Kenya FY’2021 Listed Insurance Report, & Cytonn Monthly – May 2022

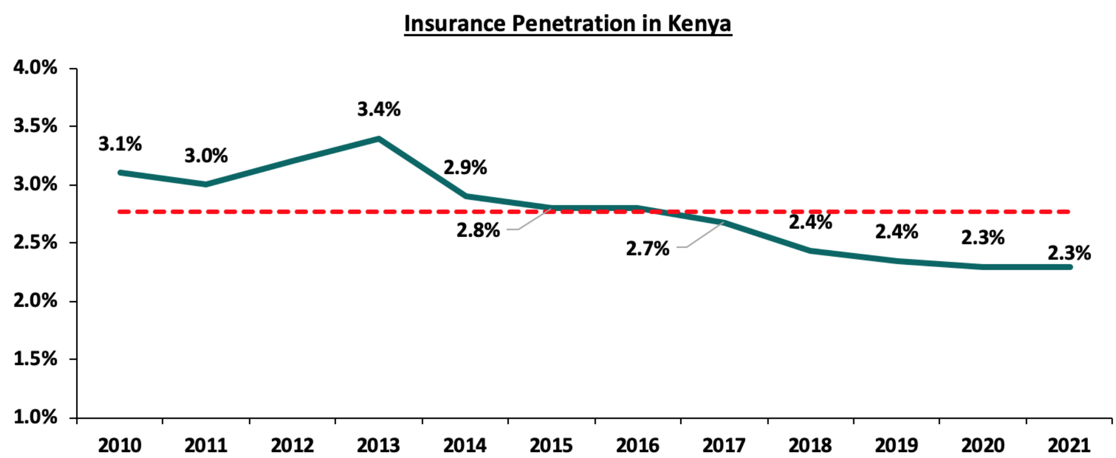
Focus of the Week

Following the release of the FY’2021 results by Kenyan insurance firms, the Cytonn Financial Services Research Team undertook an analysis on the financial performance of the listed insurance companies and the key factors that drove the performance of the sector. In this report, we assess the main trends in the sector, and areas that will be crucial for growth and stability going forward, seeking to give a view on which insurance firms are the most attractive and stable for investment. As a result, we shall address the following:

I. Insurance Penetration in Kenya
II. Key Themes that Shaped the Insurance Sector in FY’2021,
III. Industry Highlights and Challenges,
IV. Performance of The Listed Insurance Sector in FY’2021, and,
V. Conclusion & Outlook of the Insurance Sector.

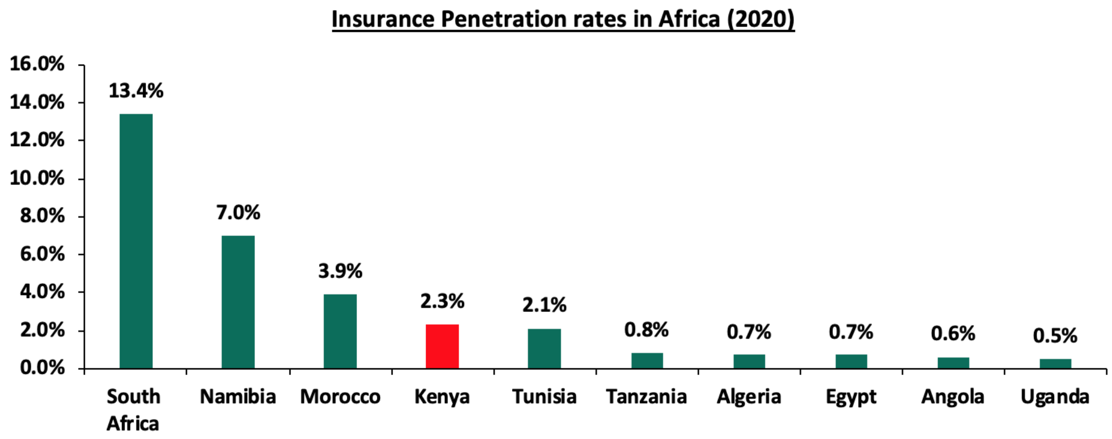
Section I: Insurance Penetration in Kenya

Insurance uptake in Kenya remains low compared to other key economies with the insurance penetration coming in at 2.3% as at FY’2021, according to the Q4’2021 Insurance Regulatory Authority (IRA) and the Kenya National Bureau of Statistics (KNBS) 2022 Economic Survey. The low penetration rate, which is below the global average of 7.4%, is attributable to the fact that insurance uptake is still seen as a luxury and mostly taken when it is necessary or a regulatory requirement. Notably, Insurance penetration remained unchanged at 2.3% in 2021, same as what was recorded in 2020, despite the economic recovery that saw an improved business environment. This further highlights the low insurance uptake in the country, considering that despite the improved business environment yet insurance penetration did not increase.



Source: CBK Financial Stability Reports

The chart below shows the insurance penetration in other economies across Africa:



**Kenya data as of 2021*

Source: Swiss Re, GCR Research, KNBS

Insurance penetration in Africa has remained relatively low, averaging 2.8% in 2020, mainly attributable to lower disposable income in the continent and slow growth of alternative distribution channels such as mobile phones to ensure wider reach of insurance products to the masses. South Africa remains to be a leader in insurance penetration in the continent, owing to a mature and highly competitive market, coupled with strong institutions and a sound regulatory environment.

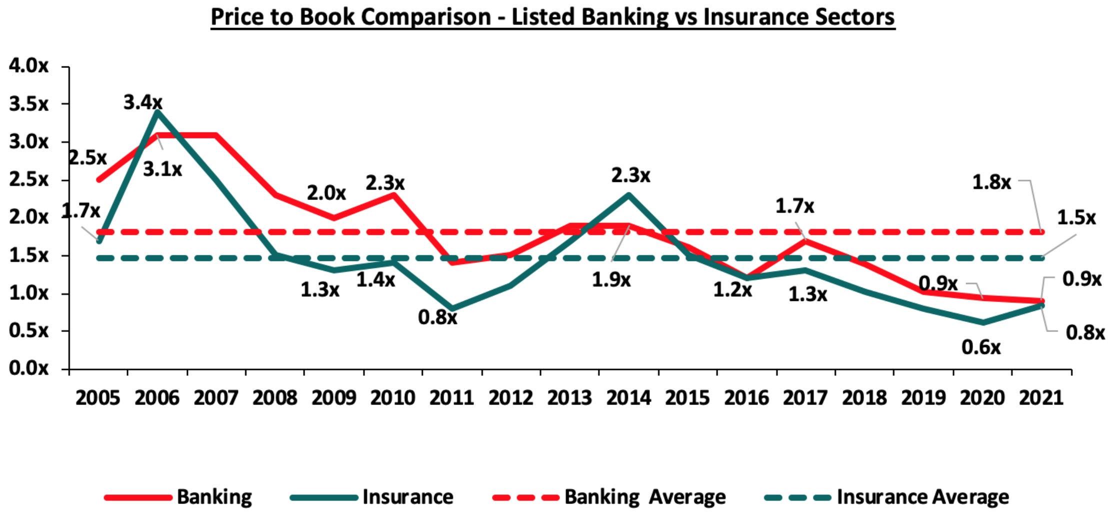
Section II: Key Themes that Shaped the Insurance Sector in FY'2021

In FY'2021, the country saw an improvement in the business environment, following the increased vaccine inoculation, coupled with the lifting and easing of COVID-19 measures that had been put in place in 2020. The improved operating environment led to the sector recording an 18.5% growth in gross premiums to Kshs 276.0 bn in FY'2021, from Kshs 233.0 bn in FY'2020. Insurance claims also increased by 20.7% to Kshs 151.2 bn in FY'2021, from Kshs 125.2 bn in FY'2020. During the period under review, the NASI index gained by 9.5% compared to a decline of 8.6% in FY'2020. This in turn helped to grow the insurance sector's bottom line as a result of fair value gains in the equities investments. However, it is key to note, Year to Date (YTD), NASI has declined by 22.6% which will have a direct impact on the sector's bottom-line, due to the expected fair value losses on the quoted securities.

Key highlights from the industry performance:

i. Convenience and efficiency through adoption of alternative channels for both distribution and premium collection such as Bancassurance and improved agency networks,
ii. Advancement in technology and innovation making it possible to make premium payments and through mobile phones,
iii. Continued recovery from the economic shocks that shrouded 2020 that saw both individuals and businesses seek insurance uptake to cover for their activities, leading to growth in gross premiums which increased by 18.5% to Kshs 276.0 bn, from Kshs 233.0 bn in FY'2020 and,
iv. Increased investments income, which significantly increased by 38.1% to Kshs 63.3 bn in FY'2021 from Kshs 45.9 bn in FY'2020, mainly attributable to the fair value gains on investments on equities in the capital markets.

On valuations, listed insurance companies are trading at a price to book (P/Bv) of 0.8x, lower than listed banks at 0.9x, but both are lower than their 16-year historical averages of 1.5x and 1.8x, for the insurance and banking sectors respectively. These two sectors are attractive for long-term investors supported by the strong economic fundamentals.



The key themes that have continued to drive the insurance sector include:

A. **Technology and Innovation**

Although the industry has been slow in adopting digital trends, the onset of the COVID-19 pandemic in FY'2020 saw the adoption of digital distribution of insurance products as a matter of necessity. Consequently, majority of insurance companies continue to take advantage of the available digital channels to drive growth and increase insurance penetration in the country. Mobile subscribers as at December 2021 stand at 65.1 mn against a population of 48.7 mn, translating to a mobile penetration of 133.6%, according to the Q4'2021 Communications Authority of Kenya industry release. The high mobile penetration implies that mobile phones provide a headroom and increases opportunities to distribute insurance products to the younger generation of consumers and those consumers that have not been served through traditional distribution methods. Given that the process of handling and inspecting claims manually is cumbersome and imperfect, the use of Artificial Intelligence (AI) assists in investigating the legitimacy of claims and identifying those that are fraudulent. An example is Jubilee Holdings which has rolled out a digital virtual assistant, through which clients can receive real-time services that include the end to end purchase of insurance products and access to services free of human intervention.

B. **Regulation**

To ensure that the sector benefits from a globally competitive financial services sector, the regulator has been working through regulation implementations to address some of the perennial, as well as emerging problems in the sector. The COVID-19 environment proved challenging especially on the regulatory front, as it was a balance between remaining prudent as an underwriter and adhering to the set regulations given the negative effect the pandemic. Regulations used for the insurance sector in Kenya include the Insurance Act Cap 487 and its accompanying schedule and regulations, Retirement Benefits Act Cap 197 and The Companies Act. In FY'2021, regulation remained a key aspect affecting the insurance sector and the key themes in the regulatory environment include;

i. **IFRS 9 -** IAS 39, Financial Instruments Recognition and Measurement was replaced with IFRS 9, Financial Instruments to address the classification and measurement of financial instruments, impairment, and hedge accounting. The guidelines introduce new classification and measurement especially for financial assets, necessitating insurers to make judgements to determine whether financial investments are measured at amortised cost or fair value and whether gains and losses are included in the profit or loss or other comprehensive income. The new impairment model under IFRS 9 is based on expected credit losses and subsequently, all financial assets will carry a loss allowance, meaning that insurers will have to provision higher for impairment losses. Many insurance companies have opted to use the temporary exemption from implementation of IFRS 9, by continuing to apply IAS 39, but the temporary exemption expires January 2023. IFRS 9 will enable insurance companies to develop appropriate models for their customer debtors and develop plans that will help them lower their credit risk in the future,

ii. **IFRS 17-** The standard establishes the principle for recognition, measurement, presentation and disclosure of insurance contracts with the objective of ensuring insurance companies provide relevant information that faithfully represents the contracts. However, as a way to protect the insurance industry from the negative effects of the pandemic the International Accounting Standards Board (IASB), the international body responsible for setting up financial reporting standards deferred its implementation to be effective from January 2023 or earlier. The standard, having replaced IFRS 4, is expected to give better information on profitability by providing more insights about current and future profitability of insurance contracts. Separation of financial and insurance results in the income statement will allow for better analysis of core performance for the entities and allow for better comparability of insurance companies, and,

iii. **Risk Based Supervision** - IRA has been implementing risk-based supervision through guidelines that require insurers to maintain a capital adequacy ratio of at least 200.0% of the minimum capital by 2020. The regulation requires insurers to monitor the capital adequacy and solvency margins on a quarterly basis, with the main objective being to safeguard the insurer's ability to continue as a going concern and provide shareholders with adequate returns. We expect more mergers within the industry as smaller companies struggle to meet the minimum capital adequacy ratios. We also expect insurance companies to adopt prudential practices in managing and taking on risk and reduction of premium undercutting in the industry as insurers will now have to price risk appropriately.

C. **Capital Raising and share purchase**

The move to a risk based capital adequacy framework presented opportunities for capital raising initiatives mostly by the small players in the sector to shore up their capital and meet compliance measures. With the new capital adequacy assessment framework, capital is likely to be critical to ensuring stability and solvency of the sector to ensure the businesses are a going concern. In May 2021, Allianz and Jubilee Holdings announced the completion of acquisition of 66.0% stake in Jubilee General Insurance Company (property and casualty) with the exception of medical in Kenya, Uganda, Tanzania, Burundi and Mauritius, for a total consideration of Kshs 10.8 bn. We expect that this amount will be ploughed back in to the company as part of the capital boost to grow other business lines.

In capital raising activities year to date, we have seen market activity between Sanlam Limited, a South African financial services group listed on the Johannesburg Stock Exchange, announce that it had entered into a definitive Joint Venture agreement for a term of 10 years with Allianz SE, a global integrated financial services firm listed on the Frankfurt Stock Exchange with the aim to leverage on the two entities footprints in Africa and create a leading Pan-African financial services group, with an estimated equity value of Kshs 243.7 bn. Sanlam South Africa indirectly owns 100.0% in Hubris Holdings Limited, which is the majority shareholder in Sanlam Kenya Plc, a listed insurance and financial services entity on the Nairobi Stock Exchange. We expect that the Joint Venture will provide for Sanlam Kenya Plc, Allianz General Insurance Kenya and Jubilee General Insurance (which Allianz owns the majority stake in – 66.0%), to combine operations to grow their market share, asset base and bottom lines. According to the Insurance Regulatory Authority's Q4'2021 industry release, were the entities to combine operations, they would amass a total asset base of Kshs 37.6 bn as of Q4'2021. We expect such consolidations to continue as the market players in the insurance sector seek growth, stability and seek to meet capital adequacy requirements.

Section III: Industry Highlights and Challenges

Following the stable growth achieved by the insurance sector over the last decade, we expect the sector to experience sustained gradual growth on the back of an improving economy and subsequent growth in insurance premiums, which will enhance the capacity of the sector to sustain profitability.

The following activities were undertaken by the Insurance Regulatory Authority (IRA), in line with their mandate of regulating and promoting development of the insurance sector;

I. **Industry Circulars**

In FY'2021, IRA issued 12 circulars to the industry ranging from the Private Security Regulations Act No. 13 of 2016, Anti-Money Laundering Guidelines, Registration renewal requirements for service providers to the enhanced medical insurance policy wordings. The circular on enhancing medical insurance policy wordings, was as a result of heightened complaints and enquiries from policyholders and beneficiaries of medical insurance covers where their claims were declined by insurers. The contentious issues were centered on; i) chronic and pre-existing conditions, (ii) waiting period of the medical insurance covers, and, iii) authorization for admission to hospital. IRA addressed the complaints by redefining the terms for the above issues and directed all medical underwriters to review their medical insurance contracts and harmonize as provided for in the circular. Additionally, as a risk mitigation measure, insurers were advised to provide for payment of COVID-19 vaccination for their medical insurance clients.

II. **Recently Developed or Repackaged Insurance Products**

In FY'2021, 23 new or repackaged insurance products were filed by various insurance companies and approved by IRA. The onset of COVID-19 and uncertainty that came along with the pandemic accelerated the repackaging of insurance products where 7 or 30.4% of the 23 products were medical plans, while life products accounted for 14 or 60.9% of the total new/repackaged products.

Industry Challenges:

- **Fraud:** Insurance fraud is an intentional deception committed by an applicant or policy holder for financial gain. Recent years have seen an increase in fraudulent claims especially in medical and motor insurance, with estimates indicating that one in every five medical claims are fraudulent mainly through inflated medical bills and hospitals making patients take unnecessary tests. In FY'2021, 120 fraud cases were reported, with fraudulent motor accident injury claims accounting for 17.5%, followed by theft by agents at 12.5%. The sector has been adopting the use of block chain and artificial intelligence to curb fraud within the sector, as well as most companies setting up their own assessment centres across the country so as to better determine the actual compensation,
- **Increased loss ratios:** Core insurance business performance has been dwindling, mainly attributable to the high loss ratios, which have deteriorated further, following the increase in claims outpacing increase in premiums. In FY'2021, general insurance claims increasing by 22.3% to Kshs 70.1 bn in FY'2021, from Kshs 57.4 bn in FY'2020. On the other hand, premiums for general insurance business grew by a slower 16.7% to Kshs 106.4 bn in FY'2021, from Kshs 91.2 bn in FY'2020. As a result, loss ratio for general insurers increased by 5.2% points to 68.8% in FY'2021, from 63.6% in FY'2020. The increase was attributable to increase in motor classes' claims by 20.2% in FY'2021, which can be partly tied to easing of travel restrictions around the country which allowed for unabated movement. As a result of this, accidents increased and claims increased too. The loss ratios under the long term business eased slightly, to 70.4% from 70.8% in FY'2020, attributable to the 20.1% increase in premiums to Kshs 115.1 bn from Kshs 95.8 bn in FY'2020 that outpaced the 19.5% growth in net claims and policyholder's benefits to Kshs 81.0 bn from Kshs 67.8 bn from FY'2020,
- **Cut throat competition**: The local insurance sector is served by 56 insurance companies offering the same products, despite the low insurance penetration in the country. The battle for market share has seen some insurers resort to underhand methods of gaining competitive advantage, such as premium undercutting which refers to the practice where an insurance company secretly offers clients unrealistically low premiums in order to gain competitive advantage and to protect their market share. This is a major driver of underwriting losses suffered by the industry. The

regulator retaliated plans to engage a consultant to relook at the industry pricing in March 2021, and the plans are still underway. This however comes on the back drop of muted insurance penetration that could be worsened by increased premiums pricing. Some industry players have argued price fixing will kill innovation and that the industry players should be left free to set their own prices,

- **Dwindling trust from insurance consumers:** During FY'2021, IRA received 1,668 complaints, lodged against insurers by policyholders and beneficiaries, with general insurance accounting for a lion's share of the complaints at 1,265 complaints (75.8%), while long term insurers recorded 403 (24.2%) complaints against them. The complaints range from insurance companies failing to settle claims and constant haggling over terms of insurance contracts, fuelling the public mistrust against insurers and increasing insurance apathy in the country,
- **Regional regulators:** Subsidiaries of Kenyan insurance companies are facing challenges in the areas of operation. For instance, in Tanzania, insurance brokers are required to be at least two-thirds (67.0%) owned and controlled by citizens of Tanzania. In Kenya, regulation on capital has made it difficult for smaller insurance companies to continue operating without increasing their capital or merging in order to raise their capital base.

Section IV: Performance of the Listed Insurance Sector in FY'2021

The table below highlights the performance of the listed insurance sector, showing the performance using several metrics, and the key take-outs of the performance.

Listed Insurance Companies FY'2021 Earnings and Growth Metrics

Insurance	Core EPS Growth	Net Premium growth	Claims growth	Loss Ratio	Expense Ratio	Combined Ratio	ROaE	ROaA
CIC	301.3%	5.5%	5.8%	71.6%	52.2%	123.8%	3.4%	1.6%
Britam	100.8%	8.1%	(4.3%)	69.4%	82.1%	151.5%	0.4%	0.05%
Jubilee Insurance	57.0%	9.0%	18.2%	108.4%	41.3%	149.7%	17.6%	4.5%
Sanlam	13.7%	34.8%	50.3%	93.3%	45.7%	139.0%	(46.0%)	(1.7%)
Liberty	(87.9%)	0.6%	42.8%	78.3%	79.3%	157.6%	0.9%	0.2%
***FY'2021 Weighted Average**	**89.2%**	**8.9%**	**11.9%**	**87.9%**	**59.5%**	**147.4%**	**6.6%**	**2.1%**
****FY'2020 Weighted Average**	**(157.9%)**	**1.6%**	**9.5%**	**88.1%**	**62.9%**	**151.1%**	**(9.4%)**	**(1.3%)**

Market cap weighted as at 03/06/2022

****Market cap weighted as at 21/05/2021***

The key take-outs from the above table include;

i. Core EPS growth recorded a weighted growth of 89.2%, compared to a weighted decline of 157.9% in FY'2020. The increase in earnings was attributable to increased premiums during the period following robust recovery by the sector from the COVID-19 pandemic, coupled with gains recorded in the equities markets and higher yields from government papers,
ii. The premiums grew at a faster pace of 8.9% in FY'2021, compared to a growth of 1.6% in FY'2020, while claims grew at an aggressive faster rate of 11.9% in FY'2021, from the 9.5% recorded in FY'2020 on a weighted average basis,
iii. The loss ratio across the sector eased slightly to 87.9% in FY'2021, from 88.1% in FY'2020,
iv. The expense ratio eased to 59.5% in FY'2021, from 62.9% in FY'2020, owing to a decline in

operating expenses, a sign of increased efficiency,

v. The insurance core business still remains unprofitable, with a combined ratio of 147.4% as at FY'2021, compared to 151.1% in FY'2020, and,
vi. On average, the insurance sector delivered a Return on Average Equity (ROaE) of 6.6%, an increase from a weighted Return on Average Equity of (9.4%) in FY'2020.

Based on the Cytonn FY'2021 Insurance Report, we ranked insurance firms from a franchise value and from a future growth opportunity perspective with the former getting a weight of 40.0% and the latter a weight of 60.0%.

For the franchise value ranking, we included the earnings and growth metrics as well as the operating metrics shown in the table below in order to carry out a comprehensive review:

Listed Insurance Companies FY'2021 Franchise Value Score

Insurance Company	Loss Ratio	Expense Ratio	Combined Ratio	Return on Average Capital Employed	Tangible Common Ratio	Franchise Value Score	Ranking
Jubilee	108.4%	41.3%	149.7%	21.7%	27.2%	14	1
CIC Group	71.6%	52.2%	123.8%	12.3%	18.6%	19	2
Sanlam	93.3%	45.7%	139.0%	(35.1%)	1.9%	22	3
Britam	69.4%	82.1%	151.5%	7.2%	10.9%	24	4
Liberty	78.3%	79.3%	157.6%	3.6%	18.9%	26	5
Weighted Average FY'2021	**87.9%**	**59.5%**	**147.4%**	**11.8%**	**18.9%**		

The Intrinsic Valuation is computed through a combination of valuation techniques, with a weighting of 40.0% on Discounted Cash-flow Methods, 35.0% on Residual Income and 25.0% on Relative Valuation. The overall FY'2020 ranking is as shown in the table below:

Listed Insurance Companies FY'2021 Comprehensive Ranking

Bank	Franchise Value Score	Intrinsic Value Score	Weighted Score	FY'2021 Ranking	FY'2020 Ranking
Jubilee Holdings	1	1	1	1	2
Liberty Holdings	5	2	3.2	2	1
Britam	4	3	3.4	3	5
Sanlam Kenya	3	4	3.6	4	3
CIC Group	2	5	3.8	5	4

Major Changes from the FY'2020 Ranking are;

1. Jubilee Holdings improved to position 1 in FY'2021 from position 2 mainly due to the improvement in the franchise score in FY'2021, driven by reduction in expense ratio to 41.3% in FY'2021, from 56.3% in FY'2020. As a result, the combined ratio also declined to 149.7% in FY'2021, from 157.6% in FY'2020,
2. Liberty declined to position 2 in FY'2021 from position 1 in FY'2020 mainly due to declines in both the franchise score in FY'2021, driven by the deterioration in the loss ratio to 78.3%, from 55.2% in FY'2020 while the expense ratio increased to 79.3%, from 45.9% in FY'2020,

3. Britam Holdings improved to position 3 in FY’2021 from position 5 in FY’2020 driven by an improvement in the franchise score attributable to the improvement in the loss ratio to 69.4%, from 85.7%, taking the combined ratio to 151.5%, an improvement from the 164.2% in FY’2020,
4. Sanlam declined to position 4 in FY’2020 from position 3 in FY’2020 mainly due to deterioration in the franchise score, driven by deterioration in loss and combined ratios to 93.3% and 139.0%, from 83.7% and 137.9%, respectively,
5. CIC Group declined to position 5 in FY’2021, from position 4 in FY’2020, on the back of weaker franchise and intrinsic scores driven by deterioration of its loss ratio to 71.6% in FY’2021, from 71.4% in FY’2020, and combined ratio to 123.8% in FY’2021, from 121.5% in FY’2020.

Section V: Conclusion & Outlook of the Insurance Sector

The sector has continued to suffer from low penetration rates which has been worsened by the pandemic and its effects on the economy and Kenyans’ disposable incomes. However, the sector continues to undergo transition where traditional models have been disrupted, mainly on the digital transformation, innovation and regulation front, which have positively impacted the outlook. We expect a steady growth in premiums as underwriters come up with products suited to the planning for unforeseen events like COVID-19, mainly in the medical and life businesses. With the full resumption of economic activities that were slowed down in 2020, we expect the claims to continue to grow as well. As such, we are of the opinion that the insurance sector will have to perform delicate balancing acts to ensure that they remain profitable. We are of the view that insurance companies have a lot they can do in order to register considerable growth and improve the level of penetration in the country to the 2020 world average of 7.4%, some of this include:

i. We are of the opinion that insurers have to aggressively look into portfolio optimization by re-evaluating their products and services in-order to sustain post-pandemic growth and remain profitable. Insurers will have to focus on their core and profitable offerings and disposing non-core offerings. This could manifest through sale of business units considered unprofitable. One such example is Jubilee Holdings sale of its general insurance units within Kenya and its regional subsidiaries with the exclusion of its medical unit to Allianz. We expect this portfolio optimization to extend into offloading or reducing stake in non-profitable subsidiaries and associates. Products are also set to be affected as the underwriters extend focus to profitable products,
ii. We expect most underwriters to renew their efforts towards increasing investment income through diversifying their investments through avenues such as pension schemes, unit trusts, fund management and investment advisories. This shift from the brick and mortar underwriting business is necessitated by the increasing combined ratios that have seen insurers’ suffer losses in their core business, with increase in underwriting expenses and claims outpacing the increase in premiums. On the investment front, we also expect insurers to continue to look into non-traditional asset classes such as infrastructure. An example is Jubilee Holdings investment in associates such as Bujagali hydropower plant in Uganda, PDM Holdings Ltd and IPS Cable Systems Ltd whose share of profits has been boosting its bottom-line. In FY’2021, Jubilee Holdings profits from associates increased by 41.2% to Kshs 1.9 bn in FY’2021, from Kshs 0.9 bn from Kshs 1.3 bn in FY’2020,
iii. We expect robust insurance awareness campaigns by the insurers in order to increase knowledge of insurance products, among the masses, as there still remains a gap on insurance understanding. According to a survey commissioned by the Association of Kenya insurers (AKI), the 2nd largest contributor to low insurance uptake at 27.0%, is lack of knowledge of the various insurance products and their benefits. This gives a lot of headroom for insurers, to educate, repackage, and tailor their products to different institutions and individuals,
iv. We expect continued partnerships and alternative distribution channels, by linking with other financial services players including Fund managers who have ventured into offering insurance linked products as well as the current bancassurance relationship with Banks. Insurance companies will still want to leverage on the penetration of bank products to also push insurance

products. Integration of mobile money payments to allow for policy payments is also expected to continue because of convenience which it provides and also mobile phone penetration in the country is high therefore insurance companies will want to leverage this to improve penetration,

v. We expect increased use of technological tools and innovations such as Artificial Intelligence and real time data in hyper personalization of insurance marketing so as to use customer information to customize content, products and services according to the customer wishes and preferences. This will also assist insurers in responding to changes in buying behaviours and tailoring products and services to the needs of the customers to ensure high customer retention in an era where new client acquisition remains difficult. We also expect to see increased inclusion of advancements like smart contracts through block chain that would help eliminate processing costs, reduce insurance fraud and fictitious claims and improve customer satisfaction through immediate claims payment, and,

vi. We also expect that there will be increased regulation in the sector from the regulatory body and other international players to ensure its solvency and sustainability. Insurers have to adjust their insurance contract recognition methods in preparation to the coming into effect of IFRS 9 and IFRS 17 in January of 2023 or earlier. The concerted push by the regulator to have the desired capital adequacy levels will likely see increased consolidations as insurers struggle to reinstate their capital buffers following the effects of the pandemic.

For the FY'2021 Insurance Report, please download it **here**

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