a brief look at the table it should be evident that there are already a number of life and personal accident microinsurance products in the Kenyan market, with a growing number of agricultural and health insurance products. Currently all of these insurance products rely on distribution through a group (i.e. not the traditional one-on-one sales method). This includes sales through Equity Bank, MFI and cooperatives.

¹⁴⁴ Internationally, insurance extension through MFIs has mainly been limited to compulsory, tied credit life products that served to protect the MFI from default in the event of the death of the loan holder.

In the process of conducting the study, several interesting microinsurance products came to light. See Appendix E for additional examples of agriculture insurance products:

| Life and personal accident | | | | | |
|----------------------------|-----------------------------------|--|---------------------|--|---|
| Policy type | Product | Premium | % of GDP per capita | Distribution | Benefits |
| PA & Disability | Safari Bima Orient | KSh30 (per day) (18% of GDP pc) | 18% | Distribution through cell phone | KSh100,000 (US\$ 1,327) on death or permanent disability of policy holder |
| Life | CFC Life Cover | Min KSh2,500 (per month) (4% of GDP per capita) | 4% | - | KSh 100,000 (US\$ 1,327) death cover and savings component |
| Life/Funeral | Last Expense Pan Africa | Min KSh1,000 (per month) (2% of GDP pc) | 2% | Distributed through MFI | KSh50,000 (US\$ 664) on death of policy holder or |
| Credit Life | CIC/Jamii Bora | 1% of loan | - | Distribution through MFIs | Covers outstanding loan and pays 200% of savings to next of kin |
| Medical & Funeral | Kinga ya Mkulima Britak | KSh1,020 (annual) | 1.5% | Distributed using Kenya Tea Development Agency | Total cover of KSh100,000 (US\$ 1,325) for medical and funeral |

| Agriculture | | | | | |
|----------------------------|---|---|---------------------|---|--|
| Policy type | Product | Premium | % of GDP per capita | Distribution | Benefits |
| Agriculture Input | Kilimo Salama UAP/Syngenta | 5% of benefit amount (once off) | - | Distribution through agricultural dealers | Insures feed, fertilizer or herbicides against failed crops |
| Livestock | Bima Ya Mifugo UAP/Equity | Min KSh2,000 (yearly) | 3% | Distribution through Equity Bank | Insures livestock of economic value against diseases, accidents, theft, calving complications |
| Agriculture ¹⁴⁵ | APA/Equity Bank Weather Index Insurance | A range of 6.7% to 14.6% of sum insured | - | Distributed through Equity Bank | Insurers farmers crops against adverse weather risks to protect their cost of inputs and their incomes |

Table 20: Examples of microinsurance product offerings: Life, personal accident and agriculture

Source: Various sources

¹⁴⁵ FSD/World Bank/Rockefeller Foundation supported

| Health Insurance products | | | | | |
|----------------------------|-----------------------------------|---|---------------------|--|--|
| Policy type | Product | Premium | % of GDP per capita | Distribution | Benefits |
| Medical (private) | Equihealth UAP/Equity | KSh6,700 (US\$ 89) (yearly) | 10% | Equity Bank | Comprehensive family cover with outpatient (max of KSh20,000/US\$ 265) and inpatient (max of KSh75,000/US\$ 995) cover. |
| | Fualuafya Pioneer/Faulu | Min KSh7,000 (US\$ 93) (yearly) | 10% | Distribution through Faulu MFI | Comprehensive family cover with unlimited outpatient and limited inpatient care |
| Medical (public) | NHIF | KSh1,920 (US\$ 25) (yearly) - voluntary category | 3% | Distribution through Employees and NHIF agents | Inpatient - and outpatient in selected areas - cover at network hospitals. Level of benefits received depended on hospital and ranges from comprehensive cover in government hospitals to cover for selected procedures in private hospitals |
| Medical (private & public) | Bima ya Jamii CIC | KSh3,650 (US\$ 48) (yearly) | 6% | Distribution through SACCOs and MFIs | NHIF cover plus loss of income cover (KSh2,000/US\$ 26), KSh100,000 (US\$ 1,327) accidental death cover and KSh30,000 (US\$ 398) funeral cover. |
| Medical & Funeral | Kinga ya Mkulima Britak | KSh1,020 (US\$ 14) (yearly) | 1.5% | Distribute using Kenya Tea Development Agency | Total cover of KSh200,000 (US\$ 2,653) for medical and funeral |

Table 21: Examples of health microinsurance product offerings

Source: Various sources

9. Demand-side perspectives on risk management and insurance

In this section, we summarise the features of the low-income and currently uninsured market as captured in the findings of the 2009 FinAccess survey. We also analyse the Kenyan low-income market's experience of risk, as well as their perceptions of, and demand for insurance products. This analysis draws on insights gained from a series of 29 focus group discussions commissioned for the study (see **Error! Reference source not found.**, below, for discussion of the focus group methodology), as well as broad-level conclusions from another set of focus group discussions conducted in 2003 which focused on the risk experience of East African (Kenyan, Tanzanian and Ugandan) microfinance clients.

Box 9: Kenyan microinsurance focus group methodology

Focus group discussions (FGDs) is a qualitative market research tool that is used to test and analyse perceptions around certain issues (in this case, risk experiences and insurance). Ideally, focus group discussions consist of small groups that are formed where interactive discussions with a professional moderator are held (Hougaard et al., 2009).

The focus group discussions commissioned for this study were held in and outside Nairobi, over a two week period from 22 March to 2 April 2010 with a total of 245 participants. Participants were from the low-income market and included artisans and traders, civil servants, microfinance clients, farmers and/or traders in farm products. The participants were recruited from the urban and peri-urban low-income areas of Nairobi and its surrounding areas, including the Kiambu rural area and town.

Respondents were differentiated by age and gender (see Table 22). The majority of respondents were female (approximately 60%). The split between individuals under the age of 35 and over the age of 35 was almost equal. With regards to location, the majority of respondents, (approximately 64%) were from urban area.

| | Urban | Peri-urban | Total |
|-------------------------|-------|------------|-------|
| FGD Participants | | | |
| Women | 92 | 55 | 147 |
| Men | 65 | 33 | 98 |
| Ages 25-35 | 60 | 48 | 108 |
| Old than 35 | 97 | 40 | 137 |

Table 22: Sample frame for focus group discussions

Source: Odera, 2010a

In order to provide a nuanced perspective of the different risks that low-income Kenyans face, four categories of focus group discussion (FGD) participants were identified and recruited:

- **Farmers and agricultural traders (agricultural sector):** Farmers and those trading in farm produce in Kiambu (an agricultural town 25 kilometres outside Nairobi) were included to provide information on agricultural-specific risks, coping strategies and the use of and perceptions of insurance in this environment.
- **Microfinance institutions' (MFI) clients:** MFI clients were included to provide additional information on the low-income market's use of and experience with credit life insurance, as most MFIs require clients to pay for this product if they want to take a loan.
- **Civil servants:** Civil servants were included as they are able to provide information on their use of and interaction with the National Hospital Insurance Fund (NHIF) and other formal insurance

products due to the regularity of income associated with their salaried employment in the formal sector.

- **Informal sector artisans and traders:** Artisans and traders were included in the sample to provide information on risks that small business owners face, their coping strategies and use of insurance in the informal sector.

The key objective of the focus group discussions was to explore the different risks faced by low-income households in Kenya, as well as the coping strategies and mechanisms utilised by this market. In addition, related objectives of the study include understanding the severity of the different risks they face, their perceptions of the insurance market, and their insurance purchase decision-making criteria (Odera, 2010a).

9.1. Profile of the unserved market

Differences between the insured and uninsured. Before we consider the demand-side insights gained from the focus group research and FinAccess analysis, it is important to form an idea of the characteristics of the insured in comparison to the uninsured market in Kenya. It is clear from FinAccess that the insured are more affluent than their uninsured counterparts.

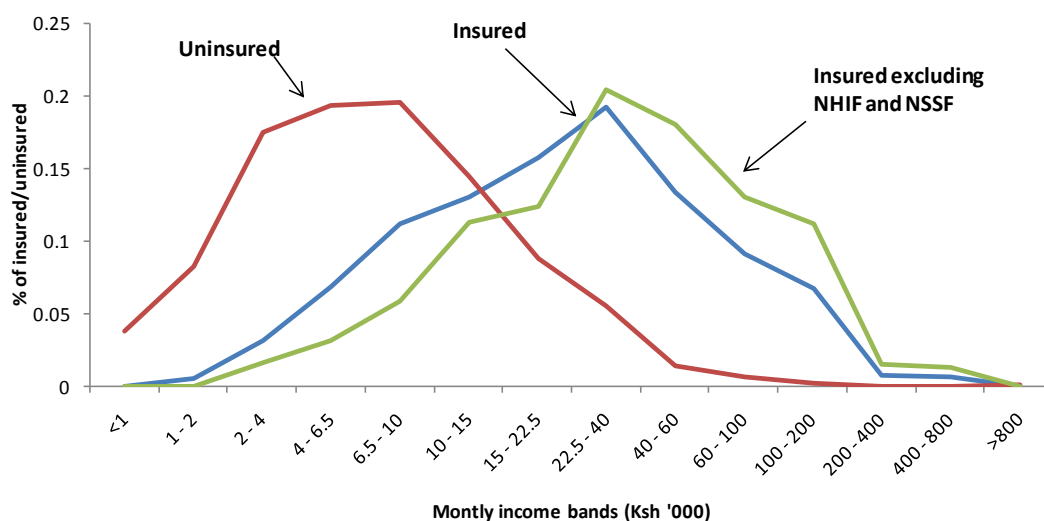


Figure 15: Income distribution of the insured versus the uninsured

Source: FinAccess, 2009

Currently the majority of insurance users are clustered in the KSh22,500 (US\$ 299)-KSh40,000 (US\$ 530) per month income groups, with the distribution spread evenly around this income band when including NHIF and National Social Security Fund (NSSF) usage. When excluding NHIF and NSSF, we see insurance usage to be skewed towards incomes above the KSh22,500 (US\$ 299) - KSh40,000 (US\$ 530) income band.

In addition, the FinAccess data sketches the following picture:

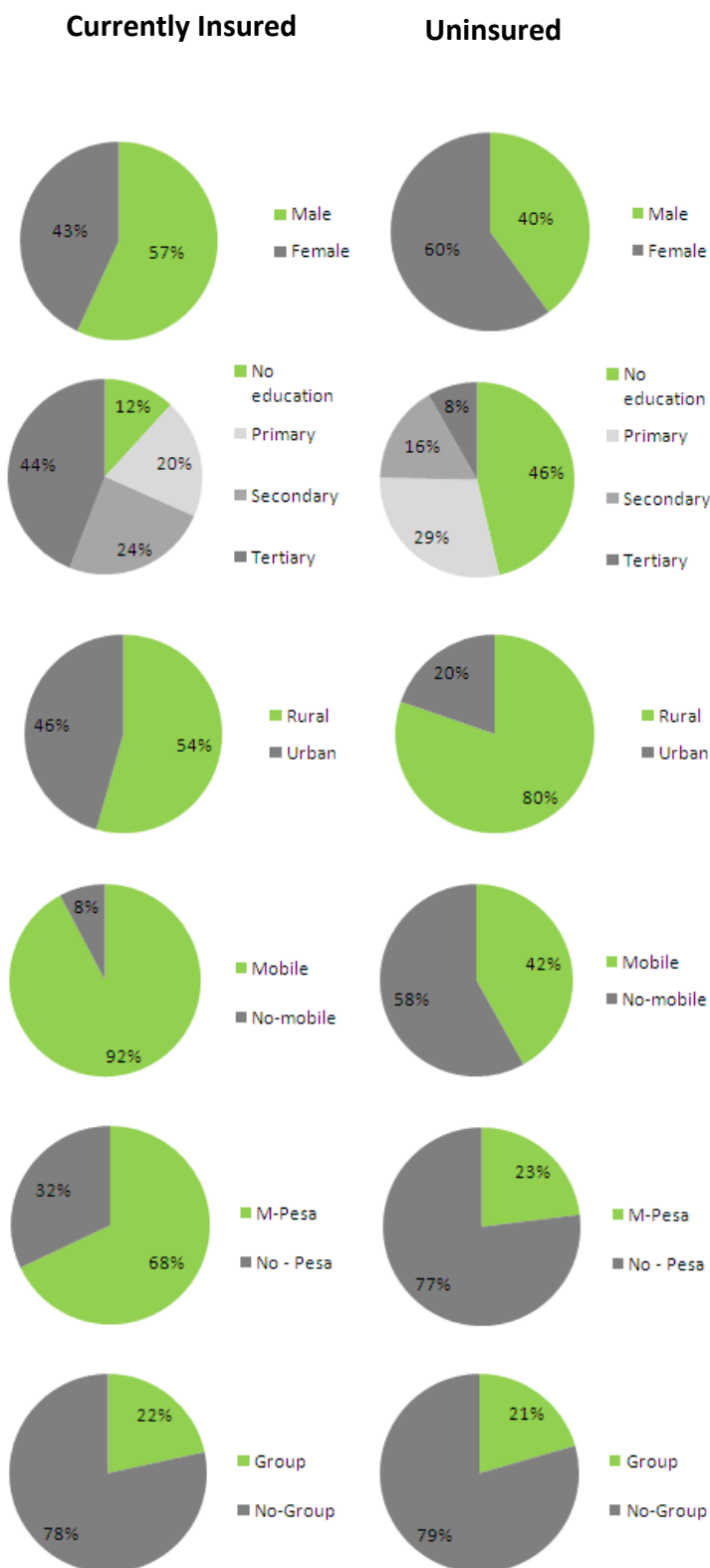


Figure 16: Profile of insured and uninsured
 Source: FinAccess, 2009

Notes

The **uninsured are more likely to be female** (60%) than male (40%). The insured male female distribution - 57% Male, 43% Female - remains similar when excluding compulsory NHIF and NSSF insurance.

The **uninsured are more likely to have no education** (46%) or only a primary level education (29%) than the insured – 12% and 20% respectively.

The **uninsured are more likely to be rural** (80%) than urban (20%).

45% of Kenyan adults own a cell phone with ownership skewed towards the insured with more than 92% of the insured owning a cell phone. The uninsured cell phone usage is slightly below the national average with 42% reporting to own a cell phone.

At the time of the FinAccess survey (May, 2009) 26.3% of adults made use of M-PESA. M-PESA usage among the uninsured is slightly below this figure at 23%.

Individuals belonging to a welfare group for the purpose of mitigating risk (e.g. funeral) are not significantly more likely to be uninsured.

9.2. Risk experience, perceptions and categories of risk

FinAccess underlines loss of main wage-earner, followed by drought and/or famine as major risks. According to FinAccess, the following risks (as shown in Figure 17) are identified by Kenyans as their main risks¹⁴⁶.

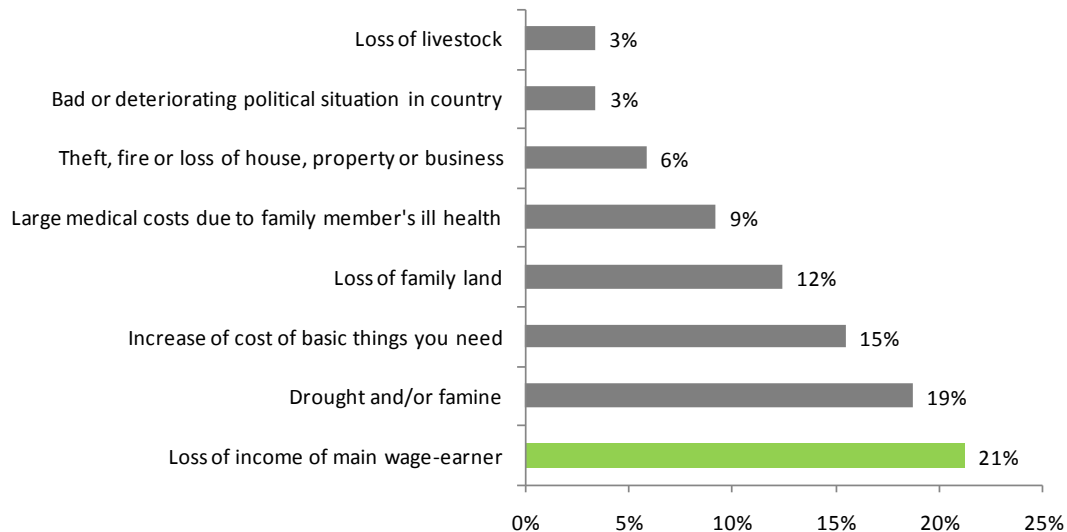


Figure 17: Biggest “main” risks faced by Kenyans

Source: FinAccess, 2009

Despite variations, the FinAccess findings are similar to those of the focus group discussions commissioned for this study:

- Focus group discussion respondents rated **the death of the breadwinner** (or the main wage-earner) as the greatest risk that they faced. Focus group respondents rated **sickness and accidents** as the second greatest risk they face due to their large financial impact. When these risk events occur, large sums of money are required to pay for sudden and unexpected lump sums due to hospitalisation and the use of drugs and medication. Furthermore, sickness and accidents may also lead to loss of income.
- Focus group respondents ranked **loss of property** as the third most important risk in terms of financial and emotional as the impact. The loss of property through fire and theft was identified as a common and daily occurrence within the informal settlements where a large number of respondents live. Microfinance clients have also lost the property they used as collateral for their loans due to their inability to pay back their loans. In addition, respondents highlighted the loss of property due to electoral violence as a risk and a concern.
- In addition, **drought and famine** were rated as key risks that are specific to the agricultural group of focus group respondents.

¹⁴⁶ The risks identified as the “main risk” by most respondents to FinAccess when they were asked to identify one, main risk.

Box 10: Voices of respondents on their experience with loss of property

“One is also robbed and raped as you go to work.”

“A lot of stress came from the post election violence. I stayed for two months without sleeping. We are still here, what will happen during another election period? Election is coming and I don’t have anywhere else to go.”

“Fire in the slum is common, and can leave you with nothing but the clothes you are wearing.”

“For theft it’s the same but you have to start all over again. You look for other work such as in construction sites, washing people’s clothes or work in a shamba (farm) to rebuild capital.”

“There is a lot of theft. Even capital can be stolen as you work. You can be going to the market to buy supplies and the thieves ask you for the money you are carrying. It never ends; we are in a slum area. The young men here have no jobs, so they wait for you.”

Source: Odera, 2010a

Despite categorisation of FGDF respondents, there were certain universal risks faced by all. There were risks that all respondents experienced as low-income people, despite the fact that there were others that were more applicable to particular livelihood groups or respondent profiles. Universal risks experienced across all respondent profiles included loss of income, death of family members, death of a breadwinner, and sickness and/or accidents. In addition, the inability to pay for the education of children was also identified as a major risk.

Error! Reference source not found., below, highlights the voices of artisans, as captured using the focus group discussions, concerning their vulnerability. Artisans, as livelihood category, viewed themselves as more vulnerable than the other livelihood groups.

Box 11: Voices of artisans and traders on vulnerability

Tunavumilia” (we are persevering).

“Small scale people are not catered for by the government. For example if I fall sick, it will be upon my friends to contribute for my hospitalisation.”

“Tunajihurumia” (we pity ourselves).

“Biashara ni ngumu sana” (business is very difficult).

“There is no money for stock and you have to pay rent and feed the children.”

“Ni mzito sana nikujikaza” (it is very difficult, you have to struggle)

“I can go to Gikomba market for my stock and it’s very difficult to even make KSh200 (US\$ 2.65) per day and sell.”

“Tunajinyima” (we deny ourselves). “I have to sacrifice for example I take porridge, keep measuring rations on unga (posho), no meat in the diet.”

Risks vary according to income source and livelihood category. While there are a number of general risks that applied to all respondents, certain risks are more applicable to certain livelihoods categories. For example, farmers are likely to face farm risks such as drought, flood and famine.

| FGD participant livelihood category | Risks faced |
|-------------------------------------|---|
| MFI Clients | Inability to repay MFI loans |
| Farmers | High and increasing cost of inputs |
| | Livestock diseases |
| | Floods, drought and famine |
| | Theft of animals |
| | High cost of farming, low income |
| Artisans and traders | Defaulters bad debts |
| | High operational costs |
| | Eviction and demolition by city council workers |
| | High levels of competition |
| Civil servants | Loss of employment |

Table 23: Livelihood-specific risks faced according to FGD participant profiles

Source: Odera, 2010

Risks faced by MFI clients: MFI clients face all the risks associated with owning and running a business. However, the fact that they have funded or part-funded their business through a loan exposes them to other risks. Clients' assets may be used as collateral to their loans and the failure to meet the necessary loan payments may result in a loss of property. Furthermore, in the event that MFI clients are unable to keep up with payments, they are at risk of losing other benefits (such as cover for health and death shocks) that are often tied with loan products. Cohen and Sebstad (2003) identify the misappropriation of loan funds received by spouses as another risk that MFI clients may potentially face.

Risks faced by farmers: As farmers are engaged in agricultural activities for their source of livelihood, their risks are related to these. Weather phenomena such as drought and famine which determine their crop yield ultimately affect their source of food and income. Other risks which are agricultural-specific include the high (and fluctuating) cost of agricultural inputs such as fertiliser and livestock disease.

Risks faced by artisans and traders: Artisans and traders are vulnerable due to the nature of their profession which affects the size and regularity of their income. Artisans face enterprise risks such as bad debts, loss of equipment or stock, as well as high and increasing operational costs. Price fluctuations and high levels of competition also impact on the levels and stability of income which they receive.

Risks faced by civil servants: Due to the stable nature of their incomes, the key risk affecting civil servants is the loss of employment.

9.3. Financial impact of risk events

As shown in Table 23, focus group participants face different income-specific risks. Artisans and traders face enterprise or small business risks, while farmers face agricultural (including weather-related and crop and cattle diseases-related) risks. These different risks imply different levels of impact and financial implications and costs which, in turn, determine the type of coping mechanism used. Apart from these livelihood-specific risks, general cross-cutting risks such as death of a breadwinner (or family member) and sickness and accidents also lead to specific costs.

Costs associated with funeral events

The cultural significance attached to funerals in Kenya often translates into a financial burden for the family of the deceased¹⁴⁷. Focus group participants view funerals as a source of pressure not only for the family, but for the greater community. Members of the community come together and try to raise funds for the various costs associated with the burial including transportation of the body to the ancestral land, the coffin and food for mourners for the duration of the mourning period. However, more often than not, the various social and risk pooling groups and strategies are unable to meet the costs associated with funerals.

Welfare group payouts cannot fully cover funeral and hospitalisation costs. Unfortunately, payouts from the welfare groups are never sufficient to cover the costs associated with death and hospitalisation. Funeral costs mentioned by the focus group participants range from KSh150,000 (US\$ 1,990) to KSh200,000 (US\$ 2,654) if burials take place in Nyanza, the Coast Province or areas 350-400km away from Nairobi, with welfare groups tending to contribute only between KSh20,000 (US\$ 264) and KSh50,000 (US\$ 663) in the case of death of a member (Odera, 2010a). A risk diversification strategy that has been adopted by low-income people is to belong to several welfare groups. "Respondents belong to several groups with majority being in at least two groups and at most six groups" (Odera, 2010a). An additional risk diversification strategy that is employed by low-income people is the supplementation of their contributions from the various groups with other self-insurance mechanisms including liquidation of savings and Harambees (discussed below).

¹⁴⁷ It should, however, be noted that there is significant cultural variation across different communities in Kenya and not all communities attach the same significance to funerals.

9.4. Risk coping strategies

A number of risk management and risk coping strategies were identified from the focus group discussions and findings from FinAccess 2009 as can be viewed in Table 24 below.

| Coping strategy | % adults citing strategy |
|---|--------------------------|
| Family member support | 25.5% |
| Find a better job/additional job | 16.6% |
| Savings | 12.7% |
| Can't do anything | 12.5% |
| Depend on charity from church mosque, Red Cross | 10.3% |
| Loan | 10.0% |
| Sell assets | 8.6% |
| Claim insurance | 0.8% |

Table 24: Major coping strategies for risky events

Source: FinAccess, 2009

The FinAccess findings provide a quantitative perspective on risk coping strategies used by Kenyan adults. While these findings are not solely focussed on the low-income market, they provide valuable insights and assist in drawing broad conclusions. The risk coping strategy mentioned most frequently by respondents (25%) is relying on the support of family members. Less than 1% of adults say they would cope with a financial risk by claiming from insurance.

In identifying risk coping strategies, it is important to note that there are two categories, namely, *ex ante* (used prior to the risk event) and *ex post* (only used after the event).

9.4.1. Ex ante risk coping strategies

Ex ante risk coping strategies are measures that are taken prior to the occurrence of the risk event. In the focus group discussions the following ex ante risk coping strategies were identified.

Savings:

Respondents accumulate savings in their homes, bank accounts and M-PESA accounts.

Insurance products:

Some of the focus group participants, particularly the civil servants and MFI clients, had insurance products. Findings from the focus group discussions indicate that, except in the case of products offered by MFIs and the NHIF, all insurance products were purchased from insurance agents and brokers. Furthermore the usage of insurance products potentially differs according to the individual respondent profiles. For example, civil servants are the predominant users of education policies.

- **Insurance products to cope with death/life events:** A few participants, particularly civil servants, make use of life insurance products to manage and deal with the risks associated with life events. Civil servants that had insurance products make use of the life insurance products provided by Pan African Life and CFC Life British American (BRITAK).
- **Insurance products dealing with health shocks:** Furthermore, there are also formal insurance products that are used to cope with risks that arise from health shocks such as illness and bodily injury. All civil servants used NHIF cards (NHIF is compulsory for the formally employed), while a few have voluntary medical insurance.
- **Other insurance products:** Respondents, particularly civil servants, had two types of educational policies. These were the CFC Educator Plan and the Britak Investment Plus Plan, which allow policyholders to save for the education of their children.

Microfinance institutions (MFIs) clients use two main types of insurance products:

- **Credit life:** The credit life insurance is bundled with the loans provided by the MFIs.
- **Health insurance:** Microfinance institutions have developed health insurance products in collaboration other parties namely health management organisations and insurance companies. In the focus group discussions, reference was made to health cards which offer inpatient treatment in approved hospitals, including the Afya Card offered by K-Rep Development Agency (KDA) in conjunction with the health maintenance organisation AAR, as well as the Kenya Women Trust Health Card which was developed by the Co-operative Insurance Company in collaboration with the National Health Insurance Fund (NHIF).

Risk pooling groups (welfare groups/societies):

Generally, respondents belong to several groups, including burial societies and welfare groups. Burial societies are primarily community-based and are continually evolving to “reflect new bases for group formation” (Cohen and Sebstad, 2003). Burial societies are rooted in the belief in ‘reciprocity’ which is a core part of Kenyan culture (Cohen and Sebstad, 2003).

Welfare groups typically consist of relatives and friends, with risk pooling as an explicit function for most: “The primary function of these welfare associations is to cover the cost of the funeral, coffin, food for mourners and transport costs. They usually do not address the need for financial support for those left behind,” (Cohen and Sebstad, 2003). Such groups exist within the background of churches, wider family, urban areas, work and business environment. Formally structured welfare groups are registered with the Ministry of Gender, Children and Social Development and have elected officials such as a treasurer, chairperson and secretary, as well as a constitution which governs operations. Membership is obtained through a once-off registration, and subscriptions are mostly paid monthly (Odera, 2010a).

The more sophisticated welfare groups that pool risks mainly for death and health shocks, such as burial and hospitalisation, are urban-based, function on a pre-collection basis (ex ante) and are highly organised with elected officials, a constitution and a bank account.

The less sophisticated welfare groups, whose core activities often include rotating savings, do not necessarily have a bank account and tend to be more rural-based. These welfare

groups may also provide more social (compared to more financial) support when a particular risk event occurs. Rural groups typically require contributions from all members at the time of a member's death (thus being an ex post coping mechanism) (Cohen and Sebstad, 2003). For rural groups, the cost of the funeral typically equals the amount which is collected once a death takes place. More information on the functioning of a specific welfare society is provided in Box 12, below.

In the sample of focus group respondents, the civil servants and microfinance institution clients tended to be members of the more 'sophisticated' and formally organised welfare groups which have bank accounts, while artisans and traders were members of the less sophisticated merry-go-round welfare groups, (Odera, 2010b).**Error! Reference source not found.**

9.4.2. Ex post risk coping strategies

Ex post risk management strategies are measures that are taken after the risk event has occurred. In the focus group discussions, the following ex post risk management strategies were identified:

Harambees:

Harambees (which is Swahili for 'let us pull together') are used as an ex post risk management tool to assist with the settlement of large hospital bills and funeral costs beyond what the immediate family can manage. They rely on the principle of reciprocity, with the assumption that if you benefit from a harambee to cover the costs of a family member's funeral now, in future you will be required to make contributions to the contributors' funerals (or those of their family members).

A harambee is an event which is organised by the family with the assistance of friends and relatives. The role of the organisers of the event is to contribute financially and to identify a guest of honour such as a businessperson, Member of Parliament (MP), senior civil servant or church leader with a wide network of friends. The family of the patient or deceased often bears the cost for the organisation of harambee. These costs include venue hire, use of a public address system, and refreshments. Unfortunately, harambees no longer yield valuable results as they have been overused for other fund-raising activities (Odera, 2010a). Friends and relatives typically contribute small amounts that vary from KSh200 (US\$ 2.65) to KSh500 (US\$ 6.63) per harambee (Odera, 2010a). The success of harambees is viewed as being dependent on the social class of the deceased and "herein lies their limits for the poor" (Cohen and Sebstad, 2003). Findings of the focus group discussions confirm this as harambees often do not raise adequate funds for artisans and traders.

Due to the low returns associated with a single harambee, a series of harambees may be held in preparation for a larger event. Funds raised from smaller harambee(s) events are used to pay for the costs of the final (and very large) harambee.

Loans from ASCAs, SACCOs and microfinance institutions:

Civil servants often take out loans with SACCOs or obtain salary advances from their employers. Microfinance clients also ask for emergency loans from their respective MFIs. Many MFIs offer emergency loan products, with the loan typically tailored to meet the needs of the specific emergency. Furthermore, in the case of artisans and traders, loans will be taken out from family and friends.

Liquidation of savings:

Artisans and traders often use this strategy, more so than the other categories of respondents. This may be due to the fact that they have the least stable source of income.

Selling of livestock and produce:

In the case of emergencies, farmers will sell cereal produce and livestock as a means to acquire the necessary financial resources to deal with the impact of the risk.

9.5. Perceptions of and experiences with insurance

The focus group discussions reveal that low-income Kenyans may perceive the risk of taking insurance as greater than not taking it at all. Generally, participants displayed a high level of distrust towards insurance companies, their brokers and agents. These views are fuelled by the negative experience of others who have taken out insurance, as well as individuals' own difficulties with realising their claims. The negative perceptions held by current and potential clients of insurers and their products have definitely contributed to low demand for these products in Kenya.

There are a number of barriers to entry which also limit or bar low-income people from taking up insurance products:

Low engagement and low awareness of insurance companies and their products. Findings from FinAccess highlight that only 0.8% of Kenyan adults use insurance as a risk coping strategy. Most focus group respondents have heard of insurance, but do not know or understand the detailed workings of products and how insurance companies operate. Most of the information they have on insurance has been obtained on second hand basis from friends and neighbours. The levels of awareness differ according to the livelihood category of the respondents. For example, artisans and traders had the lowest level of awareness, while civil servants are the most aware of insurance companies as some use education and life policies.

Low understanding of product offering. With the exception of microfinance clients, none of the focus group respondents, even the few that have insurance policies, understand the product offering of insurance companies (Odera, 2010a). Unfortunately, brokers and agents leave out important information and details during the sales process and fail to fully explain the insurance product. Participants stated that agents and brokers “only give few details (mostly positive) and leave out important information on exclusions, limitations” and other important information.

Products need to be appropriate and affordable. Respondents indicated that they want “products that are not only affordable, but also appropriate to their needs,” (Odera, 2010a). They also mentioned that they want insurance products that “cover their risks” matched with “premiums that do not take away too much money out of their family incomes” (Odera, 2010a). Interestingly “all respondents find NHIF cover affordable at the premium of KSh160 (US\$ 2) per month or KSh1,920 (US\$ 25) per year”¹⁴⁸ (Odera, 2010a).

Trust of insurance firms and intermediaries:

Most respondents feel that insurance products are useful when insurance companies honour their claims, particularly clients of microfinance institutions who have credit life insurance policies. These clients feel that credit life insurance is useful as it protects their assets and “the policy holder’s family left in peace to continue with their lives” (Odera, 2010). The main factors which determine whether respondents trust insurance firms are timeliness of payments and the ease of receiving claims during the risk event. Civil servants and other NHIF users perceived the NHIF to provide good value for money as it is widely accepted at many government hospitals, easy to use and affordable. Clients who were using the Pan African Life Last Expense product felt that their claims were paid without any difficulties. Furthermore, respondents who mentioned being aware of or owning the Britak Education Policy indicated that they perceived it to be trustworthy as they had witnessed friends receiving their payments on time.

Artisans and traders “remember the collapse of Kenya National Assurance” and this contributes to the belief that that if they were to “take out insurance, they can lose their little investments,” (Odera, 2010a).

Furthermore, the groups revealed that some artisans and traders have heard (possibly from friends and relatives) that brokers become rude when people are making claims. Other views that were expressed concerning brokers and agents are included in Box 12 below.

Artisans and traders also hold the perception that insurance companies only give out timely payments with regards to death shocks. They expressed “it is only in death when insurance companies pay claims fast” (Odera, 2010a). Box 14 highlights some of the comments related to participants’ views on insurance companies.

Box 12: Artisans’ and traders’ view on insurance companies

“Insurance people are not honest, they are complicated and the common man cannot understand. I am not sure about what will happen at the end when I have a claim.”

“You can be paying for even three years and at the end, you do not get the benefit, which is scary. They should reduce the period of maturity.”

“They are more concerned about their business than they are about helping the mwananchi (the public). They just make money out of us. They should clear the perception that they are ripping people off.”

¹⁴⁸ They did not, however, explicitly indicate whether the benefits provided for this amount are sufficient.

10. Conclusions and opportunities

In this section we summarise the key outcomes of this analysis under four themes, concluding with the immediate opportunities for microinsurance development that were identified:

- Facilitative economic context and financial sector environment creates a market and opportunity for microinsurance;
- Innovative but still limited insurance industry;
- Kenyans are not unfamiliar with risk pooling and are signalling their interest in insurance through voluntary take-up of microinsurance products;
- Modernisation of insurance regulation provides opportunity to facilitate microinsurance development; and
- Easy-to-reach market segments can extend the microinsurance market by at least three times.

Facilitative economic context and financial sector environment creates a market and opportunity for microinsurance. A number of economic and financial sector environment factors bode well for the development of the Kenyan microinsurance sector.

Poor but viable market. Compared to its immediate neighbours in East and Southern Africa, Kenya has the lowest proportion of the population living below the US\$ 2 (39.3%) and US\$ 1.25 (19.7%) per day poverty lines. This means that while many Kenyans are poor, 53% of Kenyans have incomes between US\$ 2 and US\$ 10 per day, representing a large potential target market for microinsurance. This is an important factor when considering the delivery of low-income insurance products where the primary restriction on the potential is the availability of income to contribute to premiums for such a product. The estimated market for microinsurance could include as many as 11 million individuals in Kenya with some of them within easy reach as will be discussed below.

Rapidly expanding financial sector penetration driven by key players. The financial sector is rapidly growing and also changing in configuration. The introduction of M-PESA has brought 9.5 million (March 2010) people into the reach of financial services and has forever changed the financial landscape. In parallel, the banking sector has seen a similar rapid expansion in reach, largely driven by the Equity Bank expansion drive. Interestingly, FinAccess data shows that banks are reaching a younger population than MFIs and SACCOs and achieved substantial penetration amongst low-income consumers comparable to that of MFIs and SACCOs. The expansion of Equity and M-PESA may have come at a cost to other players and other banks and payment system platforms continue to vie for position. The percentage of adults with bank accounts increased from 14% in 2006 to 22% in 2009, while the usage of savings and credit co-operatives (SACCOs) decreased significantly from 13.1% to 9% of adults for the same period. This corresponds with an aggressive expansion in the banking and microfinance markets and suggests that SACCOs are losing ground to these entities. Equity Bank has grown its market share (in terms of clients) from 19% in 2006 to 48% in 2009 and has also made inroads in the client bases of other banks. During the same period, the use of microfinance institutions (MFIs) doubled from 1.4% to 3.4% of the adult population¹⁴⁹. This consisted of an increase in MFI savings clients from 1.5% to 3.2% and an increase in credit

¹⁴⁹ Figures represent adult population over the ages of 18 years old.

clients from 0.8% to 1.8% (FinAccess, 2006/9). Despite this growth, the overall reach of the financial sector remains limited with opportunities for growth.

Innovative but still limited insurance industry. The same degree of expansion has not yet been seen in insurance sector and the sector has been mostly dependent on the growth in the banking and MFI markets.

Limited insurance reach. The insurance market is small and dominated by insurance for corporate and employer groups and has not grown much over last ten years despite the substantial growth in the rest of the rest of the financial sector. Unlike the banking market, the retail insurance market remains largely unexplored and insurers have very little experience with retail distribution. Currently, the Kenyan insurance sector serves only 3% of the adult population, if only voluntary insurance products are considered. Only 1% of adults report having any form of life insurance. However, insurance coverage increases to 7.3% if compulsory insurance products like NHIF and NSSF are included. This reflects, in particular, the progress that has been made to provide coverage under the NHIF (including extending coverage to the informal market).

Despite the vast unserved market, Kenyan insurers are still focused on fighting for their share of the existing market share by undercutting each other. In short, the market is captured by a state of “cannibalistic competition”. The insurance market’s narrow focus on the corporate market reflects the fact that profits are still available in the existing market, but more importantly, it reflects insurers’ have not yet resolved the retail distribution problem. While regulatory barriers to low-cost and more efficient distribution may have contributed to this, the primary problem has been to find the right business model to enter the low-income market and, in particular, the right channels through which products can be sold.

Recent microinsurance innovations. During the last two years, however, a number of new microinsurance models have been launched. These models have been quite innovative in their approaches and include agricultural insurance distributed through the value chain, public private partnerships delivering a combined health and funeral product, funeral insurance linking with welfare groups and personal accident insurance distributed through mobile phones and airtime agents. Although it is too early to judge their success, insurance companies have shown their commitment to these experiments and have invested in market research and product development. It is likely that the next phase of development will see insurance companies competing for access to the large and growing client portfolios of Equity, M-PESA and the other players vying for position.

Kenyans are not unfamiliar with risk pooling and signalling their interest in insurance through voluntary take-up of microinsurance products.

Strong demand signals. The fact that insurance companies in Kenya have been able to sell microinsurance products on a voluntary basis confirms the need, but also indicates real demand for these products. The popularity and sophistication of welfare societies in Kenya as an informal means of risk management for a large part of the population further supports this and reflects a wider familiarity with risk pooling. Up to 4 million adult Kenyans indicate that they are part of a society or group which fulfils, amongst other things, a welfare

function such as the provision of a funeral payout for a death in the family or payment of hospitalisation costs (FinAccess, 2009).

Informal mechanisms not sufficient. Informal mechanisms are, however, not necessarily able to adequately address the risks of the poor. The social significance of one such informal mechanism, harambees (a funeral post-payment mechanism), is gradually being eroded, with households reportedly being asked to contribute to these events on an increasing frequency. Focus group research also reports that funeral costs can be up to four times higher than the pay-outs received from welfare groups. In recognition of this, some funeral insurance products are now emerging that cover members of welfare groups. In such a way informal mechanisms may, therefore, provide a stepping stone into the formal system and, at the least raise an awareness of the insurance mechanism.

Trust remains barrier. While insurance can help provide a bridge for the gap between cover provided by welfare groups and actual funeral expenses, insurance companies will first have to gain the trust of the public. Low-income Kenyans distrust insurance companies and their brokers and agents to such a degree that they perceive the risk of taking insurance as greater than not taking it at all. This is particularly fuelled by the negative experience of those who have taken out insurance and struggled to successfully realise their claims, as well as the failure of seven insurance companies over the last decade. From the early innovation experience it seems possible to overcome this trust barrier by focusing on priority risks (e.g. health and funeral) and working through trusted intermediaries (e.g. cooperatives, MFIs, and the NHIF).

Modernisation of insurance regulation provides opportunity to facilitate microinsurance development. The newly established Insurance Regulatory Authority has inherited a dated Insurance Act that does not sufficiently address the issues facing the current market (for example, the need for health insurance-specific regulation), as well as a market that has experienced solvency challenges over the last decade. To address this, a process is currently underway to revise the legislation. As a precursor to the proposed regulatory changes, capital requirements were raised to catalyse consolidation with the goal of improving stability. It is important to note that there may be an unintended conflict between this strategy and the objective to grow the market. Given the limited market penetration, an attractive alternative strategy to improve stability may have been to encourage scale through growth whilst focusing on improving company risk management practices. While regulatory reform provides the opportunity to create a microinsurance-friendly regulatory framework, some of the intended reforms may actually increase barriers to entry and market expansion. These include further increases to capital requirements, doing away with the composite insurance license and an increased emphasis on professionalisation of the industry. Careful and explicit consideration would need to be given to pursuing the stability objective without unnecessarily jeopardising development.

Case-by-case exemptions facilitate microinsurance, but can be formalised. While the reforms are underway, a pro-active approach has been used to facilitate microinsurance through case-by-case exemptions. Certain banks have, for example, been exempted from the restrictions in the Banking Act that prevented them from establishing insurance agencies. Exemptions have also been used to allow the development of alternative distribution models where these distributors (e.g. MFIs, cooperatives, etc.) are typically not registered as agents. This approach has allowed for the development of microinsurance, but, given that the

exemptions were not captured in directives or otherwise generalised to all players, it also creates some uncertainty and may result in an unlevel playing field. Thus, for example, while some banks have already established insurance agencies, others are not yet aware of this option.

Increased capital requirements and compliance burden may discourage both new and existing players from entering the microinsurance market. There are a number of entities with low-income clients that may be interested in offering insurance to their clients. While these entities could act as intermediaries to an insurer, they may also be interested in underwriting these products themselves (for example, an MFI currently offering informal insurance). The threat of such entry may be what is required to demonstrate opportunity and catalyse outreach by the existing market. High capital requirements may exceed that which is required by the nature of microinsurance business and will present a barrier to such entities entering the market. Increasing capital requirements and compliance cost will also reduce the attractiveness of low premium (and low margin) microinsurance products for existing players.

Separation of long-term and general business into separate licenses makes it difficult to deliver composite products. In the interest of efficiency and value it may make sense to consider composite insurance products (combining asset, health or life cover) and there are currently a number of composite microinsurance products on offer. While it is possible to develop composite products using different licenses, the separation (particularly the separation of management structures) imposes additional costs and complications into the innovation process.

Cost controls may inhibit innovation and product development. Current insurance regulation defines specific caps for management expenses and commissions. Given the low premiums for microinsurance, management expenses and commissions (even if quite low) may be a larger proportion of premiums than for traditional insurance (and therefore than the caps allow). The structure of the caps is also based on traditional insurance cost structures and may undermine innovative partnerships between insurers and distribution partners where costs may be spread differently across the value chain. This argument does not condone inefficiencies and unnecessary high cost structures. Clients need to be provided with value for their money. The new regulatory framework will be challenged to develop approaches that may be less restrictive on innovation but may still incentivise value delivery to the client.

Absence of health insurance-specific regulation may undermine development of this sector. Health insurance currently falls under the personal accident category of general insurance as specified in the Insurance Act. However, the Act is silent on specific issues that affect health insurance such as different service provider reimbursement methods (e.g. capitation vs. fee-for-service) that may lead to a risk transfer between the underwriter and service providers. The Act also does not prescribe prudential requirements specific to the nature of health risks. In the absence of health insurance-specific regulation, private health insurers have been able to experiment with health insurance products in a space unrestricted by specific regulatory definitions. In the long-term, however, the absence of regulatory certainty on the treatment of health insurance may undermine both the stability and development of the sector.

Flexible and low-cost intermediation regime required for microinsurance. The development of alternative and low-cost distribution channels will be critical to the development of microinsurance. As noted above it is important to provide regulatory certainty and enable the distribution of insurance by a variety of entities, including banks, MFIs and SACCOs. The distribution of health insurance by agents also needs to be facilitated.

Co-operative and mutual insurers not accommodated in current regulatory framework. Kenya has the second largest co-operative movement in Africa and one of the largest in the world. While co-operative insurers have found ways of establishing themselves as co-operatively owned entities, the currently regulatory framework does not allow co-operatives to register as insurers. This restriction should be reconsidered as part of the review of legislation currently underway.

Areas relevant to microinsurance not articulated in regulation. In addition to the specific issues noted above, there are also other aspects of regulation that are missing and may undermine development. Limited attention is given to administrators and outsourcing arrangements and its impact on the contractual relationships with clients in the current regulation. This will be important areas for microinsurance and would benefit from clarification. Another area is the limited extent of consumer protection regulation. Care should be taken to balance the development objectives with appropriate protection for vulnerable consumers.

Better understanding of informal market required to inform regulation. As noted earlier, there are a variety of entities in Kenya assisting households and individuals to mitigate their risks on an informal basis. This includes welfare societies, medical insurance providers and private health service providers offering unregulated hospital plans¹⁵⁰, some large MFIs offering informal credit life, as well as funeral parlours offering funeral cover with benefits stated in-kind. These providers are likely to play a significant role in the microinsurance market and may already cover a substantial client base. Limited information is available on the exact nature and extent of activities, and it will be essential to gain a better understanding of these markets in order to formulate an appropriate regulatory response. One of the key issues would be to reconsider the exemption of in-kind funeral benefits as this excludes potentially key component of the market from the mandate of the regulator.

Easy to reach market segments can extend the microinsurance market by at least three times. So what does all of the above mean in terms of the opportunities for further expansion and the potential market for microinsurance in Kenya?

Low-hanging fruit could extend current microinsurance market by up to three times. Based on stakeholder conversations this analysis places a conservative estimate of the current voluntary microinsurance market at 150,000-200,000 policyholders. If a conservative estimate of the users of formal credit life insurance policies through bank, cooperative and MFI loans are added to this number, the current microinsurance market increases to 650,000-700,000 users, totalling slightly more than 3% of the Kenyan adult population. It is likely that the majority of these are not yet picked up by FinAccess, especially given that FinAccess does not measure the usage of credit life insurance. In addition the analysis

¹⁵⁰ In the case of these entities, informal means unregistered as the Insurance Act requires all insurance risks to be underwritten on a formal basis.

suggests that an expansion of up to three times the size of the current microinsurance market, up to 10% of Kenyan adults, is possible if the following distribution opportunities are realised:

- *Reaching unserved formally employed market:* Of the 2 million adults that are formally employed, only 30% of individuals currently use any form of insurance, including compulsory insurance products such as NHIF and NSSF. This implies that up to 1.4 million individuals have regular salary incomes and could be reached through their employers, allowing easier access and enabling premium deductions through a payroll mechanism (the “check-off” system as it is referred to in Kenya).
- *Cross-selling of insurance products to the banked, MFI and SACCO markets:* 85% (or 3.9 million) of Kenyan adults that have bank accounts do not currently have any form of insurance product. This category represents one of the biggest immediate microinsurance opportunities as these individuals are accessible through banks and premium collection is possible through their accounts. In addition, 81% (1.7 million) of SACCO members and 90% of MFI clients report to not have any kind of voluntary insurance. It is likely that a relatively large percentage of loan clients may be unaware that they are currently covered by a credit life insurance and a substantial proportion of this may be underwritten on an informal basis. This provides potential for the sales of voluntary microinsurance products as well as partnership with formal insurers to formalise and improve the value of the credit life offering. Ensuring that loan clients are aware of and can use their credit life policies will also create awareness and first-hand experience with insurance that will support the development of the market.
- *Serving welfare society members with formal insurance products:* 96% (4m) of adults that belong to a society that provides some type of welfare function currently do not have any form of insurance. Welfare society members may not all necessarily be viable insurance clients but it does reflect a target audience that is familiar with risk pooling and willing to pay to manage their risks. While insurance will be unable to fully replace the social function fulfilled by welfare societies, findings from the focus group discussion indicate that payouts from welfare societies are unable to fully cover the costs of funerals. Some insurers are exploring partnerships to provide enhanced cover to society members. Societies also provide groups of people that could be leveraged for distribution. This is particularly useful as such societies may help to overcome the trust barrier.
- *Other networks, including trade associations, remain to be explored:* There are an estimated 680,000 Jua Kali (an association for informal artisans and manufacturers) members in Nairobi alone. Besides Jua Kali associations and their network federation, there are a number of other trade associations with thousands of members with specific livelihoods. These groups could be leveraged for distribution and may help to overcome the trust barrier.

In addition to these distribution opportunities, there are also specific product opportunities that are worth exploring.

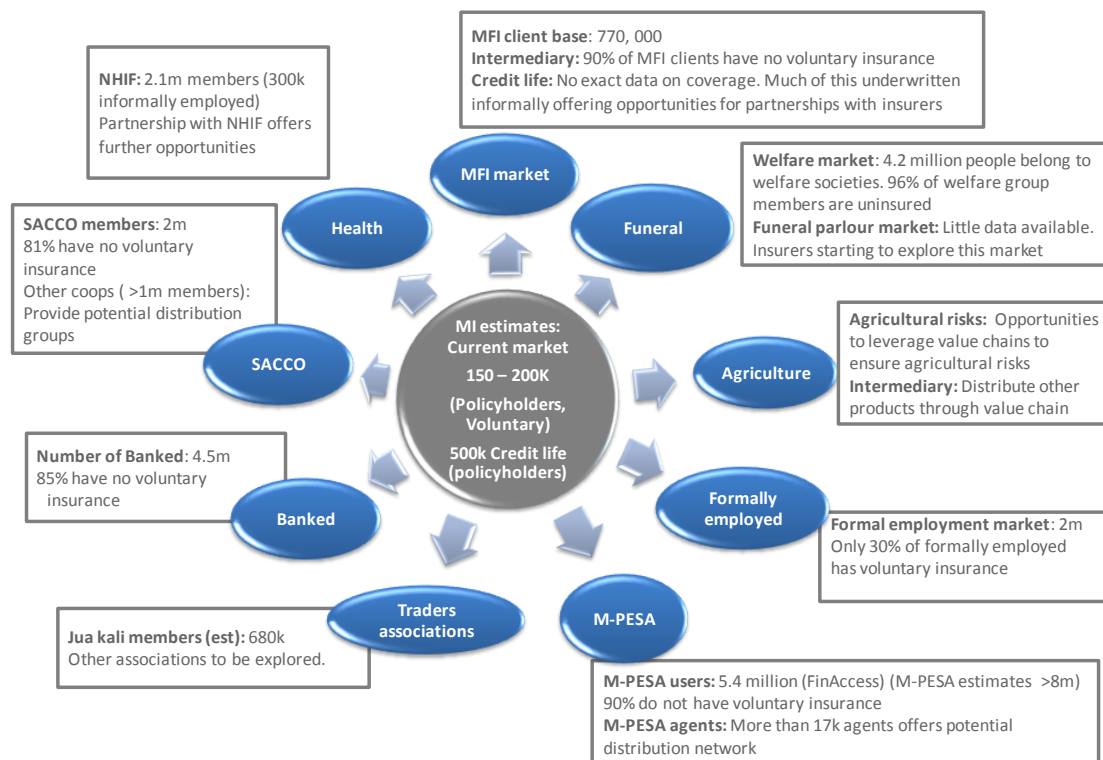


Figure 18: Opportunities for microinsurance distribution and products

Source: Various sources and interviews, including authors' own analysis of FinAccess 2009.

Funeral insurance. The focus groups highlighted the fact that the death of a family member (including the cost of a funeral) represents a significant risk for the household. The extensive use of welfare societies also demonstrates that low-income households are willing to pay regulator premiums in order to manage this risk. While there is some initial exploration of this market by insurers, the funeral insurance market remains largely unexplored. Very little information is available on the funeral services market, which is likely to be a driver of the development of this market. Further exploration of this market is likely to yield opportunities for development, particularly if regulatory reform will bring in-kind benefits back into the regulatory fold.

Health insurance. Demand-side research highlighted the significance of health risks for low-income households. Health insurance has also been noted as a highly valued product by groups with exposure to such products¹⁵¹. With membership reported in excess of 1.5 million adults, the NHIF has achieved substantial success in extending in-patient cover to both the formal and informal sector. The NHIF still, however, only covers 4% of total health expenditure while 29% are covered by households on an out-of-pocket basis. In addition, there are other costs over and above the cost of hospitalisation that may make it difficult to utilise the NHIF cover. This may include the cost of transport to particular hospitals, loss of income, cost of medicines and the cost of out-patient cover. Given available information on the NHIF's operations and its size, it may not make sense for private insurance companies to want to compete with the NHIF's cover, especially now that its cover is being expanded to include out-patient care. Rather, private insurance companies may want to explore how they can offer additional or enhanced cover in partnership with the NHIF, or through other

¹⁵¹ Focus group discussions were held with the civil servants as well as MFI groups with health insurance.

channels. For companies already offering health insurance products in the low-income market, it is essential that the regulatory space for health insurance be clarified to support the development of the market in a way that appropriately manages the risks.

Agricultural insurance. The agricultural sector presents both product (covering agricultural risk) and distribution opportunities (utilising the agricultural value chain for agricultural and other insurance).

While a clear need for agricultural risk mitigation exists, the fragmented and inefficient nature of the smallholder farming present significant complications for the delivery of insurance on a traditional basis. Inefficient farming practices mean that meagre incomes are produced (i.e. limited surplus income is generated that can be paid towards risk management through insurance). These practices also complicate the underwriting of crop outputs on the traditional multi-peril basis (i.e. difficult to judge/assess impact of particular risk event).

However, microinsurance models, such as British American Insurance Tea Growers' model and the Syngenta agro-dealers models have started to take advantage of the opportunities offered by the agricultural value chain and suggest that there are further opportunities to explore using a combination of value chain delivery (particularly aligning with input providers) and parametric products. Government is a key player in the agriculture value chain and public private partnerships could also be explored. The delivery of other insurance products such as life and health insurance through the agricultural value chain has not yet been explored.

Asset insurance. The demand-side insights and findings from the focus group discussions indicate that small business owners (particularly traders) face substantial asset risks. Combined with the option of distribution through groups such as trader associations, this presents an opportunity worth exploring. The focus groups also found that asset loss due to political uncertainty¹⁵² and fires in informal settlements is a particularly prominent risk for low-income Kenyans. Without a very efficient distribution and management system, asset insurance will remain a challenge.

¹⁵² Please note that political risks are typically excluded from insurance cover. The South Africa Special Risks Insurance Agency provides an interesting example of collective effort around political risk that may be worth exploring in Kenya.

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12. Appendix A: Meeting list

| | Organisation | Person met | Designation |
|----|--|---|---|
| 1 | APA Insurance | Saagar Khimasia Francis Ngari Ashok Shah Joseph Muraguri | - Business Developer – Agriculture Charter Insurer Divisional Director |
| 2 | Association of Kenya Insurers (AKI) | T. M. Gichuhi | Executive Director/CEO |
| 3 | Association of Microfinance Institutions (AMFI) | Benjamin Nkungi | CEO |
| 4 | Assured Insurance Brokers | Anne Rama | Managing Director |
| 5 | British American | Stephen O Wandera James Irungu K. | Managing Director Business Research & Innovations Manager |
| 6 | Catholic Relief Services | Anthony Mang’eni | Microfinance Program Manager |
| 7 | CFCLife | Alex L. Amolloh | Head of Life Operations |
| 8 | Chartis | Japh Olende Walter Orato | Managing Director Assistant General Manager (Accident & Health) |
| 9 | CIC Insurance | David K. Ronoh Nelson C. Kuria | General Manager (Life & Medical Business) Managing Director |
| 10 | College of Insurance | Ken N. Osinde | Director/CEO |
| 11 | Co-operative Alliance of Kenya Limited (CAK) | Francis A. Munane | Executive Director |
| 12 | Co-operative Bank of Kenya | Peter N. Ndegwa | Head (Agricultural Business Development) |

| | | | |
|----|--|---|--|
| 13 | Equity Insurance Agency | Winnie Njau-Mbugua | General Manger (Insurance) |
| 14 | Insurance company of East Africa Limited | Justus M. Mutiga | General manager (Life and Pensions Division) |
| 15 | Insurance Regulatory Authority (IRA) | Nkirote Mworira Njiru | Corporation Secretary/Legal Affairs Manager |
| 16 | Jubilee Insurance | Patrick Tumbo Nyamemba | General manger & principal officer |
| 17 | Kenindia Assurance | S. Mishra | Managing director |
| 18 | Kenya Post Office Savings Bank (Postbank) | Phyliss Ong'ondo Vincent O. Makori | Marketing & business development Marketing & business development |
| 19 | Kenya Women Finance Trust (KWFT) | Juliana E. Wanjiru Joyce Kabura Njenga | Business development & marketing manager Research and product development officer |
| 20 | K-Rep Development Agency | Aleke Dondo | Managing director |
| 21 | Majani Insurance Brokers Ltd | Gerald Kommo | Marketing manager |
| 22 | Microfinance Opportunities | Anas Klincic Andrews | Consultant |
| 23 | National Hospital Insurance Fund (NHIF) | Richard L. Kerich Pius K. Metto | CEO Manager Operations – Micro Insurance |
| 24 | Pan Africa Life | Martin M. Nzomo | Corporate business manager |
| 25 | Pioneer Assurance | Isaac W. Maina Moses N. Kimani | Marketing manager (Corporate Business) Managing director |
| 26 | Policyholders' Compensation Fund | Anna Rama | Trustee |
| 27 | Safaricom | Joseck Luminzu Mudiri | Senior manager (M-PESA) Principal In-House Counsel M-PESA |

| | | |
|----|--|---|
| | Brian Muthiora | Advisory |
| 28 | Shaddai Insurance Agency | Philip Muteti Musau Principle officer |
| 29 | The Treasury, Republic of Kenya | Ezra Onondi Anyango Senior microfinance expert (Economic Affairs) |
| 30 | UAP Insurance | Jerim Otieno Life manager |
| 31 | Syngenta Foundation | Rose Goslinga Co-ordinator (Syngenta Foundation's Agricultural Insurance Initiative) |

13. Appendix B: Performance indicators

Life insurance industry

| Ratio | Description | International Standards | British American | ICEA | Pan African | Jubilee | Old Mutual | Kenindia | CFC Life | Madison Insurance | UAP | Heritage | Top 10 Industry average | Industry Average |
|--|---|-------------------------|------------------|--------|-------------|---------|------------|----------|----------|-------------------|-------|----------|-------------------------|------------------|
| Return on equity (ROE) | Net Income for the year/equity X 100 | 6 to 12% | 4% | 350% | 37% | N/A | 12% | 28% | 22% | N/A | N/A | 52% | 72% | 10% |
| Change in equity | (Current Year equity - Prior year equity)/prior year equity | 5 to 12% | 20% | 0% | 0% | 0% | -2% | 40% | 108% | 0% | -73% | -54% | 4% | 4% |
| Benefits paid ratio | Benefits Paid/Net Premium written | 45% to 70% | 17.59% | 74.71% | 41.97% | 11.83% | 35.20% | 37.24% | 39.34% | 55.72% | 2.71% | N/A | 35.15% | 39% |
| Surplus relief ratio | Reinsurance Commission/EquityX100 | up to 15% | | | | | | | | | | | | |
| Solvency ratio | Equity/LiabilitiesX100 | > 4.5% | 54.42% | 0.28% | 12.82% | 0.85% | 11.11% | 6.63% | 13.27% | 8.53% | 2.32% | 16.98% | 12.72% | 17% |
| Investment in mortgages & real estate | Investments in Mortgages& Real Estate/EquityX100 | 150% to 300% | 25.01% | 0.00% | 62.64% | 0.00% | 0.00% | 0.00% | 27.90% | 0.00% | 0.00% | 0.00% | 11.56% | 19% |
| Mortgages default ratio | Mortgages in default/Equity X 100 | up to 30% | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Non-investment grade ratio | Non-Investment Grade bonds/Equity | 15% to 150% | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Affiliated investment ratio | Affiliated Investments/Equity * 100 | < 30% | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| Change in net premium Written | (Current year Net Premium written - Prior year Net Premium Written)/Prior year net premium written *100 | - 30% to 50% | 105% | -36% | 27% | 33% | 267% | 18% | -45% | 5% | 55% | N/A | 48% | 13% |
| Net risk ratio | Net Premium Written/Equity | up to 5.5 | 0.89 | 55.06 | 4.12 | 26.92 | 2.71 | 2.58 | 0.84 | 5.25 | 19.61 | N/A | 13.11 | 1.58 |

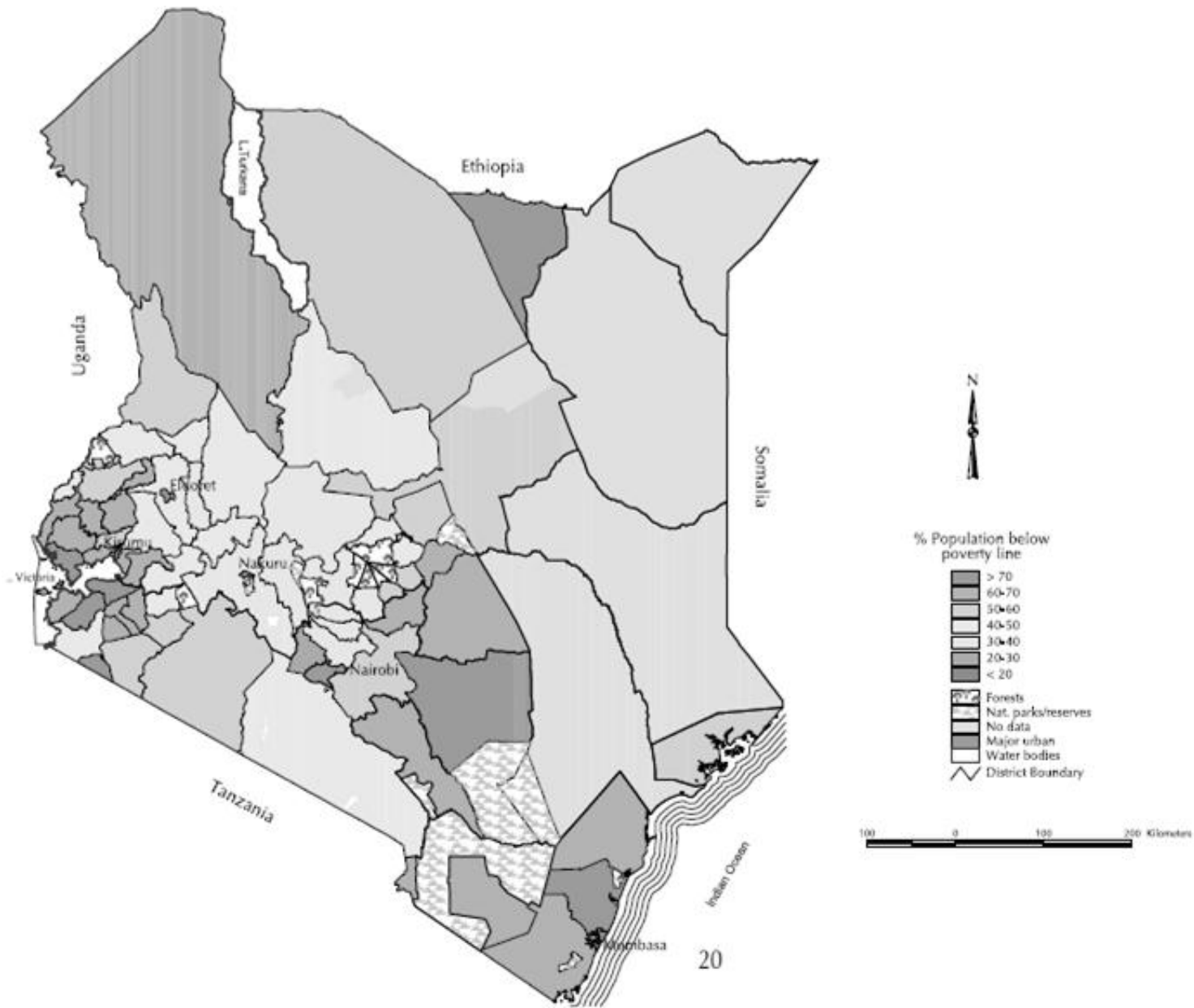
General insurance industry

| Type of ratio | Description | International Standard | APA | Jubilee | Kenindia | UAP | AIG | Heritage All | Lion of Kenya | ICEA | First Assurance | Cooperative | Top 10 Unweighted Industry Average | Out of range | Industrial Average |
|----------------------------------|---|------------------------|-------|---------|----------|------|------|--------------|---------------|------|-----------------|-------------|------------------------------------|--------------|--------------------|
| Return on equity (ROE) | Net Income for the year/Equity X 100 | Market | 12% | 37% | 18% | 5% | 24% | 6% | 30% | 16% | 29% | 24% | 20% | - | 17% |
| Change in equity | (Current year equity - Prior year equity)/prior year equity | -10 to 50% | -21% | -41% | 39% | -27% | 26% | -15% | 40% | 3% | 35% | 26% | 7% | 4 | 8% |
| Net trade debt to equity | Net trade debtors /Equity X100 | Max of 50% | 105% | 153% | 117% | 33% | 139% | 87% | 86% | 38% | 4% | 51% | 81% | 8 | 37% |
| Current (liquidity) ratio | Current Assets/Current Liabilities | Min of 1.25 | 10.27 | 4.14 | 13.44 | 2.10 | 2.65 | 17.30 | 9.29 | 8.69 | 5.48 | 12.13 | 8.55 | 0 | 6.14 |
| Change in net writings | (Current year Net Premium written - Prior year Net Premium Written)/Prior year Net Premium written X 100 | -33 to 33% | 19% | 38% | -3% | 13% | 14% | 25% | 13% | 25% | 30% | 7% | 18% | 1 | 15% |
| Change in gross writing | (Current year Gross Premium written - prior year Gross Premium written)/ Prior year gross premium written X 100 | -33 to 33% | 27% | 26% | -7% | 24% | 16% | 14% | 34% | 24% | 30% | 24% | 21% | 1 | 15% |
| Gross risk ratio | Gross premium written/Equity | Max of 7 | 2.36 | 3.63 | 3.97 | 0.80 | 4.96 | 1.57 | 1.16 | 1.32 | 3.50 | 2.97 | 2.62 | 0 | 1.43 |
| Net risk ratio | Net premium written/Equity | Max of 3 | 1.73 | 3.29 | 2.69 | 0.56 | 2.39 | 1.27 | 0.66 | 0.86 | 2.21 | 2.30 | 1.79 | 1 | 1.04 |
| Net claims ratio | Net claims incurred/Net earned premium | Max of 0.7 | 0.70 | 0.66 | 0.71 | 0.54 | 0.64 | 0.59 | 0.81 | 0.75 | 0.63 | 0.58 | 0.66 | 1 | 0.61 |
| Expense ratio | Total expenses/Net premium earned | Max of 35% | 36% | 28% | 47% | 60% | 66% | 48% | 39% | 47% | 42% | 39% | 45% | 9 | 54% |
| Underwriting result | Underwriting profit (Loss)/Net earned premium X 100 | -10 to 30% | 1% | 6% | 6% | 5% | 9% | 0% | -2% | -13% | 11% | 6% | 3% | 1 | 3% |

14. Appendix C: List of AMFI members

1. AAR Credit Services
2. ADOK TIMO
3. Agakhan Foundation
4. AIG Insurance
5. Barclays Bank of Kenya Ltd
6. Biashara Factors
7. BIMAS, Blue Limited
8. Canyon Rural Credit Limited
9. CIC Insurance
10. Co-operative Bank
11. Elite Microfinance
12. Equity Bank
13. Faulu Kenya
14. DTM Limited
15. Fusion Capital Ltd
16. Jamii Bora
17. Jitegemea Credit Scheme
18. Jitegemee Trust
19. Juhudi Kilimo Company Limited
20. K-rep Bank Ltd, K-rep Development Agency
21. KADET
22. Kenya Eclof
23. Kenya Entrepreneur Empowerment Foundation (KEEF)
24. Kenya Post Office Savings Bank
25. Kenya Women Finance Trust
26. MIC Microcredit limited
27. Micro Africa
28. Molyn Credit Limited
29. OIKO Credit
30. Opportunity International
31. Pamoja Women Development Programme
32. Renewable Energy Technology Assistance Programme (RETAP)
33. Rupia Limited
34. SISDO, SMEP
35. Swiss Contact
36. Taifa Option Microfinance
37. U & I Microfinance Limited
38. WEEC
39. Yehu Enterprises Support Services

15. Appendix D: Small area poverty map of Kenya



Source: Geographical Dimensions of Well-Being in Kenya, World Bank

16. Appendix E: Agriculture insurance products

| Product | Premiums | Distribution | Benefits |
|--|---|---------------------------------|--|
| FSD/World Bank/Rockefeller Foundation supported weather index for Agriculture: APA/Equity | A range of 6.7% to 14.6% of sum insured | Distributed through Equity bank | Insurers farmers crops against adverse weather risks to protect their cost of inputs and their incomes |
| FSD/World Bank/Rockefeller Foundation supported weather index for Agriculture: CIC/K-rep | A range of 6.7% to 14.6% of sum insured | Distributed through K-rep bank | Insurers farmers crops against adverse weather risks to protect their cost of inputs and their incomes |
| FSD/DFID supported weather index for Livestock: UAP/Equity | A range of 3.25% to 5.5% of sum insured | Distributed through Equity bank | Insurers pastoralists against drought risk on their livestock |
| FSD/World Bank/Rockefeller Foundation is supporting weather index for Agriculture: APA/AFC | A range of 6.7% to 14.6% of sum insured | Distributed through AFC | Insuring farmers crops against adverse weather risks to protect their cost of inputs |
| Agriculture: Heritage | TBA | Various channels | Multi peril crop insurance |
| Agriculture: CIC | TBA | Various channels | Multi peril crop and traditional livestock insurance |
| Agriculture: APA | TBA | Various channels | Multi peril crop and traditional livestock insurance |
| Agriculture: ICEA | TBA | Various channels | Multi peril crop insurance |
| Agriculture: BlueShield | TBA | Various channels | Multi peril crop and traditional livestock insurance |

17. Appendix F: Example of weather index-based agriculture insurance

Index-based weather insurance: Equity Bank/APA insurance

Equity Bank in partnership with APA insurance under the support of FSD Kenya, Rockefeller Foundation and World Bank have developed weather index-based agriculture products for maize, wheat, banana and coffee targeting either the input costs and/or the expected income of farmers. Under their products offer, farmers are free to identify the suitable inputs and an accredited supplier from their location who the bank works with. Equity Insurance Agency who handles the sales and scheme administration supports both the borrowers and non borrowing customers. The project has a partnership with the Kenya Met Department (KMD) for weather data and has donated automated stations to KMD.

Policy, premium and benefits: The products cover either the cost of inputs or the expected income from adverse rainfall recorded at the reference automated weather station (AWS). In the upcoming season the farmers will be paying a range of 6% to 14% of sum insured depending on the crop and the region representing a reduction from 17%-18% range in the previous season. The reinsurance services were offered by the Swiss Re.

Delivery channels, premiums collection and claims: Equity Bank acts as the delivery channel through their technical insurance personnel within their extensive branch network. For cereal crops, the bank works with the agro-dealers for input management and the ministry of agriculture for extension services under the Kilimo Biashara initiative. The bank does not only offer agricultural credit to farmers but also supports insurance premium financing for farmers.

Performance to date: The products were first rolled out this year and have expanded to include maize, wheat, banana and coffee contracts. Additional crops in diverse regions are under development.