Faida Securities Ltd
MEMBER OF NAIROBI STOCK EXCHANGE

KENYA RE-INSURANCE CORPORATION

RECOMMEND: BUY

Bob Karina – Managing Director

Dennis Waweru – Marketing Director & Head Dealer

David Mataen – Director, Corporate Finance & Research

Rina Karina – Financial Analyst

Offer details

Offer Price per Offer Share	KShs	9.5
Par value of each Offer Share	KShs	2.5
Authorised share capital of the Corporation	KShs	2,000,000,000
Total number of issued shares	Shares	600,000,000
Total number of Offer Shares	Shares	240,000,000
Gross proceeds of the Offer	KShs	2,280,000,000
Net profits for the twelve (12) month period ended 31.12.2006	KShs	390,449,000
Dividend paid for the twelve (12) month period ended 31.12.2006	KShs	150,000,000
DPS for the twelve (12) month period ended 31st December 2006	KShs/Share	0.25
EPS for the twelve (12) month period ended 31st December 2006	KShs/Share	0.65
Implied dividend yield based on the DPS for the twelve (12) month period ended 31.12.2006	%	2.6
Implied PE (historical) based on the EPS for the twelve (12) month period ended 31st December 2006	x	14.6
Average NSE PE for Financial Sector for past 6 months	x	20.56
Forecast full year net profits as at 31st December2007	KShs	707,738,000
Forecast EPS as at 31.12.2007	KShs/Share	1.18
Forecast DPS as at 31.12.2007	KShs/Share	0.25
Implied PE as at 31.12.2007 based on the Forecast EPS	X	8.05

- Sound profitable business with a consistent dividend payout over a long period
- Sound balance sheet with sufficient financial flexibility to respond to unforecasted cash calls without damage to the capital base
- Investment income boosts or makes up for volatility in re-insurance revenues
- An ambitious and successful international business development drive
- Corporate rating potential upside still largely untapped
- Promising revenue opportunities in aviation and marine contingent upon capacity addition
- Tremendous opportunities for efficiency gains and cost savings upon transition to a listed company

Faida Securities Ltd
Windsor House 1st Floor
University Way/Muindi Mbingu Street
P.O. Box 45236, 00100
Nairobi
Tel: +254-20-243811/2/3
Fax: 254-20-243814

	Population (m)	Penetration rate	GDP (US$ bn)	Gross Premium (US$ m)	% of GDP
India	1,083	3.7%	796	20,719	3%
Egypt	75	0.95%	102	915	1%
S.Africa	44	14.6%	200	26,407	13%
Kenya	33.4	2.6%	19.7	499	3%

There is a huge untapped potential for Re-Insurance business in Kenya

Kenya is under-insured at a penetration rate of 2.6% for a population of 33.4 millions. Compares poorly with India at 3.7% penetration for a population of over a billion and contrasts with South Africa with a penetration of 14.6% for a population of 44 million.

This signifies the necessity of having an insurance sector that can add more to the economic development of the country therefore a huge potential for the insurance business in Kenya.

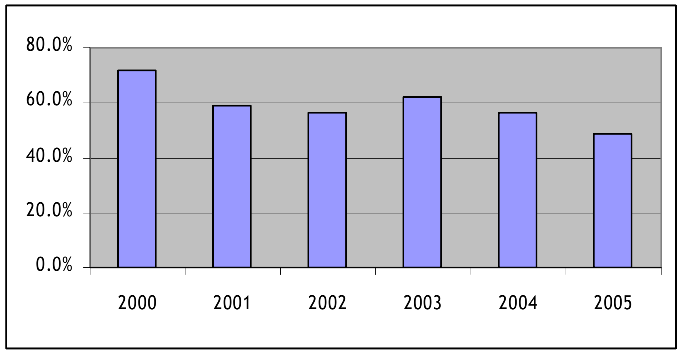
Kenya Insurance and Re-Insurance markets size

KShs m	2002	2003	2004	2005
Gross General Insurance Premiums	18,676	20,696	24,063	25,014
Market Growth	15.83	10.82	16.27	3.95
Reinsurance Market Premiums	6,664	7,601	7,208	7,392
Rein Prem. as a % of Ins. Prem.	35.68	36.72	29.96	20.36
Kenya Re - Local Market Cessions	1,187	1,429	1,291	1,186
Kenya Re Local Re-In Premium Share	17.81	18.8	17.91	16.04
Market Retention	82.19	81.2	82.09	83.96
Kenya Re cessions as %age of Local General Insurance premium	6.35	6.9	5.36	4.74

Insurance sector growth has been steady though re-insurance is lagging behind primary

Kenya’s insurance sector has been growing steadily and over the past five years. Reinsurance has not however grown in tandem and its shares of the local industry has been reducing. Kenya Re has had to make up for this by tapping the international markets.

Industry average loss ratio



Underwriting quality is improving

The chart above demonstrates the steady decline of the average industry loss ratios since the year 2000. This is good news to insurers since this translates into increased profitability. Admittedly, the levels of insurance loss ratios are still high.

Reinsurance Corporation	Net Reinsurance Premiums Written			Pretax Operating Income ($ Mil.)	
	2005	**2004**	**% Change**	**2005**	**2004**
Africa Re	295.5	269	9.9	17.2	10.4
Kenya Re	31.4	24.1	30.6	9.4	8.2
PTA Re	19	18.8	1	1.8	2
East Africa Re	13.9	11.8	17.3	1	0.6
Total	**359.8**	**323.7**	**11.2**	**29.4**	**21.2**

The framework of the Kenya Re-Insurance sub-sector

1. Compulsory Ceding

Compulsory cession are coming to an end soon & usher unfettered competition

Kenya Re enjoys 18% compulsory cessions of all treaty insurance business from all insurance companies in Kenya. When the compulsory ceding was introduced, it was meant to help Kenya Re build local capacity for reinsurance. Over time this need has lost importance. The compulsory ceding is to end in the year 2011 or when the Corporation is fully privatized. This may expose Kenya Re to a reduction of the premium it collects since insurance firms will no longer be obligated to reinsure with Kenya Re. However, this may not turn out to be the case because, currently, Kenya Re accounts for more than 21% of the local market share of premium. This means that Kenya Re can survive without the compulsory treaty cessions.

2. International competitiveness of local firms

Regulation is constraining competitiveness of local firms vs international firms

Locally registered reinsurance firms operate under the Insurance Act which stipulates that all business be written locally. International reinsurance companies operating in Kenya but incorporated outside Kenya are free to take their business wherever they wish. The ability to diversify their business across the globe allows them to reduce exposure to country risk. This gives them a competitive advantage compared to locally incorporated ones.

3. Reinsurance Rates

Re-insurance rates are coming down owing to competitive pressures and reduction in underwriting losses

Reinsurance premiums have reduced in the past as a result of the premiums in the primary insurance market decreasing due to increased competition in both the life and general insurance market. Despite the reduction in the premiums, claims have remained constant which have seen the compulsory re-insurers and the insurers paying the price in the form of lower profits. As a consequence, re-insurers with high ratings are not typically rewarded with better business, which partly accounts for the rating compression in recent years.

An industry-wide premium rating committee will be established to rationalize rates

As a result of this fluctuation in insurance premiums, a premium rating committee has been set up by the Commissioner of Insurance. This committee is composed of re-insurers, insurance brokers and insurance companies who monitor the local and international trends in insurance and reinsurance rates and determine the risks faced by the industry. Once the rates have been agreed upon, they are filed with the Commissioner of Insurance. These then form the base rates recommended by the Commissioner of Insurance.

Kenya Re core strengths

- Increasing presence in Africa and International Markets
- Large Underwriting capacity
- Technical know-how (qualified staff)
- International Rating
- Reciprocity in the market

Kenya Re global footprint

Region	Number of Countries	Number of companies
Kenya	1	46
Africa	22	80
Overseas	18	40
TOTAL	**41**	**166**

Kenya Re fastest growing business is international re-insurance

Kenya Re has realized a considerable growth of international business premium income from KES 55 million in 1997 to over KES 1,08 billion in 2007. This has been as a result of prudent underwriting and the confidence the international markets have demonstrated by responding to the services offered by Kenya Re including technical advice.

The net premium collected in Kenya shillings from the 41 countries is given in the table below:

Jurisdictions	2006	2005	2004	2003
Kenya	512,786,366	461,629,045	215,759,256	643,502,044
Africa	246,948,994	126,101,291	145,376,073	90,319,746
Overseas	47,143,033	105,088,708	158,160,005	147,610,104
Total	**806,878,393**	**692,819,043**	**519,295,334**	**881,431,893**

Competitive Strengths

Kenya Re presents a solid re-insurance balanced between local and international

Kenya Re has a strong presence in Kenya and the East African Economy. It has established a name for itself within the insurance market as a leader in reinsurance business and in investments through its extensive property portfolio. Earlier in the year, Kenya Re put in place aggressive marketing strategies to capture the African markets as well as retain its existing market within Kenya.

The rating obtained from AM Best has added to its credibility within the international insurance and reinsurance markets. Kenya Re has automated most of its operations and is continually upgrading or improving on the systems and processes.

Marketing

A well resourced marketing function has been put in place to prepare the business for the withdrawal of compulsory cession

With the imminent withdrawal of the compulsory cessions the management has refocused the marketing functions and embarked on a deliberate marketing onslaught on strategically identified areas and regions for business expansion, acquisition and retention. The marketing strategies are tailored to take care of both the local and international business.

In view of this, Kenya Re intends to increase its business development and marketing as part of its overall strategy. The marketing strategies it intends to put forward over its five-year plan are described below:

a) Intensify marketing activities locally and internationally through;
- market penetration, market development and product development strategies

b) Increase the level of customer service and focus in all departments of the Corporation.

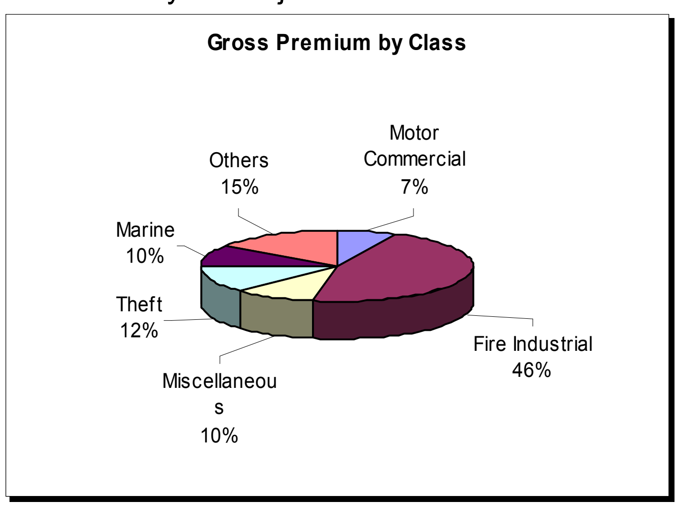
c) Emphasize and intensify personal selling in Kenya Re's marketing communication strategy.

d) Pursue a competition oriented pricing strategy in all markets.

Product Analysis of Kenya Re

Kenya Re deals in a diverse range of insurance products with fire being the dominant business by far, marine and aviation presenting opportunities for growth

Kenya Re transacts in over 12 classes of insurance business. These are: Engineering, Fire industrial, Fire domestic, Public liability, Personal accident, Marine, aviation, Motor private, Motor commercial, Theft, Workman compensation and life business. The pie chart below shows the percentage of gross premiums contributed by the major class of businesses



Marine and Aviation – There is huge potential for business in these products. At the moment, 70% are directly insured in overseas markets. The Kenyan Insurance Act states that no marine or aviation business shall be placed in the open markets without express authority from the Commissioner's office. Marine and aviation business has remained insignificant over the period because the business from marine and aviation pose high risks and liabilities to the Corporation, hence it has attempted to limit the amount of business written in the two areas.

Fire – Due to related low GDP levels in the country, most people prefer not to insure in spite of high levels of awareness on the importance of protection against fire. Fire, especially industrial fire, has contributed significantly to the total premiums over the period ranging between 39% and 44% of the total premiums written. The growth in fire has been mainly due to the increasing risk, companies in Kenya have been facing, and the need to ensure that companies holding easily inflammable stocks are insured adequately.

Huge revenue growth reflects successes in penetrating foreign mkts. Investment income has consistently contributed about 20% of total income, enough to diversify revenue sources while not too big to detract from the core business. Claims have however grown disproportionately as catastrophe frequencies increased

KShs m	2007F	2006	2005	2004	2003	2002
Gross premium	3,348.90	3,034.70	2,612.70	1,823.40	1,679.70	1,339.20
Net written premium	2,998	2,711.50	2,288.80	1,628.80	1,537.30	1,230.60
Net earned premium	2,950.80	2,791.60	2,111.40	1,718.20	1,486.80	1,212.60
Change	*0.06*	*0.32*	*0.23*	*0.16*	*0.23*	
Investment Income	778.8	753.1	490.9	584.8	341.4	465.2
Change	*0.034*	*0.534*	*-0.161*	*0.713*	*-0.266*	
Total income	**3,729.60**	**3,544.70**	**2,866.60**	**2,303.10**	**1,828.20**	**1,677.90**
Change	***0.05***	***0.24***	***0.24***	***0.26***	***0.09***	
Claims incurred	-1,521.70	-1,522.50	-923.5	-766.3	-457.8	-770.1
Commissions payable	-873.85	-806.8	-700	-520	-465.3	-388.1
Management expenses	-435.4	-603.1	-290.3	-193.4	-195.9	-200.2
Change	*-0.28*	*1.08*	*0.50*	*-0.01*	*-0.02*	
Profit from operation	898.6	612.3	946.7	563.6	709.2	319.4
Profit before tax	**898.6**	**647.3**	**961.5**	**600.3**	**735.8**	**338.3**
Change	**0.39**	**-0.33**	**0.60**	**-0.18**	**1.17**	
Income tax expense	-190.9	-256.8	-213.3	-111.1	-154.8	-67.7
Profit for the year	**707.7**	**390.4**	**748.2**	**489.2**	**581**	**270.5**
Dividends paid		150	150	150	120	**120**
Claims/Net earned premiums	52%	55%	44%	45%	31%	64%
Commission/net premiums	30%	29%	33%	30%	31%	32%
Investment/total income	21%	21%	17%	25%	19%	28%
Mgmt expense/total income	12%	17%	10%	8%	11%	12%

Short term deposits, government securities, and financial assets for sale contributed to growth in assets over the past 2 years. An indication that Kenya Re is holding more liquid resources for flexibility in paying claims

Liabilities have remained fairly stable and flat over the past 5 years, the Corporation therefore having to fund liquidity demands from retained earnings and property and investment sales proceeds.

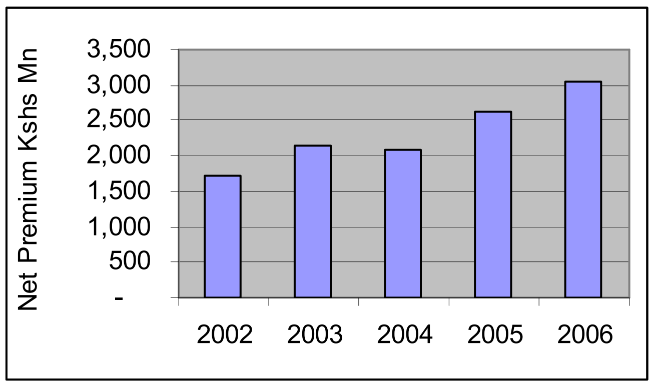
KShs m	2007F	2006	2005	2004	2003	2002
ASSETS						
Property and equipment	17	52.5	88.0	239.4	283.0	332.3
Non-current assets held for sale	317	317	317		-	-
Prepaid operating lease rentals	-	-	-	13	13	13
Investment in associate		254	219	199	155	124
Intangible asset	4	5	2	3	5	-
Deferred income tax	35	35	20	16	-	-
Government securities	2,861	2,122	1,839	1,471	1,497	1,184
Financial assets for sale	2,481	2,258	1,756	1,292	1,284	563
Mortgage loans	781	616	393	329	320	313
Investment properties	3,270	3,270	3,270	3,683	4,206	4,206
Sundry debtors	98	0	0	0	0	0
Current income tax recoverable	31	4	-	124	-	-
Due from cedants & reinsurers	1,747	1,155	1,125	413	352	300
Inventories	341	484	809	556	447	603
Short term deposits	608	559	397	448	251	158
Cash and bank balances	47	45	92	150	40	40
Total assets	**12,636**	**11,264**	**10,378**	**8,965**	**8,998**	**8,045**
LIABILITIES						
Long-term contract liabilities	2,449	2,123	1,816	1,658	1,534	1,363
Outstanding claims	2,133	1,961	1,917	1,990	2,250	2,240
Unearned premiums	500	453	533	355	445	394
Deferred income tax		-		-	5	47
Bank overdraft		-		-		4
Dividends payable		-		-	120	120
Due to cedandant & reinsurers	528.5	295	294	256	213	851
Defined benefit liability	32.3	32	32	34		-
Sundry creditors	163	246	201	218	224	278
Current income tax payable		-	35	-	135	67
Total liabilities	**5,805**	**5,110**	**4,829**	**4,511**	**4,924**	**5,363**
NET ASSETS	**6,831**	**6,154**	**5,549**	**4,454**	**4,074**	**2,682**
Capital and reserves						
Share capital	1,500	1,500	1,500	1,500	1,000	1,000
Revaluation and other reserves	2,161	2,050	1,685	1,188	1,198	106
Retained earnings	3,170	2,454	2,214	1,616	1,776	1,526
Proposed dividends	-	150	150	150	100	50
SHAREHOLDERS' FUNDS	**6,831**	**6,154**	**5,549**	**4,454**	**4,074**	**2,682**

One- off catastrophe claims depressed profitability in 2006

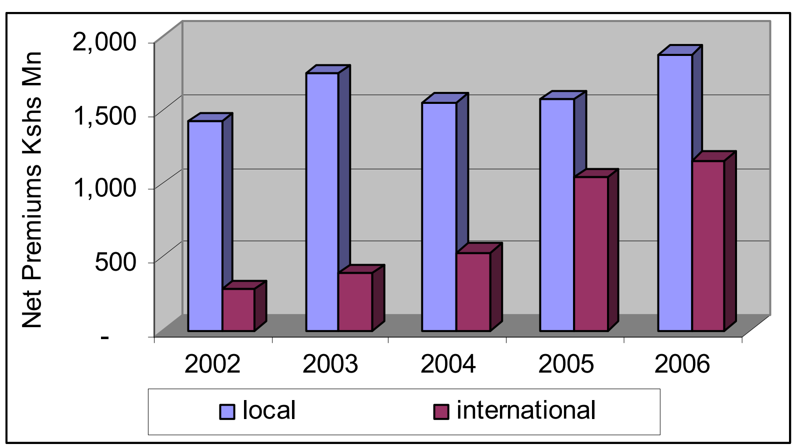
The significant decline in profitability in 2006 is largely explained by the one off provision of Kshs 150 Millions made in respect of the long standing balances with cedants and reinsurers. In 2006, there were a number of huge claims which were made against Kenya Re following the Tsunami and Monsoon catastrophes that hit parts of Asia. As a consequence the claims paid during the year were significantly higher than the previous years.

Underwriting business has grown exponentially driven by international sales

The underwriting business of Kenya Re has recorded considerable growth in the last five years. The total net premium both for the life and general business grew from Kshs 1.7 billion in 2002 in 2002 to Kshs 3.03 billion by the end of 2006. The chart below shows the consistent growth in business.



The net premium grew by an average of 15.5% annually. The growth is largely attributed to Kenya Re's foray into the international arena. The net premiums have grown at an annual compounded average rate of 7.1% while the international business has been growing at an annual rate of rate of 42.3%.



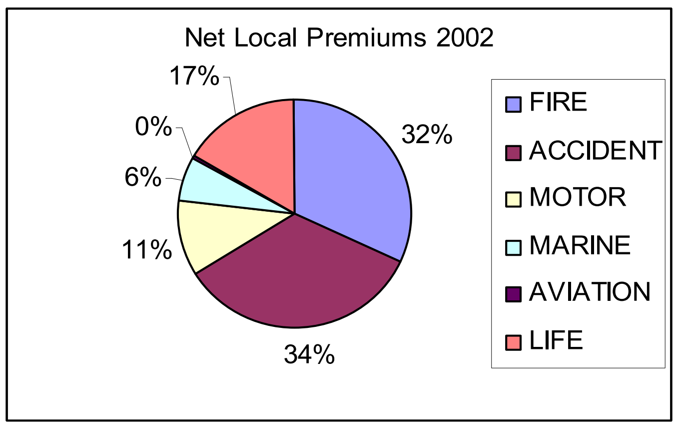
In 2002, the net premium from international business accounted for 16.5% of the total net premiums. As at the end of 2006, this had grown to 38.1%. Significantly, international business has been greatly boosted since the Corporation was rated.

Accident, fire and life in that order, are the traditional hinterlands of Kenya Re business

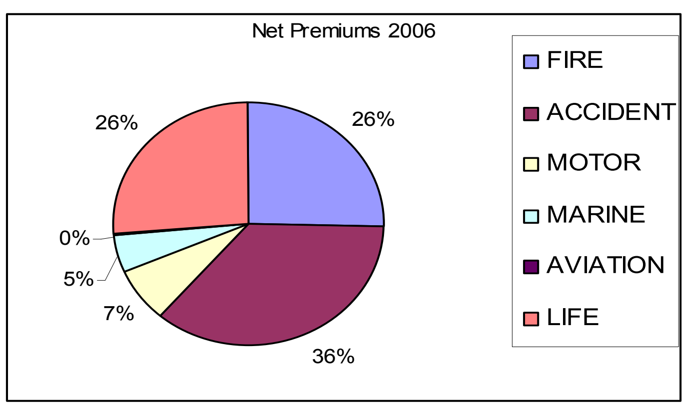
Local business

Fire and Accident classes account for the largest share of net premiums received. In 2006, they jointly contributed a total of 61% of the local net premium received. Fire accounted for 25.5% while Accident accounted for 35.6%. The contribution of these two classes has remained relatively stable since 2002 when they jointly accounted for 65.8%.

Life accounts for 26.4% of the net local premium. The period under review has seen the contribution of life grow from 16.5% to 26.4% at the end of 2006.

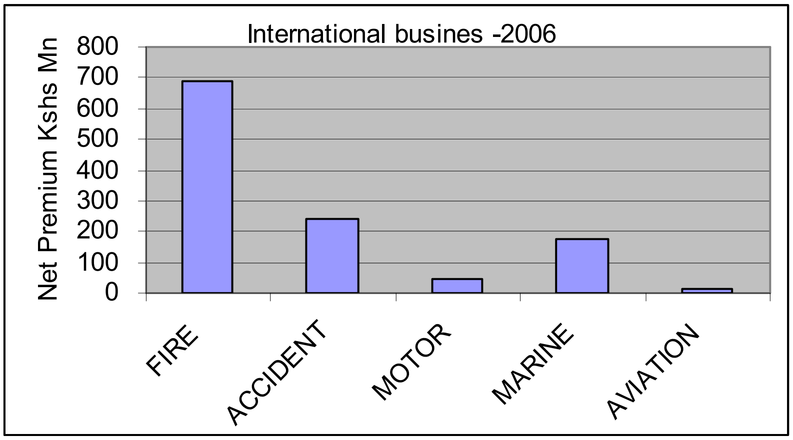


Life has been the fastest growing category to top Fire in 2006



International business

As noted earlier, the international business of Kenya Re has been growing appreciably from Kshs 282 million in 2002 to Kshs 1,156 million in terms of net premium by the end of 2006. The class of Fire is the major contributor to the premium having contributed 59.4% in 2006 followed by accident at 20.6%. Kenya Re does not carry out life business in the international market.



Kenya Re had a pension funding deficit of KShs 27.3 million at the last actuarial valuation done in 2004

Pension Scheme

Kenya Re operates a closed defined benefit pension scheme for all its employees. The last actuarial valuation was carried out in December 2004 by Alexander Forbes Financial Services (East Africa) Ltd. This valuation disclosed a past service actuarial deficit of Kshs 27.325 million. The level of funding was at 87.3%. This had improved from the previous actuarial deficit of Kshs. 41.515m and a funding level of 74.2%. Contract employees are not eligible for pension, but the terms of contract provides for gratuity equivalent to 31% of the basic salary.

Kenya Re-retrocession arrangements

Kenya Re has a fairly low tolerance for big business risk re-troceding 100% of business above KShs 1.5m threshold

This includes further spreading of risks by way of retroceding parts of risks accepted to other reinsurers who do not already hold the same risks. For all the life risks accepted, prior to March 2004, Kenya Re retained the entire risks below the reinsurance sum assured of KShs 1m and reinsured the sum assured in excess of this amount. For all risks accepted since March 2004, Kenya Re retains the risks below the reinsurance sum assured of KShs 1,500,000 and reinsures the sum assured in excess of this amount. All amounts in excess of these surplus levels are retroceded 100% to other reinsurers.

Five percent of the retroceded amount is placed with Africa Re and 95% is retroceded to Swiss Re. This applies to both group and individual risks.

There are currently no form of accumulative or catastrophe risk retrocession agreements in place for the Kenya Re Life business.

Investment and property management

Investment portfolio has over the past supported Kenya Re through rough patches in Re-insurance business

Over the years the Corporation policy laid emphasis on maintaining steady growth in all aspects of investments and every class of business. This policy made it possible for the Corporation to be among a handful of state Corporations that have consistently made profits. In this case, the investment income has contributed significantly to the corporation's profit.

The portfolio has grown steadily over the past 4 years lifted mainly by NSE valuation improvements

The investments portfolio has increased over the period, with the exception of properties which has reduced from 50% to 42%. The overall portfolio increased by 6% in 2005 from 2004. The growth in the portfolio is mainly attributed to investments in Government Securities which increased by Kshs. 367.5 million (24.9%) and Nairobi Stock Exchange (NSE) quoted shares which grew by Kshs. 313.3 million (37%) in 2005.

Summary of the Investment Portfolio

The table below summarise the asset classes of the investments made by Kenya Re as at 31st December 2006.

Asset Class	(Kshs m)	Weight
Government Securities	2,122.3	22.50%
Equity	2,244.1	23.79%
Mortgages Loans	615.5	6.53%
Investment Properties	3,270.0	34.67%
Short-term Deposits	558.6	5.92%
Land and Building Held for sale**	621	6.58%
Total	**9,431.5**	**100.00%**

ECONOMIC AND TRADING PROSPECTS

Frequency of natural catastrophes likely to undermine underwriting capacity, and trigger innovations in risk transfers and could lead to an increase in cost of insurance

Increasingly frequent catastrophe losses could lead to capacity contraction, especially in the retrocession market. There is no doubt that the cedants would radically change their approach to the writing of catastrophe risks. It is even probable that market players – insurers and re-insurers could be constrained to adopt new forms of risk transfer, if the available traditional capacity is reduced, compelling them to opt for bank loans so as to prop up their balance sheets. However, some observers believe that, as was the case after the acts of 11 September 2001, the aftermath of these losses will be characterised by an increase in the cost of insurance. This could trigger the inflow of capital in search of better returns on investment, thus creating new opportunistic capacities and price stability.

CHALLENGES FACING THE INSURANCE AND REINSURANCE SECTOR

The main challenge for Kenya insurance sector is building the life business

The major challenge for the insurance industry in Kenya is to increase penetration in the life sub – sector. Marketing techniques and improving perceptions have been highlighted as important strategies in achieving this. As foreign firms enter the market particularly in life underwriting, local insurers must improve efficiency and marketing strategy in order to survive.

In addition, service delivery needs to improve, particularly in the reliability and responsiveness of operators.

CHALLENGES FACED BY KENYA RE

New risks coupled with more international exposures are likely to challenge Kenya-Re's underwriting ability

Rising costs for re-insurers, particularly in relation to catastrophes in East and Central Africa in 2005, as well as ongoing foreign exchange risk will pose a challenge for Kenya Re's underwriting performance. This will be particularly relevant as the Corporation continues to expand by reinforcing itself in the East and West Africa, as well as competing with South Africa based players in Southern African markets.

Language & cultural barriers in francophone world

The penetration in the Francophone countries has been a challenge and the Corporation has recruited a French speaking underwriter to reinforce the continuing efforts.

Lack of capacity for certain categories force primary insurers to seek covers abroad

While the domestic reinsurance sector has not exhausted capacity, primary insurers still pursue foreign contracts due to perceived capacity and service level constraints on the part of local re-insurers. In order to

tap this outward flow of business, the Corporation has deliberately established service level standards to match international standards. In addition, a close working relationship with key overseas reinsurance brokers continues to give added benefit.
Nonetheless, accelerated globalization will lead to significant reinsurance business going to overseas markets as domestic primary insurers look beyond Kenya Re and other local market participants.

Needs to increase income from core business to win more foreign business

As has been emphasized by rating agencies and industry observers, Kenya Re must continue efforts in reducing the ratio of income derived from investments relative to core underwriting activities. This will require further advances in the Corporation's operating efficiency to insulate the balance sheet from fluctuations in the real estate market.

AIDs claims continue to chip away at Kenya Re income

The sector continues to be under pressure due to hefty claim awards particularly to public service vehicle accident victims and the HIV/AIDs epidemic.

Establishment of Re-insurers in the region

Going forward, the Corporation will face challenges that include the new reinsurance companies established in traditional markets such as Tanzania, Rwanda, Uganda and Arab World (Takafu).

Risk Factors

A number of the risks referred to below could have a material adverse effect on the Corporation. The following is a summary of potential risks and does not purport to indicate the likelihood of such risks materialising. The risks set out below may not be exhaustive. Additional risks and uncertainties may arise or become material in the future.

INDUSTRY SPECIFIC RISKS

Insurance risk
Life insurance risk

Retrocessions believed to take reasonable care of this risk

Life insurance risk arises through the firm's exposure to mortality, morbidity and unforeseen expenses. The Corporation's framework is reviewed fairly frequently. The overall retrocession programme is assessed centrally to manage the risk exposures of the Corporation as a whole.

Prudential systems and arrangements have been put in place to mitigate these risks

General insurance risk

General insurance risk arises from the following:

- Fluctuations in the timing, frequency and severity of claims and claim settlements relative to expectations
- Unexpected claims arising from a single source
- Inaccurate pricing of risk when underwritten
- Inadequate reinsurance protection or other risk transfer techniques
- Inadequate reserves

Corporation wide policies exist for underwriting, claims management, retro-cessions and reserving, and operate within the group's risk management framework.

Mechanisms have been put in place in each of the business units to identify, quantify and manage accumulated exposures within the limits of the Corporation's risk appetite.

Retrocession arrangements are only placed with providers that meet minimum security standards. The adequacy of the general insurance reserves is ultimately determined and approved by the consulting actuaries. The reserves are subject to audit and peer review.

Kenya Re holds sufficient reserves to meet plausible loss scenarios.

The underwriting activities of insurance-licensed entities in geographical areas outside Kenya expose the Corporation to the possibility that actual claims experience will exceed that anticipated in the setting of premium rates. Kenya Re avoids or takes on a minimal amount of risk in geographical areas that are prone to natural and catastrophic disasters.

Asset and Liability Management (ALM)

Kenya Re sets out the minimum ALM principles that the respective business units are required to adopt. It can then monitor adherence to this policy. In this regard the Corporation has a framework for matching assets with appropriate liabilities, approaches to take when liabilities cannot be matched and the monitoring processes that are required.

Political Risk

Economy diversification reduces the business exposures to this risk

With the upcoming elections, if they are unfairly conducted, the national economic conditions could deteriorate. This would have an impact on the direct insurance premiums written, which would in turn affect the reinsurance business. The negative impact on the economy would also hurt the firm's investment portfolios, property and equity in particular. Kenya Re also faces political risk from its international business operations. The Corporation has mitigated against such risk by diversifying its business into different countries.

Market risk

Diversified revenue sources from different product categories and investment asset classes

Market risk is based on a firm's sensitivity to adverse changes in values of financial instruments resulting from fluctuations in foreign currency exchange rates, interest rates, property prices and equity prices. By diversifying into different sectors of the economy, the potential of this risk is lessened. Kenya Re has diversified its sources of revenue by investing in real estate and property, quoted and unquoted shares and in government securities.

Foreign currency exchange risk

Holding deposits in foreign currency reduces exposure to this risk

Due to Kenya Re's current international reinsurance business portfolio, it is exposed to some degree of foreign currency exchange risk. The non-domestic reinsurance contracts are backed up by foreign fixed deposit investments which are held in hard currency (British Pound and US Dollar). The Corporation does not hedge against this currency exposure and changes in exchange rates can result in volatility in the corporation's earnings, which are reported in Kenyan Shillings.

Property price risk

A program for deliberate divestments from all non-critical properties is in place

Kenya Re's investment portfolio contains a high percentage of property investments, which are subject to large fluctuations in market prices. However, the Corporation is divesting its property investments in order to bring their holdings in line with set guidelines.

Regulatory and Legal Risks

Changes in financial services and taxation laws, regulations and government policies could have an adverse effect. The Corporation has set up systems to ensure that they are in compliance with all stated regulatory and legal requirements and has ensured that it has access to competent lawyers.

Actively building international business is mitigating against domestic competition

Risk from Competition

Competition could affect Kenya Re's market share, business, operation results or financial condition. Some of Kenya Re's competitors are large in size and financially stronger. Their strength notwithstanding, Kenya Re still enjoys a local market share of more than 21%. This is a result of the confidence that Kenya Re has imparted in the local industry. The growth of its international business attests to its solid reputation.

COMPANY SPECIFIC RISKS

Risk related to Market Perception of Kenya Re

Warm corporate communications and good customer service are tailored to improve Kenya Re's image

Kenya Re has been viewed as a Government parastatal that has imposed compulsory cessions on insurers in the past. The compulsory cessions are to end either in 2011 or following full privatization whichever is earlier. This poses a risk to Kenya Re as with the end of the compulsory cessions, it will have to rely on the relationships it has built and its reputation.

Kenya Re's reputation will depend on its total impact on society and its stakeholders. It proposes to improve on its relationships with stakeholders through Stake-holders engagement, dialogue and cultivate sensitivity to stakeholders. On the international scene, Kenya Re has an increasing portfolio of international business. The Corporation has to nurture its international outlook to be ranked as an international re-insurer.

Asset/Liability Matching Risk

Holding liquid resources helps smooth out obligatory mismatches

Failure to adequately match assets to liabilities could result in the need to supplement reserves. This would increase servicing costs or other costs for this capital. To this end, Kenya Re has ensured that it maintains certain ratios of its assets to liabilities.

Sufficient cash is maintained to ensure availability of funding of its liabilities. The Corporation sets limits on the minimum proportion of maturing funds available to meet claims arising from unexpected levels of claims.

Risk related to the experience based on the assumptions used

Being conservative on assumptions for actuarial valuations reduces actual variances

The corporation's Embedded Value (EV) depends to a large extent on whether its actual experience is consistent with its underwriting, claims and pricing assumptions at the time the contract is taken. The Corporation monitors its actual experience against the actuarial assumptions to determine the amount it will ultimately pay to meet its liabilities. It believes that it bases its calculations on tightened assumptions.

Operational Risk

Arises from inadequate controls for internal processes or systems, human error, external events, and any other risks that the Corporation is exposed to, other than the financial risks and strategic and group risks. E.g. information technology, information security, human resources, project management, outsourcing, tax, legal, fraud and compliance.

Compartmentalisation of operational risk at divisions increases quick detection and mitigation

Line management in business units has primary responsibility for the effective identification, management, monitoring and reporting of operational risks to the business unit executive management team. The risks assessed as having the highest impact are escalated to the executive management team on a regular basis so as to effectively manage the firm's overall risk.

Deficit in the defined benefit pension scheme

The deficit isn't big and the pension returns are expected to reduce it

The closed defined benefit scheme is not fully funded and has a small deficit of Kshs 30 Million. This could result in Kenya Re having to make additional contributions to the fund to reduce the deficit. However, the deficit may also be covered by returns from the fund's assets.

Credit Risk

Strict criteria for credit extensions helps reduce exposure to this risk

Credit risk is the risk of loss in the value of financial assets due to counter-parties failing to meet part or all of their obligations, or changes to the market value of assets caused by changed perceptions of the creditworthiness of those counter-parties.

To manage this risk, Kenya Re has developed strict guidelines and policies that outline criteria that needs to be met by counterparties with whom they do business.