

Initial Market Assessment - Country Scoping Note: Kenya¹

Executive Summary:

Kenya has well-established insurance and banking sectors, both of which have demonstrated high levels of capacity through strong profit margins over time. There is high insurance penetration (compared to neighboring countries), sufficient levels of reinsurance capacity and expertise in-country and a ground-breaking innovative mobile money market.

Kenya represents an excellent opportunity to make targeted investments aimed at increasing disaster resilience among vulnerable population using market-mediated solutions. Links could be explored to integrate market-mediated insurance solutions into social safety net programs, such as the Hunger Safety Net Program. Coordination with broader Horn of Africa resilience efforts (such as those of the Global Alliance and Political Champions Group) could also be explored. A technical assistance program could be established by donors, looking to enable the government to develop mechanisms and establish frameworks to execute such mechanisms.

Property catastrophe insurance markets could also be stimulated. Insuring key public assets (of a given level of building standard) against catastrophe risk would create a market for private sector organizations, as well as demonstrate the viability of property catastrophe risk insurance in Kenya. Such a venture would ensure the critical mass is achieved for private sector insurance companies to invest and develop the market further, looking to compete and provide catastrophe insurance cover to other non-governmental organizations.

1. Background

1.1 Country's exposure to natural disasters

Kenya is highly vulnerable and exposed to several disaster crises which negatively impact social and economic development, and are being exacerbated by climate variability and change. These crises have derailed societal development and negatively influenced the achievement of the Millennium Development Goals (MDGs) and Kenya Vision 2030². Between 1993-2010 the international database on disasters showed that 73 disaster events (covering drought, epidemics, flood, landslide and a tsunami) occurred and affected a cumulative total of over 48 million people (averaging 2.9 million people annually). The event with the highest number of people affected was the drought in 1999 which impacted over 23 million people (approximately 75% of the population).

¹This scoping note is part of a series of seven country scoping notes produced by WB/GFDRR and DFID, with inputs and feedback from the expert-level group (including representatives of Allianz, DFID, European Commission, GIZ, ILO, Munich Re, SECO, Swiss Re, USAID, WB, and Willis Re). This scoping note aims to inform the Political Champions Group (PCG) on potential opportunities to promote stronger partnerships between the public sector and the private sector to increase disaster resilience of vulnerable populations using market-mediated insurance solutions. The team has made every attempt to verify the contents presented, but the information should be interpreted with due consideration to its limitations resulting from the fact that indirect sources have been used where primary sources were not available. Contact: Olivier Mahul, omahul@worldbank.org.

²The Kenya Vision 2030 is the national long-term development blue-print that aims to transform Kenya into a newly industrializing, middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment

Droughts are particularly damaging in Kenya, and when followed by heavy rains can lead to flood events. In the last decade drought episodes were experienced in 2001, 2003, 2006, 2009 and 2011. In addition major floods occurred in 2006 and 2010, as heavy rains followed drought periods. The overall effects of the 2008-2011 drought in Kenya has been estimated at US\$12.1 billion (which are estimated to have caused a reduction of GDP of 2.8% per year during that period)³. The impacts of climate change are expected to create further uncertainty for rainfall in Kenya going forward⁴.

In Kenya agriculture is risky, and that risk has large human and economic costs. Agriculture is key to the Kenyan economy, generating approximately 24% of annual GDP and approximately 50% of revenue from exports. However, agriculture is risky, often lacking irrigation, and given that agriculture is a climate-sensitive activity, it is highly vulnerable to the impacts of climate change⁵. Adverse movements in agricultural commodity and input prices, together with production-related shocks (e.g. from weather, pest or disease) can directly threaten farmer and herder livelihoods, and firms active in the agricultural sector. Moreover, without adequate mechanisms to mitigate or transfer agricultural risk, rural lending may not be viable for many farmers or herders, leading to underinvestment in the agricultural sector and slowing the transformation from subsistence farming to a commercially-oriented agriculture sector.

Key Indicators: Kenya's HFAWDI Disaster Risk Reduction progress score is 4.0; it scored 7.82% on the World Risk Index (placed 67th in the world)⁶. A significant percentage of the population, at 63.4% has increased mortality risk due to multiple hazards⁷.

1.2 Economic, financial and fiscal impact of natural disasters

Kenya's fiscal exposure to natural disasters is significant. Repeat disasters cause large economic losses to the country on a recurrent basis. In 2004 a tsunami caused by an earthquake in the Indian Ocean struck the east coast of Kenya, estimated to cost in the region of US\$100 million⁸. More recently, floods in 2012 are estimated to have cost US\$100 million⁴. Droughts also result in large economic losses, with the overall effects of the 2008-2011 drought estimated at US\$12.1 billion, with the livestock and agriculture sectors being worst hit. Looking at 2009 in particular, the total loss was approximately US\$4.0 billion which accounted for 13% of GDP. The Government is not legally liable to compensate people when catastrophes occur, however provides humanitarian assistance through the (former) ministry of special programs which operates on a stringent budget.

1.3 Government's general engagement in Disaster Risk Management

The Government has undertaken initial steps to develop a Disaster Risk Management (DRM) framework. In 2008 the Government implemented the National Disaster Response Plan, with the responsibility for the implementation lying with the Ministry for State for Special Programmes in conjunction with National Disaster Operation Centre. Recent initiatives include the creation of a thematic working group on Emergency and Disaster Response to mainstream disaster risk reduction into vision 2030 and the Medium Term Plan II. A National Drought Management Authority (NDMA) was created to manage recurrent drought disaster and has field staff in 23 counties.

³ Kenya Post-Disaster Needs Assessment (PDNA) 2008-2011 Drought. GoK European Union, United Nations, and World Bank

⁴ GAR 2013

⁵ Republic of Kenya: National Climate Change Action Plan 2013-2017

⁶ World Risk Report 2011 - Ranges from 32% for Vanuatu, the riskiest, to 0.02% for Qatar

⁷ Natural Disaster Hotspots - A Global Risk Analysis; World Bank 2005

⁸ EM-DAT

Kenya has now placed a focus on DRM going forward. With the new constitution that was promulgated in 2010, disaster management has been highlighted. A comprehensive disaster management policy has been drafted, which is now at an advanced level (awaiting cabinet approval).

Several ministries and policies have been established to increase focus on DRM. Ministry of State for Development of Northern Kenya and other Arid lands (no longer exists) was created to spearhead development and has drought management policy in place with a fully flagged authority for drought management in Arid and Semi-Arid areas of Kenya. In addition, various sectorial policies (i.e. agriculture, water, food and nutrition, health, livestock, forestry etc.) exist and have been instrumental in guiding disaster risk/ natural resource management by the respective sectors. In September 2011, the Government also drafted a ten-year strategy for ending recurrent drought emergencies in Kenya.

Lack of a unified and comprehensive disaster management policy has affected coordination on disaster management both within government and amongst other stakeholders. This has resulted into low prioritization of risk reduction matters when it comes to allocation of national budgets. Within the Ministry of State there are inadequate human resources in the area of disaster risk reduction. DRM governance has not fully been devolved to the local communities in Kenya save for ad hoc efforts mostly by the NGOs.

2. Government's public financial management of natural disasters

2.1 Budget instruments

The Government has a national consolidated disaster management fund; however it is under resourced and does not have specific disaster fund allocation. In 2012 approximately US\$120 million (0.3% of GDP) was set aside and it is expected that US\$140 million will be set aside in 2013. The frequency and severity of the disasters being experienced in Kenya attract most of the funds available towards response, leaving little or none for risk reduction.

There are no contingency funds for emergency response, given the competing needs for funding.

Given the lack of adequate funding, devolving DRM to the local level is a key challenge. Priority for response and poverty eradication has continued to supersede Risk reduction.

2.2 Market-based solutions

We were unable to find any market-based solutions used by the Government to manage their exposure to natural disasters.

Government assets are insured by the private sector (except the state houses, for example where the president's office is located, for security reasons). These insurances are done through an open tender system where companies submit their bids.

The African Risk Capacity (ARC) has conducted a scoping mission in Kenya. ARC intends to be a continent-wide risk pool that aims to provide market-based (parametric) drought risk insurance for governments. Discussions are at initial stages in Kenya. This initiative should be integrated in a comprehensive national disaster risk financing and insurance strategy to provide the government with (i) immediate funding post disaster through a three-tiered risk financing: domestic reserves for low risk layers, contingent credit for medium risk layers and catastrophe risk transfer solutions for top risk layers, and (ii) transparent and effective post-disaster budget execution processes.

3. Ex ante public interventions from government and donors

3.1 Safety net programs against natural disasters, including credit guarantee schemes and subsidy programs

Kenya has a well-documented history of providing social welfare, with a number of well-established social insurance schemes and safety net programs. Spending on social welfare has been increasing in recent years, nearly doubling from 2005 to 2010, where it stood at 0.80% of Kenya's GDP. The main form of safety net support has been through food aid, which has been mobilized in response to crises, such as drought and floods⁹. In more recent years, higher levels of the Government spending has been on cash transfers¹⁰ and there is currently a project underway which is looking to develop a program that will scale-up cash transfers in response to on-coming drought, as triggered by an early warning system.

The social welfare programs have limited coverage and suffer from several challenges. Cash transfers are still limited to disaster response initiatives while insurance of climate related agricultural or livestock risks has not really taken root. Funding challenges are common and corruption and mismanagement cases have been reported in some of the schemes.

There is a Fertilizer Cost Reduction Project in Kenya 2030 which seeks to reduce the cost of fertilizer for farmers in Kenya. The project aims at reducing fertilizer costs by improving the purchasing and supply chain and supporting local manufacture of fertilizer.

3.2 Public investment in market infrastructure for disaster risk insurance (data, models, subsidies, delivery channels, education campaigns)

Kenya has developed early warning systems to drought and flood in specific areas of the country. The food security sector have developed drought early warning systems at the grassroot level that use information of early warning from the National Metrological stations to plan and response to slow onset drought. Western Kenya Flood mitigation program utilizes the information from its flood early warning system in its planning process to mitigate the effects of floods.

Kenya has a developed financial distribution network, with a high proportion of the population with access to financial services and excellent outreach of mobile money. Financial markets are well developed for a developing country with 19% of the population having access to formal financial services through banks and an additional 8% served by microfinance institutions (MFIs) and savings and credit cooperatives (SACCOs). Mobile phone penetration and sophistication is also high, with MPESA used by over 17 million Kenyans, equivalent to more than two-thirds of the adult population; and around 25% of the country's gross national product flowing through it¹¹.

4. Post disaster public interventions from government and donors

4.1 Ex post bailouts (e.g. credit) (including respective roles of government and donors)

The Government and donor organisations have equally shared emergency assistance costs. Looking over the last decade, the Government has spent approximately US\$1.9 billion in emergency

⁹WB Pad National Social protection

¹⁰ Five main cash transfer programs – the Older Persons Cash Transfer (OPCT), the Cash Transfer for Orphans and Vulnerable Children (CT-OVC), the Hunger Safety Net Programme (HSNP), the Urban Food Subsidy Cash Transfer (UFS-CT), and the Persons with Severe Disability Cash Transfer (PWSD-CT) – coverage currently to 1.65 million people or 4% of the population. (Source: WB Pad National Social protection)

¹¹<http://www.economist.com/blogs/economist-explains/2013/05/economist-explains-18>

assistance(66% of total), whereas donors and other humanitarian funding provided approximately US\$1 billion (34% of total)¹².

There are several donor initiatives in place in Kenya, however funding tends to be scarce. The UN led Emergency Response Fund (ERF), received funds (US\$2.6 million) from Sweden and Norway, of which US\$1.1 million has been allocated to ten projects focusing on drought response, emergency livestock and nutrition interventions in urban areas as well as providing rapid assistance to those affected by fire, cholera outbreaks¹³. International Humanitarian support again led by the UN in the form of Consolidated Annual Appeals included both emergency response and early recovery projects.

The Government has also reallocated budget post disasters to meet the emergency response costs. In July 2011, the Ministry of Finance allocated US\$160million drawn from national contingency funds and budget reallocations to support drought response by line ministries. This funding was used to maintain water resources, with significant support to livestock, coordination, and livelihood based food security interventions¹⁴.

Contingency planning for major hazards is not yet fully institutionalized in Kenya. Subnational structures still lack the technical capacity to develop or implement contingency plans. However, there is proposed the establishment of a National Drought and Disaster Contingency Fund that will provide immediate funds to respond to disasters once it comes into effect.

There have been some country led initiatives to raise funding post shock events. The “Kenya for Kenya” citizens and residents as well as those in the diaspora contributed about US\$4 million through personal and institutional donations to support the humanitarian and long-term food security and livelihood recovery efforts of government and partners.

4.2 Ad hoc social transfers (including respective roles of government and donors)

N/A

5. Potential donor overlap

Below are listed all donor initiatives found through research in Kenya:

- There is a weather index based crop insurance pilot led by FSD with World Bank technical support and Rockefeller co-funding;
- ILRI are leading a satellite-based livestock insurance, with funding from DFID, EC through GIIF¹⁵, and USAID through I4¹⁶. (IBLI is also currently working with Takaful Insurance to adapt the livestock insurance products for sharia compliance)

¹²Economics of Resilience Study – Kenya Country Report. Catherine Fitzgibbon, June 2012

¹³ERF Kenya Report 2010

¹⁴PDNA

¹⁵The Global Index Insurance Facility (GIIF) is a program aimed at reducing the vulnerability of populations, mainly in the Africa, Caribbean, and Pacific (ACP) region, to external shocks and vulnerabilities caused by weather and catastrophic risks through index insurance. The European Commission is the largest donor (committing 24.5 million EUR). The program is implemented by the International Finance Corporation (IFC) with support from the International Bank for Reconstruction and Development (IBRD).

¹⁶The Index Insurance Innovation Initiative (I4) is a USAID-supported program that seeks to expand the availability and improve the efficacy of index insurance instruments for developing country contexts. Rigorous impact evaluation, built into pilots implemented by private sector partners, contribute to the evidence base and best practice documentation.

- EC funded GII supports two projects: (1) a weather index insurance program led by Syngenta Foundation which leverages the mobile money market in Kenya, (2) a review existing laws and regulation to include index products in the context of micro-insurance regulation
- GIZ funded satellite weather based insurance program led by Planet Guarantee
- The monitoring and evaluation project to assess the impact and efficiency of the Hunger Safety Net Programme commissioned by DFID
- The potential to expand the "R4 Rural Resilience Initiative" to Kenya
- There are also activities undertaken by Global Alliance on Resilience in the Horn of Africa
- The Agriculture Insurance Development Program (AIDP), a component of the Disaster Risk Financing and Insurance (DRFI) program at the World Bank, has conducted an exploratory mission to Kenya and received strong verbal endorsement from government
- The World Bank are conducting some preliminary work in linking social safety net programs to market based mechanisms to enable them to scale up post shock events, thus increasing the resilience of low income households. Initial investigations are focused on the National Safety Net Program scaling-up in response to on-coming drought, as triggered by the early warning system, in Northern Kenya

6. State of domestic non-life insurance market

Kenya, at on a regional basis, has relatively developed insurance market. There are 34 insurers and 7 reinsurers registered to write non-life insurance in Kenya. The high number of profitable insurance companies in Kenya underlines the significant amount of insurance capacity available in country. There are no substantial local multinationals, captives, ART vehicles in Kenya. Takaful has also recently become a feature of the Kenyan market providing non-life and health takaful covers.

The domestic insurance market is largely broker-driven, with intermediaries controlling an estimated 90% of the market. Intermediaries remain the dominant force in the local market: brokers are estimated to handle in the region of 80% of non-life business and agents handle a further 10%. There is a certain amount of business placed on a direct basis and the extent to which this distribution channel is used varies from company to company. There is potential however to develop other distribution channels.

6.1 Property risk insurance

Penetration of property catastrophe risk insurance in Kenya is low, and it is limited by low penetration for non-life insurance more generally. At an estimated 2.02%¹⁷ of GDP, Kenya sits above the African average for non-life insurance penetration (1.12% of GDP), but is below the more developed African markets of South Africa (2.6% of GDP) and Namibia (2.5% of GDP). Penetration considered in the context of percentage of population covered, instead of percentage of GDP, indicates that there are vast numbers of Kenyans who do not currently use insurance – for example only 0.2% of the adult population has purchased house insurance¹⁸, mainly those of Kenyans in the top income group or expatriates.

The properties that are insured, however, can acquire sufficient reinsurance protection. Kenyan reinsurance treaties, in general, do not contain any large risks exclusion or special clauses, and are usually ceded on a sum insured basis.

Micro-insurance is expected to be a large growth driver going forward. Targeting small scale farmers, welfare organisations and traders in the informal sector, bancassurance and takaful micro-insurance has large growth potential in Kenya. That said, in order for these vulnerable segments of the population to

¹⁷ Swiss Re Sigma No 3/2012

¹⁸ FinAccess 2009

be reached, investments will be required in risk market infrastructure to develop the public goods required by insurance companies to underwrite such business.

6.2 Reinsurance

With the exception of a few major risks, the Kenyan market is capable of handling the majority of the business written in country. Kenya has a developed reinsurance market compared to regional counterparts. Insurer capacities and retentions for 2012 have on average increased and the wide use of coinsurance enables the reinsurance market to absorb in country risk. Retakafulis also available.

However, catastrophe insurance cover remains limited. Catastrophe excess of loss covers are available to the market but are not universally used. Catastrophe programmes cover the standard range of perils including earthquake, windstorm and flood. Reinstatement is often offered, sometimes at an additional premium.

6.3 Agriculture insurance

Outreach of agriculture insurance in Kenya is extremely low. There are currently four models for indexed agricultural insurance in Kenya which together have been responsible for approximately 70,000 insurance policies sold (detailed in Potential donor overlap). However with over 70% of the population living in rural locations of which approximately 14 million are farmers and herders, this leaves agriculture insurance penetration at less than 0.2% of the target population. A GIIF grant through EC funding to the Syngenta Foundation has developed a scheme that delivers the insurance product, collects the premiums and pays claims automatically over the mobile money platform. This model of delivery enables rapid claim payments once a claim is triggered.

Local insurance companies recognize the potential for agriculture insurance in Kenya, but despite investments made in recent years, progress remains slow. Local insurance companies are looking to expand to the agriculture insurance market, and are exploring new and innovative ways to do so by investing in additional human resources, employing agronomists and leveraging new distribution channels. That said, the lack of reliable data and high costs of insurance associated with it, coupled with low insurance awareness are proving challenging to the insurance companies, and take-up remains low.

A multi-peril crop insurance (MPCI) coverage is available in Kenya, which currently protects over 80,000 hectares to date, underwritten and managed by local insurers and free of subsidies with reinsurance and technical expertise supplied by Swiss Re.

6.4 Legal and regulatory environment

Insurance regulation in Kenya is governed by several pieces of legislation. The Insurance Act Chapter 487, which commenced in 1987, and the Insurance Regulations of 1986, both having been extensively amended, control insurance in Kenya. The Insurance Regulations of 1986 have most recently been amended by the Insurance (Amendment) Regulations of 2011.

Current regulation does not account for catastrophe risk. Net premiums and assets are taken into account to calculate the capital and solvency margin, but not the possibility of large correlated losses to the portfolio as a result of a disaster. Quantification of catastrophe risk either through scenario analysis or probabilistic catastrophe modelling is not taking place, and is therefore not informing regulation. Catastrophe losses to the insurance industry are, however, currently limited by the extremely low level of insurance penetration.

Domestic insurance companies must have their reinsurance approved by the regulator. Annual renewal of registration is dependent on annual approval of the reinsurance arrangements by the commissioner's office.

A recent amendment to the insurance regulations specifically recognises micro-insurance. The Insurance (Amendment) Regulations, 2012, effective 15 June 2012, introduced micro-insurance as a defined new class of business and stipulated that the commission rate for micro-insurance business is 10%.

East African Commonwealth (EAC) countries have agreed to cooperate in the regulation and supervision of the EAC insurance sector. A memorandum of understanding was signed in August 2010 by members of the EAC.

6.5 Demand for insurance

Given the low levels of non-life insurance penetration in Kenya, there is a clear need for expansion of the insurance market. Taking house insurance as an example, approximately only 0.2% of the population of Kenya currently have house insurance, the majority of which held by the population being individuals of mid-high income households, there is clear logic that there is a need to expand the non-life insurance market.

Despite the recognized need for a commercially-oriented, internationally competitive and modern agricultural sector, rural lending in Kenya is low. Agricultural lending accounts for only 4.3% of total lending in Kenya in 2012. Given the high level of contribution of the agriculture sector to GDP in Kenya, this indicates that there is a high need for expansion of agricultural credit. Agriculture production risks, no doubt, are a large part of the reason for the reluctance of the banks to engage more in agriculture lending, although transaction costs in reaching rural areas and low loan sizes, also are other contributors to the lack of credit to agriculture.

Drought and famine were rated as key risks specific to the agricultural groups of focus group respondents in a demand research study undertaken in Kenya¹⁹. Given the high level of importance of these risks for agricultural communities, there should be a demand for insurance products that help manage the cost associated with them.

Kenya benefits from having a poor but viable target market for micro-insurance. 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 (micro)insurance. 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 expanding insurance could include as many as 11 million individuals in Kenya¹⁴.

7. Opportunities

- **Help the Government's work to establish a national integrated DRFI Strategy.** This strategy would incorporate the **development of the catastrophe insurance market** and well as the **development of a comprehensive sovereign DRFI plan**. The sovereign DRFI plan will give the Government immediate access to funding and transparent and effective budget execution processes post shock events, enhancing the proposed work of the ARC. The strategy could push to pass a disaster management policy. It would also be aligned with the policy recommendations of the ASCU.

¹⁹Kenya microinsurance landscape - Market and regulatory analysis. Cenfri 2010

- **Develop mechanisms to scale up social safety net programs using market-mediated disaster risk (and particularly agricultural) insurance solutions**, improving the disaster resilience of vulnerable households to disasters. Initial focus could be on the Hunger Safety Net Program, which is one of the five cash transfer programs that constitute the National Safety Net Program. The investment program could have the following components:
 - A technical assistance program which would assist GoK in developing the framework and mechanisms required to execute the scaling up of the safety nets. This program would also investigate options for GoK to manage the excess exposure of the enhanced safety net program, initially looking to reinsure it directly by GoK or potentially through local reinsurance markets. The technical assistance program could also investigate frameworks that leverage local commercial insurers, using their experience, expertise and business acumen to develop commercially viable insurance products to provide the coverage. Such mechanisms delivered through social safety net programs would create a critical mass of policyholders for agriculture insurance.
 - The critical mass achieved through the social safety net programs could be used to support donor investments in the risk market infrastructure that is required (and essential) for the development of agriculture insurance markets. These investments could initially focus on the data market infrastructure. These investments can be leveraged by the well-established and stable private sector insurance market present in Kenya, unlocked its potential to spur the development of commercial agriculture insurance penetration into rural and vulnerable areas, further improving the resilience of such locations against disaster events.

- **Establish a Technical Support Unit, in partnership with public and private stakeholders**, to develop domestic market infrastructure and allow insurance to play the appropriate role in an effective, efficient and sustainable disaster and social protection framework. To ensure the desired results, the various initiatives underway in respect of agriculture insurance, microinsurance and disaster risk insurance will benefit from the leadership and ownership of a dedicated agency with the right expertise and appropriate funding. By housing all the expertise under one mission and lead, it can transcend boundaries between rural protection, social safety nets, inclusive and sovereign insurance, and implement solutions across sectors and ministries. With appropriate governance, it will attract the private sector to make public private solutions the default in risk transfer, and partner with all existing agriculture insurance pilots.

List of Acronyms

AIDP	Agriculture Insurance Development Program
ARC	African Risk Capacity
ART	Alternative Risk Transfer
DFID	Department for International Development (UK)
DRFI	Disaster Risk Financing and Insurance
DRM	Disaster Risk Management
EAC	East African Commonwealth
EC	European Commission
ERF	Emergency Response Fund
FSD	Financial Sector Deepening Trust of Kenya
GIIF	Global Index Insurance Facility
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GoK	Government of Kenya
HFA	Hyogo Framework for Action
ILRI	International Livestock Research Institute
MDG	Millenium Development Goals
MFI	Microfinance Institutions
MPCI	multi-peril crop insurance
NDMA	National Drought Management Authority
PDNA	Post-Disaster Needs Assessment
SACCOs	Savings and credit cooperatives
WDI	World Development Indicator