Social Health Insurance Fund (SHIF) Review, and Cytonn Weekly #41/2024

Executive Summary:

Fixed Income: During the week, T-bills were oversubscribed for the second consecutive week, with the overall oversubscription rate coming in at 304.3%, higher than the oversubscription rate of 224.8% recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 18.5 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 462.7%, higher than the oversubscription rate of 433.8% recorded the previous week. The subscription rates for the 182-day and 364-day papers increased significantly to 287.9% and 257.4% respectively from the 202.1% and 164.0% respectively recorded the previous week. The government accepted a total of Kshs 31.2 bn worth of bids out of Kshs 73.0 bn bids received, translating to an acceptance rate of 42.7%. The yields on the government papers were on a downward trajectory, with the yields on the 364-day, 182-day, and 91-day papers decreasing by 39.1 bps, 40.5 bps, and 69.6 bps to 16.3%, 16.1%, and 15.0% respectively from 16.7%, 16.5% and 15.7% respectively recorded the previous week;

Also, during the week, the Central Bank of Kenya released the auction results for the re-opened bonds, FXD1/2016/010 with a tenor to maturity of 1.8 years, and a fixed coupon rate of 15.0% and FXD1/2022/010 with a tenor to maturity of 7.6 years, and a fixed coupon rate of 13.5%. The bonds were oversubscribed with the overall subscription rate coming in at 169.9%, receiving bids worth Kshs 51.0 bn against the offered Kshs 30.0 bn. The government accepted bids worth Kshs 31.3 bn, translating to an acceptance rate of 61.4%. The weighted average yield of accepted bids for both the FXD1/2016/010 and the FXD1/2022/020 came in at 17.0%, which was in line with our expectation of within a bidding range of 17.0%-17.3% for the FXD1/2016/010 and 16.9%-17.2% for the FXD1/2022/010. Notably, the 17.0% yield on the FXD1/2016/010 was lower than the 17.9% rate recorded on the last sale in September 2023, while the yield on the FXD1/2022/020 was higher than the 13.5% recorded the last time it was offered in September 2022. With the Inflation rate at 3.6% as of September 2024, the real return of the FXD1/2016/010 and the FXD11/2022/020 is 13.4% each.

The Monetary Policy Committee (MPC) met on October 8th, 2024, to review the outcome of its previous policy decisions against a backdrop of improved global outlook for growth, easing in inflation in advanced economies as well as the persistent geopolitical tensions. The MPC decided to lower the CBR rate by 75.0 bps to 12.00%, from 12.75% which was in line with our expectation for the MPC to lower the CBR rate. Our expectation to cut the rate was mainly on the back of rate cuts by some major economies, a stable exchange rate, and anchored inflationary pressures, with inflation coming in at 3.6% in September 2024 from 4.4% in August, remaining within the CBK preferred range of 2.5%-7.5% for the fifteenth consecutive month, as well as the need to support the economy by adopting an accommodative policy that will ease financing activities;

Equities: During the week, the equities market was on an upward trajectory, with NSE 20 gaining the most by 1.9%, while NSE 10, NSE 25, and NASI gained by 1.8%, 1.8%, and 1.7% respectively, taking the YTD performance to gains of 28.3%, 25.7%, 19.7% and 19.7% for NSE 10, NSE 25, NASI and NSE 20 respectively. The equities market performance was mainly driven by gains recorded by Equity Group, KCB Group, and DTB-K of 6.3%, 4.1%, and 2.5% respectively. The gains were however weighed down by losses recorded by large-cap stocks such as EABL, COOP Bank, and NCBA of 2.4%, 0.7%, and 0.5% respectively;

Real Estate: During the week, the Kenya National Bureau of Statistics (KNBS) released the Q2'2024 GDP Report which highlighted that the Real Estate sector posted steady growth of 6.0% in Q2'2024, which is 2.1% points slower than the 8.1% growth registered in Q2'2023;

On the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 25.4 and Kshs 22.2 per unit, respectively, as per the last updated data on 11th October 2024. The performance represented a 27.0% and 11.0% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price;

Focus of the Week: For 58 years, the Kenyan government has offered health insurance to its citizens through The National Health Insurance Fund (NHIF). The fund was established in 1966 through an act of parliament, with a core mandate of providing affordable medical insurance coverage to all Kenyans. However, years later, the state of public healthcare in the country remained below par, with inefficiencies that have led to repeated civil actions, inequality in health care provision, sub-par infrastructure, and a host of other challenges. In 2017, the Kenyan government made a strong commitment to achieve universal health coverage (UHC) as one of the Big 4 Agenda by the year 2022 and started designing and implementing priority reforms to accelerate progress. This was then picked up by the Bottom Up Economic Transformation Agenda, which also set out universal health care as one of its plans. This week, we review the new Social Health Insurance fund and shed light on its current state in terms of the milestones achieved and the challenges faced while looking at the expectations of the public. We shall also make a comparison with similar initiatives in other countries and private offers in Kenya, and give our recommendations towards achieving a sustainable Fund;

Investment Updates:

- Weekly Rates:
    - Cytonn Money Market Fund closed the week at a yield of 18.11% p.a. To invest, dial *809# or download the Cytonn App from Google Play store here or from the Appstore here;
- We continue to offer Wealth Management Training every Tuesdays, from 7:00 pm to 8:00 pm and Saturdays, from 10:00 am to 11:00 am. The training aims to grow financial literacy among the general public. To register for any of our Wealth Management Trainings, click here;
- If interested in our Private Wealth Management Training for your employees or investment group, please get in touch with us through wmt@cytonn.com;
- Cytonn Insurance Agency acts as an intermediary for those looking to secure their assets and loved ones' future through insurance namely; Motor, Medical, Life, Property, WIBA, Credit and Fire and Burglary insurance covers. For assistance, get in touch with us through insuranceagency@cytonn.com;
- Cytonn Asset Managers Limited (CAML) continues to offer pension products to meet the needs of both individual clients who want to save for their retirement during their working years and Institutional clients that want to contribute on behalf of their employees to help them build their retirement pot. To more about our pension schemes, kindly get in touch with us through pensions@cytonn.com;

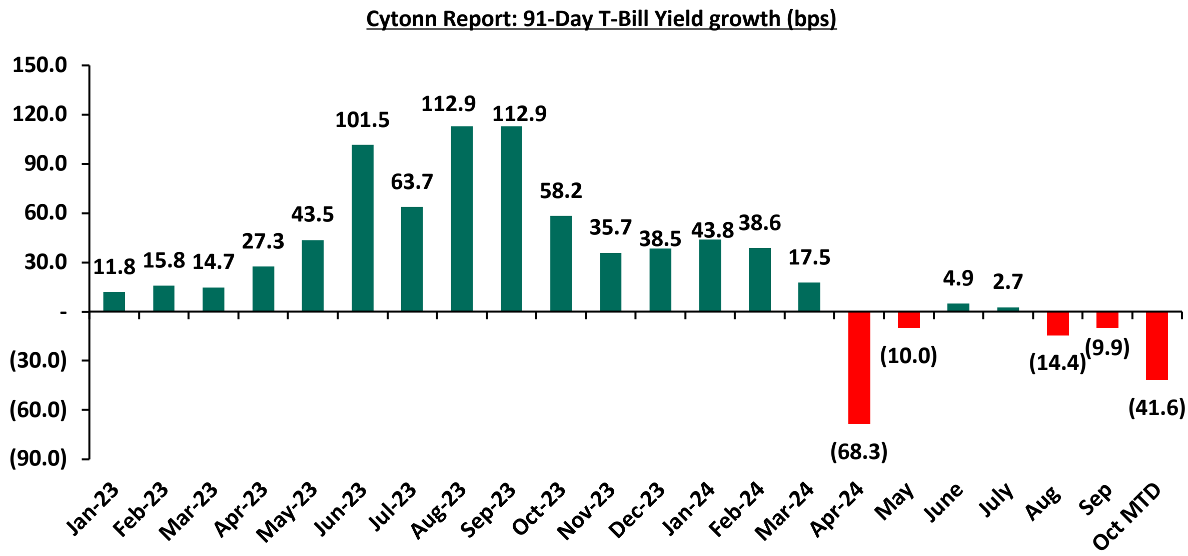
Hospitality Updates:

- We currently have promotions for Staycations. Visit cysuites.com/offers for details or email us at sales@cysuites.com;

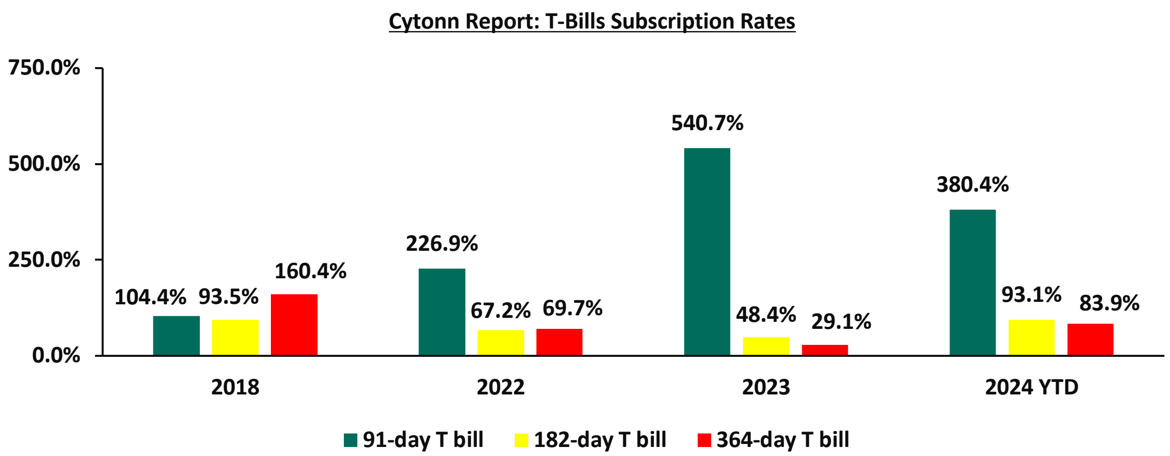
Fixed Income

Money Markets, T-Bills Primary Auction:

During the week, T-bills were oversubscribed for the second consecutive, with the overall oversubscription rate coming in at 304.3%, higher than the oversubscription rate of 224.8% recorded the previous week. Investors' preference for the shorter 91-day paper persisted, with the paper receiving bids worth Kshs 18.5 bn against the offered Kshs 4.0 bn, translating to an oversubscription rate of 462.7%, higher than the oversubscription rate of 433.8% recorded the previous week. The subscription rates for the 182-day and 364-day papers increased significantly to 287.9% and 257.4% respectively from the 202.1% and 164.0% respectively recorded the previous week. The government accepted a total of Kshs 31.2 bn worth of bids out of Kshs 73.0 bn bids received, translating to an acceptance rate of 42.7%. The yields on the government papers were on a downward trajectory, with the yields on the 364-day, 182-day, and 91-day papers decreasing by 39.1 bps, 40.5 bps, and 69.6 bps to 16.3%, 16.1%, and 15.0% respectively from 16.7%, 16.5% and 15.7% respectively recorded the previous week. The chart below shows the yield growth rate for the 91-day paper over the period:



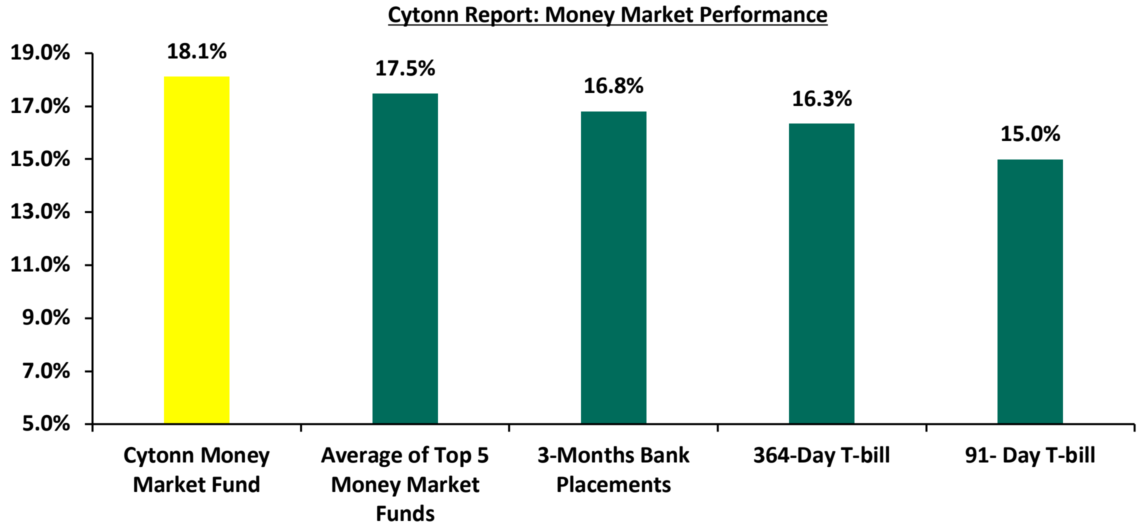
The chart below compares the overall average T-bill subscription rates obtained in 2018, 2022, 2023, and 2024 Year-to-date (YTD):



During the week, the Central Bank of Kenya released the auction results for the re-opened bonds, FXD1/2016/010 with a tenor to maturity of 1.8 years, and a fixed coupon rate of 15.0% and FXD1/2022/010 with a tenor to maturity of 7.6 years, and a fixed coupon rate of 13.5%. The bonds were oversubscribed with the overall subscription rate coming in at 169.9%, receiving bids worth Kshs 51.0 bn against the offered Kshs 30.0 bn. The government accepted bids worth Kshs 31.3 bn, translating to an acceptance rate of 61.4%. The weighted average yield of accepted bids for both the FXD1/2016/010 and the FXD1/2022/020 came in at 17.0%, which was in line with our expectation of within a bidding range of 17.0%-17.3% for the FXD1/2016/010 and 16.9%-17.2% for the FXD1/2022/010. Notably, the 17.0% yield on the FXD1/2016/010 was lower than the 17.9% rate recorded on the last sale in September 2023, while the yield on the FXD1/2022/020 was higher than the 13.5% recorded the last time it was offered in September 2022. With the Inflation rate at 3.6% as of September 2024, the real return of the FXD1/2016/010 and the FXD11/2022/020 is 13.4% each.

Money Market Performance:

In the money markets, 3-month bank placements ended the week at 16.8% (based on what we have been offered by various banks), and the yields on the government papers were on a downward trajectory, with the yields on the 364-day and 91-day papers decreasing by 39.1 bps and 69.6 bps respectively, to 16.3% and 15.0% respectively from 16.7% and 15.7% respectively recorded the previous week. The yields on the Cytonn Money Market Fund decreased marginally by 3.0 bps to close the week at 18.1%, remaining relatively unchanged from the previous week, while the average yields on the Top 5 Money Market Funds decreased by 7.8 bps to 17.5%, remaining unchanged from last week.



The table below shows the Money Market Fund Yields for Kenyan Fund Managers as published on 11th October 2024:

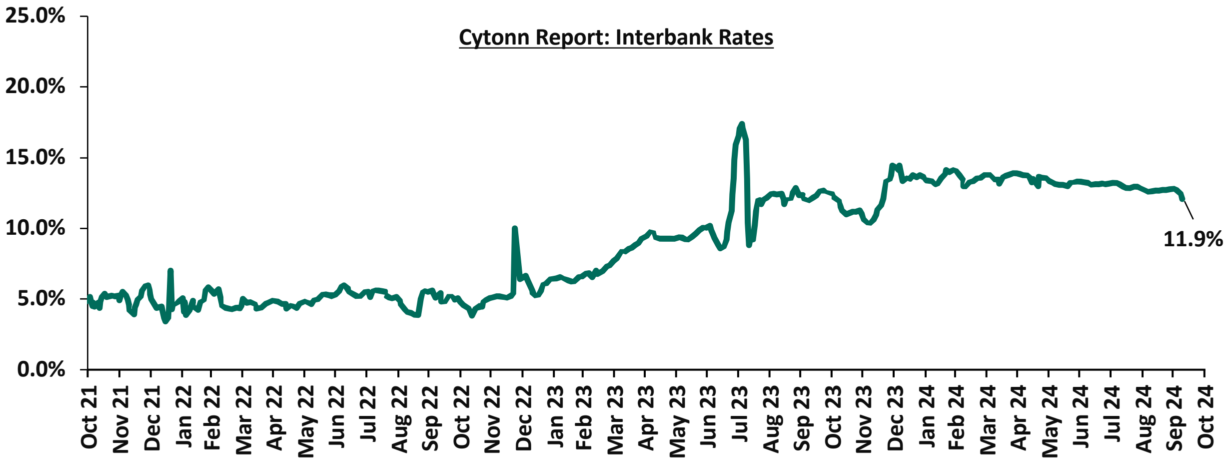
Cytonn Report: Money Market Fund Yield for Fund Managers as published on 11th October 2024		
Rank	**Fund Manager**	**Effective Annual Rate**
1	Cytonn Money Market Fund *(Dial *809# or download the Cytonn app)*	18.1%
2	Lofty-Corban Money Market Fund	18.0%
3	Etica Money Market Fund	17.3%
4	Kuza Money Market fund	17.0%
5	Arvocap Money Market Fund	16.9%
6	GenAfrica Money Market Fund	16.3%
7	Nabo Africa Money Market Fund	16.0%
8	KCB Money Market Fund	15.8%
9	Jubilee Money Market Fund	15.7%
10	Ndovu Money Market Fund	15.5%
11	Co-op Money Market Fund	15.4%
12	Mali Money Market Fund	15.2%
13	Enwealth Money Market Fund	15.1%
14	Absa Shilling Money Market Fund	15.0%
15	Apollo Money Market Fund	15.0%
16	Orient Kasha Money Market Fund	14.7%
17	Sanlam Money Market Fund	14.6%
18	Genghis Money Market Fund	14.5%
19	Stanbic Money Market Fund	14.5%
20	AA Kenya Shillings Fund	14.4%

21	Madison Money Market Fund	14.1%
22	Old Mutual Money Market Fund	14.1%
23	Dry Associates Money Market Fund	13.9%
24	CIC Money Market Fund	13.7%
25	ICEA Lion Money Market Fund	13.7%
26	Equity Money Market Fund	13.3%
27	British-American Money Market Fund	13.2%

Source: Business Daily

Liquidity:

During the week, liquidity in the money markets eased, with the average interbank rate decreasing by 56.5 bps, to 12.2% from the 12.8% recorded the previous week, partly attributable to government payments that offset tax remittances. The average interbank volumes traded increased significantly by 90.2% to Kshs 34.1 bn from Kshs 17.9 bn recorded the previous week. The chart below shows the interbank rates in the market over the years:



Kenya Eurobonds:

During the week, the yields on Eurobonds were on an upward trajectory, with the yields on the 13-year Eurobond issued in 2021 increasing the most by 23.1 bps to 9.9% from 9.7% recorded the previous week. The table below shows the summary of the performance of the Kenyan Eurobonds as of 10th October 2024;

Cytonn Report: Kenya Eurobonds Performance						
	2018		2019		2021	2024
Tenor	10-year issue	30-year issue	7-year issue	12-year issue	13-year issue	7-year issue
Amount Issued (USD)	1.0 bn	1.0 bn	0.9 bn	1.2 bn	1.0 bn	1.5 bn
Years to Maturity	3.4	23.4	2.6	7.6	9.7	6.3
Yields at Issue	7.3%	8.3%	7.0%	7.9%	6.2%	10.4%
01-Jan-24	9.8%	10.2%	10.1%	9.9%	9.5%	
01-Oct-24	8.6%	9.9%	8.3%	9.6%	9.4%	9.5%
03-Oct-24	9.0%	10.2%	8.7%	9.8%	9.7%	9.9%
04-Oct-24	9.1%	10.2%	8.9%	9.9%	9.8%	9.9%
07-Oct-24	9.1%	10.2%	8.9%	9.9%	9.8%	10.0%
08-Oct-24	9.2%	10.3%	8.9%	10.0%	9.9%	10.0%
09-Oct-24	9.1%	10.3%	8.9%	10.0%	9.9%	10.0%
10-Oct-24	9.2%	10.3%	8.8%	10.0%	9.9%	10.0%
Weekly Change	0.2%	0.1%	0.1%	0.2%	0.2%	0.1%
MTD Change	0.6%	0.4%	0.5%	0.5%	0.5%	0.5%
YTD Change	(0.6%)	0.1%	(1.3%)	0.1%	0.4%	-

Source: Central Bank of Kenya (CBK) and National Treasury

Kenya Shilling:

During the week, the Kenya Shilling depreciated marginally against the US Dollar by 1.4 bps, to remain relatively unchanged at the Kshs 129.2 recorded the previous week. On a year-to-date basis, the shilling has appreciated by 17.7% against the dollar, a contrast to the 26.8% depreciation recorded in 2023.

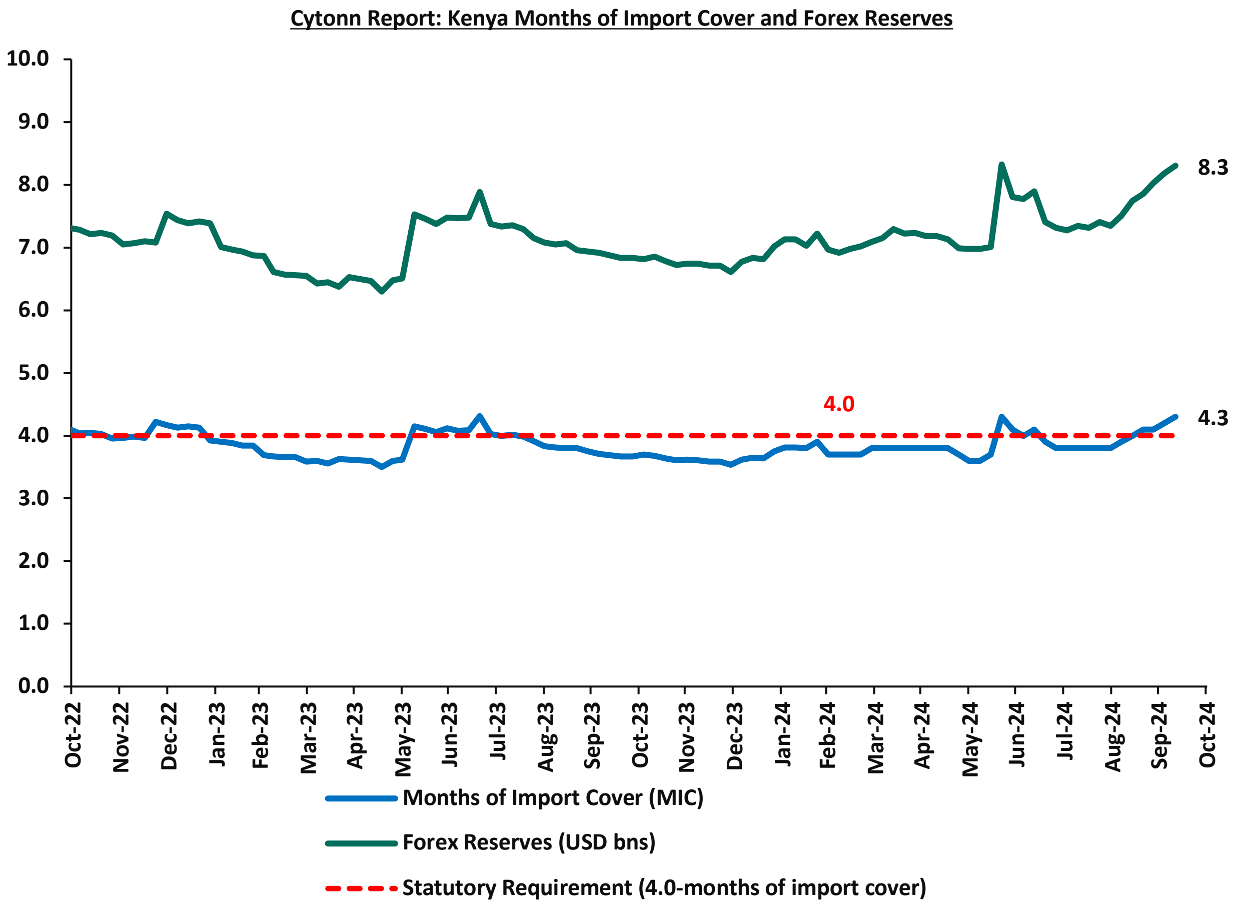
We expect the shilling to be supported by:

i. Diaspora remittances standing at a cumulative USD 4,644.5 mn in the 12 months to August 2024, 12.7% higher than the USD 4,119.7 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the August 2024 diaspora remittances figures, North America remained the largest source of remittances to Kenya accounting for 58.5% in the period, and,
ii. The tourism inflow receipts which came in at USD 352.5 bn in 2023, a 31.5% increase from USD 268.1 bn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 21.0% in the 12 months to August 2024, compared to a similar period in 2023.
iii. Improved forex reserves currently at USD 8.3 bn (equivalent to 4.3-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, but lower than the EAC region’s convergence criteria of 4.5-months of import cover.

The shilling is however expected to remain under pressure in 2024 as a result of:

i. An ever-present current account deficit which came at 3.8% of GDP in Q2’2024 from 3.7% recorded in Q2’2023, and,
ii. The need for government debt servicing, continues to put pressure on forex reserves given that 67.9% of Kenya’s external debt is US Dollar-denominated as of March 2024.

Key to note, Kenya’s forex reserves increased by 1.4% during the week to close the week at USD 8.3 bn from the USD 8.2 bn recorded the previous week, equivalent to 4.3 months of import cover, up from the 4.2 months recorded last week, and above to the statutory requirement of maintaining at least 4.0-months of import cover. The chart below summarizes the evolution of Kenya's months of import cover over the years:



Weekly Highlights:

I. Monetary Policy Committee (MPC) October Meeting

The monetary policy committee met on October 8th, 2024, to review the outcome of its previous policy decisions against a backdrop of improved global outlook for growth, easing in inflation in advanced economies as well as the persistent geopolitical tensions. The MPC decided to lower the CBR rate by 75.0 bps to 12.00%, from 12.75% which was in line with our expectation for the MPC to lower the CBR rate. Our expectation to cut the rate was mainly on the back of rate cuts by some major economies, a stable exchange rate, and anchored inflationary pressures, with inflation coming in at 3.6% in September 2024 from 4.4% in August, remaining within the CBK preferred range of 2.5%-7.5% for the fifteenth consecutive month, as well as the need to support the economy by adopting an accommodative policy that will ease financing activities. Key to note, the MPC had cut the CBR rate to 12.75% in the previous meeting in August from 13.00%. Below are some of the key highlights from the October meeting:

I. The overall inflation eased by 0.8% points to 3.6% in September 2024, from 4.4% in August 2024, positioning it below the mid-point of the preferred CBK range of 2.5%-7.5%, mainly driven by the decline in fuel inflation. Fuel inflation decreased to 1.1% in September 2024 from 4.7% in August 2024, largely attributable to a downward adjustment in pump prices and lower electricity tariffs. The food inflation declined by 0.2% points to 5.1% in September from 5.3% recorded in August, attributable largely to declines in prices of a few vegetable food items i.e. tomatoes, potatoes, onions, and cabbages. The non-food non-fuel inflation slightly decreased by 0.1% points to 3.4% in September 2024 from 3.5% in August 2024, reflecting the lagged effects of previous monetary policy tightening. We expect the overall inflation to remain below the mid-point of the target range in the near term, supported by lower food inflation owing to improved supply from the ongoing harvests, a stable exchange rate, and stable fuel prices,

II. The recently released Quarterly Gross Domestic Product Report, for Q2'2024 showed a slowdown in the performance of the Kenyan economy, with real GDP growing by 4.6%, although slower than the growth of 5.6% recorded in a similar period in 2023. This was attributable to a deceleration in growth in most sectors of the economy, particularly agriculture and forestry, real estate, financial and insurance, information and communication, and transport and storage. The economy is expected to continue to strengthen in 2024, supported by a resilient services sector, sustained performance in agriculture, and enhanced exports. However, this positive outlook is tempered by potential risks, including geopolitical tensions,

III. Goods exports increased by 8.8% in the 12 months to August 2024, compared to a similar period in 2023, reflecting a rise in exports of agricultural commodities and re-exports. Receipts from tea and fruits and vegetables exports increased by 3.9% and 14.1% respectively, while re-exports grew by 73.5% in the period. Notably, exports increased 14.4% in the first eight months of 2024 compared to the same period in 2023. Imports increased by 3.8% in the 12 months to August 2024 compared to a similar period in 2023, mainly reflecting increases in machinery and transport equipment, crude materials, and miscellaneous manufactures. In addition, imports increased by 7.3% in the first eight months of 2024 compared to the same period in 2023. Tourist arrivals improved by 21.0% in the 12 months to August 2024, compared to a similar period in 2023. Remittances totalled USD 4,645.0 mn in the 12 months to August 2024 and were 12.7% higher compared to USD 4,120.0 mn in a similar period in 2023. The current account deficit is estimated at 3.8% of GDP in the 12 months to August 2024, up from 3.7% of GDP in a similar period in 2023, and is projected at 4.0% of GDP in 2024, reflecting improvement in exports of agricultural products, sustained remittances, recovery in imports supported by stable exchange rate and effects of regional trade integration initiatives,

IV. The CBK foreign exchange reserves, which currently stand at USD 8,247 mn representing 4.2 months of import cover, continue to provide adequate cover and a buffer against any short-term shocks in the foreign exchange market,

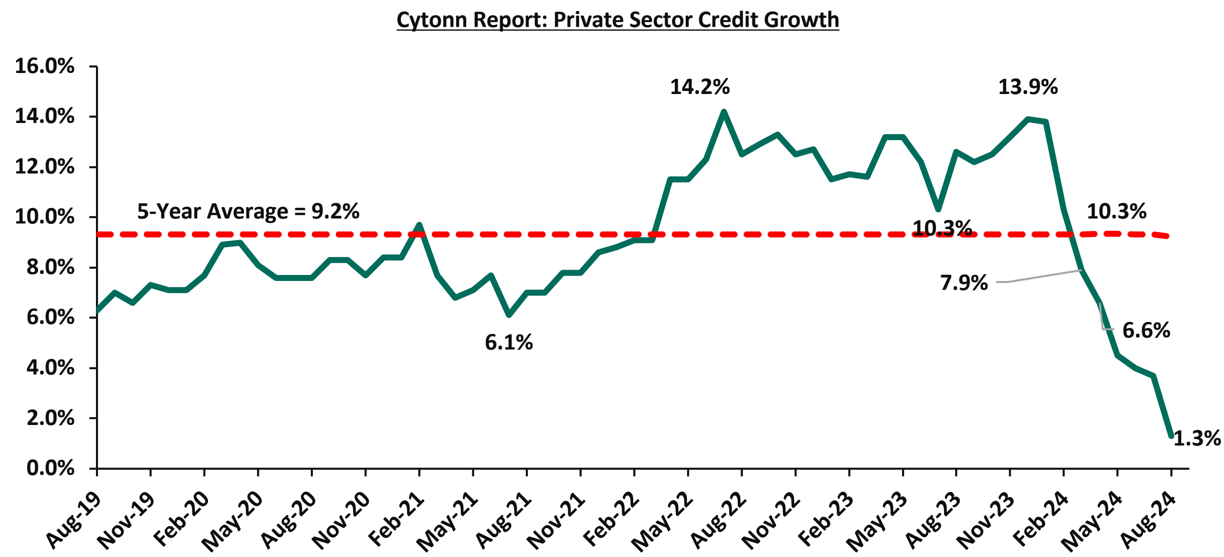
V. The banking sector remains stable and resilient, with strong liquidity and capital adequacy ratios. The ratio of gross non-performing loans (NPLs) to gross loans increased to 16.7% in August 2024 compared to 16.3% in June 2024. Increases in NPLs were noted in the transport and communication, personal and household, trade, real estate, and manufacturing sectors. Banks have continued to make adequate provisions for the NPLs,

VI. The CEOs Survey and Market Perceptions Survey conducted ahead of the MPC meeting revealed sustained optimism about business activity and economic growth prospects for the next 12 months. The optimism was attributed to the stable macroeconomic environment reflected in the low inflation rate and stability in the exchange rate, expectations of a decline in interest rates, continued strong performance of agriculture, the resilience of the services sector, and improved global growth prospects. Nevertheless, respondents expressed concerns about the high cost of doing business, subdued consumer demand, and high cost of credit,

VII. The Survey of the Agriculture Sector for September 2024 revealed an expectation for inflation to either remain unchanged or decrease in the next three months, on account of improved food supply with the ongoing harvests, the stable exchange rate, and reductions in pump prices,

VIII. Global growth is expected to continue to recover, attributable to strong growth in the United States, strong growth in some large emerging market economies such as India, and improved growth prospects in the United Kingdom. Additionally, headline inflation rates have moderated, with central banks in some major economies including the US Federal Reserve lowering their interest rates. Food inflation has risen slightly, mainly driven by higher edible oil prices. International oil prices have moderated, but the risk from the Middle East conflict remains elevated following the recent escalation of tensions,

IX. Growth in private sector credit decreased to 1.3% in August 2024 from 3.7% in July 2024, mainly attributed to exchange rate valuation effects on foreign currency-denominated loans due to the appreciation of the Shilling. In August, local currency loans increased by 5.2%, while foreign currency loans, which make up around 26.0% of total loans, decreased by 10.6%. The chart below shows the movement of the private sector credit growth over the last five years:



X. The Committee acknowledged the ongoing implementation of the FY'2024/25 Supplementary Budget I. These measures are anticipated to further support fiscal consolidation, reducing the fiscal deficit to 4.3% of GDP in FY'2024/25, from 5.2% of GDP in FY'2023/24. The fiscal consolidation in the medium-term should reduce debt vulnerabilities while moving the present-value-of-debt to GDP ratio towards the target anchor of 55.0%.

The MPC noted that its previous measures have successfully reduced overall inflation to below the mid-point of the target range of 2.5% - 7.5%, stabilized the exchange rate, and anchored inflationary expectations. The Committee also noted a moderation in NFNF inflation, while central banks in several major economies have reduced interest rates in response to easing inflationary pressures, with signs that others may soon follow suit. Consequently, the MPC concluded that there was scope for a gradual easing of monetary policy, while maintaining exchange rate stability, which we expect to gradually ease the interest rates in the country. The MPC will closely monitor the impact of its policy measures, as well as developments in the global and domestic economy, and stands ready to take further action as necessary in line with its mandate. We anticipate that the reduction in the CBR rate will start to lower borrowing costs, leading to increased spending and an uptick in the business environment as well as reduced debt servicing costs for the government, as the MPC closely monitors inflation and exchange rate stability to ensure the continuation of the current trend of stability and eased inflation. The Committee will meet again in December 2024.

Rates in the Fixed Income market have been on a downward trend given the continued low demand for cash by the government and the occasional liquidity easing in the money market. The government is 127.5% ahead of its prorated net domestic borrowing target of Kshs 117.8 bn, having a net borrowing position of Kshs 268.0 bn. However, we expect a downward readjustment of the yield curve in the short and medium term, with the government looking to increase its external borrowing to maintain the fiscal surplus, hence alleviating pressure in the domestic market. As such, we expect the yield curve to

normalize in the medium to long-term and hence investors are expected to shift towards the long-term papers to lock in the high returns.

Equities

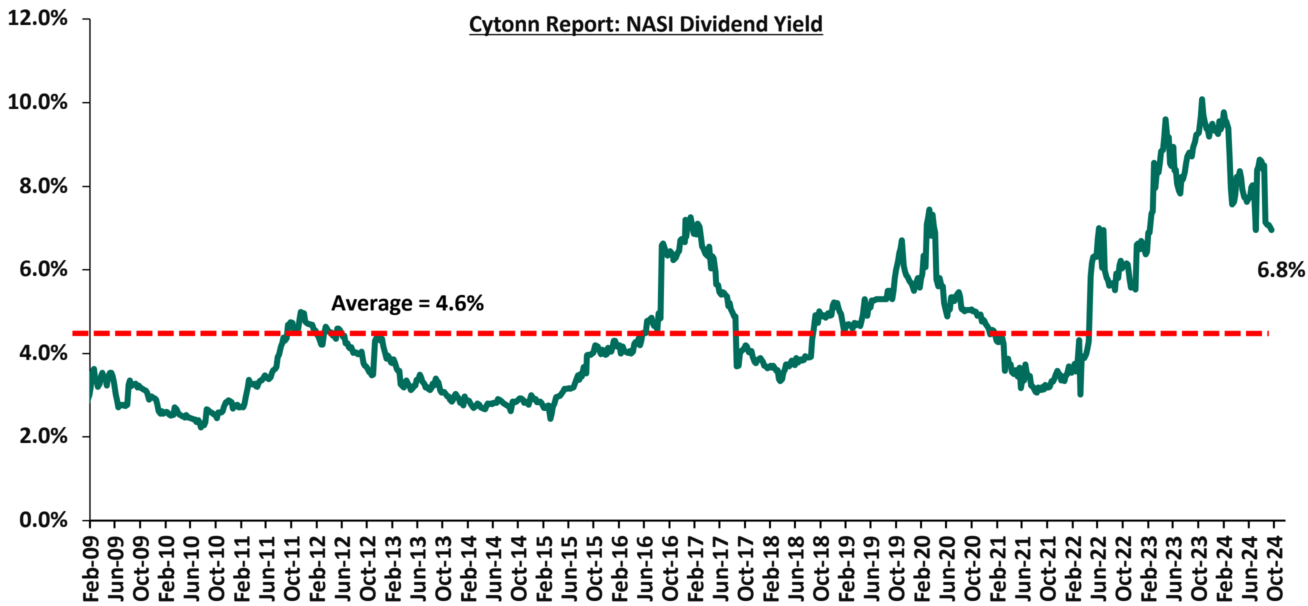
Market Performance:

During the week, the equities market was on an upward trajectory, with NSE 20 gaining the most by 1.9%, while NSE 10, NSE 25, and NASI gained by 1.8%, 1.8%, and 1.7% respectively, taking the YTD performance to gains of 28.3%, 25.7%, 19.7% and 19.7% for NSE 10, NSE 25, NASI and NSE 20 respectively. The equities market performance was mainly driven by gains recorded by Equity Group, KCB Group, and DTB-K of 6.3%, 4.1%, and 2.5% respectively. The gains were however weighed down by losses recorded by large-cap stocks such as EABL, COOP Bank, and NCBA of 2.4%, 0.7%, and 0.5% respectively

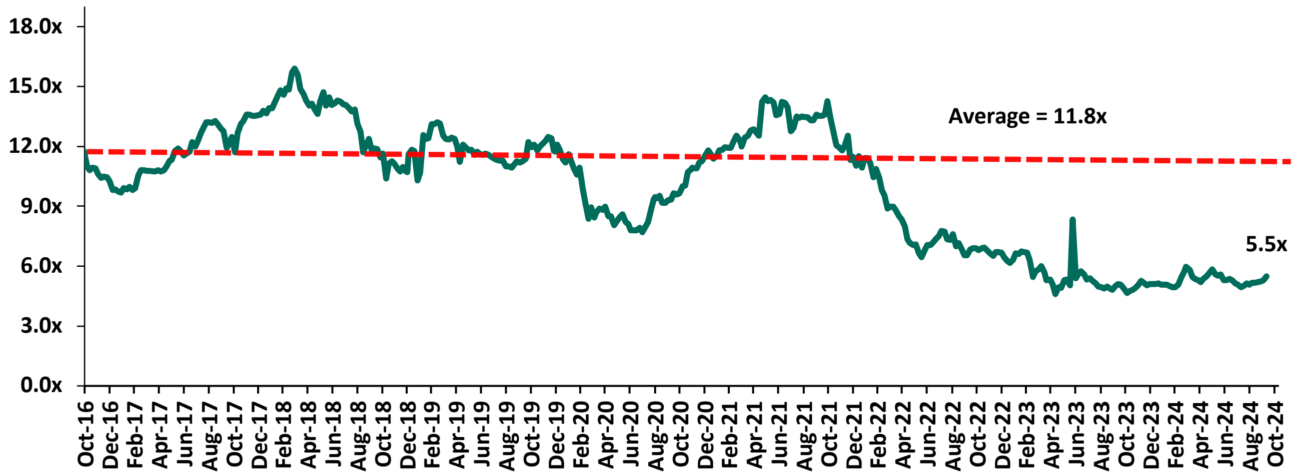
During the week, equities turnover declined by 11.4% to USD 6.9 mn from USD 7.8 mn recorded the previous week, taking the YTD turnover to USD 497.2 mn. Foreign investors became net sellers first time in five weeks, with a net selling position of USD 1.5 mn, from a net buying position of USD 1.0 mn recorded the previous week, taking the YTD net buying position to USD 1.7 mn.

The market is currently trading at a price-to-earnings ratio (P/E) of 5.5x, 53.4% below the historical average of 11.8x, and a dividend yield of 6.8%, 2.2% points above the historical average of 4.6%. Key to note, NASI's PEG ratio currently stands at 0.7x, an indication that the market is undervalued relative to its future growth. A PEG ratio greater than 1.0x indicates the market may be overvalued while a PEG ratio less than 1.0x indicates that the market is undervalued.

The charts below indicate the historical P/E and dividend yields of the market;



Cytonn Report: NASI P/E



Universe of Coverage:

Cytonn Report: Equities Universe of Coverage										
Company	Price as at 04/10/2024	Price as at 11/10/2024	w/w change	YTD Change	Year Open 2024	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Average
Jubilee Holdings	163.0	163.0	0.0%	(11.9%)	185.0	260.7	8.8%	68.7%	**0.3x**	Buy
Diamond Trust Bank	49.5	50.8	2.5%	13.4%	44.8	65.2	9.9%	38.3%	**0.2x**	Buy
CIC Group	2.1	2.1	2.4%	(7.4%)	2.3	2.8	6.1%	38.2%	**0.7x**	Buy
Co-op Bank	13.7	13.6	(0.7%)	19.8%	11.4	17.2	11.0%	37.5%	**0.6x**	Buy
NCBA	44.2	44.0	(0.5%)	13.1%	38.9	55.2	10.8%	36.4%	**0.8x**	Buy
Equity Group	44.5	47.3	6.3%	38.3%	34.2	60.2	8.5%	35.7%	**0.9x**	Buy
Stanbic Holdings	118.5	120.5	1.7%	13.7%	106.0	145.3	12.7%	33.3%	**0.8x**	Buy
ABSA Bank	14.2	14.2	0.4%	22.9%	11.6	17.3	10.9%	32.7%	**1.1x**	Buy
Britam	6.0	5.8	(4.0%)	12.5%	5.1	7.5	0.0%	29.8%	**0.8x**	Buy
KCB Group	35.2	36.7	4.1%	67.0%	22.0	46.7	0.0%	27.3%	**0.6x**	Buy
Standard Chartered Bank	211.3	215.3	1.9%	34.3%	160.3	235.2	13.5%	22.7%	**1.4x**	Buy
I&M Group	23.5	24.0	2.3%	37.5%	17.5	26.5	10.6%	21.0%	**0.5x**	Buy

*Target Price as per Cytonn Analyst estimates
**Upside/ (Downside) is adjusted for Dividend Yield
*** Dividend Yield is calculated using FY'2023 Dividends

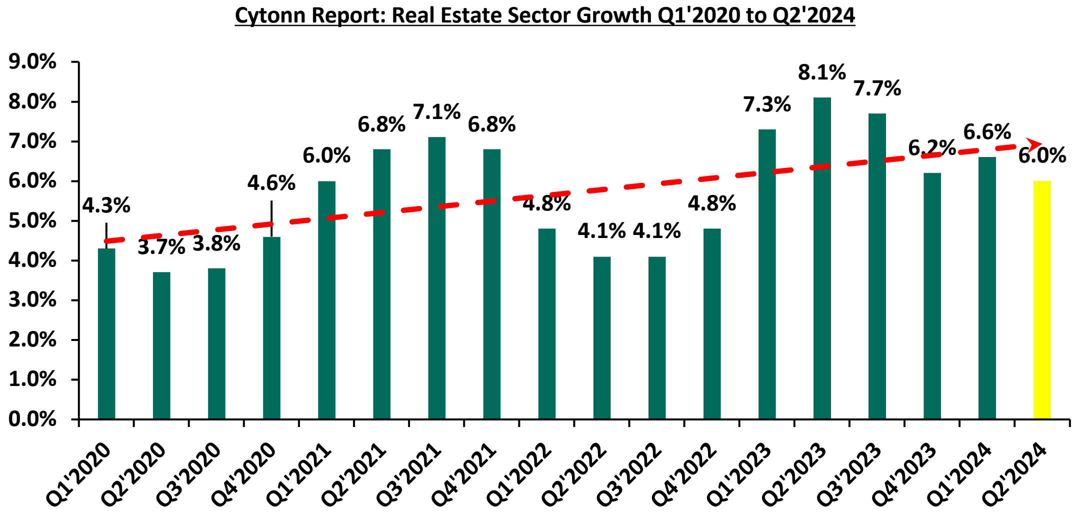
We are "Neutral" on the Equities markets in the short term due to the current tough operating environment and huge foreign investor outflows, and, "Bullish" in the long term due to current cheap valuations and expected global and local economic recovery. With the market currently being undervalued for its future growth (PEG Ratio at 0.7x), we believe that investors should reposition towards value stocks with strong earnings growth and that are trading at discounts to their intrinsic value. We expect the current foreign investors' sell-offs to continue weighing down the equities outlook in the short term.

Real Estate

I. Industry Report

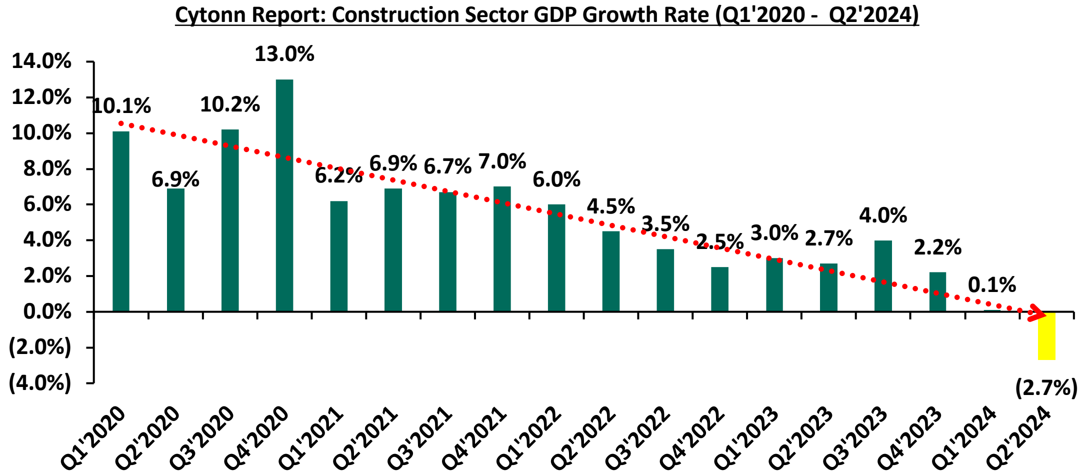
During the week, the Kenya National Bureau of Statistics (KNBS) released the Q2'2024 GDP Report, and below are the key take-outs related to the Real Estate sector:

i. **Steady growth in the Real Estate Sector** - The Real Estate sector posted steady growth of 6.0% in Q2'2024, which is 2.1% points slower than the 8.1% growth registered in Q2'2023. This growth can be attributed to the increasing need for housing in the country. However, the growth remained subdued compared to Q2'2023 due to the sustained increase in the cost of construction materials, which posed a hurdle to investors and reduced the number of activities in the sector during the period under review. Despite this, the value of approved building plans in the Nairobi Metropolitan Area (NMA), a major contributor to the Real Estate market in the country, increased y/y basis by 136.1% to Kshs 59.8 bn in Q2'2024, from Kshs 25.3 bn recorded in Q2'2023. On a quarter-on-quarter basis, this represented a 0.6 %-points decrease from the 6.6% growth recorded in Q1'2024. The overall decreased growth in the sector can be linked to tough macro-economic conditions including rising interest rates, which led to expensive borrowing, further dampening demand for mortgages and lending to developers, and Inflationary pressures, particularly in building materials and labour costs, increased project costs, reducing the profitability of new developments and slowing down ongoing projects. The graph below shows the Real Estate sector growth rates from Q1'2020 to Q2'2024.



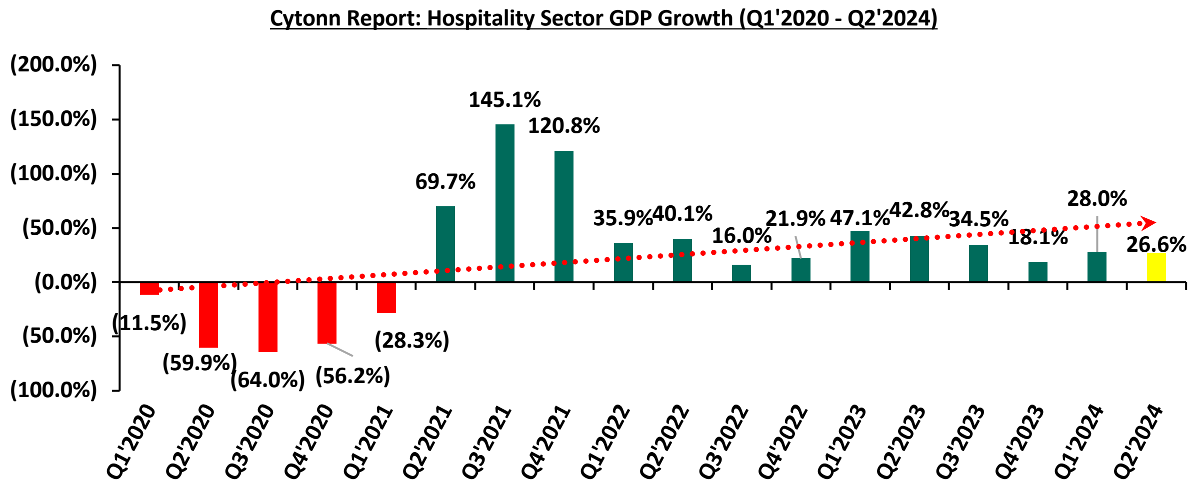
Source: Kenya National Bureau of Statistics (KNBS)

ii. **Subdued growth in the construction sector -** The construction sector contracted by 2.7% in Q2'2024, which is 5.4% points slower than the 2.7% growth in Q2 2023. On a quarter-on-quarter basis, this performance represented a 2.8%-point decrease from the 0.1% growth recorded in Q1'2024. The subdued performance is attributable to; i) The rise in non-performing loans (NPLs) within the Real Estate sector has prompted lenders to demand additional security, which has, in turn, slowed down development projects, ii) Construction costs have surged by 17.6%, driven by increased prices for key materials like cement, steel, and paint, with current costs averaging Kshs 83.71 per SQM, and, iii) Delays in obtaining construction permits have further hindered construction activities. The graph below illustrates construction sector growth rates from Q1 2020 to Q2 2024.



Source: Kenya National Bureau of Statistics (KNBS)

iii. **Sustained Recovery in Accommodation and Restaurant Sector –** The accommodation and restaurant services grew by 26.6% during Q2'2024, representing a 16.2%-points y/y decline from the 42.8% growth recorded in Q2'2023. On a q/q basis, this performance represented a 1.4%-point decrease from the 28.0% growth recorded in Q1'2024. The decline in performance can be attributed to rising operational costs driven by tough macroeconomic challenges, particularly those stemming from disruptions in the global supply chain due to the Russia-Ukraine war and the Israel-Palestine conflict. These conflicts have significantly impacted material availability and escalated costs, straining the sector. Nevertheless, the performance reflects a gradual recovery from the effects of COVID-19, with the lifting of travel restrictions playing a key role in boosting activity across the real estate market. Also, the heavy rainfall that caused nationwide flooding during the quarter contributed to the decline since transport was affected. The sector is however expected to gain from an increased number of international arrivals; for instance, in June 2024, the number of arrivals was 149,922, representing a 13.3% increase compared to 132,297 arrivals in June 2023. The graph below shows the accommodation and restaurant sector growth rates from Q1'2020 to Q2'2024;



Source: Kenya National Bureau of Statistics (KNBS)

We expect the Real Estate sector in Kenya to grow, supported by several factors such as: i) an increase in the number of international arrivals by 16.9% to 370,923 in Q2'2024 from 317,196 in Q2'2023 ii) relatively high urbanization and population growth rates of 3.7% p.a and 2.0% p.a, respectively, against the global average of 1.7% p.a and 0.9% p.a, respectively as at 2023, showing that there is a sustained demand for more housing units in the country, and Real Estate in general, iii) the continued rollout of the Affordable Housing Programme by the government, and iv) increased activities by industry players, especially in the residential sector. However, we expect the sector's growth to be impeded by the current political environment in the country, the increased cost of construction, and the increased cost of borrowing for Real Estate projects.

II. Real Estate Investments Trusts (REITs)

REIT Weekly Performance

On the Unquoted Securities Platform, Acorn D-REIT and I-REIT traded at Kshs 25.4 and Kshs 22.2 per unit, respectively, as per the last updated data on 11th October 2024. The performance represented a 27.0% and 11.0% gain for the D-REIT and I-REIT, respectively, from the Kshs 20.0 inception price. The volumes traded for the D-REIT and I-REIT came in at Kshs 12.3 mn and Kshs 31.6 mn shares, respectively, with a turnover of Kshs 311.5 mn and Kshs 702.7 mn, respectively, since inception in February 2021. Additionally, ILAM Fahari I-REIT traded at Kshs 11.0 per share as of 27th October, 2024, representing a 45.0% loss from the Kshs 20.0 inception price. The volume traded to date came in at 138,600 for the I-REIT, with a turnover of Kshs 1.5 mn since inception in November 2015.

REITs offer various benefits, such as tax exemptions, diversified portfolios, and stable long-term profits. However, the ongoing decline in the performance of Kenyan REITs and the restructuring of their business portfolios are hindering significant previous investments. Additional general challenges include: i) insufficient understanding of the investment instrument among investors leading to a slower uptake of REIT products, ii) lengthy approval processes for REIT creation, iii) high minimum capital requirements of Kshs 100.0 mn for REIT Trustees compared to Kshs 10.0 mn for pension fund Trustees, (iv) limiting the type of entity that can form a REIT to only a trust company, and v) minimum subscription amounts or offer parcels set at Kshs 0.1 mn for D-REITs and 5.0 mn for restricted I-REITs. The significant capital requirements still make REITs relatively inaccessible to smaller retail investors compared to other investment vehicles like unit trusts or government bonds, all of which continue to limit the performance of Kenyan REITs

We expect Kenya's Real Estate sector to remain on a growth trend, supported by: i) an increase in the number of international arrivals in the hospitality sector, ii) the initiation and completion of major infrastructure projects, opening up areas for development, iii) demand for housing sustained by positive demographics, such as urbanization and population growth rates of 3.7% p.a and 2.0% p.a, respectively, against the global average of 1.7% p.a and 0.9% p.a, respectively, as at 2023, iv) activities by the government under the Affordable Housing Agenda (AHP), v) heightened activities by private players in the residential sector, vi) demand for quality offices, especially in the Nairobi Metropolitan Area, and, vii) increased investment by local and international investors in the retail sector. However, challenges such as rising construction costs, strain on infrastructure development (including drainage systems), high capital requirements for REITs, and existing oversupply in select Real Estate sectors will continue to hinder the sector's optimal performance by limiting developments and investments.

Focus of the Week: Social Health Insurance Fund (SHIF) review

For 58 years, the Kenyan government has offered health insurance to its citizens through The National Health Insurance Fund (NHIF). The fund was established in 1966 through an act of parliament, with a core mandate of providing affordable medical insurance coverage to all Kenyans. However, years later, the state of public healthcare in the country remained below par, with inefficiencies that have led to repeated civil actions, inequality in health care provision, sub-par infrastructure, and a host of other challenges. In 2017, the Kenyan government made a strong commitment to achieve universal health coverage (UHC) as one of the Big 4 Agenda by the year 2022 and started designing and implementing priority reforms to accelerate progress. This was then picked up by the Bottom Up Economic Transformation Agenda, which also set out universal health care as one of its plans. These reforms included the following:

i. Increasing the share of (mandatory) pooled resources through a health insurance-based mechanism built on the existing National Health Insurance Fund (NHIF);
ii. Enhancing the capacity of the NHIF to function as a strategic purchaser of health services; expanding coverage of health services equitably through an emphasis on primary healthcare (PHC); and,
iii. Improving public financial management (PFM) arrangements to enhance the effectiveness of public funds in the devolved health sector.

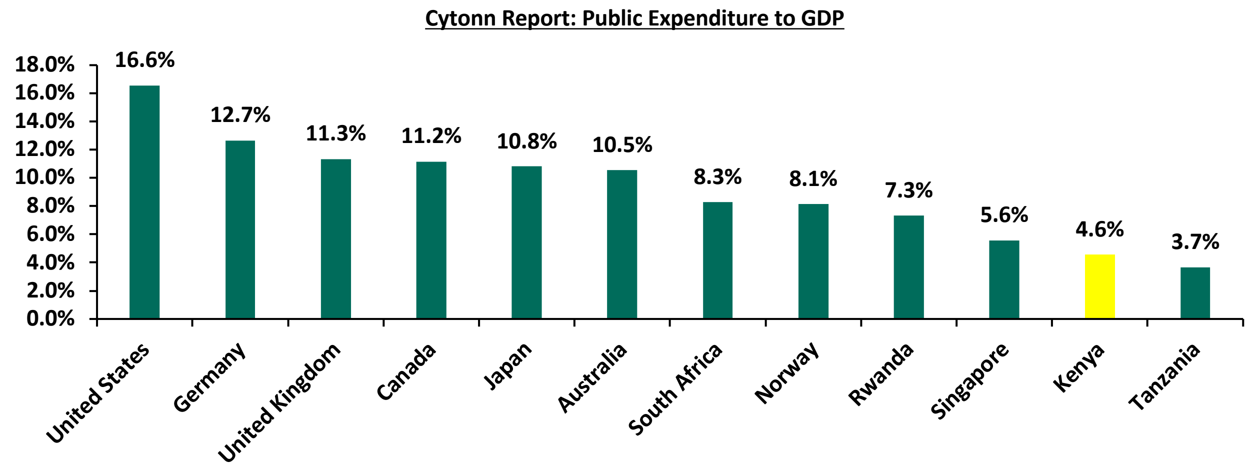
In line with these goals, on 1 May 2023, President William Ruto announced that there would be changes to the National Health Insurance Fund (NHIF), and in the same year, the Social Health Insurance Fund was established under the Social Health Insurance Act of 2023. The newly established fund has been scheduled to kick in as of October 1st 2024, after facing off a series of court battles in court, with the latest Court of Appeal ruling giving the fund a temporary nod. Given the public concern with this new model, we saw it fit to review the Social Health Insurance Fund (SHIF) and shed light on its current state in terms of the milestones achieved and the challenges faced while looking at the expectations from the public. We shall also make a comparison with similar initiatives in other countries and private offers in Kenya, give our recommendations towards achieving a sustainable Fund. We shall undertake this by looking into the following;

i. The State of Public Healthcare in Kenya,
ii. The Social Health Insurance Fund (SHIF),
iii. The Legal Status of the Social Health Insurance Fund (SHIF),
iv. The Status of Implementation of the fund,
v. Case Studies and Recommendations, and,
vi. Conclusion,

Section I: The State of Public Healthcare in Kenya

Through Vision 2030, the government set out to work towards universal health coverage for its citizens. Universal Health Coverage/Care (UHC) is defined by the World Health Organization (WHO) as 'the ability for persons to receive the health services they need without suffering financial hardship. Over the past decade, Kenya has made major improvements in access and utilization of quality care and, as a result, on health outcomes. The cooperation between various county governments and the national government has led to an increased number of hospitals and upgrading of a number of hospitals. However, challenges still remain and the goal of a properly functioning system is still achievable but requires more work.

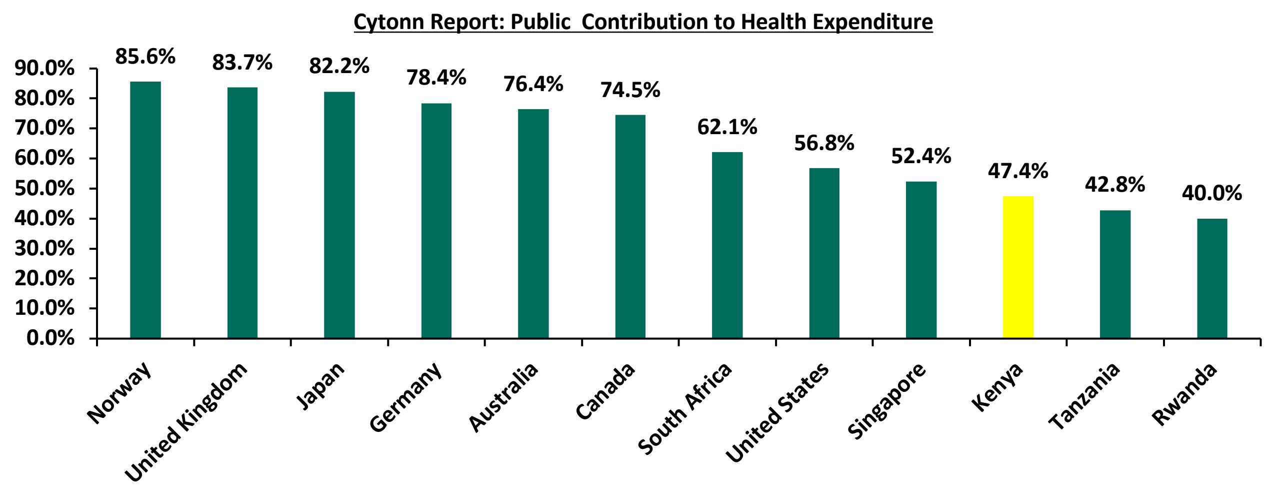
Despite the growth over the period, Kenya's public health expenditure to GDP remains below some of its peers. This metric indicates how much the government invests in its healthcare programs relative to the size of its economy. The graph below shows this ratio, as compared to other select countries:



Source: World Bank

Kenya's Public Health expenditure to GDP stands at a meagre 4.6%, the second lowest among select countries. Compared to countries with known working healthcare systems like Germany, Canada and Australia, there is still much that needs to be done. Achieving Universal Health Care will require a well-funded public health system that can provide equitable access to care for all citizens. With the higher unemployment and poverty rates in Kenya, which stand at 12.7% and 38.6% respectively as compared to these other countries, achieving this equality will require much more investment into healthcare than is currently being made.

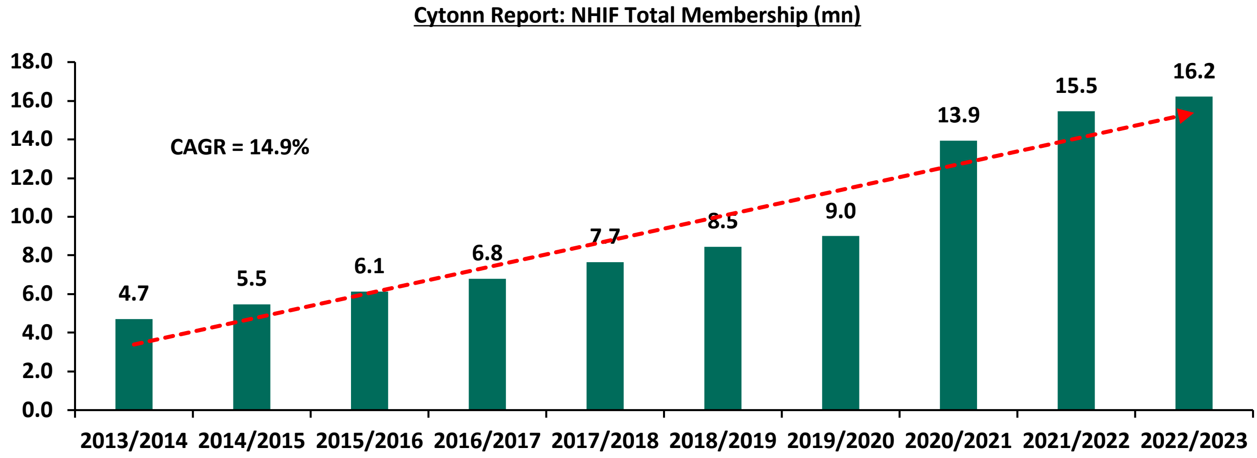
A comparison of how much of health spending in the country is covered by the government also reveals some deficiencies in Kenya's healthcare system. Unlike some of the countries with working systems like Norway, Germany, and Australia, more than half of Kenya's health expenditure is done through private insurance and out-of-pocket payments by individuals in the country. With a lower public contribution, the private health sector often has to fill in the gap, leading to higher costs and potentially overburdening private facilities.



Source: World Bank

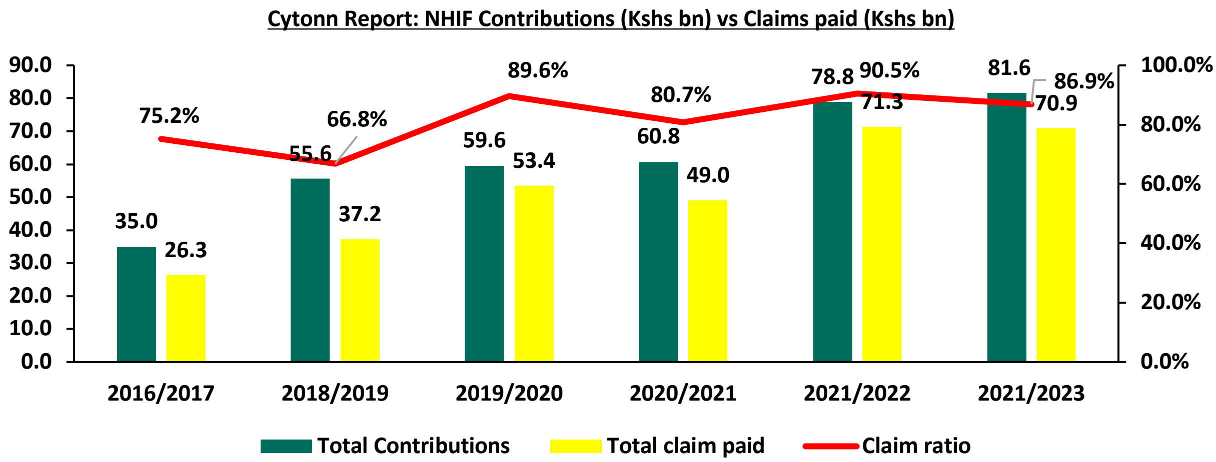
In addition, Health insurance coverage in Kenya has generally been low at 26.0% according to treasury documents, with those at the bottom of the economic pyramid having the least coverage of less than 5.0%. As earlier noted, many Kenyans incur catastrophic expenditures from out-of-pocket healthcare payments, while many more do not seek care when they fall ill, because they simply cannot afford it.

The government has offered medical insurance services to Kenyans primarily through the National Hospital Insurance Fund. As of 2023, the fund had a membership of 16.2 mn, a significant compounded annual growth rate (CAGR) of 14.9% from the 4.1 mn in 2013, as illustrated in the table below:



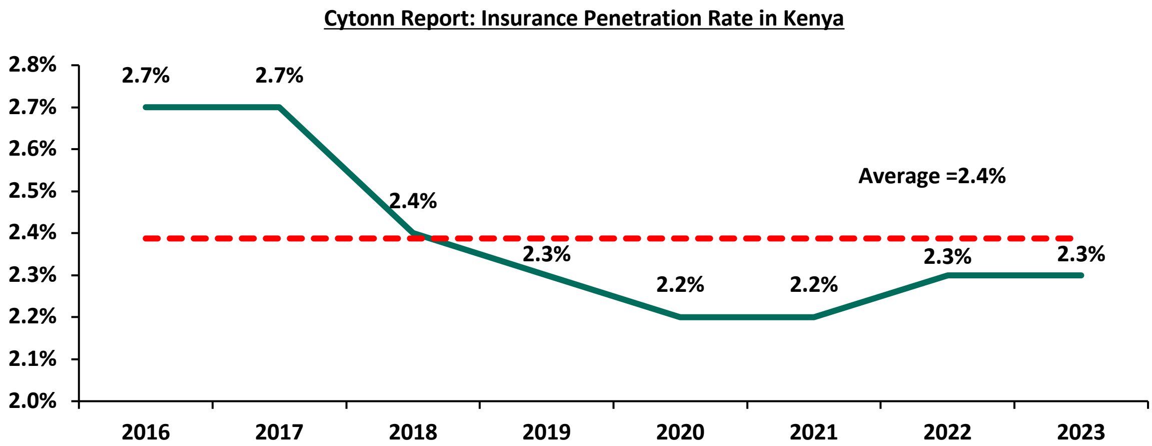
The fund, however, faced a number of challenges and had gaps in its operations. Some of the notable challenges included:

i. **High payout ratio** - Despite the fact that NHIF premium contributions have been increasing over the years, with total contributions to the Fund growing at a 5-year CAGR of 8.0% to Kshs 81.6 bn in FY'2022/2023 from Kshs 35.0 bn in FY'2018/2019, the growth in total payout from the fund has outpaced the growth in total contribution received, having grown by a 5-year CAGR of 13.8% to Kshs 70.9 bn in FY'2022/2023, from Kshs 37.2 bn in FY'2017/2018. This has led the claim ratio for FY'2022/2023 to increase by 20.0% points to 86.9% from the 66.8% claim ratio recorded in FY'2017/2018. As such, the high pay-out ratio reduced the fund's net operating surplus, increasing the Fund's solvency risk and the possibility of its inability to meet future financial obligations. Below is the graph of the growth of the claim ratio for the last 5 years:



Source: NHIF Financial Statements

ii. **Low Insurance Penetration –** Insurance uptake in Kenya continues to remain low compared to other key economies, with insurance penetration at 2.3% as of FY'2023, according to the Q4'2023 Insurance Regulatory Authority (IRA) and the Kenya National Bureau of Statistics (KNBS) 2023 Economic Survey. The low penetration rate, which is below the global average of 7.0%, according to the Swiss RE institute, is attributable to the fact that insurance uptake is still seen as a luxury and is mostly taken when it is necessary or a regulatory requirement. Notably, Insurance penetration remained unchanged at 2.3% in 2023, similar to what was recorded in 2022 and 2021. The chart below shows Kenya's insurance penetration for the last 8 years:



Source: CBK Financial Stability Reports

These challenges with the fund, together with the still underdeveloped healthcare provision in the country, made a good case for the introduction of the new fund; the Social Health Insurance Fund.

Section II: The Social Health Insurance Fund (SHIF)

One of the biggest challenges about the National Health Insurance Fund that had served the country for 58 years, was that it was designed to cover only citizens with a regular income, with non-employed citizens only having to make voluntary contributions. As a result, those at the bottom of the pyramid only had a 5.0% insurance penetration rate, and a majority of them were excluded from accessing healthcare insurance. Through his Bottom Up Economic Transformation Agenda, President Ruto set out to sort this issue out through:

i) providing a fully publicly financed primary health care system, an emergency care fund and a health insurance fund that will cover all Kenyans,
ii) installing digital health management information system,
iii) setting up a Fund for improving health facilities
iv) setting up an Emergency Medical Treatment Fund,
v) establishing a National Insurance Fund that covers all Kenyans, and,
vi) availing medical staff who would deliver Universal Health Coverage.

In line with this, the president assented to The Social Health Insurance Act on 19th October 2023 and the Act came into force on 22nd November 2023. The Act operationalized the Social Health Insurance Fund (SHIF), the Primary Health Fund (PHF), and the Emergency, Chronic, and Critical Illness Fund (ECCIF). The Social Health Insurance Fund would replace the existing NHIF, on the appointed day of 1st October 2024, and the NHIF would wind up within one year after this date, and transfer all its cash balances and all other assets held to the Social Health Authority (SHA).

The Social Health Authority (SHA) is the governance body that was mandated by this Act to take over all the functions and operations of the Board of National Health Insurance Fund (NHIF). The Authority consists of 11 members, including a non-executive chairperson appointed by the president, currently Dr. Timothy Olweny, and other members who include:

i. the Principal Secretary of Health or a representative,
ii. the Principal Secretary of Finance or a representative,
iii. the Director–General for Health,
iv. a representative of the County Executive Committee Health Caucus,
v. a nominee of the council of County Governors, not being a Governor, with knowledge in the field of finance, accounting, health economics, law or business and management,
vi. a person, not being a public officer, with proven experience in matters of health insurance, health financing, financial management, health economics, and healthcare administration,
vii. four persons, not being public officers, nominated by:

a) the Kenya Medical Association,
b) the informal sector association,
c) the consortium of health providers, and,
d) the Central Organization of Trade Union-Kenya.

viii. the Chief Executive Officer of the Authority, who is an ex-officio member of the Board.

The law mandated that SHIF would be funded by contributions from every Kenyan household, non-Kenyan residents who have lived in the country for more than twelve months, employers, national and county governments, monies appropriated by the National Assembly, gifts, grants, donations and any other innovative financing mechanisms. These contributions would be made as follows:

i. Members who draw their income from salaried employment shall make contributions every month as a statutory deduction from wages or salary by the employer. The regulations proposed a rate of 2.75%, but with a floor of Kshs 300,
ii. Households without a salaried Income would make an annual contribution of 2.75% of their income as determined by a means testing system that would be developed, and this shall also not be less that Kshs 300, payable fourteen days before the lapse of the annual contribution,
iii. Households/Members that require financial assistance as determined by the set-up means testing instrument would have their contributions paid by government at a rate apportioned from the funds appropriated by Parliament and County Assemblies as prescribed, and,
iv. People under custody would have their contributions paid by the government at a rate apportioned from the funds appropriated by Parliament.

The table below shows a comparison of the previous NHIF contributions and the current SHIF contributions for different monthly income bands;

Cytonn Report: Estimated contributions from initial NHIF contribution bands		
Income Band	**NHIF Contributions**	**SHIF contributions**
Unemployed	Voluntary Kshs 500 contribution	2.75% of annual income as determined by the means testing system
0 - 5,999	150.0	300.0
6,000 - 7,999	300.0	300.0
8,000 - 11,999	400.0	330.0
12,000 - 14,999	500.0	330.0 - 413.0
15,000 - 19,999	600.0	413.0 - 550.0
20,000 - 24,999	750.0	550.0 - 688.0
25,000 - 29,999	850.0	688.0 - 825.0
30,000 - 34,999	900.0	825.0 - 963.0
35,000 - 39,999	950.0	963.0 - 1,100.0
40,000 - 44,999	1000.0	1,100.0 - 1,238.0
45,000 - 49,999	1,100.0	1,238.0 - 1,375.0
50,000 - 59,999	1,200.0	1,375.0 - 1,650.0
60,000 - 69,999	1,300.0	1,650.0 - 1,925.0
70,000 - 79,999	1,400.0	1,925.0 - 2,200.0
80,000 - 89,999	1,500.0	2,200.0 - 2,475.0
90,000 - 99,999	1,600.0	2,475.0 - 2,750.0
100,000	1,700.0	2,750.0
200,000	1,700.0	5,500.0
500,000	1,700.0	13,750.0
1,000,000	1,700.0	27,500.0

While NHIF used flat rates for different bands of income, SHIF will apply a 2.75% of the income with no maximum limit, and therefore the figures indicated on the SHIF column are the average contributions for the different income bands in the previous system.

The means testing system alluded to in the contribution methods would consider a number of parameters, including, housing characteristics, access to basic services, household composition and characteristics, and any other socio-economic aspects that may be relevant.

According to the Ministry of Health, this new system is projected to raise Kshs 133.0 bn annually, a significant increase from the Kshs 78.8 bn that was collected by NHIF in FY'2023/2024. The government's aim is to use this increase to enhance coverage for the new fund. Coverage under the new SHIF is outlined in the Social Health Insurance Act.

Some key highlights from the coverage terms include:

i. Outpatient Care services including consultation, lab tests, prescription processing, counselling, et cetera, are covered for all registered persons under the Primary Healthcare Fund (PCF) at a tariff of Kshs 900 per person per annum. For SHIF, outpatient cover extends to Essential diagnostic laboratory investigations for Diabetes, Cardiovascular diseases, Sickle-cell & Chronic Obstructive Pulmonary Disease (COPD)/Asthma at a tariff of Kshs 4,300, Kshs 2,850, Kshs 6,800 and Kshs 700 respectively, with a limit of once per year per person,
ii. Screening for common health conditions targeted screening for cancers and management of precancerous lesions will only be covered under the Primary Healthcare Fund (PCF), with different rates for different conditions to a maximum tariff of Kshs 3,600 per person,
iii. The Primary Healthcare Fund will also cover optical health services, including eye health education and counselling, eye tests, and treatment of refractive errors through eye glasses at a tariff of Kshs 950 per person, and a limit of Kshs 1,000.0 per household per annum. The fund will also cover end-of-life services including embalming at a tariff of Kshs 3,000.0 and storage at Kshs 500.0 per day for a maximum of five days,
iv. The Primary Healthcare Fund shall also cover inpatient services including hospital accommodation charges, intra-admission consultation, bedside consultations et cetera, at level 3 hospitals at a tariff of Kshs 2,240.0 with a limit of 180 days per household per annum. SHIF would then cover these services at level 4 to 6 hospitals, at a rate of Kshs 3,360.0, Kshs 3,920, Kshs 4,480 for level four, five, and six hospitals respectively up to a limit of 180 days per household per annum,
v. The Social Health Insurance Fund will cover maternal, neonatal, and child health services at tariff rates of Kshs 10,000.0, Kshs 30,000.0, and Kshs 6,000.0 for normal deliveries, cesarean deliveries and anti-D serum respectively,
vi. The fund (SHIF) will also cover renal care services package to a limit of a specified number of sessions for different complications/conditions as outlined in the Act, tariffs for this will go to a maximum of Kshs 700,000 for recipient surgeries in transplants,
vii. For mental wellness benefits, SHIF will cover counselling, screening, monitoring, rehabilitation and other forms of treatment, including expenses for drug and substance abuse for up to Kshs 4,480 per person in Level 6 hospitals and rehabilitation costs of up to Kshs 67,200.0,
viii. The Social Health Insurance Fund will also cover medical and surgical procedures not locally available to a maximum of Kshs 500,000.0 per person per annum at overseas empaneled and contracted healthcare providers,
ix. For surgical services, SHIF will cover 3 minor procedures per household per year, 2=two major procedures per household per year, and 1 specialized procedure per household per year, and,
x. Oral services, including oral health education, tooth extractions, suturing, and wound cleaning, shall be offered by the Social Healthcare Insurance fund with different tariffs for different conditions, but with a limit of Kshs 2,000 per household per annum, and shall only be rolled out subject to availability of resources.

These are just some highlights from the Act, which further elaborates on various aspects such as procedures, coverage tariffs, limits, approval processes, and eligibility criteria. The detailed provisions aim to ensure comprehensive healthcare access and financial protection under SHIF.

Section III: Legal Status of the Social Health Insurance Fund

Kenya's democracy is marked by a robust and dynamic legal culture where citizens, civil society, and even government entities regularly challenge laws and regulations in court. This litigious nature is not a sign of dysfunction but rather a testament to Kenya's constitutional democracy, where judicial oversight plays a crucial role in maintaining checks and balances. Nearly every significant law, from electoral regulations to tax policies and health reforms, undergoes judicial scrutiny, emphasizing the courts' role as a protector of constitutional rights. The Social Health Insurance Act was no exception.

In a constitutional petition filed by Joseph Enock Aura, on 19th July 2024, the High Court declared some provisions of the Social Health Insurance Act (SHIA), the Digital Health Act (DHA), and the Primary Health Care Act (PHCA) unconstitutional primarily because of infringement to the right to emergency treatment, but suspended the effect of its judgment for 120 days to allow for amendments to the unconstitutional provisions and public participation. A three-judge bench found that Sections 26 (5) and 27 (4) of the Act were unconstitutional to the extent that they violated the right not to be denied emergency medical treatment as guaranteed by the Constitution. Further, the Court found that the Acts were enacted without sufficient public participation. In the judgment, the court directed that Parliament amend the unconstitutional provisions and undertake sensitization, adequate, reasonable, sufficient, and inclusive public participation. Section 26 (5) had made registration and contribution as a precondition for accessing public services from national and county government hospitals while section 27(4) provided that one could only access healthcare when their contributions were up-to-date and active.

The Cabinet Secretary for Health later filed an appeal against the judgment of the High Court and simultaneously sought a stay of the High Court judgment pending the determination of the appeal resulting in the Court of Appeal’s pronouncement on 20th September 2024, which stayed the High Court’s judgment pending the hearing and determination of the substantive appeal.

As it stands, the three Acts remain fully operational even as we await the final verdict on their constitutionality. On 23rd September 2024, the Ministry of Health issued a public notice to all employers, reminding them to register all their employees ahead of the transition date, which was set for 1st October 2024.

Section IV. Implementation of the Social Health Insurance Fund (SHIF) in Kenya

SHIF officially commenced operations on 1st October 2024, as per a government directive. The Ministry of Health is in the final stages of transitioning from NHIF to SHIF, with new operational structures set up under the Social Health Authority (SHA), which will oversee SHIF's management and ensure compliance with the new law. Employers were mandated to register their employees and dependents with SHA, ensuring a smooth handover from NHIF, which had a deadline of 30th September 2024, while unregistered members from NHIF were transferred to the new fund. Key operational guidelines have been issued, with payments made before 9th October 2024 credited to NHIF and those made thereafter allocated to SHIF. Starting with the October 2024 payroll, employers are required to deduct 2.75% from employees’ gross salaries, subject to a minimum of Kshs 300.0 per month, and remit these to the Social Health Authority (SHA).

Ahead of the 1st October 2024 rollout, only about 2.0 mn Kenyans had registered with SHA as of 29th September 2024. According to the Ministry of Health of Kenya, as of 10th October 2024, over 12.7 mn Kenyans have registered under SHA, with 1,442 healthcare providers contracted to deliver services to registered members. This number of registrations includes verified members who were under the defunct NHIF and who have been transitioned to the Social Health Authority as per Legal Notice No. 147 of 2024.

This widespread registration has greatly expanded healthcare coverage, ensuring that a significant portion of the population continues to receive essential medical services under SHIF, making healthcare more affordable for low-income households by adjusting contributions based on income, and subsidies are provided to those who cannot afford the premiums. With over 1,400 contracted healthcare providers, SHIF has expanded the healthcare network, improving access.

Despite the progress, SHIF faces a number of challenges:

i. **System and operational failures:** The rollout of Kenya's Social Health Insurance Fund (SHIF) has faced significant challenges, particularly with its transition from the National Health Insurance Fund (NHIF). One of the primary shortcomings has been technical failures in SHIF's claims processing system, including widespread issues with the biometric system. These glitches have left many patients unable to access healthcare services, as their NHIF cards were deactivated before SHIF's system was fully functional,

ii. **Expensively Procured Technology System:** The government procured an integrated healthcare information Technology system from a Safaricom-led consortium at a staggering cost of Kshs 104.0 bn, a number that has been in public discourse as overly priced. Despite the cost, the system is yet to be fully operationalized and has seen hospitals go back to the old NHIF system. With the NHIF system already one of the few aspects of the fund that was functional, this further emphasizes the public's concern about the wastage of resources,

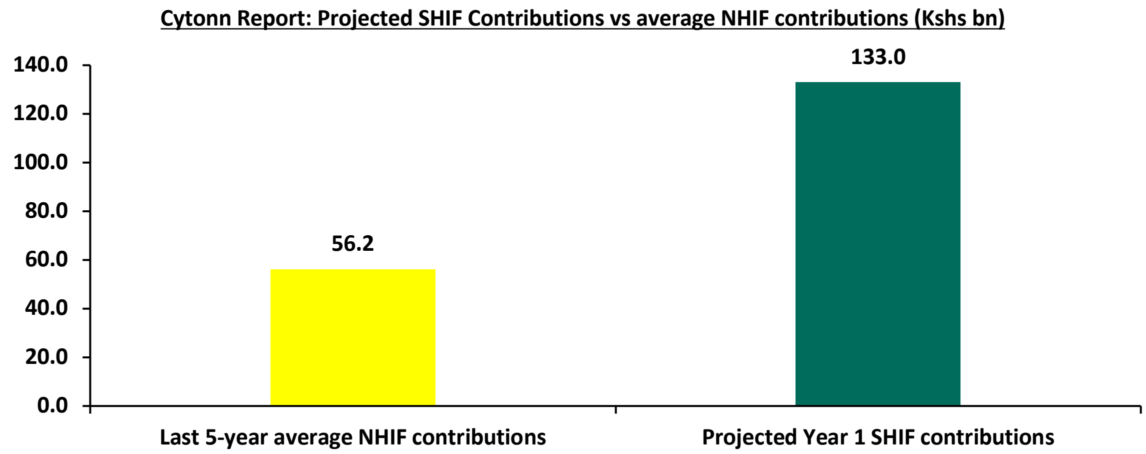
iii. **Healthcare Provider Pushback:** In addition to technical difficulties, there is a lack of clarity surrounding SHIF's contractual arrangements with healthcare providers. Many hospitals have expressed concerns over who will reimburse them for services rendered, as formal agreements between SHIF and facilities are yet to be solidified. This uncertainty has contributed to financial strain on patients, some of whom are being asked to pay out-of-pocket for services that should have been covered by the insurance,

iv. **Capitation Model:** While the ministry and stakeholders rush to complete the transition from NHIF to SHIF, the model for capitation for the new fund is yet to be fully operationalized. According to the Rural and Urban Hospitals Association of Kenya, the technical working group has only achieved three out of the ten set tasks, that is setting up, creating a draft proposal, and first meeting. Crucial items such as identification of hospitals, patient redistribution, and fund disbursements are still pending,

v. **The Means-Testing System:** Just like the university model system, this means-testing system introduced through this model has so many deficiencies, with the major one being the complexity and almost impossibility of accurately assessing the financial states of households and individuals in the majority of the informal economy. There is a definite risk of exclusion errors, where vulnerable individuals may be denied access due to misclassification or lack of documentation. This means testing fails to capture real needs, as income alone doesn't account for factors like family size or chronic illness, and it risks creating regional disparities due to varying costs of living across Kenya,

vi. **Delayed Training:** Medical administrators, patients, and required stakeholders have not been taken through one session of training regarding the operations of the new systems. This has paralyzed some operations such as preauthorization and claim submissions for surgical patients. The government says it is still monitoring the new system in order to completely understand it before going out to train in various hospitals,

vii. **Unnecessary Limits to Benefits Covered**: SHIF introduced a payroll deduction of 2.75% from employees' gross salaries, subject to a minimum of Kshs 300.0 per month, which is higher than the previous NHIF contributions and even more so for the higher income earners who were previously offered a flat rate for high-income earners, but now have no maximum limit. Additionally, the Ministry of Health projects collections of up to Kshs 133.0 bn for the first year of SHIF operation, which is more than double the average collections that NHIF has recorded in the last five years. However, the benefits provided, in almost all sections are subject to limits such as specific household amounts or specific hours/days annually. For chronic illnesses, specifically, these kinds of limits are not sensible and serve no purpose for insurance coverage. Limiting inpatient services, for instance, to just 180 days annually for a household, may not work for cancer or even diabetes patients. The chart below shows the comparison between NHIF contributions for the last five years and the projected annual Social Health Insurance Fund (SHIF) contribution for year one;



viii. **Public Confusion and Resistance:** The transition from the National Hospital Insurance Fund (NHIF) to SHIF has been poorly communicated, leaving many Kenyans unsure about how the new system works or how it benefits them. Many have expressed frustration with the lack of clarity on coverage and contributions, with some citizens even refusing to migrate to the new system, and,

ix. **Public Trust and Transparency:** Past governance issues in NHIF have led to a trust deficit, with concerns over the management of funds and possible corruption. SHIF must demonstrate greater accountability to win back public trust and confidence.

Section V: Case Studies and Recommendations

National and Social Health Insurance Funds are government-sponsored insurance covers aimed at ensuring its citizens get affordable medical coverage irrespective of their socioeconomic status. This enables the citizens to access health care services without having to dig into their pockets to pay medical expenses. In most cases they are mandatory and a portion of the employee's salary is deducted and remitted to these funds. National Health Insurance Funds have been created in several countries, and often vary in terms of structure and systems of operations. In this topical, we shall focus on the United Kingdom National Health Service and Japan National Health Insurance System. Additionally, we shall discuss key takeouts from the Case Studies;

Cytonn Report: Summary of Health Insurance Funds in Various Countries	
Institution	**Key-Take-outs/Features**
Japan National Health Insurance System (NHIS)	• Japan's National Health Insurance System (NHIS) was established in 1961 to provide medical coverage to all residing in Japan, which has enabled Japan to achieve Universal Health Coverage. Enrolment in public health insurance is compulsory for all residents in the country, regardless of one's citizenship. Residents in Japan have the freedom to choose their preferred hospitals and the frequency of the treatment, through a system known as the "Free Access System". However, there are guidelines that have to be followed such as having a referral letter when seeking outpatient services for large hospitals and one has to be willing to Co-insure (Meaning one pays a particular percentage of the fee and the insurance cover settles the remainder) the medical expenses • The public health insurance plans are designated as either employment-based plans or residence-based plans. In employment-based plans, the premium rate is set at 10.0% of the employee's salary and the premium cost is shared between the employee and employer on a 50/50 basis. For residence-based plans, the national and local governments fund a portion of the individual mandatory contributions and cover the self-employed and unemployed residents. All the public health insurance plans have the same benefit package which is determined by the national government and includes: hospital visits, physical therapy, prescription drugs, and home care services, among others • The coinsurance rates remain the same for all the health insurance plans and vary depending on the age and income of the residents. The coinsurance is set at 20.0% for children below the age of 6 years and 30.0% for individuals under the age of 70 years. For those aged between 70 years and 74 years, the rate is set at 20.0%. Residents aged above 75 years have a rate of 10.0% if their income is lower than the average workforce income and 30.0% if their income is higher than the average workforce income • Additionally, the NHIS has a subsidy program called "High-Cost Medical Expense Benefit System" aimed at shielding the residents from the burden of medical expenses in the instance they surpass their monthly limits. The system sets the maximum threshold an individual can pay out of pocket depending on the age and income of the residents • The government plays a critical role in the regulation and operations of the NHIS. The government is responsible for preparing the fee schedule which entails the fees for all the services offered by the health facilities and enforces strict adherence to the regulations by the health service providers. This is achieved by restricting the health service providers from charging fees that are above the national fee schedule, except for specific instances such as experimental treatment, after hours' service, and hospitalization of 180 days or more • The premium per individual is based on the previous year's income. In case the previous year's income is below the minimum threshold, then the premiums to be paid are reduced
United Kingdom National Health Service (NHS)	• The National Health Service, was established in 1948 through the National Health Service Act and housed in England, Scotland, Wales, and North Ireland. NHS covers both citizens and non-citizens residing in the United Kingdom • This system is different from national health insurance funds in other countries, as it is primarily funded by the government via taxation and free at the point of use. The UK government through its budget allocates funds to the Department of Health and Social Care (DHSC) which funds NHS. According to the Office of the National Statistics, UK total health expenditure stood at £283 bn (Kshs 43.4 tn) in 2022, with government spending £230 bn (Kshs 35.3 tn) and this represented 81.5% of the total health care spending • NHS sources of funding are general taxation through the local and central government, national insurance tax (which is an additional tax charged on the residence), and patient charges. The level of funding is usually depicted by the central government projections. In the event the revenue from national insurance tax and the patient charges are determined not to be sufficient through the Spending review process, funds from general taxation are used to ensure the NHS receives the level of funding it was originally allocated • Each county in the UK has a different structure for the NHS which are dependent on the need-based funding formula. The local health boards of the individual countries are responsible for the funding and provision of the NHS services • However, NHS has diversified its revenue income through treating patients privately, prescription charging, and charges on NHS dental charges. Additionally, the individual NHS are generating income from non-core activities such as investing in real estate where they are able to earn extra income from parking fees, leases, and land sales

Source: Cytonn Research

In order to ensure the effectiveness of the NHIF, the government in collaboration with the SHIF's board of management and health services providers can borrow a number of key takeouts from Japan NHIS and UK NHS, and, work together to address some of the challenges faced by the funds. As such, we recommend the undertaking of the following actionable steps:

i. **Cut Corruption in Healthcare Sector:** Corruption is endemic in our society. With collections more than doubling what was being collected in NHIF, there is going to be a concerted effort on corruption through the usual means such as procurement fraud and overpricing of services.

ii. **Transparency, Openness and Accountability:** Ensure there is transparency, openness and accountability in the conduct of the affairs of the fund.

iii. **Improve Infrastructure of Public Hospitals:** To achieve a Universal Health Care (UHC) system, the government should invest in facilities in public hospitals to ensure they offer quality services, given majority of individuals in rural areas access health services from public hospitals due to difficulty in accessing private hospitals. According to the UK Department of Health and Social Care Annual Report and Accounts 2022-2023, the NHS spent £32.1 bn (Kshs 4.9 tn) to finance the commissioning of new hospitals, renovate the existing health care facilities, and health care equipment among others. UK investment in improving health facilities infrastructure has enabled one of the best health care systems as it is among the top 5 best health systems in the world according to the Common Wealth Secretariat,

iv. **Creation of Strong partnership with both the public and private health services providers**: With the bad blood we experienced between NHIF and the local health service providers on the back of delayed remittance of the amounts owed, SHIF should propose to rebuild a cordial relationship with them in order for Kenyan Citizens to access health care services in any health facility. In most instances in the previous system, Kenyans have been forced to pay for health services out of their pockets as some hospitals decline the use of NHIF cards to settle for expenses. In Japan, the good relationship between NHIS and the health service providers has enabled Japan's residents to have the freedom to access health care services anywhere at any time,

v. **The Government should have an active role in setting up the Fees charged by the service providers**: Given that there have been reports showing that some health service providers participated in altering or falsifying information to increase their payouts from the previous Fund, the government should play an active role in setting the baseline fees for the services offered in health institutions to prevent Kenyans and the fund from being overcharged. In Japan, the government is responsible for preparing the fee schedule entailing all the fees for all the services offered by health institutions and ensuring strict adherence to the schedule, and,

vi. **The government should consider including a subsidy program for SHIF** – The elevated prices in food and fuel have reduced Kenyan residents' disposable income and therefore Kenyans have to dig into their pockets in the event that they have surpassed their limits. Insurance penetration in Kenya continues to remain low compared to other key economies, with insurance penetration at 2.3%, which is below the global average of 7.0%, according to the Swiss RE institute, and is attributable to the fact that insurance uptake is still seen as a luxury and is mostly taken when it is necessary or a regulatory requirement. As such the government should come up with a subsidy program aimed at cushioning Kenyans from the rising medical costs. Case in point; Japan has a subsidy program called the "High Cost Medical Expense Benefit System" aimed at shielding the residents from the burden of medical expenses in the instance they surpass their monthly limits. The system sets the maximum threshold an individual can pay out of pocket depending on the age and income of the residents.

Section VI: Conclusion

The rationale behind the introduction of the Social Healthcare Insurance plan is quite solid and essential for the achievement of the Universal Healthcare goal. However, like with all great ideas, the real challenge lies in the implementation. The transition has so far faced significant challenges that need to be addressed for the new system to succeed. Technical failures in claims processing, healthcare provider pushback, and a lack of clarity in contractual agreements have hindered a smooth rollout. The wastage of resources through, for instance, expensively procured systems further hurt the idea in the eyes of the public. The technological system is one of the areas that NHIF had done really well, with a functional portal and mobile app, that defies the need for a new expensive system. The other issue is in the limits on the covers that make it really discouraging, especially given the increased rates of deduction. By addressing these operational and financial issues, and by fostering strong partnerships with healthcare providers, and considering feedback from the public, SHIF can become a robust, inclusive system that provides quality healthcare for all Kenyans.